

CLIENT MEMORANDUM

THE NEW TAX CREDITS: IMPACT ON CLAIMANTS, EMPLOYERS AND THE SELF EMPLOYED

The new system of tax credits has now been with us for over a year.

The rules are very complex, and there have been major teething problems since their introduction. The deadlines for submitting (or revising) claims are tight.

There are significant implications for claimants, employers and the self-employed, and the purpose of this memorandum is to give an overview of the current position including details of potential pitfalls and planning opportunities.

The credits are in essence social security benefits, but most of them are administered by the Inland Revenue. However, the Pension Credit is operated by the Department for Work and Pensions (DWP).

THE PENSION CREDIT

The Pension Credit took effect in October 2003, and it replaced the Minimum Income Guarantee for people aged 60 or over.

The credit is available to a single person aged between 60 and 65 if their income is below £105.45 per week. This amount rises to £160.95 per week in the case of a married couple.

The credit is higher if the claimant (or the claimant's partner) is severely disabled or looks after a severely disabled person.

If the claimant has savings, then he (or she) is regarded as receiving £1 per week for every £500 capital (or part thereof) above £6,000. In order to optimise the position a potential claimant may, in certain circumstances need to plan his/her financial affairs with care. The claimant's home does not count when looking at capital assets. Thus, a person who owns a house worth £200,000, subject to a £50,000 mortgage and also has £40,000 in a building society will probably not qualify for the credit due to the "capital limit rule". However, their neighbour might have a £200,000 house with a £10,000 mortgage and no savings. This person may well qualify for credit, even though his net assets of £190,000 are exactly the same as his neighbour's.

THE WORKING TAX CREDIT

This credit applies to both employed and self-employed people. It replaced – from 6 April 2003 – the Working Families Tax Credit and the Disabled Person's Tax Credit.

There is a guaranteed gross minimum income for claimants. The various rates of benefit are set out in the Appendix. There are special elements to cover disability or severe disability. There is also an additional element of credit for a claimant who is over 50.

There is also a special childcare element. This applies if care is provided for a child by a registered child-minder or an accredited organisation. The claimant must be a lone parent working 16 hours a week or more, or a couple who both work at least 16 hours per week (or where one works more than 16 hours per week and the other is disabled).

The Working Tax Credit is paid to the working adult. If there is a childcare element, this goes directly to the main carer for the children.

The credit is paid via the employer. In the case of self-employment or the early days of a new employment the credit will be paid directly by the Inland Revenue.

There is an annual income threshold of £5,060 and a reduction of 37p per annum for every extra £ of income.

The following example shows how the threshold works (this applies also for purposes of Child Tax Credit).

Example

Jack and Jill would be entitled to credits of £5,640 if their annual income was £5,060. Jack earns £12,800 per annum and Jill does not work.

Entitlement

As above	£5,640.00
Less restriction: 37% of income above £5,060 i.e. 37% of £7,740	£2,863.80
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Tax Credits due	£2,776.20
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CHILDREN'S TAX CREDIT

This was replaced by the Child Tax Credit from 6 April 2003. One of the main anomalies no longer exists: this credit was available to a household where each parent earned £30,000 per annum but not to a household where one parent earned (say) £40,000

THE CHILD TAX CREDIT

Applying from 6 April 2003, it applies to around 5.75 million families. Benefits are paid to the main carer, and eligibility does not depend on the working status of the parents.

The rates are set out in the Appendix. The Credits are available for a family with income up to £58,000 per annum (£66,000 in the first year of a child's life). It should be noted that they are paid to the bank account of the main carer, not through the PAYE system.

CHILDCARE

There have been a number of legislative changes in recent years designed to alleviate the costs of childcare in certain circumstances. Some of these have already been covered, but it is important to note that some of these new benefits are not strictly "Tax Credits" but can still be very helpful.

Under current legislation no taxable benefit or National Insurance charge arises on an employee if childcare is provided by an employer for children of an employee. There are a number of criteria which have to be met. For example the child must be under 18, the care cannot be provided in a private

home, and the premises or the carer must have appropriate registration.

