

NEW TAX CREDITS - ENSURING COMPLIANCE

NEW TAX CREDITS – ENSURING COMPLIANCE

Background to new tax credits

1. In April 2003 the Government introduced two new tax credits. Child Tax Credit (CTC) for families with children and Working Tax Credit (WTC) for low-income working households. These new tax credits help deliver the Government's commitment to support families, make work pay and tackle poverty.
2. In earlier phases of reform, the objectives of making work pay and tackling child poverty were addressed through reforms such as the introduction of the 10% starting rate of income tax, the National Minimum Wage and changes to National Insurance for the low paid. These were complemented by the first generation of payable tax credits – Working Families' Tax Credits and Disabled Person's Tax Credits – to deliver support for working families and disabled workers through the tax system. CTC and WTC are the next step in the Government's programme of reform and integration of the tax and benefits system. They replace the Working Families' and Disabled Person's Tax Credits, the children's tax credit and, from 2004, the support for children in Income Support and income-based Jobseeker's Allowance.
3. Family Credit and Disability Working Allowance were social security benefits administered by the Benefits Agency of the Department of Social Security (now the Department for Work and Pensions (DWP)). They were replaced in 1999 by Working Families' Tax Credit (WFTC) and Disabled Person's Tax Credit (DPTC) respectively, administered by the Inland Revenue. WFTC and DPTC went further in addressing the policy objectives by, for example, introducing payment through employers to reinforce the message that work pays and providing support related to actual child care costs, rather than a disregard of income. But they retained the essential characteristics of the forms of government support which they replaced. For example, entitlement to WFTC and DPTC was

based on a 'snap shot' of claimants' circumstances and income around the time of the claim.

4. With CTC and WTC, the Government has introduced more fundamental reform which is not constrained in the same way by existing frameworks. So the new tax credits separate out support for children in a family from support for adults and are brought much closer into line with the income tax system. CTC provides a single seamless system of support for families with children, paid to the main carer and available in and out of work. WTC provides support for low income working households, including those without dependent children or a disabled worker. New tax credits awards run for up to a year, in line with the tax year, are based on annual income for a tax year and can respond to changes in family circumstances at the point of change.

Getting the right money to the right people

One of the key objectives in delivering any support for citizens is to ensure that as many people as possible receive the money to which they are entitled while at the same time ensuring people do not receive more than they are entitled to.

5. The development of new tax credits has provided an opportunity to learn from the operation of social security benefits and the administration of the tax and tax credits systems. Lessons have been taken into account in
 - designing the new tax credits (see paragraph 11 onwards)
 - producing advice and guidance for claimants to encourage them to apply and help them get it right first time (see paragraph 16 onwards)
 - further developing approaches to tackling deliberate non-compliance (see paragraph 20 onwards).

Approaches to ensuring compliance

6. In parallel with work on the compliance regime for the new tax credits, the Revenue has been continuing to develop its approach to ensuring compliance generally. The Inland Revenue's core purpose is to "ensure that everyone understands and receives what they are entitled to and understands and pays what they owe, so that everyone contributes to the UK's needs".
7. To deliver this the Revenue needs to recognise the factors that impact on:
 - people's understanding of what they are entitled to or need to pay – how can the system be made easier to understand?
 - people's behaviour – once people understand what they are entitled to or need to pay, how can they be encouraged to claim what they are due, pay their tax or tell the Revenue when their circumstances change?
8. Identifying and addressing the factors that impact on people's understanding and behaviour requires analysis of a range of different risks and the development of approaches to tackle them. The balance of risk factors vary across the range of the Department's business and the approach to ensuring compliance in a particular area of business needs to be targeted appropriately.
9. Looking at compliance in this way makes it clear that any strategy needs to concern itself not only with the risk of deliberate error and fraud – which will rightly always be a matter of serious concern – but also with other risks including the risk of lower level mistakes by the claimant which can too easily be seen as unimportant. Examination of WFTC and DPTC claims has shown that the majority of the errors made by claimants involve small amounts of money and in many cases will be the result of simple oversight or misunderstanding (see Appendix A paragraph 18).

10. To maximise compliance in new tax credits it is therefore important that these types of error are identified and tackled but the appropriate response in these cases will be quite different from that for, say, cases of fraud. To ensure people understand and receive what they are entitled to, and understand and pay what they owe, the Revenue needs to adopt a range of responses from “enabling” – helping people understand and putting them right for the future – to “regulating” – deterring and tackling deliberate error and fraud.

