

## **Working Families' Tax Credit and Disabled Person's Tax Credit: publication of evaluation findings**

### **Summary**

Her Majesty's Revenue and Customs (HMRC) has published a series of reports and papers as part of its evaluation of the impact of the Working Families' Tax Credit (WFTC) and the Disabled Person's Tax Credit (DPTC). WFTC and DPTC were launched in 1999 and were replaced by the New Tax Credits in April 2003. The evaluation has spanned a number of years, involving quantitative surveys and qualitative research with WFTC and DPTC recipients and employers.

The Government welcomes this research, which shows the following key findings:

### **Working Families' Tax Credit**

- Take-up of WFTC showed a substantial rise between 2000-01 and 2002-03 and WFTC take-up is higher amongst those in most need;
- WFTC has moved an estimated 81,000 extra individuals into the labour force – adding over five percentage points to the lone parent employment rate;
- The costs of claiming fell under WFTC compared to its predecessor, Family Credit;
- There was no evidence to support the view that WFTC had an adverse effect on wage progression, and may even have encouraged it;
- The childcare tax credit element of WFTC has helped families get back into work and has enabled more choice in securing childcare provision.

### **Disabled Person's Tax Credit**

- DPTC was a strong work incentive – a third of recipients said DPTC allowed them to work or made work more worthwhile financially;
- DPTC was a necessary part of family incomes: 80 per cent said they found it essential or very helpful, and for some it had a major positive financial impact;
- Stigma was reduced by receiving support as a tax credit – 61 per cent agreed it was less stigmatising to claim a tax credit than a benefit, and only 9 per cent disagreed;
- Recipients were very positive about the administration of DPTC: almost half felt it was better that DPTC was administered by Inland Revenue, with only 11 per cent disagreeing; and there was high satisfaction with the service received, with staff described as polite, helpful and well-informed.

### **Tax credits and employers**

- Payment Via the Employer (PVE) was easy to operate for employers: nine out of ten said it was either very easy or quite easy to run, with only two per cent saying it was very difficult;

- Compliance costs were low on both objective and subjective measures of costs. No statistically significant impact of PVE on payroll costs was found;
- Employers can see the benefits of tax credits on recruitment and retention, with a fifth of PVE employers saying it had definitely or possibly had a positive impact on recruitment and a quarter said it had an impact on retention;
- Employers spoke of some beneficial aspects of tax credits in terms of reducing stigma associated with receipt of in work support and improved morale amongst employees.

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The Government welcomes the publication of these reports and is encouraged by the findings, which support its strategy in tackling worklessness and poverty, particularly amongst families with children and people with disabilities. Issues highlighted by this body of analysis and research have been taken forward and addressed in the design and implementation of the new tax credits.

Many of the key findings are described in more detail below.

### **Working Families' Tax Credit: key findings from the research**

#### Take-up of WFTC

HMRC analysis found that take-up of WFTC in its final year was higher than Family Credit in its final year. Caseload take-up rates were estimated at 72-76 per cent in 2002-03 compared to 66 to 70 per cent under Family Credit in 1998-99.

As in previous years, take-up was highest for those entitled to the biggest awards. Take-up by expenditure continues to be higher than take-up by caseload, showing those entitled to higher awards – who tend to be on lower incomes - are more likely to take-up. The take-up rate by expenditure was 82 to 88 per cent in 2002-03, compared to 73 to 79 per cent under Family Credit in 1998-99.

These findings were supported by analysis of take-up of in work support (WFTC and Family Credit) by the Institute for Fiscal Studies (IFS) which showed that the probability of take-up is positively related to entitlement (so those entitled to the most money are more likely to take-up). The IFS also found that the greater generosity of WFTC relative to Family Credit meant that the take-up of WFTC was higher than would have been expected had FC simply continued unchanged.

#### Take-up of the childcare tax credit element of WFTC

Research by MORI confirms existing evidence that take-up of the childcare element of tax credits amongst parents using eligible childcare is good. They found that non-take-up of the childcare tax credit element was due to ineligibility, not lack of knowledge: to quote their report, "The main reason for not applying for the childcare tax credit element was not using childcare...most of the non-recipients who were using childcare were using ineligible provision".

The MORI report found that the design of tax credits had a positive impact on take-up. MORI reported that "Encouraging factors when deciding whether to apply for the childcare tax credit element included the range of childcare eligible for support, and for WFTC as a whole, the amount of support available and the low minimum working hours threshold". This tallies with the finding that recipients understood the main features of tax credits: MORI said that "Understanding of the 'headline' eligibility

criteria [of WFTC and the childcare tax credit element] such as minimum working hours, the types of childcare that were eligible, and the earnings taper, was strong”.

