



**HM REVENUE & CUSTOMS**

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# **Child and Working Tax Credits**

**Error and fraud statistics  
2007-08**

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## Estimates of error and fraud in Tax Credits 2007-08

### Introduction

#### The tax credit system

1. Child Tax Credit (CTC) and Working Tax Credit (WTC) were introduced in April 2003 and replaced Working Families' Tax Credit, Disabled Person's Tax Credit and Children's Tax Credit, as well as some other forms of financial support for families with children. For the first time, WTC also extended in-work financial support to families without children or a disability. The aims of the tax credits were set out in Budget 2002, and are as follows<sup>1</sup>:
  - supporting families with children, recognising the responsibilities that come with parenthood;
  - tackling child poverty, by offering the greatest help to those most in need, such as low-income families;
  - helping to make sure that work pays more than welfare and that people have incentives to move up the earnings ladder.
2. Tax credits offer support to nearly 20 million people, including 6 million families, supporting around 10 million children and targeting resources to the most economically disadvantaged people in society.
3. This report presents results from the tax credits Error & Fraud Analytical Programme, which is designed to measure error and fraud across the tax credits population. For 2007-08 this exercise took a stratified random sample of cases which were selected to be representative of the tax credit population. Around 4,800 cases were then taken up for examination by claimant compliance officers who worked the cases as they would for any other enquiry. The figures in this publication are based on around 4,100 of these enquiries that had been completed by the time this publication was produced. The results from these sample cases were then scaled up to population numbers to estimate the overall level of error and fraud in the tax credit system.
4. Because of the size and diversity of the claimant population, and the possible variations of compliance risk, the sample has been stratified so that we can measure

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<sup>1</sup> "The Child and Working Tax Credits, the Modernisation of Britain's Tax and Benefit System Number Ten", April 2002

the level of compliance for various claimant groups, as well as for claimants as a whole. More details about the sampling methodology used can be found in Annex A.

5. The Error & Fraud Analytical Programme helps to provide an understanding of the overall level of error within the Tax Credit system. The level of error and fraud by monetary value was 10-14% under Working Families Tax Credit, 9.2% for Income Support and 13.2% for Job Seekers Allowance in 1997-98 when the Government first collected data on a systematic basis.
6. When we published the first set of error and fraud statistics for tax credits in July 2006, covering the tax year 2003-04, we also published a document explaining what we were doing to tackle this issue. In 2007-08, the latest year for which statistics are available, the level of error and fraud was around 8.6% of finalised tax credit entitlement.
7. The Government has now set HMRC a challenging target to reduce the level of error and fraud in the tax credits system to no more than 5% by March 2011. We have therefore refreshed and adapted our strategy to reduce further the level of customer and official error and tackle fraud. This is outlined in more detail in the document Reducing error and fraud in Tax Credits<sup>2</sup>.

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<sup>2</sup> This can be found at <http://www.hmrc.gov.uk/about/reducing-error-fraud.pdf>

## Section 1: Likely levels of error and fraud

Table 1: total error and fraud as a proportion of finalised entitlement, 2007-08

	Error and fraud as a percentage of finalised entitlement		
	Lower bound	<b>Central estimate</b>	Upper bound
<i>Estimated error &amp; fraud favouring the claimant</i>	7.9	<b>8.6</b>	9.2
<i>Estimated error favouring HMRC</i>	0.8	<b>1.1</b>	1.4

8. Table 1 shows for 2007-08 the proportion of finalised tax credit entitlement that was accounted for by error and fraud. Since these and the detail presented in the following tables are based on a sample of cases there are margins of errors associated with these estimates; therefore, tables 1, 2, 3 and 4 also illustrate the 95% confidence intervals associated with these central estimates – and note that the estimates presented in the rest of the tables are the central estimates.
9. Error and fraud favouring the claimant refers to cases where the claimant has been found to be non-compliant in a way that has led HMRC to pay them more tax credits than they were entitled to for the year – i.e. there was a monetary gain for the claimant and hence a monetary loss for HMRC. Error and fraud favouring HMRC refers to cases where the claimant has been found to be non-compliant in a way that has led HMRC to pay them less tax credits than they were entitled to for the year – i.e. there was a monetary gain for HMRC and hence a monetary loss for the claimant.

Table 2: overall level of error and fraud, 2007-08

	Number ('000)			Amount (£m)		
	Lower bound	Central estimate	Upper bound	Lower bound	Central estimate	Upper bound
Estimated error and fraud favouring the claimant	1,030	1,100	1,180	1,580	1,710	1,840
Estimated error favouring HMRC	350	410	470	170	220	280

10. Table 2 shows central estimates and their associated 95% confidence intervals for the overall levels of error and fraud for 2007-08.