Designing in compliance

11. The key objective of ensuring compliance – ensuring that as many people as possible receive the money to which they are entitled while at the same time ensuring people do not receive more than they are entitled to – has been central to the development of new tax credits from the beginning. This means that some of the compliance challenges have been addressed in the best way possible, by designing solutions into the system from the start.
12. For example, the new tax credits provide a simpler framework of help for families by integrating a variety of different channels of support available for children into a single credit. This design feature, together with the transfer of responsibility for Child Benefit to the Inland Revenue in April 2003, encourages take up by enabling parents to access support for their children from a single Government department.
13. The rules for new tax credits do not exclude claimants from entitlement on the basis of the level of savings they have. Instead, they take account of the actual income the claimant receives from his or her savings (such as interest or dividends). Families with only small amounts of income from capital (income below £300) need not report this income at all. This design feature addressed one of the main sources of error in WFTC and DPTC applications: the WFTC and DPTC capital limit of £8,000 and the rules for calculating deemed income on savings of less than £8,000 were often misunderstood and accounted for 15% of the errors made in WFTC

and DPTC applications (see Appendix A paragraph 18). The approach taken to capital and savings in new tax credits also brings them into line with tax and enables cross-checking of information.

14. A key change with the move to new tax credits is that entitlement is based on an individual or couple's annual income for a tax year. This design feature makes it easier for claimants to use information they have or provide for tax purposes in making their claim. It also produces a fairer result overall for claimants on fluctuating incomes. Annual income is less open to being influenced by short term adjustments – for example, by claimants choosing not to work overtime in the basis period. This contrasts with the rules for WFTC and DPTC – which were carried forward from Family Credit - where entitlement was based on a snapshot of the family or individual's income around a particular date.
15. Basing new tax credit entitlement on claimants' annual income helps maximise compliance in other ways. Using annual income instead of a snap shot makes it easier for the Revenue to identify claims where the figures given might be incorrect. This will be done by checking the figures given for earnings on new tax credit applications against the figures returned for tax purposes (by employers for employees and under the Self Assessment regime for the self employed). Any discrepancies will be followed up and resolved. In this way the design of new tax credits has addressed the biggest cause of error in WFTC and DPTC applications (see Appendix A paragraph 18).

Advice and guidance for claimants

16. The Revenue's approach to publicity, advice and guidance for new tax credit claimants is designed to maximise compliance by helping as many people as possible 'get it right first time'. For new tax credits 'right first time' means a claimant:
 - applies at the right time and puts the right details on the application form

- tells the Revenue about changes in his or her circumstances where appropriate
- completes the renewal process correctly at the end of the year and provides the right details.

17. There will of course always be a need for the Revenue to identify claims where errors have been made and put these right (see paragraph 20 below) but the aim should be to reduce the requirement for this type of work by helping the vast majority of claimants, who want to get it right first time, to do so. This approach frees up Revenue staff, who otherwise would be employed in correcting avoidable errors, to tackle the small minority of claimants who deliberately try to abuse the system.

18. Publicity, forms design, leaflets, guidance, the advice from contact centres and work with voluntary sector intermediaries and advisers all play a part in helping as many claimants as possible get it right first time. Work in all these areas has been informed by experience from WFTC and DPTC, social security benefits and tax. There has been an unprecedented level of consultation on the design of new tax credits including with voluntary sector intermediaries and representative bodies and the Revenue continues to consult on the practical implementation of its strategy for ensuring compliance.

19. Publicity, leaflets and guidance are kept under review. Work on new tax credit claims which are found to be wrong can help identify common mistakes and the need for changes to guidance, leaflets or forms. Procedures are in place to feed this learning back and make sure changes are made.

Spotting errors – risk assessment

20. All areas of the tax and benefits system need arrangements in place to spot errors and put them right. Traditionally this has often involved checking all cases at the time a claim is made or information is provided. This approach meant that all cases were looked at in the same way and

received broadly the same level of attention. A better and more modern approach is to distinguish between the cases which are most likely to contain errors and those which are less likely to be wrong. Risk assessment is an approach which enables this to be done systematically and consistently. Risk assessment therefore enables the Revenue to target its resources at the cases most likely to include errors and optimises its ability to spot these and put things right.

