The true cost of tax credit overpayments: A fairer approach

September 2021

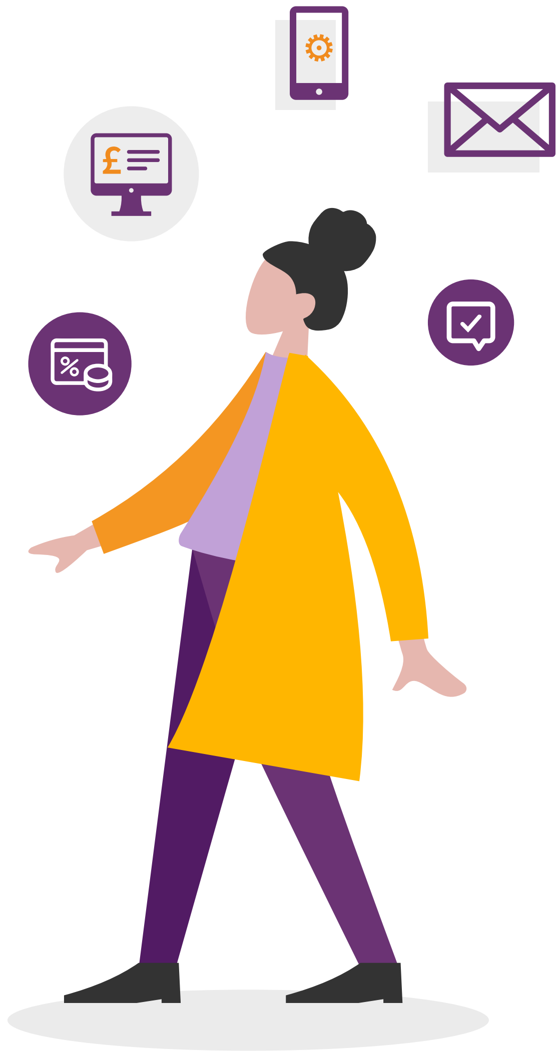
Summary

For some time, advice sector organisations have been raising concerns about the harm caused by poor quality government debt management practices.[1] As a result, last July the Cabinet Office launched a Call for Evidence on this issue with a full response expected in the autumn.[2]

The Department for Work and Pension's (DWP's) approach to deducting repayments from social security payments is an area where harm to those subject to government debt management is particularly acute. As people transfer onto Universal Credit (UC) they have faced deductions from standard payments to repay debts to government and other essential service providers. Following a 2014 agreement between HMRC and DWP, tax credit overpayment debts are one of the debts collected through deductions from UC.

Nearly **8 million** of these debts are scheduled to transfer to DWP with more than **£5 billion** worth of debt to be recovered.[3]

As with most public sector debts like council tax arrears or parking fines, StepChange clients who have tax credit overpayment debts face more challenging circumstances than those faced by other clients. They are much more likely to have a negative budget (meaning they do not have enough to cover essential expenditure after the budgeting process) and to have an additional physical or mental vulnerability on top of their financial hardship. This makes it even more important that the approach to collection is based on a careful assessment of affordability, as well as full consideration of any vulnerabilities and clear and accessible communication.



[1] Citizens Advice (2018), Hidden debts: The growing problem of being behind on bills and in debt to the government

[2] StepChange (2020), StepChange Debt Charity response to the Cabinet Office call for evidence on government debt management

[3] The original Memorandum of Understanding between DWP and HMRC in 2014 predicted 7.8m debts to be transferred between the departments. In a response to a question in the House of Lords the government stated that over £3bn of debt had transferred to DWP with another £2.4bn still to be passed on by HMRC

