The economics of universal credit

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LITRG reflects on its response to the House of Lords Economic Affairs Committee call for evidence on universal credit.

Universal credit was brought in to simplify the benefits system by combining support for those in and out of work, who may also have housing and childcare costs, with additional payments for people who have disabilities or caring responsibilities.

LITRG's response to the call for evidence outlined some problem areas in the system.

Universal credit was intended to be administratively simple (and also to limit claimant error) by taking PAYE real-time information (RTI) collected by HMRC and sending it to the Department for Work and Pensions (DWP) to assess employees' entitlement to universal credit. However, the definition of earned income for universal credit does not always neatly match up with the tax data.

The first problem outlined in our submission focused on timing of pay. Workers paid four-weekly or monthly can experience a 'double-pay' problem, due to the claimant's pay dates not always matching the universal credit monthly assessment period. In some cases, this problem has been exacerbated by coronavirus; for example, with some employees being furloughed but their employer paying them later than usual on receipt of a Coronavirus Job Retention Scheme grant.

One might assume that the claimant should not be any worse off overall because although they will receive a lower universal credit payment in one assessment period, where two pays are taken into account, they will correspondingly receive a higher universal credit payment in the next, where there is no reported pay information. The answer depends on the circumstances of the case. Some people may be better off in the longer term, whereas others could lose out due to:

- losing out on the work allowance in the months where the RTI indicates no earnings;
- hardship caused by an unexpected missed payment of universal credit;
- extra pay which might end the universal credit claim, meaning that the claimant will have to claim again; and
- potentially triggering the benefit cap and surplus earnings rules.

If an objective of universal credit was to combat poverty by improving claimants' ability to manage their money, in such cases precisely the opposite effect has been seen.

Another issue is that RTI data does not always give the DWP the full picture for universal credit employed earnings, particularly with regards to unreimbursed expenses. Claimants might be able to deduct expenses that they have necessarily incurred and that their employer has not reimbursed, yet this is not clear in the claim process or in DWP guidance for their staff.

Somewhat surprisingly, even the net-of-tax income figure that the DWP receives through RTI may not reflect the claimant's true net income for universal credit. The universal credit regulations state that, from the earnings figure, income tax and primary class 1 contributions **in respect of the employment** are to be deducted. This is rather odd, because HMRC do not calculate tax separately on individual sources of income. Instead, the data received by DWP from HMRC may show tax deducted that isn't necessarily in respect of the employment. This can occur if the claimant's PAYE code includes other tax debt which is coded out.

A mismatch can also arise if the claimant's PAYE code is incorrect, meaning that the claimant is paying too much or too little tax. If paying too much, a later tax refund can (if certain conditions are met) be treated as earned income for universal credit when it is received from HMRC. If paying too little, the claimant should be able to have the tax underpayment in respect of the employment deducted from universal credit earnings in a later assessment period if they settle it with HMRC direct (or it would be automatically taken into account if 'coded out' and they still claim universal credit when that PAYE code is operated).

However, HMRC do not notify DWP of PAYE tax refunds (nor, we assume, PAYE underpayments). The claimant should declare them to DWP, to be factored into their universal credit award. It is not clear to us how the claimant would know to do this.

Furthermore, the claimant will probably not know to what the tax refund relates as HMRC do not give a breakdown of refunds in their P800, Simple Assessment or Self Assessment tax calculations. Therefore, although one reason for using RTI was to 'design out' opportunities for claimant error, hidden errors may remain.

The self-employed also face mismatches between tax and benefits. Take, for example, the introduction of the £1,000 a year 'trading allowance' for income tax. For welfare benefits, these amounts are still assessed as income. This can cause confusion, as people could easily believe that they need not report amounts up to £1,000 to government at all.

As universal credit stands, it seems administratively to work best for those with a single job, steady income and stable personal circumstances. However, in our experience, such 'idealised' circumstances are not typical. The self-employed are likely to see peaks and troughs in their income throughout the year, yet universal credit works on a strict monthly assessment basis. It would be fairer to have a system which allowed income to be smoothed across the year, for example by averaging.

LITRG's full response to the call for evidence can be found on the LITRG website.

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