Introduction

Child tax credit (CTC) and working tax credit (WTC) form a single system of support for people with children, whether or not working, and people in work, whether or not they have children. They share a single claim procedure.

Despite their name, they are not tax deductions and do not affect tax liability. However, entitlement depends on taxable income, and both are administered by HM Revenue and Customs (HMRC).

CTC and WTC are not only for the very low paid. The basic 'family element' of CTC is payable in full where income is up to £50,000 (although this ceiling may be higher for large families and/or where childcare costs are high). Additional elements may be payable quite high up the income scale, depending on circumstances. People with fluctuating income, such as the self-employed, may be entitled to quite considerable payments in some years.

This section briefly explains how WTC and CTC are calculated, who can claim, how to claim and what a claimant's obligations are after making a claim.

Child tax credit

CTC is payable to individuals who are responsible for a child or qualifying young person.

- A child is a person aged under 16. For tax credit purposes a child remains a child until immediately before 1 September following his or her 16th birthday.
- A qualifying young person is a person:
    - Aged under 20 who is in full-time education other than at degree or higher national diploma level or is on an approved unwaged job-based training course. 19-year-olds only qualify if they had been accepted, enrolled or started the course before becoming 19.
    - Aged under 18 who has ceased full-time education but has registered for work or training with the Careers Service, Connexions or the Careers Service of the Department of Employment and Learning in Northern Ireland. In these circumstances, CTC continues for a further 20 weeks after cessation of full-time education.
- The child for whom a claim is made must live with the claimant.
- Where a child lives at more than one address, the parties can agree who will claim CTC. If they cannot agree, HMRC will normally award CTC to the parent with whom the child spends most time.
- Individuals living together as a couple, whether or not married or in a registered civil partnership, must claim jointly, but single parents can also claim.
- CTC is paid to the main carer of the child or children, usually the mother, by transfer into a bank, building society or Post Office account. Giro payments can be made only in exceptional circumstances.
- The claimant can choose weekly or four-weekly payment.
- CTC is paid in addition to child benefit.
- CTC is not taxable.

- CTC is paid regardless of whether either parent is working or paying tax.
- CTC is not paid in respect of a child or qualifying young person who is getting WTC in their own right, whether alone or as part of a joint claim with a partner.

Elements of CTC

CTC consists of a number of elements. Claimants may qualify for one or more of these depending on circumstances.

The full annual rates for 2010/11 are:

	£
Each child under 16 or qualifying young person	2,300
Disabled child (addition to child element)	2,715
Severely disabled child (addition to child and disability element)	1,095
Family element (at least one qualifying child or qualifying young person)	545
Baby (addition to family element for child under 1)	545

- A family can only receive one family element and one baby addition regardless of the number of children.
- The baby addition is paid during the 12 months after the birth, not for a tax year.
- The family element and baby addition are payable in full where income is not more than £50,000. For couples the limit is based on joint income. This threshold may be higher for large families and/or where childcare costs are high.
- If income is more than the threshold, the family element is reduced by 6.67p for every £1 of income above this. This is approximately £1 for every £15 of income.
- Families with children over one year old therefore normally lose CTC entirely once their income reaches £58,170 (£50,000 + (£545/0.0667)).
- A family entitled to the baby addition normally loses CTC entirely where family income is £66,341 or more.
- The family element and baby addition have not increased since the introduction of CTC in 2003/04.

The elements of CTC apart from the family element are tapered alongside WTC at a lower level of income (see below).

Following the May 2010 general election, the new Conservative-Liberal Democrat government announced that it intends to reduce child tax credits for those on the highest incomes.

Working tax credit

WTC consists of several elements, including support for childcare costs.

- WTC is paid directly to the claimant into a bank, building society or Post Office account.
- Where both parties in a couple work at least 16 hours a week they can choose which one of them is to receive WTC.

- The childcare element is paid direct to the main carer together with CTC.
- Couples, including same sex couples, must claim jointly.

An individual claimant, or at least one in a couple, must be working and meet at least one of the following conditions:

- Be aged at least 16, work at least 16 hours a week and be responsible for a child.
- Be aged at least 25 and work at least 30 hours a week.
- Be aged at least 50, not claiming benefits and work at least 16 hours a week. If this is the only condition the claimant meets, WTC is payable for only one year. If the claimant later qualifies on other grounds, for example, increases working hours to 30 or more, WTC will continue.
- Have a disability that puts the claimant at a disadvantage.

