TOPIC 5

State benefits and HMRC tax credits

LEARNING OBJECTIVES

This topic outlines the main state benefits and HMRC tax credits and the way in which they can affect financial planning.

By the end of this topic, you should have an understanding of:

- the main state benefits and HMRC tax credits for people on low incomes;
- the main state benefits and HMRC tax credits for people with children;
- the main state benefits for people who are sick or disabled;
- retirement benefits, including the state pensions;
- how these benefits and tax credits affect financial planning.

This topic covers the Unit 1 syllabus learning outcome U7.9.

THINK . . .

What do you already know about welfare provision in the UK? For instance:

- Have you claimed state benefits yourself?
- Do you understand how your National Insurance contributions record affects your entitlement to state benefits?
- Do you know why someone might have to attend a work capability assessment?
- Do you know if you are eligible for a state pension and when you will be able to claim it?

When people think about the role of a financial adviser, they might not immediately think about the need to understand state benefits, but such provision is often an important element of an individual's overall financial situation.

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5.1 How do state benefits affect financial planning?

In the UK, the government plays a vital role in providing assistance to people in need. It should be remembered that the main purpose of state benefits is to act as a safety net in times of need, rather than to support a comfortable standard of living.

State benefits can affect financial planning in two main ways.

1) State benefits can affect the need for financial protection. The amount of additional cover needed by a client can be quantified as the difference between the level of income or capital required and the level of cover already existing. Existing cover includes not only private and employer provision that the client already has, but also any state benefits to which they or their dependants would be entitled.

2) Financial circumstances can affect entitlement to benefits. Certain benefits are means-tested – in other words, the amount of benefit is reduced if the individual's (or sometimes the household's) income or savings exceed specified levels. This might mean, for example, that a financial plan that increased a person's income or the value of their assets might be less attractive than it seemed at first sight, if it also had the effect of reducing entitlement to, for instance, Universal Credit.

There is a wide range of state benefits covering many different circumstances. Many of them, however, are small in amount and can do little more than prevent people from suffering extreme poverty.

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KEEPING UP TO DATE WITH STATE BENEFITS

The benefit structure is very complex and it is not possible to cover every detail here. Rules surrounding eligibility for state benefits, rates of payment and even the names of the benefits change regularly.

The intention of this topic is to alert you to the main benefits available, so that you can seek further information if you think they may be relevant to a particular client. One source of such information is www.gov.uk/browse/benefits.

5.2 What support is available for people on low income?

5.2.1 Universal Credit

Universal Credit is a means-tested benefit for people of working age. The upper age limit is the point where people reach state pension age.

Universal Credit is not specifically an 'in work' or 'out of work' benefit; it is one benefit for people whatever their employment status. The intention is that people will not need to keep transferring from one type of benefit to another as their circumstances change. The structure is intended to be much simpler than that of the current system, where separate benefits (which often overlap) are administered by different agencies, with different methods of means testing.

Universal Credit has replaced the following benefits for new claimants, with existing claimants being moved across to Universal Credit in due course:

- Income Support;
- Income-based Jobseeker's Allowance;
- Income-related Employment and Support Allowance;
- Working Tax Credit and Child Tax Credit;
- Housing Benefit.

The amount of Universal Credit awarded to claimants depends on their income and personal and financial circumstances. There is a basic allowance with different rates for single claimants and couples (and a lower rate for younger people), and additional amounts available for those with a disability, caring responsibilities, housing costs, and children and/or childcare costs.

There is an 'earnings disregard', which is based on the claimant's needs. For example, a couple with children have a higher earnings disregard than a couple without children. As earnings increase, entitlement to Universal Credit is reduced, and there is a maximum cap on the total amount of state benefits that a household can receive (based on the average earnings of a working family); this maximum includes any Child Benefit that they receive.

The benefits that remain outside of Universal Credit include:

- Carer's Allowance;
- new style Jobseeker's Allowance and new style Employment and Support Allowance;
- Disability Living Allowance/Personal Independence Payment;
- Child Benefit;
- Statutory Sick Pay;
- Statutory Maternity Pay;
- Maternity Allowance;
- Attendance Allowance (as this is for claimants over state pension age anyway).

Full implementation of Universal Credit may not be complete for a few years. You should therefore be aware of the benefits that Universal Credit will ultimately replace.

5.2.2 Working Tax Credit

Working Tax Credit is designed to top up the earnings of employed or self-employed people who are on low incomes; this includes those who do not have children. There are extra amounts for:

- working households in which someone has a disability; and
- the costs of qualifying childcare.

