CHAPTER 30

TAX CREDITS

30.1 Introduction

There are two types of tax credit which give financial support from the Government - the **Child Tax Credit** and the **Working Tax Credit.**

In simple terms, the Child Tax Credit will give support to families for their children. Child Tax Credit is based on the family's income and claimants can claim support regardless of whether or not they are in work. Working Tax Credit is designed to support working households on low income by topping up earnings. "Working" in this context covers either employment or self-employment.

30.2 Entitlement to Tax Credits

Claimants must **usually be in the UK**. An individual who is not ordinarily resident in the UK is treated as not being in the UK. An individual who is ordinarily resident in the UK may be treated as being in the UK if he is temporarily absent from the UK. Temporary absence is defined as absence unlikely to exceed 52 weeks. The individual will be treated as being in the UK for the first 8 weeks of any period of absence or up to 12 weeks in certain circumstances.

TCA 2002, s.3

SI 2003/654

Single (or separated) individuals will claim based on their own individual financial circumstances. People who are either married and living together, or an unmarried couple living together, will claim based on their joint circumstances. This includes same sex co-habiting couples.

Working Tax Credit and Child Tax Credit are **separate credits**, although many individuals or families will get both. Both the amount of the Working Tax Credit and the Child Tax Credit are based on the income of the claimant (or on joint income if the claimants are a couple). As will be seen, both tax credits are wholly or partly withdrawn if the income exceeds certain thresholds.

Both credits are awarded for a **tax year**, for example for 2010/11. However, the credits are physically paid either every week or every 4 weeks.

30.3 Working Tax Credit

The Working Tax Credit extends support to **working people on low incomes**, including families without children. The credits are increased for working households in which one or more individuals have a disability. The **Working Tax Credit reduces with income** such that benefit will be reduced to nil once a certain threshold has been reached.

TCA 2002, s.10

A person will be entitled to claim the Working Tax Credit if he or she is either **working** at the date of the claim (or will be starting work within the next 7 days) and satisfies **any one** of the following four conditions; SI 2002/2005 Reg 4

(i) the claimant is aged 16 or over, has a child for which he (or his partner) is responsible and works at least 16 hours p.w.; or

(ii) the individual is aged 16 or over, works at least 16 hours p.w. and has a disability which puts the claimant at a disadvantage in getting a job; or

(iii) the claimant is aged at least 50, works at least 16 hours p.w. and is returning to work after a time spent claiming benefits. In this case, credits can be claimed for 12 months only; or

(iv) the claimant must be at least 25 and working for at least 30 hours p.w.

30.4 Computing the Working Tax Credit

The Working Tax Credit is made up of a number of different elements:

Element		*Yearly credit*
		£
Basic element		1,920
Additional elements for:		
Couple or lone parent		1,890
30 hour element (see note)		790
Disabled worker		*2,570*
Return to work payments where aged 50 or over working 16-29 hours (max 12 months)		*1,320*
Return to work payments where aged 50 or over working 30 hours or more (max 12 months)		*1,965*
Childcare element	80% x "eligible costs" (Eligible costs = amounts spent on approved childcare limited to a maximum of £175 p.w. for one child, £300 p.w. for two or more children)	

Note: the 30 hours per week element applies to a **couple** if **between them they work at least 30 hours per week** and one or both of them works at least **16 hours** per week SI 2002/2005 Reg 10

The childcare element is based on actual costs incurred by the claimant(s). Any **decreases in childcare costs must be notified to HMRC within one month**, unless such changes are less than £10 a week or are for less than 4 consecutive weeks. This will enable HMRC to revise the Working Tax Credit as appropriate. SI 2002/2005 Reg 16

Relief for childcare costs can be claimed if care is provided by a registered childminder or accredited childcare organisation. The provider must be registered with the Local Authority or Ofsted. A relative of the claimant can be a recognised provider as long as the relative does not look after the child at the child's home.

Claims for childcare can be made until 1st September following the child's **15th birthday**. SI 2002/2005 Reg 14 para3

To claim the childcare element, the claimant **must work at least 16 hours per week**. In the case of joint claims, **both** claimants must work at least 16 hours a week.

30.5 Annual income threshold

The Working Tax Credit is **reduced depending on the claimant's income** (joint income for couples). Full credits are given to those with annual income at or below **£6,420**. Thereafter the total amount of credit entitlement is reduced by **39p for every £1** of income in excess of the threshold.

Illustration 1

Judith is single and has no children. She is 29 and is employed on a salary of £10,000. She works 35 hours per week.

