Universal Credit: the problems

Produced by Tax Training Ltd. **www.taxtrainingltd.co** **020 8224 5695.** **November 2018**

Introduction

Universal credit (UC) is the government's flagship social security policy, being rolled out over a decade. It replaces six means-tested benefits with one benefit. It is paid monthly in arrears, like wages. It is designed to provide an income stream similar to wages or salary, and to ensure that a person is always better off in work.

UC has been plagued by delay and mistakes which have been widely reported. In 2018, foodbank use rose by 50% in areas where UC has been introduced, against 13% for other areas. UC has seen rent arrears for council houses more than double. Councils increasingly struggle to find private landlords willing to accept UC claimants as tenants, because of the problem with arrears.

The sad irony is that the principles behind UC are good. UC has these advantages over previous systems:

• a claimant does not have to change benefits as they move in and out of work

• some anomalies in the ways that previous benefits interacted. For example, someone working for 16 hours a week gained little benefit by working 24 hours

• it emulates a regular wage or salary.

The problems with implementation do not arise from the principles or clerical errors. The main problems are built into the rules for administering UC.

Social security is really taxation in reverse. It is the opposite page of the ledger for the same account — that between the state and the citizen. Looking at UC from the perspective of a tax accountant, the system is riddled with obvious problem areas, some of which could be solved by using procedures already in use in tax systems.

This article is largely the personal opinion of the author. But it has a strong factual basis, which it is hoped will explain some of the issues. Some of the material in this article about assessment periods has been taken from the article *Rough justice: problems with universal credit* by Josephine Tucker in *Poverty edition 161* published by Child Poverty Action Group.

Making work pay

It is often not realised how much tax the government takes from wages. If someone on an income from the national minimum wage upwards earns an extra £100, the government (usually) takes £20 in income tax and £12 in national insurance. The employee is left with £68. The employer pays £13.80 employer's national insurance. This means that the government has collected £45.80 in tax from £100, nearly half. And this is not charged on the wealthy. These figures apply to someone on the national minimum wage.

If the employee is paying into a workplace pension or is repaying a student loan, and if the employer is liable for the apprenticeship levy, the sums collected are even greater.

If the employee is on UC, extra pay triggers a withdrawal of benefit at the withdrawal rate of 63%. This means that almost two-thirds of the net benefit is lost.

The employee loses 63% of the £68 he or she receives from the £100 pay rise. This is £42.84. This means that the employee receives just £25.16 from the extra £100, barely one quarter.

If the employee is receiving the national living wage of £8.21 an hour from 6 April 2019, their net benefit is just £2.06.

(For 2018/19, the national living wage is £7.83 an hour, giving a net benefit of £1.97. It should also be noted that there are many other situations. Someone not working at all, will get allowances when they do not pay income tax or national insurance. The example deals with someone who is working and receives some *extra* pay.)

If we regard withdrawal of benefit as the same as tax (and it has the same consequence), an employee on UC is paying total tax of almost 75% on each extra £1 they earn.

There are expenses in working extra hours. It can involve extra travel. The standard bus fare in London is £1.50 using an Oyster card. So, at a net income of £2 an hour, a claimant must work 1½ just to pay the return bus fare.

If the claimant has to arrange childcare, extra work is very difficult to justify. Leaving a child with a registered childminder costs at least £4 an hour, so a claimant would need to earn more than £16 an hour just to pay the childcare cost.

Non-cumulation

UC is paid according to assessment periods lasting one calendar month. They can start on any day of the month. So if someone starts on, say, 15th November, their assessment periods will be for calendar months that run from the 15th of one month to the 14th of the next. Income is considered for that one month, UC is calculated and benefit paid one week later.

The system considers each month in isolation without regard to months before or afterwards (with one exception for “surplus earnings” which works to the claimant’s disadvantage anyway).

This inflexible approach can create problems, particularly when the assessment period runs to a date late in the month. Suppose a claimant has assessment periods that run to 29th of each calendar month. The claimant is employed and paid on the last working day of the month. In 2018 they will have:

- 6 assessment periods with one pay day
- 3 assessment periods with two pay days

- 3 assessment periods with no pay day.