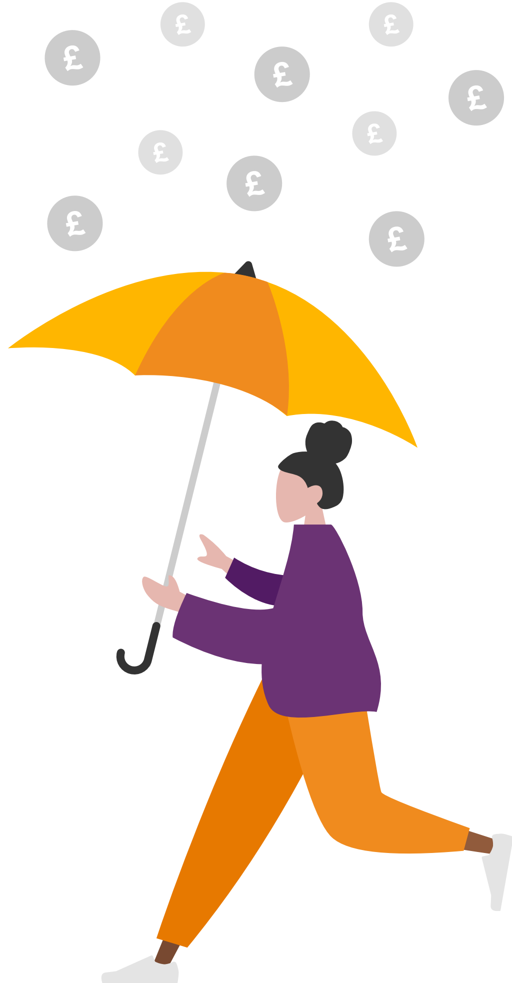
However, DWP's deductions practices can lag behind better practice for consumers seen in consumer credit and other regulated markets. We found that:

- There is no pro-active assessment of affordability. In a survey we conducted this year of clients who experienced deductions for a tax credit overpayment, 89% of clients surveyed had a payment taken which they couldn't afford. Taking unaffordable payments forces individuals to use harmful coping mechanisms to get by

98% of clients we surveyed struggled to cover essentials because of the deductions they faced, with **59%** being forced to borrow money to make up this shortfall.

- While it's possible to renegotiate levels of repayment, many do not realise they are able to do so, and many of those that have been able to may have already been pushed into hardship by the time payments are reduced
- Vulnerabilities are not efficiently identified. Data is not effectively used to pick up difficulties people face leading to an over-reliance on people coming forward to make disclosures. In a survey we conducted last year of clients with government debt, two in five vulnerable clients didn't make the DWP aware of their issues while only 11% of those that did felt they were treated fairly. 97% of vulnerable respondents experienced an increase in their anxiety or depression because of their experience of the deductions system
- Communication can be unclear. Two thirds of survey respondents did not know collections were going to start before money was taken from their UC claim while only 30% of respondents knew how much money was going to be taken. Individuals are not consistently signposted to additional support while avenues for redress and renegotiation are often not clear. This leaves people without a sense of clarity or fairness in how decisions have been made
- Few individuals see their tax credit overpayment debt written off. In 2019 68% of tax credit overpayment debt related to claims made before 2016.[4] In cases where collection has not started on these debts, our survey data suggests individuals may still be unaware they owe money. This represents a notable disparity with the commercial sector where limitation periods and regulations make historic legacy debts harder to enforce when collection activity has lapsed

Given its increasingly central role in the collection of tax credit overpayments alongside a range of other debts, it is vital that DWP's deductions system catches up with best practice seen in other sectors. The circumstances of the people subject to deductions mean that DWP arguably cannot safely use its current approach without the risk of pushing many of those receiving support into greater hardship.