21. This approach has been adopted in the new tax credits system. This includes sophisticated procedures to help identify cases where claimants have not got it right first time – either because they have not understood what was required or because they deliberately tried to abuse the system. The risk assessment weights 23 different factors and picks out combinations of factors which identify a case as one where there is a high risk that something is wrong. Automation enables the system to handle large volumes of claims while providing a consistent and comprehensive check for potential errors. And Revenue staff go on to make further enquiries and seek an explanation for any unusual aspects of a claim before reaching a conclusion about whether a claim which has been identified as high risk includes errors or not (see paragraph 42).
22. The development of the sophisticated risk assessment rules for new tax credits was informed by experience from Family Credit, WFTC and DPTC and DWP and tax generally, and specifically by information about the sources of error in these areas.
23. Reviews of Family Credit claims identified earnings figures as the main source of error. A high proportion of cases in which errors were found involved incorrect figures for either the claimant's earnings or the claimant's partner's earnings. The reviews also identified issues about whether a couple were living together as husband and wife and the rules on savings and capital as common sources of error in Family Credit claims.

24. A study of WFTC and DPTC claims found that, as with Family Credit, the main source of error was the amount of income. Of the cases in which errors were found 59% involved incorrect income figures. (The next most common source of error – found in 15% of cases involving errors - was in respect of figures for capital, a problem which was addressed at the design stage of new tax credits (see paragraph 13 above).
25. These findings influenced the weighting that was given to data about earnings and the makeup of a household in the new tax credit risk assessment.
26. Self Assessment for income tax and capital gains tax was introduced in 1996. Since then the Revenue has used automated risk assessment to help select cases for enquiry. A number of random Self Assessment enquiries have been used to help gauge the accuracy of the risk assessment and identify new factors that should be included. Lessons about the interaction between random enquiries and risk assessment have been taken into account in devising the arrangements for identifying new tax credit claims where there is a high risk of error.
27. Further work by Revenue staff (see paragraph 45 below) establishes whether the claims in cases identified as 'high risk' contain errors or not. This provides a check on the effectiveness of the risk assessment process and allows it to be refined. So the results from Revenue examinations and enquiries are fed back to further improve the risk assessment and increase its accuracy in spotting cases where something is wrong. Enquiries into a sample of cases selected at random can also support the development of the risk assessment process helping identify any new areas of risk to be fed into it.

Types of check

28. Entitlement to tax credits is based on a range of factors including the make up of the claimant's household, working hours, any child care costs and the claimant's income. Initial awards of tax credits are provisional because final entitlement depends on the relationship between the current and

previous tax years' income. The initial award is based on the figure of income for the previous tax year (except in 2003/04, the first year of new tax credits, where initial awards are based on income for the year 2001/02). After the end of the year, the claimant provides details of their income for the year just ended and information about any changes in circumstances not already notified. Final entitlement is based on current year income if that is lower than the previous year's income. If current year income has risen by £2,500 or less, final entitlement is based on the previous year's income. If current year income has risen by more than £2,500, final entitlement is based on current year income less £2,500. The end of year information is used to establish the final entitlement for the year gone by and to calculate any under or over payments. It is also used to set the initial tax credit award for the next year.

29. During the year the claimant can tell the Revenue about changes in his or her circumstances which will affect his claim, for example, if they have a child. There are some changes in circumstances which can have a significant impact on the claimant's entitlement to tax credits and in these limited circumstances the claimant must tell the Revenue about the change within three months. These are:

- a reduction in the average weekly childcare costs to nil or by at least £10 per week,
- an individual claimant becoming a member of a couple or a couple breaking up or no longer being able to claim jointly, including where the claimant or their partner is going abroad for more than 8 weeks (12 weeks if they stay abroad because the claimant is ill or a member of their family is ill or has died).

30. Comprehensive guidance (see paragraph 18 above) is provided to help claimants understand and claim what they are entitled to, complete forms correctly and know when to tell the Revenue about changes in circumstances. But there will always be cases where claimants get things wrong – either accidentally or intentionally.

