

## Statement to Treasury Select Committee on

26 October 2005

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RT HON DAWN PRIMAROLO MP,

HMRC Spring Report is in essence a statement of what the Department plans to achieve. It is early days in the merger. The aim of the merger is to achieve three strategic outcomes. Firstly, improved taxpayers' services. Early signs are encouraging. For example, the number of leaflets issued by the Department has been cut by 50% and the clarity of those still being issued is to be improved. One million people have been taken out of the self-assessment net altogether and 1½ million now have a simplified form. On efficiency, we have set the Department challenging efficiency targets and we expect them to be achieved. Again, the story so far is encouraging. About 2,500 posts have been cut; almost exactly where the Department should be at this stage to meet its 2008 targets. But this work is not simply about efficiencies, we also need to see productivity and quality gains across the Department. Thirdly, revenue yield. Revenue and Customs is aiming to collect a higher proportion of revenue than ever before and is clearly focused on closing the tax gaps on oils, tobacco, VAT and alcohol. Progress on these strategies will be reported at the time of the PBR as usual. Turning to tax credits, which I know the Committee is extremely interested in: HMRC has started the completion of the renewals process for 2004-05. That still has three months to run, until the end of January for the last applications, but early indications are that it is progressing well. More forms have been returned than last year and the helpline has dealt effectively with the increased volume of enquiries around the renewals deadline. Latest figures show that more families than ever—6.1 million—are benefiting from tax credits, with the majority of people receiving the right amount of money at the right time. But, of course, as the Committee will know from my statement of 26 May and subsequent reports published, I have set out to make sure that the Department improves measures for the administration of tax credits in three specific areas: improve how the Department communicates with families about their tax credit awards; reduce the risk of errors adding to overpayments; and improve the procedures for recovering overpayments. On improving communications, since May, HMRC has been reviewing the information it provides to claimants in written communications through its helplines and online. A new award notice, which reflects comments from the voluntary and community sector, has been agreed and will be issued from April 2006. For claimants this means they will receive a much clearer summary of their award, with an explanation of how it has been calculated and what they will be paid. Following consultation with the voluntary and community sector, the tax credits section of HMRC has redesigned the website to improve claimants' ability to access forms and information and give answers to their most frequently asked questions. HMRC will also be reducing the size of guidance notes sent out to claimants. From April next year, claimants will receive a two-page summary that explains the most important aspects of their award and tells them what information on their award needs to be checked. In 2006, a new renewal notice will be introduced so that when a claimant receives their renewals pack, they will receive a comprehensive "play-back" statement of the Department's records of their income and circumstances for the previous year. One of the most frequently made points by the voluntary sector, Hon Members and claimants is the need for a clearer message to remind claimants of the importance of providing up-to-date and clear information on any change of circumstances. A publicity campaign will run from the New Year to remind claimants to notify HMRC promptly of any changes in their circumstances. In addition, the Department is piloting more targeted approaches to remind claimants to report changes. Following the problems experienced during the introductory period of tax credits over two years ago, the performance of the helpline has been significantly improved and figures for the year to date show that 97% of calls are being answered within the target. HMRC is seeking to improve the quality of the helpline service through improved guidance, training for staff, learning from feed-back, but most importantly arranging for call-back arrangements using a case-working approach to provide more targeted support to the most complicated cases. They are also taking forward objectives to create a more flexible IT system that will allow process improvements, such as changes to award notices, to be introduced much more quickly. However, having established the integrity of the IT system and significantly improved its

performance, the priority must be to ensure that progress to more flexibility is done in a measured and orderly way. In terms of working with other organisations, HMRC is discussing with the Citizens Advice Bureau how they can best work together with a view to developing pilots to support claimants better, including offering face-to-face contact with the most vulnerable groups. It is also working, in full consultation with the voluntary sector and other interested parties, to speed up improvements in key areas including the quality of the helpline service, the handling of appeals, complaints and the code of practice on overpayments, and the Department is aiming to introduce for further discussion a new version of COP 26, the appeals procedure, by the end of this year. Finally, the Department is able to make additional payments to claimants in cases of genuine hardship. In addition, where an overpayment is being recovered from someone who is no longer receiving tax credits, there are procedures that allow HMRC to agree extended terms for recovery. Where recovery of an overpayment is disputed, in cases where there is no on-going award, there are already arrangements in place to suspend recovery. As I have said in my written Parliamentary Answer this morning, from next month, subject to final testing by HMRC, interim procedures will be put in place so that if a claimant disputes the recovery of an overpayment, action will be taken to prevent automatic recovery until the Tax Credit Office has looked into the case and made a decision. These procedures will apply both to the cases on hand and to new cases going forward. I have asked the Tax Credit Office to aim to complete all such enquiries and make decisions within four weeks. Of course, HMRC will continue to develop work on a fully computerised, automated procedure for suspending the recovery of disputed overpayments with a view to introducing this in 12 months' time, but I believe the interim procedures will give the immediate relief which so many are seeking. Thank you.

Statement on 5 December

**The Paymaster General (Dawn Primarolo):** The Child and Working Tax Credits are today benefiting over 6 million families and 10 million children. Tax credits tailor support to families' specific circumstances, providing more support when their need is greatest. They represent a more generous and inclusive system of income-based financial support than any previous system.

Over the past seven years the Government have reformed Britain's tax and benefit system to achieve three over-arching aims: to provide adequate financial incentives to work; to reduce child poverty; and to recognise the responsibilities of parenthood by supporting families with children. These reforms have helped make work pay and reduce the numbers of children in absolute poverty by one and a half million. Tax Credits have been an important part of this success and they represent the best way to continue it in the future.