So, for example, a 40-year-old childless man working 25 hours a week can only qualify for WTC if he has a disability.

Elements of WTC

Claimants may qualify for one or more elements of WTC depending on circumstances. The full annual rates for 2010/11 are:

	£
Basic	1,920
Second adult in family	1,890
Lone parent	1,890
30-hour element (where at least one person works 30 hours or more a week, or a couple with children jointly work at least 30 hours a week provided one works at least 16 hours)	790
Disability (for each disabled adult)	2,570
Severe disability (for each disabled adult)	1,095
Aged 50 plus, returning to work and working at least 16 hours but less than 30 hours*	1,320
Aged 50 plus, returning to work and working at least 30 hours*	1,965
Childcare: maximum eligible cost for 1 child	175pw
Childcare: maximum eligible cost for 2+ children	300pw
Percentage of eligible costs covered	80%

* This element is payable for a maximum of 12 months.

- All elements of WTC depend on taxable income.
- WTC can only pay for 80% of childcare costs up to a maximum of £175 a week for one child and £300 a week for two or more children.

> **Example**
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> If the actual childcare cost for two children is £280 a week, the childcare element of WTC will be £224 a week (80% of £280). If actual costs for one child are £200 a week, the childcare element of WTC is limited to a maximum of £140 a week (80% of £175).

- The childcare element is payable to a lone parent who works at least 16 hours a week. For a couple, normally both must work at least 16 hours a week.
- Childcare costs must be 'eligible'. There are several qualifying conditions.
- Costs that are covered by childcare vouchers from an employer are not eligible for WTC.

Eligible childcare can extend to the cost of employing a nanny in a family's own home, provided the nanny is not a relative and is approved under the Childcare Approval Scheme (or Scottish, Welsh or Northern Ireland equivalent). To obtain approval the nanny must:

- Have a relevant qualification or have attended an approved induction course in childcare.
- Have a suitable first aid certificate not more than three years old.
- Have an enhanced disclosure check from the Criminal Records Bureau, showing there is nothing in the nanny's background making the nanny unsuitable to care for children.
- Be at least 18 years old.

Parents can check that carers are approved.

Eligible childcare also includes certain children's activity clubs, breakfast clubs and holiday clubs. The provider of the club must be approved.

Tapering the award

All the elements of WTC and CTC are tapered by reference to the claimant's income (joint income for a couple).

The tapering calculation

First the claimant's maximum award of WTC and CTC is calculated by adding together the various elements for which the claimant is eligible based on working hours and family circumstances. The claimant's income is not taken into account at this stage.

The maximum award is then reduced by reference to annual income.

- Where a claimant is entitled to WTC, the maximum WTC plus CTC is reduced by 39p for every £1 of income above £6,420.
- Where a claimant is entitled to CTC but not WTC, for example because the claimant is not working, the child elements of CTC are tapered by 39p for every £1 of income over £16,190.
- The family elements of CTC are payable in full to families with income up to £50,000. They are reduced by 6.67p for every £1 of income over £50,000 or, if greater, the amount of income required to taper all the other elements of WTC and CTC to nil.
    - ➢ For many claimants, WTC and CTC individual elements are reduced to nil long before income reaches £50,000.
    - ➢ However, for larger families and/or those with high eligible childcare costs, the individual elements of CTC might only be reduced to nil at an income above £50,000.

Example

A family of two working parents, three children and £300pw eligible childcare costs might qualify for tax credits of £24,525 (£1,920 + £1,890 + £790 + £12,480** + (£2,300 x 3) + £545). The WTC and CTC individual elements are only reduced to nil when income reaches £67,907 (£6,420 + ((£24,525 – £545)/£0.39)). The family element is then tapered at 6.67p for every £1 of income over £67,907.

**Childcare: £300 x 0.8 x 52 weeks = £12,480.

- If WTC and CTC are both available, the order of reduction is WTC elements except childcare, then childcare, then individual CTC elements.

Families receiving income support, income-based jobseeker's allowance and pension credit are automatically entitled to the full CTC, based on the number and ages of their children, without having to satisfy income tests.

Example

Peter Jones and Ann Williams have two children aged six and eight. Both work full-time (more than 30 hours a week) and they pay £340 a week for childcare. Their joint annual income is £50,000.

Their full entitlement to CTC and WTC, disregarding their income, is:

WTC	**£**
Basic	1,920
Additional adult	1,890
30-hour element	790
Childcare (£300 x 0.8 x 52)	12,480
CTC	
Family element	545
Child element x 2	4,600
Total award	22,225

Their annual income is £50,000.