31. A programme of checks is in place to identify and address cases where things have gone wrong.
32. The structure of tax credits means that there are three points at which checks may need to be made to establish whether a claim is correct:
- before payment is made to secure the gateway to new tax credits
 - during the year while payment is being made to ensure claimants are providing information about changes in circumstances where appropriate and that the tax credits paid are as close as possible to the right amount
 - after the end of the year.
33. Where the Revenue has concerns about a claim which it is unable to resolve, its questions are put on a formal footing:
- for in year queries this is called an examination
 - for queries raised after the end of the year this is called an enquiry.

Timing of checks on claims

34. In devising a compliance strategy for new tax credits a balance had to be struck between the need to:
- pay people what they are entitled to as quickly as possible and
 - sort out any potential errors as quickly as possible.

Both are important: claims should not be held up unnecessarily while the Revenue asks questions but equally errors in claims should be put right at the earliest opportunity to ensure money is not paid out where it is not due.

35. All new tax credit claims go through a process of checking before payment is made. Data from claims is automatically verified by direct comparison of key entries, such as claimants' names and addresses, with directly comparable entries on other databases. This process secures the

gateway to tax credits by providing assurance that the people identified in the claim (both adults and children) are real and have not already appeared on another claim to tax credits.

36. The sophisticated process of risk assessment introduced for new tax credits helps distinguish between cases where there is sufficient concern about the accuracy of the claim that further questions must be asked before payment is made and those where queries can be pursued after payment has started. Risk assessment is carried out automatically which means cases of no risk or only low risk can be put into payment as quickly as possible rather than being held up while further detailed checking is carried out.
37. Some types of error have the potential to be so serious that any indication that they might be present would always cause the claim to be looked at before payment was made. For example, claims which show a risk of identity fraud will always be examined in detail pre-payment. Other types of error can be looked into post payment. For example, claims where the risk assessment suggests that the figure of hours worked may not be accurate will be checked but this might be after payment has started.
38. This strategy of carrying out a mixture of pre and post payment checks takes account of lessons learnt from Family Credit and DWP generally, WFTC & DPTC and the tax system:
39. Aspects of all Family Credit claims were checked before payment but there was no risk assessment process for identifying those cases which were most likely to contain errors, so the checks could not be targeted in any way. The same level of checking was carried out for all Family Credit claims regardless of the risk they presented. This meant that resource was used on low risk cases which could better have been directed at those where it was more likely that the case included deliberate claimant errors.
40. Aspects of claims for WFTC and DPTC were similarly subject to pre-payment checks but there was no automated risk assessment of claims which made targeting pre-payment work difficult. So, as with Family

Credit, the same level of pre-payment checking was carried out for most claims regardless of the risk they presented. But with WFTC and DPTC the Revenue introduced manual risk assessment procedures to inform the selection of higher risk cases for further checks and enquiries after payment had been made. This approach demonstrated the advantages of risk assessment in allocating resources to the most risky cases.

41. Under Self Assessment the Revenue moved from its previous practice of reviewing every tax return before acting on it, to an approach that used risk assessment to identify cases which warranted further enquiry. While a comprehensive checking regime might at first appear to give the best protection against errors of all kinds Self Assessment showed that a more targeted approach of directing resource to cases showing the greatest risk of error produced a higher level of compliance over all.

Checking claims in practice

42. The Revenue's approach to claims identified by the risk assessment as potentially being wrong is tailored to the level of risk identified.

43. Cases where the error appears to be a straightforward matter are handled by the Tax Credit Office who telephone the claimant and help them put the claim on the right footing straightaway.

44. Cases where there appears to be something wrong which would require more than a telephone call to sort out (but where there is nothing to suggest that the case is one of serious fraud) are referred to the Revenue's Risk Intelligence and Analysis Teams (RIATs) in local offices.

45. RIATs are experts in assessing risk. They cross check information from the claim against that from other sources including Revenue data bases and child care providers. Specifically, RIATs will check details of

- child care arrangements against information given by child care providers to the Revenue and

- income against figures included in Self Assessments and employers' returns.

46. RIATs will also identify tax credit claims that might contain errors based on local intelligence they receive and by evaluating information from the Revenue's data warehouse. The data warehouse is a computer based repository of Inland Revenue customer and management information. It brings together information from the Revenue's data bases and third party information such as bank and building society returns and provides sophisticated data matching and analysis.