Judith will be awarded Working Tax Credit for 2010/11, calculated as follows:

Element	£
Basic credit	1,920
Working at least 30 hours per week	790
Maximum weekly credit	2,710
Abatement:	
£(10,000 – 6,420) x 39%	(1,396)
WTC award	**£1,314**

30.6 Child Tax Credit

The Child Tax Credit is a payment to support **families with children**.

Individuals or families can claim the credit if they are responsible for the maintenance and welfare of at least one child. **It does not matter if the claimant is working**. TCA 2002, s.8

Child Tax Credit will provide support for a child until the 1st of September following the child's **16th birthday**. Note that the childcare element within the Working Tax Credit only applies up to 1st September following the child's 15th birthday. Therefore for the following year (up to the September following the child's 16th birthday), Child Tax Credit can be claimed, but no relief will be given for any childcare costs. SI 2002/2005 Reg 4

Support can be claimed for children over 16 if they are under 20 and in **full time education (not including university)**. If the child has left full-time education but does not have a job or training place and has registered with the Careers Service or equivalent, credits can be claimed for the next 20 weeks. SI 2002/2005 Reg 5

Child Tax Credit is paid **in addition to any Working Tax Credit** the claimant is entitled to, and is paid **in addition to Child Benefit**. Child Benefit payments are not restricted by income.

30.7 Computing the Child Tax Credit

We calculate the Child Tax Credit by using the tables below: SI 2002/2007

Element	*Yearly credit* £
Family element (one per family)	545
Baby element (in addition to child element for child under one year)	545
Child element (one per child)	2,300

As for the Working Tax Credit, the Child Tax Credit is **reduced depending on the claimant's income (joint income for couples)**. Working Tax Credit and Child Tax Credit will be given in full to those with annual income at or below **£6,420**. Thereafter the total amount of credit entitlement is reduced by **39p for every £1** of income in excess of the threshold.

If the claimant is only entitled to the Child Tax Credit (and not the WTC), the full amount of the tax credit will be payable until annual income reaches £16,190.

30.8 Minimum entitlement

As both the Working Tax Credit and the Child Tax Credit are reduced by reference to the family's income, there will come a point at which no Working Tax Credit or Child Tax Credit will be available.

However, there is a **minimum entitlement to Child Tax Credit.** Until the family income reaches £50,000, Child Tax Credit of **£545 per tax year** will be due, even if the abatement of 39% would reduce the credit below this level.

If the family income exceeds £50,000, the Child Tax Credit is tapered away at **£1 for each additional £15 of income** until it is reduced to nil. The cut-off point for a zero Child Tax Credit entitlement is therefore strictly £58,175 of joint income. However, under Regulation 9 of SI 2002/2008, **no award of less than £26 per annum will be made**, so the actual cut-off is approximately £57,780.

The minimum Child Tax Credit entitlement is increased to £1,090 per annum in the tax year of a child's birth, again tapered away once the £50,000 threshold is breached. The cut-off point in this instance is strictly £66,350. Again, since no award below £26 per annum will be made, the actual cut-off is approximately £65,950.

There is also no award of less than £26 per annum for Working Tax Credit.

30.9 Payment of Tax Credits

Tax Credits are paid **direct from HMRC** on either a **weekly or four-weekly basis**, at the option of the claimant. Payment must usually be paid into a bank account, although payment by giro may be made in exceptional circumstances.

If a claim for Working Tax Credit is made by a couple both working at least 16 hours a week, the couple will decide who will receive the credit, other than the childcare element. The childcare element and the Child Tax Credit will be paid directly to the person who is primarily responsible for caring for the children in the family. In most instances, this will be the mother. Therefore, even though the credits may be based on the family's joint income, the support will be given directly to the primary carer.

Illustration 1

Daniel and Louise have 1 child aged 3. Daniel works full-time earning £13,000 per annum. Louise does not work and stays at home looking after their daughter.

Daniel & Louise will be awarded Tax Credits for 2010/11 as follows:

Element	
	£
Basic credit	1,920
Couple element	1,890
Working at least 30 hours per week	790
Child element	2,300
Family element	545
Maximum credit	7,445
Abatement:	
£(13,000 – 6,420) x 39%	(2,566)
Total tax credit award	**£4,879**

The abatement will apply to the Working Tax Credit before the Child Tax Credit. This will have the effect of optimising the Child Tax Credit element paid directly to Louise.