### The impact of WFTC on childcare

Amongst those who took up the childcare tax credit element of WFTC, the MORI report found that it had enabled more choice in terms of childcare. They reported that “support [via WFTC] had widened the scope of affordable childcare for many parents...[which] meant they were more likely to be using their first choice type of provider”.

### WFTC and stigma

According to IFS analysis, the costs of taking up WFTC amongst lone mothers – which encompasses stigma, as well as costs associated with finding out about and applying for in-work support – had fallen to a level below that of Family Credit by 2002, after an initial rise. These changes induced more parents to work by encouraging take-up of WFTC.

This was backed up by MORI research which found that WFTC was seen as a step-up from benefit: according to their report, WFTC “was almost universally not viewed as a benefit, and was mentioned several times as a step-up from being on Income Support”.

The system of Payment Via the Employer, which seeks to reduce stigma by linking in-work support to the pay packet, was also found to have no clear negative impact. The MORI report said that “payment of tax credits via the employer had caused few concerns, although parents generally preferred to receive payment by Order Book or Automated Credit Transfer...because they felt this was easier to budget with”.

### The labour supply impact of WFTC

In a separate paper, the IFS found that the impact of WFTC on the labour supply was an increase of 81,000 workers, equivalent to a fall in workless households of 99,000. The impact was particularly marked for lone parents - an estimated 75,000 lone parents joined the labour supply due to WFTC. This helped contribute over five percentage points to the lone parent employment rate. Even after allowing for other changes such as rises in Income Support which happened at the same time, there was still a positive impact of between 22 and 59 thousand workers (depending on the exact method and data source used).

The positive estimated impact on families in work was confirmed by qualitative research by MORI. They found that “the availability of support for childcare had encouraged some parents to move into work” and that “WFTC and the childcare tax credit component...had developed into a key aspect of the household budget...many felt they would not be working without this additional support”.

### The impact of WFTC on wages

Some commentators have argued that the effect of the WFTC taper can reduce incentives to increase wages as in-work support is withdrawn as gross wages rise. However, an IFS paper on the impact of WFTC on gross hourly wages shows that there was no evidence for the view that WFTC impeded growth in wages. The IFS found that there is there is no evidence for the fear than recipients get “stuck” on

WFTC, and findings suggest that the reverse may even be true, that WFTC encourages wage growth.

This finding was also backed by evidence in the MORI report, who said that “sustaining working and childcare more effectively via support from WFTC had also helped some women to build up their career progression...when otherwise they would have waited until their childcare went back to school to restart work”.

## **Disabled Person’s Tax Credit: key findings from the research**

### DPTC and living standards

A report by the Institute of Employment Studies (IES), based on a large survey of DPTC recipients, found that DPTC had become a necessary addition to the family budget. They said that “almost 80 per cent of all the respondents had found the DPTC they received to be either essential (43 per cent) or very helpful (36 per cent)”. This was echoed in a qualitative report by the Social Policy Research Unit (SPRU), which reported that many recipients felt better off on DPTC. The report found that “...Some people came out on the plus side of a number of factors and felt much better off...[these] were very pleased with the amount of DPTC received and its major positive financial impact”.

As well as directly supporting living standards, the SPRU report talked of DPTC supporting the wider welfare of recipients. SPRU said that “there were a number of positive roles for DPTC [in supporting people in work]: enabling people to do work that suited them; making jobs or self-employed work financially worthwhile; increasing financial security; compensating for loss of earnings due to a partner leaving; protecting the welfare of children; maintaining health and social participation; supporting family preferences; providing platforms in trajectories of employment and health/impairment; financing sick leave; supporting business development and maintaining business diversity”.

SPRU added that in improving living standards and enabling people to move into or stay in work, DPTC had met its policy aims for many people with disabilities. They said that “for some people, DPTC did fulfil the policy aims [and had] increased personal and financial security, enabled them to do suitable work, helped to meet the costs of childcare, and increased the income flow towards children”.