47. Where the information gathered by the RIAT does not resolve concerns about a tax credit claim the RIAT passes the claim (and information gathered) to a Claimant Compliance Officer (CCO). The CCO will contact the claimant to establish whether the claim or entitlement is correct or not. This might take the form of an exchange of letters or a short meeting. In more complex cases it might take longer and need several letters or meetings. And in cases where there is an indication that the error might be due to serious fraud are referred to the Revenue's Special Compliance Office (SCO) who will look at them with a view to possible prosecution.

Outcome of examinations and enquiries

48. In all cases an examination or enquiry might show that there was an explanation for any unusual features in the claim and it contained no errors. These cases will be brought to a conclusion immediately.

49. Where an examination or enquiry shows there are errors in a claim the Revenue's response will be tailored to the nature of the case, consistent with the general approach to compliance issues outlined at paragraphs 6-10 above. As part of the enquiry Revenue staff will want to find out how and why the error happened. If it was innocent – perhaps based on a misunderstanding, or a simple arithmetical error – Revenue staff will help put things right and ensure the claimant is on the right track for the future. This is an example of the ongoing support mentioned in paragraph 8 above which will be the appropriate response in many cases.

50. If there is a significant error in a claim which appears careless or deliberate, it may be appropriate to charge a penalty to discourage future non-compliance. The amount of the penalty would depend on the nature and scale of the error. There is more about penalties in paragraph 56 below.
51. If the errors in a claim suggest fraud might be involved the case would be considered for criminal investigation and prosecution. Cases of this kind are always dealt with by SCO. There is more about prosecution in paragraph 61 below.

Penalties

52. The role of financial penalties is to help maximise compliance by dissuading the small minority of claimants who might be tempted to cheat the tax credit system and encouraging all claimants to take an appropriate degree of care in relation to their tax credit claims.
53. Ensuring compliance includes encouraging claimants to apply for the credits to which they are entitled. Penalties therefore have to be targeted only at appropriate cases so that they do not deter genuine claimants who might be worried about making a mistake.
54. Penalties will not be due in all cases where errors are found in tax credit claims. For example, there is no penalty for innocent errors: for a penalty to be due the claimant has to have been either fraudulent or negligent.
55. There are other cases where pursuing a penalty would be counter productive and serve more to put off genuine claimants than deter potential cheats: for example, where the claimant has made an error for the first time and the amounts involved are trivial. In these cases the appropriate response, consistent with the general approach outlined at paragraphs 6-10 above, will be to sort out the problem and put the claimant right for the future.

- In cases where the error is significant, penalties will be appropriate but the amount of penalty will be varied to reflect the particular circumstances of the case, including the scale of the error and the extent to which the claimant co-operates in putting things right.

56. The maximum penalties set down in the legislation are:

- £3,000 for fraudulently or negligently making an incorrect claim or providing incorrect information, and
- £300 for failure to notify relevant changes in circumstances within 3 months.

These maximum amounts will be reserved for only the most serious cases.

57. This approach to penalties in relation to new tax credits builds on the experience of Family Credit, WFTC and DPTC and the operation of the tax regime:

58. The Family Credit regime provided for the possibility of surcharges on claimants who overstated their claims but these were not frequently used. Instead the threat of prosecution was used to deter everything from fraud through to lack of care in completing the form. There is more about the role of prosecution in deterring non-compliance at paragraph 61 below.

59. For WFTC and DPTC the Revenue built on its experience of using financial penalties to deter non-compliance in the tax arena. Where fraudulent or negligent errors are made in Self Assessment returns, the maximum penalty is equal to the tax that would have been lost but this is then mitigated to take account of the size and gravity of the offence, and the extent to which the taxpayer disclosed what was wrong and co-operated with the Inspector's enquiries. A similar approach was taken to WFTC and DPTC claims.

Prosecutions

60. The sanction of prosecution is reserved for the most serious cases where errors in new tax credit claims can be shown to be the result of fraud rather than simply confusion or carelessness. As with all prosecuting authorities the Revenue operates a selective prosecution policy that targets serious cases where there is the necessary evidence and a realistic chance of obtaining a conviction.
61. The Revenue's tax credit prosecution policy builds on that operated in the past by DWP in relation to Family Credit and the Revenue's own prosecution policy in relation to tax and WFTC and DPTC. The criteria applied by both the DWP and the Revenue in selecting cases for possible prosecution include consideration of the potential loss to the Exchequer caused by the alleged fraud. The criteria used for WFTC and DPTC built on the financial criteria used by DWP to take account of further non-financial factors which could add to the seriousness of a case. For example, for WFTC and DPTC prosecution was always considered where the alleged fraud was committed by someone in a position of responsibility in relation to the tax and benefits system or a professional adviser. The criteria used for new tax credits build on the successful programme of prosecutions mounted for WFTC and DPTC cases and further refine the prosecution criteria by weighting the wide range of factors considered. This ensures that prosecution is carefully targeted at cases which involve the most serious risks.