The Chancellor is proposing to extend the exemptions from 6 April 2005, to cover “non- workplace nurseries”. This extension is likely to cover the following situations:

- (i) The childcare arrangement is accessible to all staff, and
- (ii) The employer directly contracts with the provider of the childcare, or gives childcare vouchers to the employee, and
- (iii) The childcare provider has appropriate registration or approval (usually by the local authority)

The exemption under the new proposals will be limited to £50 per week per employee

SAME SEX COUPLES

The Tax Credit legislation currently defines a “couple” as a man and a woman. This means that if a same- sex couple wishes to claim tax credits, each partner has to do so separately, based on their own particular income and circumstances. It is proposed to amend these rules so that same- sex couples will need to make joint tax credit claims on the same lines as opposite sex couples

GENERAL PRINCIPLES

It is important for the claimant to retain records of earnings/profits, etc to produce in support of any claim for benefit. It will also be necessary to report details of income from investments and other sources.

“Income” for these purposes is broadly the same as taxable income, but some benefits in kind are excluded (e.g. childcare vouchers).

Credits will normally be calculated initially by reference to the income of the preceding tax year. However for 2003- 04, they were initially calculated by reference to the income of 2001- 02, with a subsequent adjustment being made to take account of the income of 2003- 04. If there has been a significant change in the claimant’s circumstances, this needs to be notified to the authorities within three months.

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In the case of an under- payment of benefits, the adjustment will usually be made by way of a cheque payable to the claimant, after the year end.

If, at the end of the tax year, benefits have been overpaid, the excess will usually be recouped out of future benefit payments. Alternatively, it may be recovered through the PAYE system, or by way of a self- assessment adjustment (where appropriate).

It is important to note that there is a 3 month time limit for claiming tax credits. If a person is entitled to Working Tax Credit and/or Child Tax Credit at 6 April 2004, he (or she) must notify the claim by 6 July 2004. If the claim is submitted later than this there may be a loss of credit. However, a claim for pension credits can be backdated to 6 October 2003 if made by 5 October 2004.

It would seem to be advisable to submit a protective claim for tax credits as early as possible, even if there is a possibility that the claimant's income will be too high to meet the criteria for payment of Credits. The Revenue may initially issue a "nil award", but if income levels change, there will be no restriction in entitlement as a result of not meeting the time limits. In the case of an employed claimant, this will cater for the possibility of being made redundant during the year. In the case of a self-employed person it will allow for a dip in profit (e.g. due to a large bad debt or recession).

It should also be noted that the claimant should notify the Revenue within 3 months of marriage, separation or a significant fall in childcare costs. It is also advisable to make prompt notification of the birth of a child.

THE EMPLOYER'S POSITION

If you are an employer, you need to consider carefully the impact of the rules.

You may find that employees will need help to understand their entitlements, and they may need copies of payslips or P60's to support their claims.

When taking on staff or offering increases to existing staff, you will need to work with employees to achieve the best overall outcome, bearing in mind that the maximum joint family income for eligibility is £66,000. You will therefore need a good understanding of how the various credits work.

Since a Credit may be reduced due to a pay rise, you may wish to give staff certain benefits in kind (e.g. childcare vouchers) rather

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than pay rises. We can advise on what will be effective and what will not work.

The timing of a pay increase can be important. If a rise is granted after a claim for credit has been made, the credit may not be reduced until the next credit review date.

ARE YOU SELF EMPLOYED?

It is possible that the way in which you operate your business (e.g. as a sole trader, partnership or company) will have an impact on your benefit entitlement. We shall be happy to advise on this, as well as on the effect of pension contributions on your claim for credits.

FOR GENERAL INFORMATION ONLY

Please note that this Memorandum is not intended to give specific technical advice and should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topics.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

APPENDIX

	2004- 05	2004- 05
	£ a year	£ Weekly
Working Tax Credit		
Basic element	1,570.00	30.11
Couples and lone parent element	1,545.00	29.63
30 hour element	640.00	12.27
Disabled worker element	2,100.00	40.27
Enhanced disabled adult element	890.00	17.07
Childcare element		
- maximum eligible cost for 1 child	7,040.00	135.00
- maximum eligible cost for 2 or more children	10,430.00	200.00
- % of eligible cost covered	70	70
Child Tax Credit		
Family element	545.00	10.45
Family element, baby addition	545.00	10.45
Child element	1,625.00	31.16
Disabled child element	2,215.00	42.48
Enhanced disabled child element	890.00	17.07
Common Features		
First income threshold	5,060.00	
First withdrawal rate (%)	37	
Second income threshold	50,000.00	
Second withdrawal rate	1 in 15	
First threshold for those entitled to Child Tax Credit only.	13,480.00	