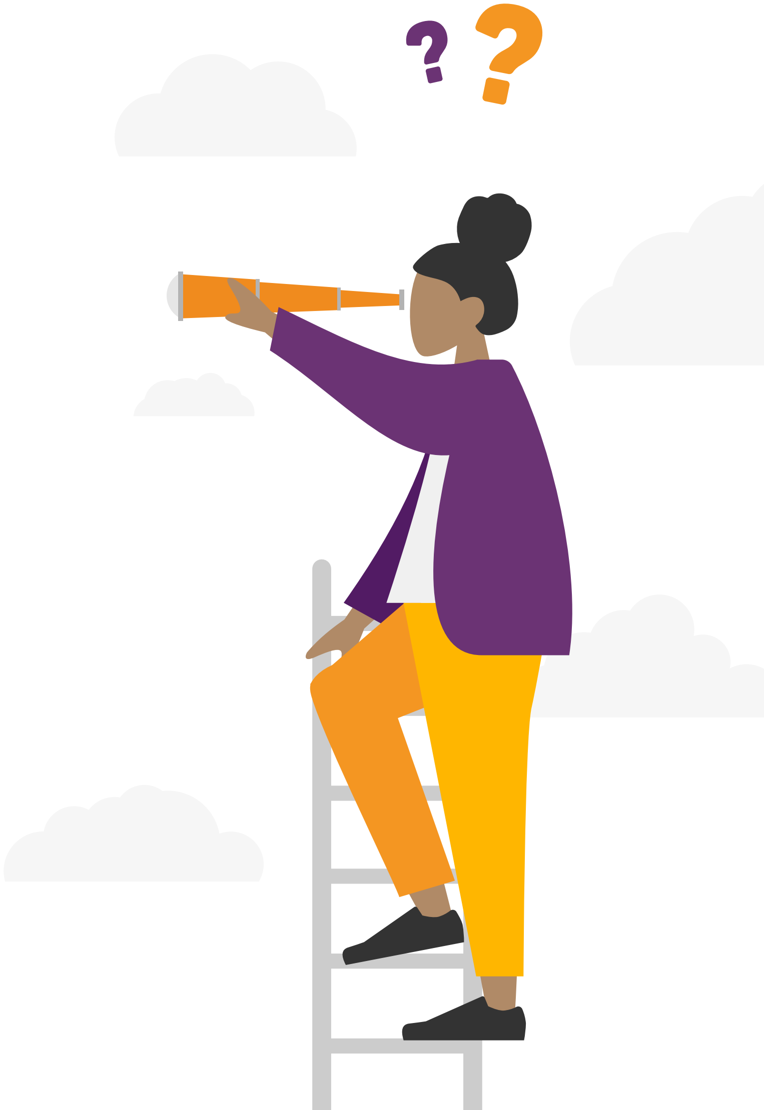
[4] APPG on Universal Credit (2019), What needs to change with Universal Credit

Recommendations

However, we believe that there are simple changes that can be made to improve the deductions system. The following could be implemented to benefit those facing deductions by using resources available to the department:

1. **DWP should use data to assess affordability before determining the rate of repayment. The maximum deduction for tax credit overpayments should be reduced to 5% and there should be a new minimum deduction of a £1 token payment**
2. **Tax credit overpayment debts over six years old should be written off and debts that will take over ten years to repay should be written down**
3. **Vulnerabilities should be proactively identified using proxy data held by DWP and other departments**
4. **Data sharing powers should be utilised to improve communications about tax credit overpayments**

More widely, we believe that there needs to be a statutory overarching framework that binds government debt management processes to accepted principles of good debt management practices. This could be based on the Fairness Principles contained in the Digital Economy Act 2017 (DEA) which would establish clear standards around affordability and vulnerability and ensure consistency of treatment for those who owe money to government organisations.[5] We recognise that this more systemic change would require legislation; debt advice providers have recommended a government debt management bill to bring government practices into line with other regulated sectors.



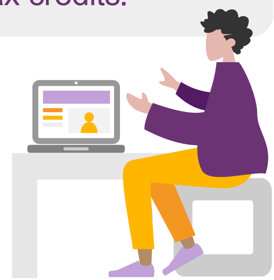
[5] Code of Practice of the Digital Economy Act 2017, The Fairness Principles for data sharing under the debt power

Tax credit overpayments

How much tax credit overpayment debt is there and where does it come from?

There is 5.4bn worth of tax credit overpayment debt[6]

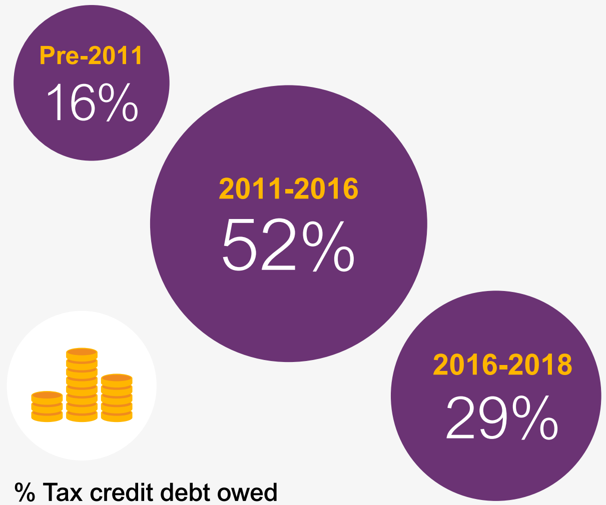
This figure is likely to grow as around 1.9 million families are still in receipt of tax credits.[7]