Looking ahead

62. The Revenue monitors all aspects of its day to day work to identify areas for future development. As part of this it continues to develop its approach to ensuring compliance across all its areas of business including not only new tax credits but also direct tax. This includes developing new approaches to spotting and evaluating risk and increasingly effective ways to counter it.

63. Monitoring is important in the first months and years of a new area of responsibility such as tax credits but it is also an essential ongoing function. Work will continue to test the effectiveness of the existing strategy and to identify and assess the need to respond to developments including changes in

- the economic environment, such as different working patterns
- social and family arrangements, such as new approaches to child care.

Inland Revenue

November 2003

APPENDIX A

REVIEW OF ERRORS IN APPLICATIONS FOR WORKING FAMILIES' TAX CREDIT AND DISABLED PERSON'S TAX CREDIT

Background

1. Working Families' and Disabled Person's Tax Credits (WFTC and DPTC) were introduced in October 1999 as successors to Family Credit and Disability Working Allowance. Initially, and as an interim measure, all payments were made direct to applicants. The WFTC and DPTC regime became fully operational in April 2000 when tax credits for claimants in work were first paid direct by their employer into their pay packet.
2. WFTC and DPTC were administered by the Inland Revenue which was keen to ensure any relevant lessons were learnt for the development of the next generation of tax credits. WFTC and DPTC have subsequently been replaced by new tax credits – Working Tax Credit and Child Tax Credit. The Inland Revenue therefore carried out a review of applications for WFTC and DPTC to validate the risk factors used for selecting cases for investigation where there were doubts about the accuracy of a claim and to inform the development of new tax credits.

The Exercise

3. The first part of the exercise, which began during August 2000 just four months from the introduction of payment via employers, covered only WFTC applications.
4. A parallel exercise looking at DPTC applications commenced in February 2001. The WFTC analysis is based on a sample of 1,031 applications taken from a six month period. An additional 250 applications were sampled from DPTC over six months.

5. The exercise was based on samples of cases which provided a snap shot of WFTC and DPTC claims in this early period. The attached appendix sets out how the types of errors, identified in the exercise, have been addressed in the intervening period. The samples were limited in size; so the resulting estimates, while statistically valid, are not very precise in some areas, particularly the monetary estimates of overpaid benefits. The results of the exercise are specific to the period over which the sample was taken: they give no indication of trends in error rates for later months or years. The results of the exercise are detailed in paragraphs 9 - 18 for WFTC and paragraphs 19 - 22 for DPTC.

The Process

6. Random selections, covering both employed and self-employed applicants, were taken on a monthly basis from all successful applications made in the previous month. Each monthly selection was stratified geographically by region to ensure there was a constant sampling rate across regions.

7. To comply with the Inland Revenue's statutory powers, full investigations were carried out within the sample selected only where there was a reason to make enquiries. Where there was no reason to make enquiries cases were accepted as being correct.

Working Families' Tax Credit Exercise

9. WFTC was a tax credit available to families who were responsible for at least one child under 16 (or under 19 if in full-time education up to A-level or equivalent standard). It was payable to two-parent and one-parent families. The applicant or the partner (if they had one) had to be working 16 hours or more per week.

9. From approximately 1.29 million WFTC applications received by the Tax Credit Office in the period from July to December 2000, 1,031 were selected for inclusion in the exercise.

Error

10. The definition of error used in this report is when an application was incorrect, and this covered actions ranging from innocent error to deliberate fraud.

Estimate of number of cases which were incorrect

11. In the WFTC exercise, errors were found in 239 cases. This figure includes a number of cases where the outcome of the enquiry was either an increase or no change in the level of the award.