Over the course of the year, they will have 12 pay days for 12 assessment periods, but that is not how UC is calculated.

In the 3 periods with two pay days, UC is calculated on the basis that the person has received double their normal pay. This means that their UC for that period is much reduced, often to zero.

In the assessment periods with no pay day, income will be regarded as zero, so UC will be more than for one pay day. But the work allowance is lost for that period as there is no income for them to be set against, so the additional UC does not compensate for the two-payday periods. An unused work allowance for one month is not carried forward.

A similar effect can arise when a pay day is varied, as UC is determined according to the day payment is made, not for when it is due. So paying someone before Christmas in December, or before they take their holiday, can have a similar effect. If the usual pay day falls in a weekend or bank holiday, the employer may pay a day or two earlier. This can also trigger this mismatch.

A tax accountant will recognise that a similar effect can arise under PAYE for income tax. Suppose an employee receives £2,000 a month in normal pay but gets a one-off payment of £3,000 (perhaps for back pay or commission) in April, the first month of the tax year. The April payslip will show gross pay of £5,000. It will calculate tax for that month on the basis that the employee is earning £60,000 a year, so a huge amount of tax will be deducted.

The difference here is that the PAYE works on a cumulative basis. For May, it will record earnings to date of £7,000 for two months, and calculate tax on the basis of annual income of £42,000 (six times £7,000). This means that some of the tax deducted in April is in effect refunded in May. This process continues throughout the year. At the end of the tax year, the employee will have paid tax on earnings of £27,000, and that figure will be the same regardless of in which month the bonus was paid.

Not so for UC. The problem of variable numbers of pay days could be solved by administering it on a cumulative basis similar to PAYE. But it isn't.

Not paid monthly

UC aims to mimic receiving a monthly wage or salary. About 75% of all employees are now paid monthly.

However, UC claimants are by definition those on low incomes where monthly payment is less common. In 2016/17, it was found that 58% of UC claimants were not paid monthly. They were mostly paid weekly or fortnightly.

A claimant paid weekly will have:

- 8 assessment periods of four pay days, and

- 4 assessment periods of five pay days.

This means that their UC will vary from month to month, even when their earnings are constant.

The article in *Poverty* magazine cites an example of a couple with two children. The man earns between £285 and £300 a week paid weekly, and the woman is paid £512 for each four-week period for part-time work. They claim UC from December 2017 from when their income does not change.

The UC they receive is:

- December: £624
- January: £466
- February: £1,185
- March: £392
- April: £0
- May: £598.

Admittedly this is a bit of a contrived example, but it neatly illustrates just how variable UC can be even when earnings and rates are constant.

It defeats one of the main planks of UC, namely of mimicking salary or wages. These are usually constant from one pay period to the next. UC, which aims to top up that salary or wage, is hugely variable. Again, cumulation would address this problem.

Benefit capping

UC is within the scope of benefit capping. This limits the total amount of benefit that a claimant can receive.

The benefit cap is quoted as a weekly figure which is quoted to a monthly figure for UC. At 2018/19 rates, the benefit cap applies if monthly benefits exceed £1,917 in London, or £1,667 elsewhere.

The way UC is calculated means claimants can be benefit-capped even when their weekly earnings are below the limit. Again, this would be resolved by a measure of cumulation.

Declaration that earnings are irregular

Almost all taxes are now assessed by the taxpayer by a simple declaration. Although HMRC has the right to query a tax return, this right is rarely used in practice. HMRC almost always accepts what the taxpayer says.

For social security, the position is completely different. Claims must be proved. The entire Real Time Information (RTI) system for PAYE was introduced solely to provide independent evidence of employees' earnings for benefit claims.

Falsely claiming benefit is the equivalent to under-declaring your tax. Both are illegal and cannot be condoned. Yet the practices are quite different in reality. Tax returns are rarely checked, and understatements often lead to no penalty at all, or a fixed penalty of perhaps £100 or 5% of the tax.

