Tax credit and tax-free childcare: update

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LITRG provides an update on the changes to tax credits

Budget 2016 included further details of the rollout of tax-free childcare, and regulations made immediately before the statement contained changes that may lead to significant cuts in some tax credit awards.

Tax credits

Overpayments

One of the most significant changes in the Tax Credits and Child Benefit (Miscellaneous Amendments) Regulations, SI 2016/360 deals with recovery of overpayments.

The Tax Credits (Payments by the Commissioners) Regulations, SI 2002/2173 impose limits on the recovery of overpayments from current awards. Regulation 5 of SI 2016/360 revises those limits from 6 April 2016. The change was announced in Budget 2014. It appears to have been reflected in revised HMRC guidance since January 2016 even though it was not set to take effect until 6 April.

LITRG has already expressed concerns about this change, and the late publication of the regulations left little time for representations on the detailed provisions. This increase in percentage rate may have a significant impact on claimants, especially those with childcare costs or disability elements included in their awards. A family with two children (one disabled child), household income of £22,000 and childcare costs of £200 a week could face a reduction of a further £3,731 in 2016/17.

We are concerned that this measure, when combined with other recent debt measures, will cause claimants to fall into hardship. The current hardship request process within HMRC is difficult to access, and not well explained or publicised for claimants or their advisers.

Regulation 5 increases the maximum rate at which overpayments may be recovered from other tax credit payments under SI 2002/2173 reg 12A(2)(c). Broadly, this provision applies when the maximum tax credit award is reduced to take account of income and the award is not limited to the family element of child tax credit only.

If the 'annual income' of the claimant (or claimants in the case of a joint claim) exceeds £20,000 the income-related percentage becomes 50% instead of 25%. 'Annual income' is taken to be the amount that HMRC is for the time being treating the claimant's annual income to be for the purposes of Tax Credits Act 2002 Part 1, regardless of whether that amount is also 'the relevant income' as defined by TCA 2002, s 7(3).

In effect, this means that HMRC will use the most recent figure it holds for the claimant, which may not be the one used to calculate the tax credit award (which uses the relevant income).

Income rise disregard

Summer Budget 2015 announced that the disregard for rises in income would be reduced to £2,500 from £5,000 from 6 April 2016. This change is made by the Tax Credits (Income Thresholds and Determination of Rates) Regulations, SI 2016/393. The income rise disregard is the amount disregarded in determining entitlement for the current year, where the income for the current year exceeds that for the previous year.

Tax-free childcare

The Budget confirmed that the new tax-free childcare (TFC) scheme, originally set to start in autumn 2015, will roll out in early 2017. The scheme was delayed because of a legal challenge, but the Supreme Court ruled in July 2015 that the government's decision to appoint National Savings & Investments as the childcare account provider was not unlawful – see *Tax Adviser* August 2015, page 71.

TFC will be rolled out ‘in such a way that allows the youngest children to enter the scheme first’, with all eligible parents brought in by the end of 2017. The existing scheme, employer-supported childcare, will remain open to new entrants until April 2018 to shadow the transition. This will ‘sit alongside’ doubling the free childcare entitlement from 15 to 30 hours a week for working families with three- and four-year-olds from September 2017, the government said.

We have raised several concerns about the interaction between TFC and other childcare schemes. People will face extremely complex and difficult decisions about whether to join TFC or stay in existing schemes including childcare vouchers, tax credits and universal credit. We have stressed the need for the government to provide detailed guidance over the next few months and ensure that potential users are given support to help them make the right choice.

The short guidance note ‘Tax-Free Childcare: 10 things parents should know’, has been updated to reflect the recent announcements.