Size of Adjustments

12. The cases that were found to be incorrect can be separated into:

- cases where the award was terminated (because after a full investigation it was found that the applicant either did not qualify for WFTC or errors identified in the application resulted in the amount of the award being reduced to nil), and
- those where the amount of tax credit due was altered as a result of the review.

13. The award was terminated in 40% of the cases which were found to be incorrect (equating to 9% of all WFTC applications). There was little difference between the average value of these awards and the published figures for the average value of all WFTC awards (£80 per week *Source: IR Analysis & Research – Working Families Tax Credits Statistics Quarterly Summary, Feb 2001*). This means that while claimants in this group made errors, there is no evidence that they exploited tax credits by maximising the amount available and is an indication that some of these errors were likely to come from simple mistakes and misunderstandings.

14. Where, following the enquiry, the credit continued to be paid there were a small number of cases where the application was incorrect but the enquiry

showed either that the applicants were entitled to more than they had claimed or that the errors had no impact on the level of the award. It is clear that these cases were incorrect as a result of simple mistakes or misunderstandings.

15. Where, following the enquiry, the credit continued to be paid but at a lower level, there were a significant number of cases where the adjustments were very small. It is likely that many of these cases were incorrect as a result of simple mistakes rather than through any deliberate misstatement by the applicant.

16. The range of the type of errors that arose is shown by the fact that most errors involved either no money or relatively small amounts: approximately 50% of incorrect awards adjusted (equating to 11.5% of all WFTC awards) were reduced by £15 or less per week (of which over half required no change in the level of the award, or reduced by £5 or less). At the other end of the scale, approximately 15% of incorrect awards adjusted (equating to 3.4% of all WFTC awards) were reduced by £50 or more each week. In these cases it is more likely that the error arose as a result of a deliberate attempt to obtain something to which the applicant was not entitled.

17. For the year under review, 2000-01, the total WFTC and DPTC awarded amounted to £5.05 billion. The sampling exercise suggested that the likely level of overpayment was between 10% and 14% of the total amount awarded. If taken over a full year, this would have amounted to between £m510 and £m710.

Types of error

18. The results gave an indication of the types of errors made in WFTC applications. These are summarised in the table below. Where more than one type of error was made in an application, each type has been shown separately in the table.

Table 1: Type of non-compliance identified

Type of error	Percent of those WFTC applications containing errors	Percent of all WFTC applications
Understated Income	36%	8%
Undeclared Subsidiary Income	23%	5%
Understated or Undeclared Capital	15%	3%
Undeclared Partner	14%	3%
Undeclared Employment/Self Employment	10%	2%
Unnotified Change of Circumstances	6%	1%
Overstated Hours	6%	1%
Childcare Costs Misrepresented	4%	1%
Fictitious Children	2%	Neg%
Other	2%	Neg%
Fictitious Employment	1%	Neg%
Fictitious Partner/Collusion	1%	Neg%
Failure to Co-operate – Award terminated	Neg%	Neg%

Disabled Person's Tax Credit Exercise

19. DPTC was a tax credit available to people who worked at least 16 hours a week and who had an illness or disability which put them at a disadvantage in getting a job.

20. From approximately 38,000 successful applications received by the Tax Credit Office in the period from January to June 2001, 279 applications were selected for inclusion in the exercise. A larger proportion of DPTC

applications were selected compared to WFTC. This was to ensure a large enough sample of DPTC cases to produce an accurate estimate of the proportion of cases with errors. With a sample of this size it is not possible to produce a monetary estimate of the value of DPTC errors.

Errors

21. In 66% of DPTC cases the Team found no reason for a full investigation to take place. Where there was no reason to make further enquiries cases were accepted as being correct. Errors were found in 35 of the remaining cases (12.5% of the sample of DPTC claims).

22. This resulted in 73 full investigations being undertaken by the Inland Revenue. Additionally, 22 enquiries were carried out by the Benefits Agency into applicants' eligibility in relation to qualifying benefits such as Disability Living Allowance (DLA).

Analysis & Research (Operational Research Unit)

Inland Revenue

ADDRESSING TYPES OF ERROR

Errors of the types identified in the review of WFTC and DPTC cases have been taken into account in

- designing the new tax credits which were introduced in April 2003
- producing advice and guidance for claimants to encourage them to apply and help them get it right first time
- further developing approaches to tackling deliberate non-compliance.