Tax accountants who think that tax penalties are draconian should look at sanctions for benefits. A claimant over 25 can be penalised at a rate of £10.40 a day (2018/19 rate) at the high rate, or £4.10 at the low rate. The low rate can be imposed for something as trivial as being a few minutes late for a job interview (perhaps because the bus was late) or not properly recording an attempt to find work.

These sanctions can take away a quarter of a claimant's UC.

If a desperate claimant commits fraud, they can lose benefit for up to three years under a separate regime from sanctions.

While non-cooperation and fraud should not be tolerated, there does seem to be a consensus that the penalties are unduly harsh, particularly when compared with tax penalties. The system does not consider what a sanctioned claimant is supposed to do for food or other living expenses while their benefit is stopped or reduced. Research has shown that sanctions do not change claimants' behaviour; they are purely penal.

If someone's tax is unusual, there are disclosure provisions to alert HMRC to this. A common example is self-assessment of income tax. HMRC assumes that one year's tax will be the same as the previous year's. If it is not, a taxpayer can simply advise HMRC of this and adjust the tax payment on account up or down. There are similar provisions for VAT and other taxes. There are no such provisions for UC.

Whole-month approach

UC is determined for a whole month at a time. This is called the "whole-month approach". It basically means that a person's situation on the last day of the assessment period is assumed to apply for the whole month.

This can lead to serious distortions when circumstances change during the month as no allowance is made for the part of the month when UC would otherwise apply. Examples include:

- moving to a property with a lower rent
- giving up a home to move back with parents
- children leaving home
- moving into temporary accommodation
- becoming a student.

If someone leaves a job during a month, they are paid a pro rata amount up to the date of leaving. Not so for UC.

Handling money

A principle of UC is that the claimant takes responsibility for their expenditure.

While most claimants can handle money responsibly, a significant number cannot. It has been estimated that 2% of people cannot handle money properly in that they cannot perform simple arithmetic, recognise the values of notes and coins, nor operate a bank account.

About a quarter of all people with debt problems do not realise that money should be borrowed at the *lowest* interest rate. They think that the higher the interest rate, the better the deal. That is why some loan companies advertise the "best" interest rate rather than the "lowest" one.

It has been estimated that 40% of the population make no real effort to budget their personal expenditure.

UC must be claimed online. Many claimants are not computer-literate and need help.

UC claimants are low earners. They include a disproportionately large number of people who have difficulties with handling money. Slick advertising and other temptations easily lead to unwise spending.

For UC this is a particular problem for housing. Whereas housing benefit was usually paid directly to the landlord, the housing element of UC is paid directly to the claimant. This is designed to mimic salary where the recipient is expected to pay their rent directly. (There is a facility called landlord portal which is now belatedly being introduced to allow some UC to be paid to landlords, but this is still difficult to arrange in practice.)

The inevitable and entirely predicable consequence is that the claimant does not pay the rent and uses the money for what is seen as more pressing items. A BBC *Panorama* programme in November 2018 found that council tenants on UC owe an average of £663 in late rent, against £262 for those still on housing benefit.

The programme looked at Flintshire in North Wales, one of the first areas to move to UC. It found that rent arrears averaged £1,424 — six times the amount owed under housing benefit. Evictions have risen by 55%. The council has spent an extra £270,000 on staff to advise claimants who need help.

The consequence is that more than half of all private landlords will no longer accept UC claimants as tenants.

Cash-strapped local councils have seen rent arrears mushroom. This puts them in the invidious position of taking the hit or evicting. The former is not fair to other council tax payers and those who struggle to pay their rent. The latter creates human tragedies as the claimant either becomes homeless or the council has to rehouse them.

Conclusion

The saddest aspect of all this is that UC does not have to be like this.

The principles of UC are sound and sensible. The staff that administer it are honest and generally competent. No politician wants to stigmatise or pauperise claimants. The human suffering caused by the failure of the system is unacceptable in a civilised and compassionate society.

The Chancellor of the Exchequer has introduced measures to alleviate some of the problems of UC in the 2017 and 2018 Budgets. But they do not address the main problem which lies in the administrative arrangements for the benefit. They could be addressed by introducing provisions such as cumulation which are well understood in tax.

This is just the opinion of one tax accountant. It is offered as a contribution to debate.