This exceeds the £6,420 threshold by £43,580.

So their maximum tax credit award is reduced by £16,996.20 (£43,580 x 0.39), giving a tax credit award of £5,228.80 (£22,225 – £16,996.20).

The award consists almost entirely of CTC (£545 + £4,600) payable to the main carer, because the non-childcare elements of WTC are reduced first, followed by the childcare elements.

Income

Income in the tax credits calculation is broadly taxable income, but there are several differences.

Where a claim is made by a couple, the income of both partners must be added together.

First, income from all sources, such as investment income, pensions, income from letting property, employment earnings, taxable social security benefits and self-employment profits, is added together.

- Employment income includes cash remuneration and certain taxable benefits, and excludes payments in respect of business expenses. Expenses that are deductible for income tax are generally deductible for tax credits as well.
- Trading profits are as calculated for tax purposes, normally for the accounting period ending in the tax year.
    - ➢ Trading losses may be deducted from other income of the same year. For a couple, the deduction is from their joint income.
    - ➢ Trading losses cannot be carried back to reduce income in a tax credits claim for an earlier year.
    - ➢ Trading losses carried forward are treated as reducing the income of the year in which they are set off against trading profits.
    - ➢ Because these rules differ from the way losses are set off for tax purposes, self-employed claimants should take care to keep separate records.
- Certain types of dependant's student grants are included in income.
- Income from individual savings accounts (ISAs), which is exempt from tax, is disregarded.
- Overseas income is included even where it is not actually taxable in the UK (for example, because it is taxed on the remittance basis) except for certain income that the claimant is unable to remit to the UK.
- An unusual feature of the tax credits rules is that a claimant who deliberately forgoes income may be treated as having that income.
    - ➢ For example, a shareholder who waives a dividend, or a director who forgoes a salary, may be treated as having the forgone income for tax credit purposes.
    - ➢ Similarly, a person who works for less than a commercial rate may be treated as having income as if he or she had been paid at a commercial rate, except that genuine charitable or voluntary work is ignored.
- The first £300 of total joint pension income, investment income, property income, foreign income and deliberately forgone income is excluded.

Then the grossed-up amount of contributions to personal pension plans and occupational pension schemes is deducted. The grossed-up amount of donations to charity under gift aid is likewise deducted.

Interest payments that are deductible against total income for income tax, such as interest on a loan used to invest in a close company or partnership, are not deductible in a tax credits calculation. Nor is there any deduction for investments under the enterprise investment scheme (EIS) or into a venture capital trust (VCT).

Capital gains are not brought into the calculation.

Who can claim tax credits?

In addition to the particular conditions for claiming CTC and WTC described above, there are some general rules.

- The claimant must be aged at least 16. There is no upper age limit.
- The claimant must be in the UK.
- Members of a married or unmarried couple (including registered or unregistered same sex couples) must claim jointly. A polygamous unit must also make a single claim. Only individuals who are not part of a couple or polygamous unit can claim as a single person.

UK presence

Being in the UK means the claimant must be physically present in the UK. However, short periods of absence are allowed, provided that:

- At the start of the period of temporary absence the total period of absence is unlikely to be more than 52 weeks.
- The claimant is ordinarily resident in the UK. Ordinarily resident for this purpose means broadly that the individual normally resides in the UK and their residence here has been adopted voluntarily and for settled purposes.

If these conditions are met, payment of tax credits will continue for up to eight weeks of absence.

If temporary absence continues beyond eight weeks, no tax credits will be paid after the first eight weeks and the claimant will have to make a new claim on return to the UK.

If one member of a couple goes abroad for more than eight weeks, the remaining partner may find it beneficial to claim as a single person during the period of absence after the first eight weeks.

In certain circumstances, people who do not live in the UK may nevertheless be eligible for tax credits. For example, people who work but do not live in the UK, and who are (or whose partner is) a national of another EEA state or of Switzerland, may qualify.

The unit of claim

An individual cannot claim as a single person if he or she is part of a married or unmarried couple, both of whom are aged at least 16.

- An unmarried couple is defined as a man and woman living together as husband and wife or a same sex couple living together as if they were civil partners under the Civil Partnership Act.
- A married couple or registered civil partnership must not be separated under a court order or separated in circumstances that are likely to be permanent.

Where a couple claim, both must sign the claim form and HMRC can supply information relating to the claim to either of the parties.