Table 3: error and fraud favouring the claimant as a proportion of finalised entitlement, 2007-08

	Error and fraud as a percentage of finalised entitlement		
	Lower bound	<b>Central estimate</b>	Upper bound
<i>Estimated error favouring the claimant</i>	7.2	<b>7.8</b>	8.5
<i>Estimated fraud favouring the claimant</i>	0.5	<b>0.7</b>	1.0

11. Table 3 shows for 2007-08 the proportion of finalised tax credit entitlement that was accounted for by error in the claimant's favour and the proportion that was accounted for by fraud in the claimant's favour. Due to the small number of sample cases in the Error and Fraud Analytical Programme classified as 'fraud' separate breakdowns of the components split by error and fraud are not available.

Table 4: level of error and fraud favouring the claimant, 2007-08

	Number ('000)			Amount (£m)		
	Lower bound	Central estimate	Upper bound	Lower bound	Central estimate	Upper bound
Estimated error favouring the claimant	1,000	1,070	1,140	1,440	1,560	1,680
Estimated fraud favouring the claimant	20	40	50	100	150	200

12. Table 4 shows the central estimates and their associated 95% confidence intervals split by the levels of error and fraud in the claimant's favour.

Table 5 - breakdown of error and fraud by type of tax credit award - central estimates, 2007-08<sup>3</sup>

<b>Estimated error and fraud favouring the claimant</b>	Numbers ('000)	Amounts (£m)
Nil award	-	-
Out of work	130	220
In work, children, more than family element	770	1,300
In work, children, family element or less	80	30
WTC only	120	150
<b>Total</b>	<b>1,100</b>	<b>1,710</b>
<b>Estimated error favouring HMRC</b>		
Nil award	20	10
Out of work	30	20
In work, children, more than family element	220	100
In work, children, family element or less	110	80
WTC only	30	10
<b>Total</b>	<b>410</b>	<b>220</b>

Table 6 - distribution of error and fraud by its value - central estimates, 2007-08

Value of error and fraud	Estimated error and fraud favouring the claimant		Estimated error favouring HMRC	
	Number ('000)	Amount (£m)	Number ('000)	Amount (£m)
Less than £100	140	5	100	5
£100 to £499	280	85	170	40
£500 to £999	230	190	80	55
£1,000 or more	460	1,420	70	125
<b>Total</b>	<b>1,100</b>	<b>1,710</b>	<b>410</b>	<b>220</b>

<sup>3</sup> To compare these figures to those presented in Table 3 (2003-04) and Table 4 (2004-05) then 'In work, children, family element or less' is equivalent to 'Flat rate' and the summation of 'Out of work', 'In work, children, more than family element' and 'WTC only' is equivalent to 'Others'.

*Table 7 - distribution of error and fraud by value of finalised award - central estimates, 2007-08*

Value of award	Estimated error and fraud favouring the claimant		Estimated error favouring HMRC	
	Number ('000)	Amount (£m)	Number ('000)	Amount (£m)
£0	-	-	15	5
Under £1,000	170	60	145	90
£1,000 to £1,999	120	90	45	30
£2,000 to £2,999	120	155	50	20
£3,000 to £3,999	100	140	30	20
£4,000 to £4,999	110	195	35	20
£5,000 to £5,999	135	285	25	5
£6,000 to £6,999	100	190	15	10
£7,000 and over	245	590	45	30
Total	1,100	1,710	410	220

13. Note that the value of the award shown in table 7 is the value of the finalised award when the random enquiry sample was drawn.

*Table 8 - Reasons for error and fraud - central estimates, 2007-08*

Reason	Estimated error and fraud favouring the claimant		Estimated error favouring HMRC	
	Number ('000)	Amount (£m)	Number ('000)	Amount (£m)
Income	420	275	275	135
Undeclared Partner	165	455	-	-
Childcare costs	260	315	30	10
Children	170	275	45	25
Work and hours	200	235	65	25
Disability	100	155	35	30
Total	1,315	1,710	450	220

14. Note that some claimants will have more than one reason for adjustment so the numbers will not sum to the total number of individuals presented in the other tables.

## **Annex A**

### **The 2007-08 Tax Credits Error and Fraud Analytical Programme (EFAP) - methodological and technical details**

#### **Introduction**

1. The tax credits system is designed to respond to changes in income and circumstances as they happen. In 2007-08, a family's award was initially based on their circumstances (e.g. number of children, any disabilities, etc.) and income as held by HMRC on their 2006-07 award at April 2007<sup>4</sup>. Once their 2006-07 award had been finalised then their 2007-08 award would be based on their finalised 2006-07 income; although, at any time they could provide an estimate for their current year income. At the end of 2007-08 families were required to tell HMRC what their final income was for the year by 31 July 2008. However, some recipients who had only been able to provide an estimate by this date were given until 31 January 2009 to provide their final 2007-08 incomes.
2. The 2007-08 exercise could not start until recipients had provided HMRC with details of their final 2007-08 incomes, which meant that compliance officers were unable to start work on some cases until after 31 January 2009 (as an enquiry can only be opened once the award is finalised).