Working Tax Credit has now been replaced by Universal Credit and new claims can only be made by those already receiving Child Tax Credit.

5.2.3 Income Support

Income Support is a tax-free benefit which was designed to help people aged between 16 and state pension age whose income was below a certain level and who were working less than 16 hours per week (if they had a partner, their partner must work less than 24 hours per week). It was available to people with no income at all or it could be used to top up other benefits or part-time earnings.

Existing claims continue for those who continue to meet the eligibility requirements. New claims for Income Support can no longer be made, but those on low incomes can apply for Universal Credit.

5.2.4 Jobseeker's Allowance

Jobseeker's Allowance (JSA) is a benefit for people who are unemployed or working less than 16 hours and actively seeking work. There are two forms of JSA: new style and income-based. Income-based JSA is being replaced by Universal Credit.

People are eligible for new style JSA only if they have paid sufficient Class 1 National Insurance contributions. It is paid at a fixed rate, irrespective of savings or partner's earnings, for a maximum of six months. Payments are made gross but are taxable. Claimants are usually credited with National Insurance contributions (NICs) for every week that they receive JSA.

5.2.5 Support for Mortgage Interest loan

Those in receipt of Income Support, income-related Jobseeker's Allowance, income-related Employment and Support Allowance, Universal Credit or Pension Credit can apply for assistance to pay the interest on their mortgage. Support for Mortgage Interest (SMI) takes the form of a loan that must be repaid.

For eligible claimants, SMI will pay interest on a mortgage up to an upper threshold (with a lower threshold if a claim is being made for Pension Credit). SMI does not pay for associated mortgage costs, such as the repayment of capital, insurance premiums or mortgage arrears. Payment is made direct to the mortgage lender at a standard mortgage rate that may be more or less than the actual rate on the mortgage.

The SMI loan is secured on the property by way of a second charge and is subject to interest. The loan is repaid when the property is sold or ownership of the property is transferred.

THE BENEFITS CAP

An often-voiced complaint about the benefits system is that people can be better off out of work (by claiming state benefits) than in work. In response to this, a cap on the maximum weekly income that can be received from benefits was introduced to limit the maximum paid per household to the level of the average UK wage.

The following benefits are subject to the cap.

- Employment and Support Allowance
- Income Support
- Jobseeker's Allowance
- Housing Benefit
- Maternity Allowance
- Child Benefit
- Child Tax Credit
- Bereavement Allowance
- Incapacity Benefit
- Severe Disablement Allowance
- Universal Credit (unless deemed unfit for work)
- Widowed Parent's Allowance

FACTFIND

Universal Credit: www.gov.uk/universal-credit

Income Support: www.gov.uk/income-support

Working Tax Credit: www.gov.uk/working-tax-credit

JSA: www.gov.uk/jobseekers-allowance

The benefit cap: www.gov.uk/benefit-cap

SMI: www.gov.uk/support-for-mortgage-interest

5.3 What support is available for those bringing up children?

Benefits related to bringing up children fall into two categories: benefits payable during pregnancy and benefits payable as the children are growing up.

5.3.1 Statutory Maternity Pay

Women who become pregnant while employed may receive Statutory Maternity Pay (SMP) from their employer, providing that:

- their average weekly earnings are above a certain threshold;
- they have been working for their employer continuously for 26 weeks prior to their 'qualifying week', which is the 15th week before the week in which their baby is due.

SMP is payable for a maximum of 39 weeks. The earliest it can begin is 11 weeks before the baby is due and the latest is when the baby is born.

There are two rates of SMP: for an initial period, the amount paid is equal to a percentage of the employee's average weekly earnings; after that, the remaining payments are at a standard flat rate or set percentage of the employee's average weekly earnings, whichever is the lower.

SMP is taxable and NICs are due on the amount paid.

5.3.2 Maternity Allowance

Some women who become pregnant are not able to claim SMP, including those who are self-employed or have recently changed jobs or stopped working. They might be able to claim an alternative benefit called Maternity Allowance. This is paid by the Department for Work and Pensions (DWP) and not by employers.

Maternity Allowance is not a benefit available to all women who become pregnant; an individual must meet the relevant eligibility criteria in order to claim.

The amount payable depends on employment status (eg employed, self-employed, recently stopped working) and is not subject to tax or NICs. Like SMP, it is payable for a maximum of 39 weeks. The earliest it can begin is 11 weeks before the baby is due and the latest is when the baby is born.

5.3.3 Child Benefit

Child Benefit is a tax-free benefit available to parents and others who are responsible for bringing up a child. It does not depend on having paid NICs. It is not affected by receipt of any other benefits.