Illustration 2

David and Lisa are married with 3 children aged 9, 6 and 2. David is 37. He works full time earning £20,000. Lisa is 36 and works part-time earning £8,000. Lisa is the primary carer of the children. Weekly childcare costs are £120.

The Tax Credits awarded for 2010/11 will be:

Element	£
Basic credit	1,920
Couple element	1,890
Working at least 30 hours per week	790
Childcare element £120 x 80% x 52	4,992
Child tax credit (2,300 x 3)	6,900
Family element	545
Maximum credit	17,037
Abatement:	
£(28,000 – 6,420) x 39%	(8,416)
Total tax credit award	**£8,621**

Again, the Working Tax Credit (other than the childcare element) would be abated first, followed by the childcare element of the Working Tax Credit and then the Child Tax Credit. As a result, the whole of the award will be payable directly to Lisa.

30.10 Claims procedures

Claims procedures for tax credits are quite complex.

Claimants will claim either or both of the credits using form TC 600. Claims will initially be based on a "**base year"** – essentially this will be an estimate. The entitlement will then be revised based on the income figures of the "**actual" year**.

The "base year" is the year preceding the "actual" year. For example, Tax Credit claims for 2010/11 were initially be based on 2009/10 income, revised to 2010/11 income once the figures are finalised.

HMRC will **only backdate claims by 3 months** – therefore if a claimant wishes to receive credits from April 2010, the form TC 600 should have been submitted by 6 July 2010. Failure to make a prompt claim will therefore result in a loss of credits.

Many taxpayers have been advised to make protective claims in order to "register" with HMRC. Therefore even if HMRC initially issue a "nil" award, if circumstances change (for example there is a fall in income later in the year), on revising the claim to an "actual" basis, some credits may be due. TCA 2002, s.14(3)

At the end of the tax year, claimants will be sent a **renewal pack**. Most claimants will be required to complete an **Annual Declaration** which asks for details of income for the year just ended to finalise the previous year's award and to enable the claimants to make a claim for the forthcoming year. The form will need to be signed (by both parties if it is a joint claim) and submitted to HMRC by **31 July**.

For example, on 6 April 2011, claimants will receive a renewal form asking claimants for their 2010/11 income in order that tax credit claims for 2010/11 can be revised to "actual". The due date for this form is 31 July 2011. If actual income for 2010/11 is not known by that date, estimates will be required. Actual figures must then be provided by the following 31 January – i.e. by 31 January 2012 in this instance.

Claimants who are only entitled to the family element of the child tax credit will only receive an Annual Review form, which is a statement of the previous year's award. Provided the details are correct, no further action is necessary and the claim is automatically renewed. If any details are incorrect, HMRC must be notified.

A penalty of **£300 can be levied for a failure to file a return.** Additional penalties of up to £60 per day can be added for continuing failures. A penalty of up to £3,000 can be levied for a fraudulent or negligent claim. These are the same penalties as exist for late filing or incorrect filing of P11Ds. TCA 2002, ss.32, 31

30.11 Changes in income and circumstances

The tax credit system is designed to be responsive, so any **changes in the claimant's circumstances should be notified to HMRC** to enable them to revise the credits due as appropriate.

Certain changes in the claimants' circumstances must be reported to HMRC within one month to avoid a penalty. These will include changes in the tax credit claiming unit (e.g. marriage, separation etc), or changes in working hours such that the 30 hours per week threshold is no longer met. A penalty of up to £300 may be charged if such changes are not notified.

The amount of tax credit entitlement is initially based on the previous year's income. Where actual income for a year exceeds the previous year's income, an increase of £25,000 or less is ignored.

It is advisable for a claimant to notify any changes in income levels as soon as possible in order that HMRC can adjust the levels of payment of credits. This will avoid large under or overpayments when the end-of-year form is filed.

If actual income for 2010/11 turns out to be less than that provisionally estimated based on 2009/10 figures, there will be **additional credits due to the claimant**. These will be paid directly into the claimant's bank account. TCA 2002, ss.28,29,30

Conversely if actual income turns out to be higher than that shown on the original form TC 600, some credits may need to be **clawed back**. In the case of a joint claim, the claimants are jointly and severally liable for this refund.

HMRC will recover the overpaid credits either by **reducing future credits or by adjusting the PAYE code**. Alternatively HMRC can issue an assessment and demand repayment within 30 days. It will be possible to arrange a repayment schedule with HMRC for large amounts of repayments.

If the increase exceeds £25,000, there will be a clawback of credits at a rate of **39% of the excess income over £25,000**.