### DPTC and work incentives

As well as the positive impact on living standards, the IES report found that DPTC had been a powerful work incentive which had enabled a large proportion of recipients to take, or stay in, work. They reported that “about a third (32 per cent) reported that DPTC had allowed them to work, or had made work more worthwhile financially, either for themselves or their partner”. Amongst those not already in work when they first found out about DPTC, “it had proved to be a positive incentive to work for more than half”. They also described one particular group of recipients for whom the work incentives aspects of DPTC were critical in their decision to work. IES said that “we identified a high impact group, of 23 per cent, who claimed they would not be doing their present job without DPTC. Furthermore, among them, DPTC was often the decisive factor in their decision to work or keep working”.

This was backed up by SPRU, who described the ways in which DPTC improved work incentives for recipients. They said that “...availability of DPTC did encourage

people to start or return to work [through] making it possible to do work that suited people; suggesting that people would be no worse off or better off financially in work; offering financial security; offering help with childcare costs; offering access to other valued benefits; keeping child maintenance arrangements separate from DPTC”.

IES also mentioned the specific work incentives aspects of the childcare tax credit element of DPTC, saying that “more than half of those respondents who received the childcare tax credit have been able to stay in work as a result of a successful application whilst one-third have been enabled to move into work because of it”.

### The administration of DPTC

Both the quantitative and the qualitative reports showed that recipients were generally satisfied with the administration of DPTC by the Inland Revenue. IES found that “almost half of those people who were on DWA feel that it is better than DPTC is administered by the Inland Revenue” (only 11 per cent disagreed).

In terms of the application process, IES said that “the process through which they [DPTC recipients] had found out about and applied for DPTC was generally found to be straightforward” and that “of those who had needed to re-apply for a subsequent award of DPTC...most reported no difficulty in re-applying”. Specifically on the childcare tax credit element of DPTC, the IES report added that “most respondents told us that they found the childcare tax credit application form easy to complete”.

The reports also spoke of recipients being pleased with the service given by the Inland Revenue. SPRU reported that “there was relatively high satisfaction with the service provided by Inland Revenue in processing claims” and that “staff in the Tax Credit Office were reported to be polite and helpful, and generally thought to be well-informed”. This was also reflected in IES’s findings on the DPTC helpline, where they said that “awareness of the DPTC helpline was high (60 per cent) although only 45 per cent of these respondents had actually contacted it...most users had found the helpline to be helpful”.

### DPTC: take-up and stigma

DPTC recipients tended to agree that tax credits were preferable to benefits and helped to reduce stigma. IES reported that “many respondents (52 per cent) agreed that it is better to receive a tax credit...related to earnings rather than a benefit which is linked to disability” (only 16 per cent disagreed) and also said “DPTC has removed (some of) the stigma related to claiming benefits”. 61 per cent agreed that was less stigmatising to claim a tax credit than a benefit, whilst only 9 per cent disagreed.

SPRU found that some recipients could see a number of benefits in paying tax credits through wages, including reduced stigma. They said that “positive feelings about receiving DPTC from employers were related to...liking visibility on wage slip...ease of checking that payments were correct; liking what seemed like a tax relief...greater self-esteem attached to receiving wage-related support rather than benefit...clearer picture from wage slip of available income for overall budgeting; good fit of wage periodicity with budgeting strategies”.

More generally, SPRU said that take-up had been encouraged by recipients’ positive experiences of DPTC. They reported that “factors which encouraged people to apply [for DPTC]...included financial influences; familiarity with and positive experiences of in-work support; hearing about other people’s positive experiences of in-work support; personal information provision, encouragement and support; knowledge of

key components (linking rule; 6 month award period; childcare tax credit); and Inland Revenue interventions and response.”

### DPTC and the new tax credits

SPRU’s findings suggested that the replacement of DPTC by new tax credits was broadly supported. They said that “bringing disabled workers into mainstream support [through the new tax credit system] addresses some of the concerns raised by people who took part in this research”. In addition, some of the wider changes made in the move to new tax credits, in particular the change to annual, responsive awards, were also supported by the research. SPRU said that “people argued for some mechanism for adjustment to changes in circumstances within a longer payment period [than the 26 weeks of DPTC]”.

## **Tax credits and employers: key findings from the research**

### **Tax credits and employers**

#### The introduction and operation of PVE

A large survey of over 6,000 employers, carried out by BRMB and the Policy Studies Institute, found that on the whole employers had found PVE easy to operate. They reported that “almost half (46 percent) of employers who had ever run PVE said it was ‘very easy’ to manage. In all, nine-in-ten said it was either ‘very easy’ or ‘quite easy’ to run, and a mere two percent found it ‘very difficult’”. This was also reflected in the findings regarding the effect of tax credits on payroll functions: they reported that “when asked to consider the impact that WFTC/DPTC had on payroll, 11 percent said it has been big or very big, although the majority (62 percent) said it had little or no impact.”