#### **Error and fraud**

3. When Claimant Compliance Officers identified non-compliance, they were required to indicate whether they believe it was due to genuine error or fraud. To be classified as fraud, a caseworker needs to have found evidence that the claimant deliberately set out to misrepresent their circumstances to get money to which they are not entitled (e.g. claiming for a child that does not exist). Error covers instances where there is no evidence of the claimant deliberately trying to deceive HMRC. It covers a range of situations, including cases where a claimant inadvertently over-claims because they simply provided HMRC with the wrong information. It could also cover a situation where the correct information has been provided but this information has been incorrectly processed by HMRC.
4. Estimates of official error were published for the first time in 2006-07. As part of the working of each case compliance officers were asked not only to classify whether or not a case that was found to be incorrect was due to either error or fraud, but also whether or not the error was due to HMRC. However, HMRC error figures for 2007-08 are not included in this publication due to the small number of cases in the sample found to be affected.

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<sup>4</sup> Unless 2007-08 is their first year of tax credit receipt in which case it will be based on their circumstances at the time of application and their 2006-07 income.

5. For cases where error or fraud have been identified the Claimant Compliance Officer also has to identify the causes of the error or fraud - and the monetary consequence of this - the adjustment categories are shown in table 7. These categorise whether or not the income reported at finalisation is under or over-stated, likewise with childcare costs. Similarly, whether or not there is a partner in the household whose income has not been declared, whether or not a child claimed for is still in full time education and being cared for by the claimant, whether or not the adults in the claim are working and if so the number of hours that they are working and whether or not the adults and children in the claim are disabled or severely disabled<sup>5</sup>.
6. Due to the nature of organised fraud and HMRC compliance procedures the vast majority of organised fraud claims are stopped quickly and awards in payment are terminated. This means that organised fraud is more likely to be detected as overpayments rather than in the analytical programme, any overpayments that are not remitted during the year will be included in the annual National Statistics publication on under and overpayments.

## Sampling

7. The sample for the 2007-08 EFAP is constructed from 4 strata of claimants; these strata, together with the sample sizes, are shown below.

<b>Stratum</b>	<b>Sample size</b>
Nil awards	200
Flat rate	500
WTC only	400
Others	3,850
Overall	4,950

8. The sample was stratified in this way to ensure that an appropriate number of both Nil, Other and WTC only awards were included in the sample. If a purely random sample had been used this would have consisted of a high number of Nil and Flat rate awards which show relatively low rates of non compliance, thus reducing the accuracy of the results of the EFAP. The use of a stratified sample allows for the levels of error and fraud in each stratum to be estimated more accurately by ensuring the number of cases in each strata is representative of the likelihood of fraud and error occurring in that strata of the population.

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<sup>5</sup> This last category also covers the small number of cases where the claimant or their partner were incorrectly in receipt of IS/JSA (passporting them to maximum CTC with no tapering) or the 50+ return to work element.

9. An individual award can fall into a number of different strata during the year depending on the circumstances of the household at a given point in time, for example a couple could initially be receiving WTC only and then half way through the year have their first child thus moving them to our other strata. In fact there are ten possible categories (which we aggregate into our four strata) that a household in award could find themselves in at a given point during the year depending on their circumstances and income. When an award moves between these categories we say that a new entitlement sub-period has been created. It is not possible to aggregate these sub-periods into one category that would give the household an overall status for the year, therefore we allocate them based on the entitlement sub-period that they have spent the most time in during that year.
10. It is important to note that our sample base is awards and not families – these two differ as a family can have a number of awards during a year. Take the following example, initially a lone parent family is in award then a new household is formed when a partner moves in and later in the year the partner moves out (the household breaks down) and they become a lone parent again, so in total they have had three separate awards during the year. We follow awards as this is the unit that the tax credit system is based around and hence is most suitable for constructing a representative sample from.
11. The sample base contains all 2007-08 awards present on the HMRC tax credit system at the end of August 2009. An award may last for a period of anywhere between one day and the whole year.
12. The samples for each stratum were selected at random and were picked using a set of randomly generated numbers.

### **Sampling errors around the estimates**

13. Estimates in the tables are rounded to the nearest £10m/10,000 in tables 2 and 4 and £5m/5,000 in the other tables. The estimates presented are the central estimates derived from the sample taking account of the methodological approach set out below. Since these estimates are based on a sample they are subject to sampling errors. These margins of error have been expressed by calculating a 95% confidence interval around the estimates. These have been calculated and are shown in tables 1, 2, 3 and 4.