Child Benefit is available for each child under age 16. It can continue up to and including age 19 if the child is in full-time education or on an approved training programme. A higher rate is paid in respect of the eldest child and a lower rate in respect of every other child.

Child Benefit is means-tested in the form of a high income tax charge if either of a couple has individual adjusted net income over the threshold. If both have adjusted net income above the threshold, it is assessed on the higher of the two incomes. The charge is equivalent to 1% of the child benefit for each £100 of adjusted net income over the threshold. The tax charge is collected through self-assessment and is applied at a rate such that, where adjusted net income reaches a specified level above the threshold, the tax charge equals the Child Benefit paid. The charge can, however, be reduced or eliminated by making extra personal pension contributions or charitable donations, as these both reduce adjusted net income.

FACTFIND

Let's say that someone with two children is entitled to receive child benefit of £2,500. If they earn £4,000 in excess of the threshold, the tax charge will be £25 (ie 1% of £2,500) for every £100 over the threshold, ie £4,000 ÷ £100 = £40 × £25 = £1,000.

Making a gross pension contribution of £4,000 (£3,200) would eliminate the charge completely, saving £1,800 in total (£1,000 tax charge + £800 tax relief).

More information about the child benefit tax charge is available at:

www.gov.uk/child-benefit-tax-charge

5.3.4 Child Tax Credit

Child Tax Credit is designed to provide financial assistance to people who are responsible for bringing up children and are on low incomes. A claim may be made by an individual who is responsible for:

- a child aged under 16;
- a child under 20 in eligible education or training.

Child Tax Credit is made up of a number of different payments called 'elements'. How much is received depends on an individual's income, the number of children, and whether any of the children are disabled.

Child Tax Credit has now been replaced by Universal Credit and new claims can only be made by those already claiming Working Tax Credit.

CHECK YOUR UNDERSTANDING 1

Jane and John have two young daughters and claim Child Benefit. John earns £48,000 per year and Jane earns £57,000 per year. If the threshold is £50,000, they will:

a) become ineligible for Child Benefit, as one of their incomes is over the threshold.

b) not be liable to an income tax charge as one of their incomes is still under the threshold.

c) be liable to an income tax charge as one of their incomes is over the threshold.

d) be entitled to an increased amount of Child Benefit as one of their incomes is under the threshold.

5.4 What support is available for people who are sick or disabled?

There is a wide range of benefits for people who are sick, injured or disabled, or who need constant care.

5.4.1 Statutory Sick Pay (SSP)

Statutory Sick Pay (SSP) is paid by employers to employees who are off work due to sickness or disability for four days or longer, providing their average weekly earnings are above the level at which Class 1 NICs are payable.

SSP is paid for a maximum number of weeks in any spell of sickness. Spells of sickness with less than a minimum number of weeks between them count as one spell. Amounts paid as SSP are liable to income tax and to Class 1 NICs, just as normal earnings would be.

5.4.2 Employment and Support Allowance

People who are ill or disabled may be able to claim Employment and Support Allowance (ESA). There are two forms of ESA. For new style ESA, eligibility depends on a person's NIC record. New style ESA is not means-tested and the payments are taxable. In contrast, income-based ESA does not depend on NICs and is means-tested but not taxable.

A key feature of ESA is the work capability assessment, which looks at the impact that a claimant's health condition has on their ability to work. As a result of the assessment, people are placed in either a work-related activity group or a support group. Those in the former group are deemed capable of working in some capacity and required to take steps to help them move into employment. For those in the support group, it is recognised that their health condition severely limits their capacity to work.

Different rates of benefit are payable to the two groups; there is also a lower rate during the initial assessment period.

Income-related ESA has now been replaced by Universal Credit and no new claims can be made. Existing claimants can continue to receive payments until they are no longer eligible.

5.4.3 Attendance Allowance

Attendance Allowance is a benefit for people who have reached state pension age and need help with personal care as a result of sickness or disability. This benefit is not means-tested and it does not depend on NICs.

There are two levels of benefit: a lower rate for people who need help with personal care by day or by night and a higher rate for those who need help both by day and by night. Some other state benefits (ie Pension Credit, Housing Benefit and Council Tax Reduction) are paid at a higher rate if the claimant is also receiving Attendance Allowance.