This was backed up by in-depth qualitative research by Kingston University. Many firms said that they “found the introduction of PVE a relatively straightforward process” due to computerisation of payrolls, and although the report found that “for employers using manual payroll systems the introduction of PVE was sometimes less smooth”, they added that “once up and running employers and payroll managers found PVE more manageable”. In terms of the day-to-day operation of PVE, Kingston reported that PVE was, overall, “a simple system and easy to maintain on a daily basis” and even for those using manual payroll it was “simple....though sometimes time consuming”.

#### Compliance costs of PVE

Evidence suggests compliance costs associated with PVE are modest. PVE was found not to have a statistically significant impact on payroll costs: BMRB/PSI found that “a number of multivariate analyses were undertaken to test the association between PVE and total payroll costs per employee. On the basis of this methodology, we conclude that PVE had no statistically significant effect on the total payroll costs per employee for the population from which our sample was drawn”. This was also true when “running separate analyses for smaller employers (fewer than 100 employees) and larger employers (100 or more employees)”.

Employers also reported that they perceived compliance costs to be relatively low. BMRB/PSI said that “the analysis of the perceived costs of WFTC/DPTC shows that

only one in four employers reported any costs of administering WFTC/DPTC, whilst only one in 50 experienced significant costs”.

#### Tax credits, recruitment and retention

The BMRB/PSI report said that some employers mentioned positive effects on recruitment as a result of tax credits. They said that “Around one in eight (12 percent) PVE and one in twenty ex-PVE employers said that WFTC/DPTC had helped them to recruit staff. Only two percent of PVE and three percent of ex-PVE employers said that WFTC/DPTC made it difficult. Furthermore, a fifth of PVE employers said WFTC/DPTC had definitely or possibly encouraged new people to join their organisation.” The Kingston report said some employers “felt that the additional income provided by the tax credits would be an aid to future recruitment” and some firms said it had allowed them to take on more experienced or better educated staff Kingston said “in a few cases, employers were able to take on more experienced part-time staff who may not have been attracted to these vacancies in the absence of tax credits”.

Positive effects were also reported in terms of retention of existing workers. According to BMRB/PSI, “a quarter of employers with experience of WFTC/DPTC said that they had definitely or possibly had a positive impact on staff retention”. The Kingston report said that tax credits had helped employers to “retain valuable members of staff who may otherwise have left” and added that “the boost to income from the tax credits has also had a positive impact on the morale of tax credit recipients at work”. Some employers could also see the benefits of tax credits in reducing stigma: Kingston reported that “among the perceived benefits were the reduction of stigma normally associated with ‘benefits’”.

#### High satisfaction with Inland Revenue service

Both the BMRB/PSI report and the Kingston report found that employers had very positive views of the tax credits service offered to employers by Inland Revenue. BMRB/PSI said that “...satisfaction was very high amongst those that had used Inland Revenue sources of information. Over nine out of 10 found the helpline and seminars useful, whilst similarly high proportions found the website (86 percent) and information pack (85 percent) useful. Over seven out of 10 also found the tax credits video and other sources useful.” Similarly, Kingston found that “the telephone helpline was described as friendly and approachable; and seminars and courses run by local tax offices were highly rated; and, for those few who had used it, the website was described as providing comprehensive and easily accessible information”.

The positive experiences of employers with specific Inland Revenue services translated into generally high satisfaction. BMRB/PSI said that “Three-quarters of employers with experience of PVE were satisfied with the service they received from the Inland Revenue in giving information and advice about WFTC/DPTC. One-third of these cases were ‘very satisfied’. Fewer than one in twenty employers expressed themselves dissatisfied with the Inland Revenue service.”

#### Employers’ awareness of PVE

BMRB and PSI found that on the whole, employers responsible for the payment of tax credits had high awareness of both tax credits generally and their responsibilities under PVE. They said that “...knowledge of WFTC/DPTC is most important among PVE employers specifically, and the data show that most PVE (94 percent) and ex PVE (90 percent) employers had some knowledge of WFTC.” In terms of PVE

responsibilities, BMRB/PSI reported that “respondents were...asked if they knew that employers were now responsible for paying these tax credits direct to eligible employees through their pay packet. Over three quarters (78 percent) said they were aware of this, and as one might expect, there were high levels of awareness amongst PVE (98 percent) and ex-PVE (94 percent) employers.”