Procedure

Claiming tax credits is often not straightforward, and those who claim have to enter into a number of obligations. HMRC will check on claims and there are penalties for incorrect claims or failing to notify certain changes in circumstances.

Claims

WTC and CTC must be claimed from HMRC. The claim cannot currently be made over the internet but must be made by completing a paper form.

Claims cannot be backdated by more than three months (except in certain cases of disability). Therefore if a claim is to cover a whole tax year, it must be made by 5 July in that year.

Obviously one cannot know one's income in advance. Therefore an initial award is made based on the income of the previous year, which is adjusted after the end of the tax year.

- A self-employed claimant may base a claim on self-employment income of the tax year ending 12 months before the tax year of claim.
- The claim must be confirmed by 31 July following the year of claim, at which point details of actual income for the year are requested.

  However, if the amount of income is not known, for example, the claimant is self-employed and has not yet prepared accounts, an estimate may be given and revised to the correct figure not later than the following 31 January.
- At the same time claimants are invited to renew their claim for the current year. This is much more straightforward than the first claim.
- In practice, claimants who are entitled only to the family element of CTC need only confirm that their income is within a qualifying range.

The fact that claims cannot be backdated by more than three months may cause difficulty for those whose income falls unexpectedly during the year.

For example, a person in a family with children might have earned £60,000 in 2009/10 and therefore not made a claim. If that person is made redundant on 1 November 2010, and fails to find alternative employment, the family will have income of less than £50,000 and be entitled to the family element of CTC. However, it cannot be paid from a date earlier than three months before the date of claim.

- It is possible to make a 'protective claim' for a tax year, even if no CTC will be due, based on the income of the relevant earlier year. If income for the claim year turns out to be lower, the initial nil award will be recalculated for the whole year, rather than only from three months before the date of a claim made after it has become apparent that income has dropped. This facility is particularly useful for self-employed people and anyone else with fluctuating income.
- An accounting date early in the tax year may make it easier for self-employed people to decide in good time whether to claim tax credits for a year, so avoiding the need to make an unnecessary 'protective claim'.

Changes in circumstances

Claimants must notify HMRC of certain changes in circumstances within 30 days of their occurrence, otherwise they may be liable to a penalty of up to £300. The main changes in this category are:

- A couple who made a joint claim separate, or one partner dies.
- A claimant starts to live with a new partner.
- A claimant who was working 30 hours or more a week, or between 16 and 30 hours a week, now works fewer than 30 hours or fewer than 16 hours respectively.

- A claimant or their partner leaves the UK permanently, goes abroad temporarily for more than eight weeks, or loses the right to reside in the UK.
- A reduction in the number of children for whom a claimant can claim tax credits, for example, a child goes to live with someone else, or a child leaves non-advanced full-time education or training before the age of 20.
- Eligible childcare costs are reduced by £10 a week or more for at least four consecutive weeks.

These changes are likely to result in a change in the award. A separate calculation based on the new circumstances is made, to arrive at the new award from the date of change.

HMRC has stated that no penalty will be charged where a claimant whose initial tax credits award is nil fails to notify one of these changes within 30 days. Of course the correct information must be given when the claim is finalised.

Certain other changes during the year may affect an award but need not be notified immediately. However, if the change results in a reduced award, the excess for the year will have to be repaid. If the change results in an increased award, the increase cannot be backdated by more than three months. The following changes are in this category:

- A baby is born or a child joins the family.
- A child of 16 stays in full-time education.
- A child over 16 leaves full-time education before the age of 20.
- An increase in working hours to 16 or over, or to 30 or over.
- Ceasing work.
- Changes in disability status of an adult or child for whom a disability element has been claimed.
- Childcare costs increase.
- A claimant starts or stops receiving income support, jobseeker's allowance, minimum income guarantee or pension credit.

For obvious reasons, the following changes should be notified but have no effect on the amount of an award:

- Changes of address.
- A change in the account into which CTC is paid.

Changes in income do not have to be notified at the time as the award will be recalculated after the end of the tax year when full income details are given. However, the claimant will have to repay any excess received during the year.

- The first £25,000 of any increase in income, compared to the income used in calculating the initial award, will not result in the reduction of an award.
- HMRC will adjust tax credits immediately where a claimant notifies a fall in income.
- A claimant who expects a fall in income for the tax year can claim tax credits based on estimated income of that year instead of actual income of an earlier year.