5.4.4 Disability Living Allowance and Personal Independence Payment

Disability Living Allowance (DLA) is a tax-free benefit for people who need help with personal care and/or need help getting around. It is currently being replaced by Personal Independence Payment (PIP) for people aged between 16 and state pension age. People born on or before 8 April 1948 can continue to claim DLA, but those born after that date will need to apply for PIP or Attendance Allowance depending on their age.

There are two components to both benefits, and people may be eligible for either or both:

- Care component: this component is for people who need help in carrying out activities of daily living such as washing, dressing, using the toilet or cooking a meal.
- Mobility component: this component applies if a person has difficulty in walking or cannot walk at all.

5.4.5 Carer's Allowance

Carer's Allowance (CA) is a benefit for people who are caring for a sick or disabled person; they do not have to be a relative of the person they are caring for in order to qualify.

The right to receive CA does not depend on having paid NICs. It is taxable and must be declared on tax returns.

It is important to be aware that claiming CA can affect the other benefits the claimant receives, as well as the benefits the person they are caring for receives.

FACTFIND

More information about financial support for people who are ill or have a disability is available at:

www.gov.uk/browse/benefits/disability

5.4.6 People in hospital or receiving residential/nursing care

When people are in hospital, some of the needs normally met by state benefits or pensions are instead met by the NHS. In general terms, state benefits that were being claimed will continue to be paid when someone goes into hospital.

FACTFIND

Further details of how benefits are affected by a temporary or permanent stay in a residential care or nursing home are available at:

www.newham.gov.uk/health-adult-social-care/paying-residential-nursing-home-care

CHECK YOUR UNDERSTANDING 2

Which form(s) of Employment and Support Allowance is/are means-tested?

a) New style ESA only.

b) Income-based ESA only.

c) Both new style and income-based ESA.

d) Neither new style nor income-based ESA.

5.5 What support is available for people in retirement?

State pensions are payable from state pension age (SPA). The SPA is subject to a system of regular reviews based on changes in life expectancy. The basis of the reviews is the principle that people should spend one-third of their adult life (regarded for these purposes as beginning at age 20) in retirement. The first review was published in March 2017 and recommended that state pension age be increased from age 67 to age 68 between 2037 and 2039.

The system of state pension benefits changed from April 2016 with the introduction of the new state pension. Before this date, state pension provision consisted of the basic state pension with an additional earnings-related element for those who were employed. The new state pension has no earnings-related element.

- Those reaching SPA before 6 April 2016 have their state pension benefits paid under the system of basic and additional state pensions.
- Those reaching SPA on or after 6 April 2016 receive the new state pension, with an adjustment paid to compensate them if they would have been better off under the previous system.

State pensions are designed to provide a basic standard of living in retirement. The system operates on a pay-as-you-go basis, with National Insurance contributions from the current working population being used to pay pensions to those entitled to receive them. It is readily apparent that, with the number of pensioners increasing and the numbers in employment decreasing, there is little scope for making generous increases to state pensions.

5.5.1 The basic state pension

Originally, the basic state pension was paid only to employed people on their retirement and was not related to their earnings. It was later extended to include self-employed people and others who had made sufficient National Insurance contributions – which meant that they had contributed for at least 30 years. Benefits were scaled down for lower contribution rates.

Those who had not made enough NI contributions of their own to qualify for a full basic state pension might be in receipt of a 'Category B' pension based on their spouse or civil partner's pension entitlement.

5.5.2 Additional state pension

Some employees who reached state pension age before 6 April 2016 are entitled to an additional state pension, on top of their basic state pension.

- The first earnings-related state pension scheme was the graduated pension scheme that operated from 1961 until 1975.
- It was replaced by the state earnings-related pension scheme (SERPS), which came into operation in 1978.
- SERPS was itself replaced in 2002 by the state second pension (S2P).

These schemes are now collectively referred to as the 'additional state pension'.

Unlike the basic state pension, additional state pension was available only to employed people who paid Class 1 National Insurance contributions. Self-employed people could not build entitlement to additional state pension benefits.

Employed people had the option to 'contract-out' of SERPS/S2P and have the NICs that would have been used to provide SERPS/S2P reduced or redirected to an alternative form of pension.

PENSION CREDIT

Pension Credit is made up of two elements:

- Guarantee Credit – this tops up an individual's weekly income to a specified minimum amount.
- Savings Credit – this is an additional payment for some people who reached state pension age before 6 April 2016 who have saved some money towards their retirement.

Pension Credit is not taxable.

5.5.3 New state pension

The complexity of the state pension system led to the introduction of a simplified state pension for those reaching retirement age on or after 6 April 2016. There is a single level of benefit with no additional earnings-related element. Pension benefits are determined by a person's NIC record. To be eligible for the maximum pension, an individual needs to have made or been credited with 35 years' NICs; those with under 10 years' NICs are not usually eligible for any state pension. Carers are credited with NICs.