Specific action to address each type of error included the following:

Understated Income

WFTC/DPTC – risk assessment processes were improved to better identify cases where errors were likely and improve targeting of Revenue compliance activity.

NTC – entitlement to NTC is based on annual income for a tax year. This makes it easier for claimants to identify the correct figure to put on their claim form and for the Revenue to check figures against those returned by employers and in Self Assessment tax returns.

Undeclared Subsidiary Income

WFTC/DPTC – increased use was made of Revenue data bases to check for subsidiary income.

NTC – the risk assessment process has been automated and processes improved making it easier to consider all aspects of an individual's case including both tax credit entitlement and tax liability. Systems changes mean more information can be checked against Revenue data bases including those holding information about secondary sources of income.

Understated or Undeclared Capital

WFTC/DPTC– increased use was made of Revenue data bases to check for undeclared capital

NTC – the rules for new tax credits do not exclude claimants from entitlement on the basis of the level of savings they have. Instead, they take account of the actual income the claimant receives from his or her savings (such as interest or dividends). The Revenue receives information from banks and building societies and checks are made against that to ensure claimants give correct details. Families with only small amounts of income from capital (income below £300) need not report the income at all.

Undeclared Partner

WFTC/DPTC – risk assessment processes were improved to better identify cases and improve targeting of Revenue compliance activity. Procedures for identifying and following up information from third parties were improved and cases of concern actively followed up.

NTC – claimants' details are checked automatically against Revenue databases to identify cases where there is likely to be an undeclared partner. Referrals from the DWP fraud hotline are used to supplement Revenue information. Further sources of information are available to Revenue staff carrying out risk assessments including data bases which can provide details of partners' income.

Undeclared Employment/Self Employment

WFTC/DPTC - increased use was made of Revenue databases to check for undeclared employment or self employment

NTC - the risk assessment process has been automated and processes improved making it easier to consider all aspects of an individual's case including both tax credit entitlement and tax liability and make links between the two. Systems changes mean more information can be checked against

Revenue databases including those holding employment and self employment details.

Unnotified Change of Circumstances

WFTC/DPTC – awards were fixed on the basis of circumstances around the time of claim (for 26 weeks) and very few subsequent changes in circumstances affected the award. Compliance activity in relation to changes in circumstances focused on the very few changes in circumstances which could affect an existing award.

NTC – routine checks will be made with child care providers which will help identify notifiable changes in child care provision. The Revenue will use this information to alert claimants to changes they will need to notify as well as to identify cases where changes should have been notified and have not. Staff working on risk assessment have access to data bases which are constantly updated with information from Self Assessment returns, third party information about savings, employment and self employment details.

Overstated Hours

WFTC/DPTC – joint projects were set up by staff working on WFTC/DPTC and those working on national minimum wage compliance to look at cases where hours appeared to have been overstated. In addition local offices set up projects to look into cases where reported self employment was thought to be bogus.

NTC - automated risk assessment has been introduced including measures to identify cases where hours were likely to have been overstated. Revenue staff working on NTC and those working on National Minimum Wage exchange information about rates of pay and hours. An information power exists to enable the Revenue to check details of hours worked with employers where necessary.

Childcare Costs Misrepresented

WFTC/DPTC - use was made of information from third parties and all allegations were followed up. A helpline was set up for childcare providers making it easier for them to provide information in cases of concern.

NTC – details provided by claimants are routinely checked against information provided by childcare providers. An information power exists to enable the Revenue to obtain information from third parties including childcare providers where necessary. Automated risk assessment includes specific risk rules to identify potential cases of misrepresented childcare costs.

Fictitious Children

WFTC/DPTC – increased checks were made against the Child Benefit database.

NTC – automated checks are made against the Child Benefit database.

Fictitious Employment

WFTC/DPTC – risk assessment processes were improved to better identify cases and improve targeting of Revenue compliance activity including following up allegations by third parties.

NTC – information provided by claimants is checked against Revenue data bases to identify employments or self employments which have not previously been notified to the Revenue and may therefore be bogus.

Fictitious Partner/Collusion

WFTC/DPTC – all third party allegations were followed up.

NTC – automated checks are made against Revenue databases to identify cases where there may be a fictitious partner or collusion with an employer or child care provider. Information from Revenue staff who check employers' records is used to inform NTC risk assessment.