In my statement of May 26 I outlined six measures to improve the administration of tax credits. These aimed to improve HMRC's communications with tax credit recipients, reduce the risk of errors and improve the procedures for recovering overpayments. Significant progress has been made in each of these areas.

Building on these improvements to the administration of the system, the Government are today announcing a package of further improvements most of which will come into effect over the next 18 months. The measures reflect the experience of the first years of operating the tax credit system and strike a balance between providing more certainty and stability of financial support for families, while maintaining flexibility to respond to changes in their income and circumstances. The measures also include clear responsibilities for claimants to report changes affecting their award.

The tax credits system is an annual one—integrated with the tax system—within which payments can be adjusted to reflect changes in a family's circumstances and income. Under an annual system, given a family's final entitlement cannot be known until the end of the year, some level of end-year adjustment will be necessary. However, for some families, especially those on lower incomes, downward adjustments to tax credit payments—to reflect changes in circumstances reported within the year or when awards are renewed—can sometimes cause difficulties. This is a particular problem where claimants had not realised their payments were too high. Better communications, which is a key part of the measures announced on 26 May, will help by improving claimants' understanding of the system.

Today's measures will improve matters further, providing greater certainty for claimants, especially those on lower incomes, through measures to reduce the need for adjustments caused by rising income and to limit the effects of adjustments. These are supported by measures to reduce the likelihood of unexpected downward adjustments resulting from

inaccurate or out of date information about a family's income or circumstances.

Analysis of overpayments suggests that they result from a number of factors: income rises from one year to the next; families overestimating the extent to which

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their income has fallen when they seek extra support during the year; provisional payments made at the start of the tax year, which are based on out-of-date information that is subsequently updated when the award is renewed; and delays in reporting changes in families' personal circumstances to HMRC.

The improvements announced today will provide greater certainty for claimants, particularly those on lower incomes, while maintaining flexibility to respond to falls in income and changes in circumstances.

To increase the flexibility of the system, from April 2006 there will be an increase in the limit on the amount that family income can rise over the current tax year without affecting tax credit entitlement for that year. The current annual income disregard of £2,500 will increase to £25,000. This will mean that, for instance, a family where a non-working partner moves into work on average earnings will not see their increased income lead to a fall in their tax credit entitlement during that year. This will maintain the incentives for people to move into work, while removing a major cause of the overpayments seen in the first two years of the system's operation.

To provide greater certainty of award for claimants, from November 2006, automatic limits will be imposed on the extent to which tax credit payments can be reduced to recover higher payments in the earlier part of the year which could lead to an overpayment for the year as a whole. These limits will be set at the same levels at which overpayments from a previous tax year are currently recovered. This will guarantee that low- to middle-income families do not face large and sudden falls in their tax credit income, and reassure people who report changes promptly.

To tackle the problem of families overestimating falls in income, from April 2007, when claimants report a fall in expected income during the year, their tax credit payments will be adjusted for the rest of the year to reflect their new income level, but will no longer include a one-off payment for the earlier part of the year. At the end of the year, their award will be finalised when their actual income is known. If they have been underpaid, a further payment will then be made. This approach will provide a buffer against any overpayment accumulated by the family during the year, especially where their estimate of income proves to have been too low.

Today's measures will also give claimants clear responsibilities to report changes promptly and more regularly. They will be helped to keep their records up to date, including through more proactive contact by HMRC, allowing HMRC to base tax credit awards on the best possible information.

In summer 2006 the deadline for providing information to finalise and renew tax credit awards will be brought forward by one month to shorten the period during which provisional payments may be made using out-of-date information.

From November 2006, the range of changes reducing entitlement that must be reported to HMRC within three months will be expanded to include changes in work status or in the number of children for which the family can claim support. From April 2007, the time allowed to report such changes will be reduced from three months to one.

In early 2007, towards the end of the tax year, HMRC will contact key groups of claimants to obtain more up-to-date income information on which to base the next year's payments while the finalisation process is completed. And from 2008–09, the income figure used in setting provisional payments will be updated by average earnings where up to date information has not been provided.

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In line with its commitment when tax credits were announced in 2002, the Government have looked to learn from the early operation of the system and will continue to do so. Together these measures, and the six measures currently being implemented by HMRC, will lead to steady and ongoing improvements in the tax credits system, allowing it to deliver support even more effectively to millions of families. Without the changes announced today, initial estimates suggest that subsequent years' overpayments would be of broadly the same level as in 2003–

04. When fully implemented, it is anticipated that today's changes will reduce the value of overpayments by around one third. I am still considering whether there is more that can be done to alert claimants about the recovery of an overpayment before HMRC starts to collect it but the scale of changes to the computer system that would be needed mean that this could not be done quickly.

I believe that these further measures will help to ensure that tax credits strike the right balance between flexibility and certainty for claimants and give clear messages about the need to report changes to HMRC. They are a positive response to the issues raised by the Ombudsman and others and will go a long way to meet the concerns they have expressed. A case has been made for a system of fixed awards, which within the framework of the annual tax credits system, would need to be based on the previous year's income. The Government will continue to listen to the case, but believe on balance that it is preferable to maintain the current system that flexibly responds to changing circumstances.

The PBR sets out the actions the Government are taking to continue improving compliance in the tax credit system. As announced on 2 December, as part of their ongoing compliance work, HMRC have identified and stopped attempts to defraud the tax credits system by making claims through the tax credits e-portal. HMRC has closed the e-portal while it develops new checks to ensure the system remains secure. A criminal investigation is also being undertaken into the apparent false use of a number of DWP staff identities in fraudulent tax credit claims. It would not be appropriate to make any further public statement at this stage.

DWP and HMRC are carrying out an in-depth investigation into how this happened. They are also working quickly to identify the records concerned and to ensure they are corrected.