### **Methodology**

14. This next section sets out a number of different methodological issues - such as how we process the data, how cases in the sample have been scaled up to represent population estimates, how certain cases have been treated etc.

## Processing

15. The underlying data is recorded by the compliance officers who carried out the enquiries, it then undergoes a number of steps where it is checked and processed before it is used to calculate the figures in this publication.
16. The final data used is created by cross checking the information held in our compliance management information system against that held in the main tax credit computer system and against information recorded about the case by the compliance officer who worked it. Where a lone parent is found to have an undisclosed partner we offset the entitlement that they would have had under their (notional) joint award against the amount that was paid out incorrectly in the single-person award and the remainder is what we classify as error/fraud in this publication.
17. Each award has a number of entitlement sub-periods<sup>6</sup> and it is clear that some of these sub-periods cannot be associated with certain types of error/fraud that are recorded, for example if 25% of an award's time is spent in a WTC only sub-period and 75% of its time in sub-periods relating to CTC then a claimant favour error/fraud relating to a child could only have occurred in the latter 75% of the award. We therefore allocate the error to the sub-periods that it could be associated with, so in the earlier example the child error would be allocated to the 75% of the award spent in sub-periods relating to CTC. HMRC favour error has been reallocated between sub-periods based on the proportion of that award spent in that sub-period.

## Projections

18. Although the figures in this publication are based on the 4,111 cases that had been settled, there were still 676 cases that had been opened but weren't completed in time to be included. Therefore, we make a projection to cover the amount of extra error/fraud that we estimate these cases will provide.
19. It is assumed in this analysis that these incomplete cases exhibit the same characteristics, on average, to those that had been settled most recently and assumed that the cases left to work to the end will on average exhibit this average level of settlements and level of non-compliance. Where there is only a small number of sample cases for recently settled cases the average level over all cases settled is used.

## Grossing

20. The sample results of the cases that have been worked to completion plus the projected results from the cases still being worked have been grossed to reflect population estimates. Differential grossing factors have been applied depending on

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<sup>6</sup> See paragraph 10 for an explanation of entitlement sub-periods.

the value of the finalised award and the characteristics of the claimant during the year. The process by which the grossing was carried out differs from that used in 2003-04 and 2004-05 as a new improved methodology was introduced from 2005-06 onwards. Although the changes set out below introduce a discontinuity into any time series comparisons this is offset by the increased accuracy that the method provides for this and future years. For reference previously published figures for 2003-04, 2004-05, 2005-06 and 2006-07 are contained in the table below.

*Error and fraud rates 2003-04, 2004-05, 2005-06 and 2006-07 previously published*

	Year of random enquiry	Error and fraud as a percentage of finalised entitlement		
		Lower bound	<b>Central estimate</b>	Upper bound
Estimated error and fraud favouring the claimant	2003-04	8.8	<b>9.7</b>	10.6
	2004-05	7.3	<b>8.2</b>	9.1
	2005-06	8.5	<b>9.6</b>	10.6
	2006-07	7.2	<b>7.8</b>	8.4
Estimated error and fraud favouring HMRC	2003-04	1.6	<b>1.9</b>	2.3
	2004-05	1.4	<b>1.9</b>	2.4
	2005-06	1.4	<b>1.9</b>	2.4
	2006-07	1.3	<b>1.7</b>	2.1

21. The sample frame used from 2005-06 onwards provided more information than that used in previous years – giving us information on all the entitlement sub-periods<sup>7</sup> that an award had had during the year compared to previously having just the last of the year. Therefore we are now able to gross our sample results to the total of entitlement sub-periods for the population over the whole year rather than to the single entitlement sub-period present at the end of the year.

22. We also now gross up to the position of the award on each tax credit profile rather than to each strata that the award falls into (the four strata are an amalgamation of the 10 different profile positions) which gives us increased accuracy over groups with potentially differing rates of error and fraud.

23. The final change was a move from grossing to the total number of awards as the control population to instead using the total amount of entitlement.

## Other

24. The figures underlying this report are based on 4,111 cases examined by claimant compliance officers supplemented by the projections for the 676 cases that were opened but have not yet been closed. In the analysis presented in this report account has been taken of:

**cases that are not taken up for enquiry** - in some cases, for example if the claimant or their children have died, an enquiry is not taken up, these cases have been excluded from the results - implicitly assuming that if they had been worked they would have the same result, on average, to the cases that have been successfully completed.

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<sup>7</sup> See paragraph 10 for an explanation of entitlement sub-periods.