If actual income is lower than the previous years, the credit entitlement will always be adjusted.

Illustration 3

Jonathan and Abigail are married with 2 children aged 10 and 4. Both work full time. Jonathan earns £20,800 per year. Abigail earns £15,600 per year. They pay childcare costs of £180 per week.

Their Tax Credit award for 2010/11 is:

Element	
	£
Basic credit	1,920
Couple element	1,890
Working at least 30 hours per week	790
Childcare element £180 x 80% x 52	7,488
Child element (£2,300 x 2)	4,600
Family element	545
Maximum credit	17,233
Abatement:	
£(36,400 – 6,420) x 39%	(11,692)
Total tax credit award	**£5,541**

When Jonathan and Abigail come to file their Annual Declaration for 2010/11, it transpires that their joint income was **higher than expected due to a bonus of £28,000 received by Jonathan in March 2011**. Their actual income for 2010/11 was:

	Original estimate	Actual
	£	£
Jonathan	20,800	48,800
Abigail	15,600	15,600
	36,400	64,400

As the income has increased by more than £25,000, we cannot ignore it. There will therefore be a clawback in credits calculated as below:

£(28,000 – 25,000) @ 39% = £1,170

This can be reconciled as follows:

	£
Original credits (before restriction)	17,233
Less: abatement	
£(64,400 – 25,000 – 6,420) @ 39%	(12,862)
Credit entitlement	4,371
Credits paid	(5,541)
Credits repayable to HMRC	**£(1,170)**

30.12 Definition of "income"

Another added complication of the credits system is that "income", for the purposes of calculating the abatement in the Working and Child Tax Credits, is **not the same as "income" for income tax purposes**. Whilst there is a broad correlation, there are significant differences. The proforma for calculating income (or joint income) for Tax Credit purposes is: SI 2002/2006

	£	£
Employment & social security income:		
Salaries etc per P60	X	
Benefits per P11D / P9D (see note 1)	X	
Expenses reimbursed	X	
Taxable termination payments	X	
Statutory sick pay	X	
Statutory maternity pay in excess of £100 per week	X	
Taxable social security benefits	X	
Less: employment expenses	(X)	
		X
Trading income (self-employment)		
Assessable profit (see note 2)		X
Investment & Pension income		
Income from pensions	X	
Interest (as for income tax)	X	
Dividends	X	
Taxable rental profits	X	
Foreign income	X	
Other income	X	
	X	
Less: investment income deduction (see note 3)	(300)	
		X
Allowable deductions		
Trading losses (see note 4)	(X)	
Approved pension contributions (gross) (see note 5)	(X)	
Gift Aid donations (gross) made in the tax year	(X)	
		(X)
INCOME FOR TAX CREDIT PURPOSES		X

Notes

1. Not all taxable benefits are included within the definition of "employment income" for tax credit purposes. The types of benefits we need to **include** are:
   - Assets transferred to employees
   - Settlement of employees' personal liabilities
   - Payments by voucher or credit card
   - Taxable mileage allowances (i.e. excess above statutory mileage rates)
   - Car benefits
   - Fuel benefits

   Other common taxable benefits such as the cash equivalent of cheap taxable loans or employer provided living accommodation etc are **excluded**.

2. The assessable profit for the year is calculated using normal trading income rules and takes account of the current year basis.

3. Investment income need only be **included if the gross amount exceeds £300**. If the amount exceeds £300, **only the excess** needs to be included. Any "unused" amounts cannot be transferred against other income. It is envisaged that, for many claimants, there will be no entry on the return for investment income.

4. Trading losses are deducted from any income (or any aggregated joint income if appropriate), regardless of the actual offset of losses under the trading loss rules.

5. Approved pension scheme contributions relates to contributions to personal pension schemes. Occupational pension contributions will have been deducted from salary per the P60.

30.13 Interaction of Tax Credits and Pensions

Pension planning can be used hand in hand with tax credits to obtain considerable tax relief for higher rate taxpayers.

Illustration 4

Phil and Liz are married with four children. Phil is employed on a salary of £38,000 a year. He has a company car benefit of £2,300. He has dividends of £6,300. Phil pays pension contributions of £250 a month to the company's pension scheme.

Liz works part time (18 hours) and earns £5,500 a year. Qualifying childcare costs are £200 a week.