One of the features of the new state pension is that it is based solely on an individual's personal National Insurance record.

THE 'TRIPLE LOCK GUARANTEE'

Once in payment, both the basic state pension and the new state pension are guaranteed to increase each year by the higher of:

- earnings (measured by the Average Weekly Earnings Index);
- inflation (as measured by the Consumer Prices Index); or
- 2.5 per cent.

This is referred to as the 'triple lock guarantee'.

UK governments have seen the state pension triple lock as a burden that is costly for taxpayers. Arguments for and against the policy have focused on cost and intergenerational fairness. Proposed modifications of the triple lock have included replacing it with a double lock based only on increases in earnings or CPI.

CHECK YOUR UNDERSTANDING 3

A major difference between the basic state pension and the new state pension is:

a) The basic state pension is paid at a later age than the new state pension.

b) The new state pension is paid at a later age than the basic state pension.

c) The new state pension has no facility for an individual to claim a state pension based on National Insurance contributions paid by the spouse or civil partner.

d) Lower levels of National Insurance contributions are required to claim a full new state pension.

FACTFIND

Go to this link for more information on the basic state pension and follow links from this page to find out further details on the new state pension, additional state pension and Pension Credit:

www.gov.uk/browse/working/state-pension

THINK AGAIN . . .

Now that you have completed this topic, how has your knowledge and understanding improved?

For instance, can you:

- list the benefits that are available to people on low incomes who have made sufficient National Insurance contributions?
- explain the difference between Statutory Maternity Pay and Maternity Allowance?
- explain what would happen to a person's state benefits if they had to spend time in hospital?
- describe the key features of the new state pension?

Go back over any points you don't understand and make notes to help you revise.

Test your knowledge before moving on to the next topic.

Test your knowledge

?

Use these questions to assess your learning for Topic 5. Review the text if necessary.

Answers can be found at the end of this book.

1) Why is it important for a financial adviser to have a working knowledge of state benefits?

2) Once Universal Credit is fully implemented, parents who are eligible for Child Benefit will have to claim Universal Credit instead. True or false?

3) Which of the following is **not** a feature of new style Jobseeker's Allowance?

    a) It is only available to claimants who have made National Insurance contributions.

    b) It is only available for claimants who have savings of less than £6,000.

    c) Benefits are taxable.

    d) Claimants are credited with NICs.

4) James has been working in IT support for 12 years. His current job is a fixed-term contract and ends next month. Assuming James has made NICs throughout his working life, what benefit is he likely to be able to claim while he is unemployed?

    a) Working Tax Credit.

    b) Income Support.

    c) New style Jobseeker's Allowance.

    d) New style Employment and Support Allowance.

5) Aliyah has been working for Abbots Transport for 16 weeks. She is 24 weeks pregnant. Which of the following state benefits may she be entitled to?

    a) Statutory Maternity Pay.

    b) Income Support.

    c) Child Tax Credit.

    d) Maternity Allowance.

6) When is the earliest that Aliyah can begin claiming this benefit?

7) Malcolm, who is 42 and self-employed, has fallen ill and cannot work. Which benefit might he be entitled to?

   a) Disability Living Allowance.

   b) Statutory Sick Pay.

   c) Employment and Support Allowance.

   d) Attendance Allowance.

8) Lucy earns £52,000 per year and her partner Howard has an annual salary of £29,000. Let's say the threshold for Child Benefit is £50,000. They have three children, one at primary school and two at secondary school; their eldest son, Ethan, is 18 and studying for three A levels. For how many children are Lucy and Howard able to claim Child Benefit?

   a) Two; they cannot claim for Ethan because he is over 16.

   b) All three, because Ethan is still in full-time education.

   c) None, because Lucy earns more than £50,000 a year.

   d) None, because their combined household income exceeds £50,000 per year.

9) Ian retired in the current tax year at the age of 66. He had made NICs for 33 years while he was working but he had had a career break of three years to care for his sick partner. Is Ian eligible for a full, new state pension?

   a) No, because he was not continuously employed throughout his working life.

   b) No, because he retired too early to claim the new state pension.

   c) Yes, because he had paid NICs for more than 30 years.

   d) Yes, because he was credited with NICs while he was a carer.

10) Lydia is 22 and has just begun a new job on a permanent, full-time contract. Her employer will offer her the opportunity to contract-out of the state second pension. True or false?