- If after the end of the year the final award is less than the amount paid, the excess is normally repaid by deducting it from the tax credits award for the coming year or through PAYE. This procedure has given rise to difficulty as families may have spent the excess tax credits received and be left with insufficient money to live on after the deduction. Interest is not imposed except where the overpayment was the result of fraud or neglect by any claimant.

- If the final award turns out to be higher than the amount paid, the addition is paid in a lump sum.

HMRC enquiries

HMRC can make enquiries at various stages:

- Into initial awards that are in payment.

- Before finalising entitlement after the end of the tax year.

- After finalising entitlement. HMRC can normally start an enquiry up to a year after 31 July following the tax year. This is extended for individuals who have to make a self-assessment tax return to the same as the normal limit for enquiries under self-assessment.

A penalty of up to £3,000 may be imposed for deliberately or negligently giving incorrect information. Up to £300 may be charged for simple failure to give information, plus a further £60 a day if the failure continues. The actual penalty charged depends on the amount of tax credits overclaimed as a result and on the claimant's degree of culpability. For example, if the claimant took reasonable care and the error was due to a mistake or misunderstanding, there will be no penalty,whereas deliberate and systematic overclaims will normally result in a penalty of 50% of the amount overclaimed. If the claimant brings an error to HMRC's attention before an enquiry, the penalty will be reduced.

Persons who knowingly commit fraud in order to obtain tax credit payments for themselves or any other person may be imprisoned for up to seven years by a Crown Court or up to six months by a Magistrates' Court. A fine may be imposed as well.

Appeals

Claimants can appeal against any initial or final decision on a tax credits award as well as against a penalty.

- The appeal must be made within 30 days of the notice of the relevant decision. The period may be extended in special circumstances.

- Appeals must be made in writing, including in electronic form.

- Appeals in England, Wales and Scotland are heard by the First-tier Tribunal (Social Security and Child Support). This is an independent tribunal run by the Tribunals Service. Northern Ireland appeals are heard by a tribunal run by the Appeal Service Northern Ireland, which is likewise independent.

Planning

A tax credit award cannot be increased by forgoing income to which a claimant is entitled or by transferring income between spouses. Pension payments and gift aid donations to charity are effective in reducing income.

The tapering of tax credits results in effect in enhanced relief for pension payments and gift aid donations to charity.

- A basic rate taxpayer or non-taxpayer who is within the income band in which tax credits are tapered at 39p for each £1 of income in effect receives tax relief at 59% for personal pension payments. This consists of the 20% basic rate relief given by deduction from the pension payment plus additional tax credit equal to 39% of the gross payment.
- A higher-rate taxpayer who is within the income band in which tax credits are tapered at 39p for each £1 of income in effect receives tax relief at 79% for personal pension payments. This consists of the 20% basic rate relief given by deduction from the pension payment, 20% higher rate given via self-assessment plus additional tax credit equal to 39% of the gross payment.
- A higher-rate taxpayer whose income is within the income band in which the family element of tax credit is tapered in effect receives total tax relief at 46.67% for personal pension payments. This consists of the 20% basic rate relief given by deduction from the pension payment, the 20% higher rate relief for the gross payment and the 6.67% increase in CTC.
- It is difficult to see any circumstances in which an additional-rate (50%) taxpayer may be entitled to any WTC or CTC.
- The calculations are similar for gift aid donations.

In some cases, increases in earnings can suffer a disproportionate rate of deduction.

Example

If an individual is a higher-rate taxpayer but still entitled to WTC and individual elements of CTC, an increase in earnings may suffer a marginal rate of deduction of 80% (40% tax, 1% NIC and 39% tax credit withdrawal).

It is difficult to generalise about marginal rates because tax and NIC are calculated on an individual basis whereas tax credits are based on joint income. The disregard of the first £25,000 of increased income also distorts the position.

Tax planning key points

- The introduction of WTC and CTC was somewhat chaotic, and their administration has remained so in many cases.
- Some claimants have found making the claim complicated, and the obligations after making the claim – to notify certain changes within 30 days and finalise the claim by 31 July following the tax year – may be onerous.
- Some people consider claiming is not worth the effort, especially if they are only entitled to the family element of CTC.
- For others, especially working parents with eligible childcare costs, and large families, WTC and CTC can be a very worthwhile benefit.
- Further information is available from any tax office, any HMRC Enquiry Centre or the HMRC website at www.hmrc.gov.uk.

This guide is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking action on the basis of the contents of this publication. The guide represents our understanding of the law and HM Revenue & Customs practice as at May 2010, which are subject to change.