Phil's income tax computation for 2010/11 will be:

	Non Savings	Dividends
	£	£
Salary and benefits (£38,000 + £2,300)	40,300	
Less: pension contributions (£250 x 12)	(3,000)	
Employment income	37,300	
UK dividends (£6,300 x $\frac{100}{90}$)		7,000
Less: Personal allowance	(6,475)	______
Taxable income	30,825	£7,000

Tax	£
£30,825 @ 20%	6,165
£6,575 @ 10%	657
£425 @ 32½%	138
Tax liability	6,960

Phil and Liz will be entitled to both the working tax credit and the child tax credit as they work for over 30 hours a week and have qualifying children.

Tax Credits for 2010/11 will be:

	£
Basic credit	1,920
Couple element	1,890
Working at least 30 hours a week	790
Childcare element: £200 x 80% x 52	8,320
Child tax credit (4 x £2,300)	9,200
Family element	545
Maximum credit	22,665
Abatement:	
£(49,500 – 6,420) x 39% (see note)	(16,801)
	£5,864

Note: Income for tax credit purposes is as below:

	£
Phil	
Earnings	38,000
Benefits	2,300
Investment income (£6,300 x 100/90 - £300)	6,700
Liz	
Salary	5,500
Total	52,500
Less: pension contributions (£250 x 12)	(3,000)
Income for tax credit purposes	£49,500

Let us assume that on 15 March 2011, Phil won a prize on his Premium Bonds and on 31 March 2011 made an additional pension contribution of £5,000.

We will calculate the tax saved as a result of this contribution:

	Non Savings	Dividends
	£	£
Employment income	40,300	
Less: pension contribution (3,000 + 5,000)	(8,000)	
	32,300	
UK dividends		
(£6,300 x $\frac{100}{90}$)		7,000
Less: Personal allowance	(6,475)	_____
Taxable income	25,825	£7,000

Tax	£
£25,825 @ 20%	5,165
£7,000 @ 10%	700
Tax liability	5,865
Tax saving:	
£(6,960 - 5,865)	£1,095

In addition, as the family income for tax credit purposes will be reduced by £5,000, this will create an additional entitlement to tax credits.

The revised tax credit award will be as follows:

	£
Maximum credit (above)	22,665
Abatement:	
£(49,500 – 5,000 - 6,420) x 39%	(14,851)
Revised credit award	7,814
Previous credit award	(5,864)
Additional tax credits	£1,950

Proof: £5,000 x 39% = £1,950

Total tax saving	
£1,095 + £1,950	£3,045

Therefore on making a pension contribution of £5,000, Phil has made a total tax saving of £3,045. This equates to tax relief at a remarkable 61%!

Example 1

Julie (aged 29) is a single parent with a child aged 4. She works part time (20 hours per week) earning £10,400. Her only other income is bank interest of £100 per year. She pays childcare costs of £60 per week.

Calculate the tax credits awarded to Julie for 2010/11.

Example 2

David and Victoria are married with 2 children. David works full time (40 hours) earning £40,000 per annum. He also has a company car (benefit £2,000) and a cheap taxable loan (benefit £1,000). David pays pension contributions (gross) of £250 per month.

Victoria works part time (20 hours) earning £18,000 per year.

Qualifying childcare costs are £200 per week.

Calculate the tax credits awarded to David and Victoria for 2010/11.

Answer 1

Entitled to WTC as responsible for a child and works at least 16 hrs pw, also entitled to help with childcare for the same reason. She will also receive a CTC.

	£
Basic credit	1,920
Lone parent element	1,890
Childcare element £60 x 80% x 52	2,496
Child element	2,300
Family element	545
Maximum credit	9,151
Abatement £(10,400 – 6,420) x 39%	(1,552)
Total tax credit award	**£7,599**

Note: the interest of £100 is ignored as it is less than £300.

Answer 2

Entitled to both the WTC and the CTC as they work for over 30 hrs pw and have qualifying children.

	£
Basic credit	1,920
Couple element	1,890
Working at least 30 hours per week	790
Childcare element £200 x 80% x 52	8,320
Child tax credit (£2,300 x 2)	4,600
Family element	545
Maximum credit	18,065
Abatement: £(57,000 – 6,420) x 39%	(19,726)
	£NIL

Minimum credit entitlement applies.

	£
Minimum annual credit	545
Abatement as income > £50,000	
£(57,000 – 50,000) x 1/15	(467)
Annual credit	**£78**

Income for tax credit purposes as below:

	£
David:	
Salary	40,000
Car benefit	2,000
Loan benefit	Ignored
Victoria	
Salary	18,000
Total	60,000
Less: pension contributions £250 x 12	(3,000)
Annual income	£57,000