Overpayments and underpayments are a feature of tax credit claims, largely due to the nature of the tax credit system which means awards are calculated based on an estimate of earnings for the year ahead. Reconciliation is then at the end of the year when a calculation can be based on real earnings.[8]

Since their introduction in 2003 tax credits have been an administrative challenge. Awards are calculated on an annual basis, changes in circumstances or income during the year often lead to under- or over-payments. To deal with the frequent overpayments, the income disregard threshold was raised from £2,500 to £25,000. This meant that increases in income below this amount did not lead to a change in an award in that year and introduced more stability into payments. In 2011 this 'disregard' figure was reduced to £10,000, then in 2013 to £5,000 and £2,500 in 2016 (from 2012, HMRC also introduced a £2,500 disregard for falls in income). This means changes in income, alongside other changes in circumstances often leave people liable for overpayment debt.

Much of the money now being pursued relates to tax credit claims from years ago. In 2019, 16% of tax credit debt owed related to claims made before 2011 while only 29% of overpayment debt came from the previous three years.[9]



% Tax credit debt owed

[6] House of Lords (2021), Question for Department for Work and Pensions

[7] HMRC (2021), Child and Working Tax Credits statistics: provisional awards - April 2021

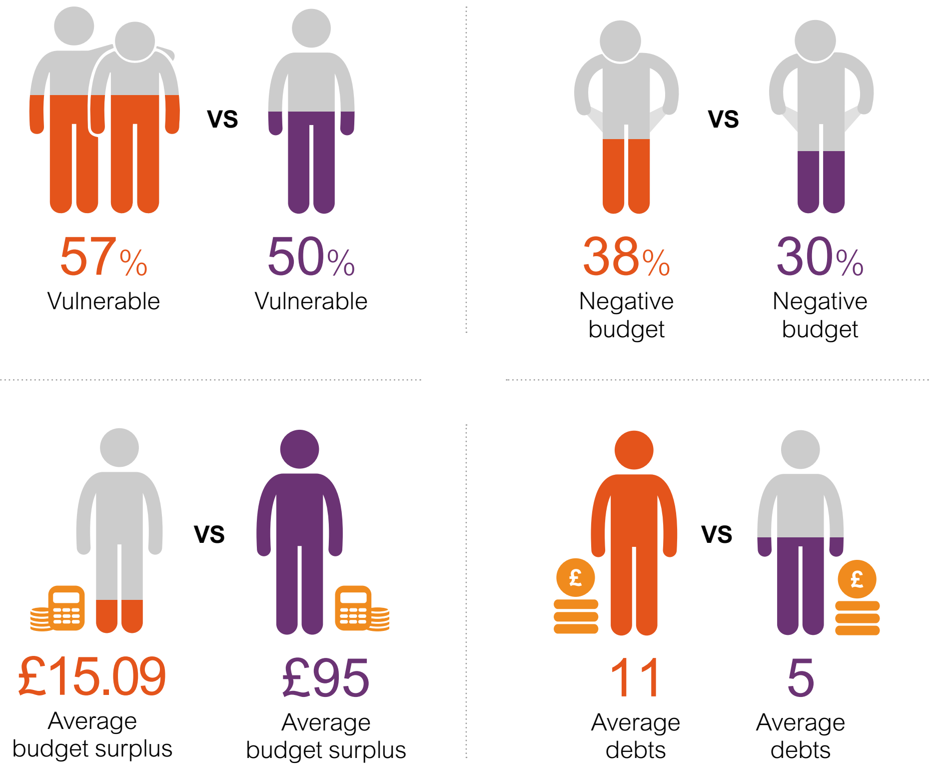
[8] HMRC (2021), 2019-2020 Annual Report and Accounts

[9] APPG on Universal Credit (2019), What needs to change with Universal Credit

Who holds tax credit debt?

StepChange clients with debts to government are more likely to be in a negative budget, have additional vulnerabilities and be balancing more debts than the average for all clients. Those holding tax credit overpayment debt typify this trend.

Demographics of StepChange clients with tax credit overpayment debt vs average for all clients



Tax credit overpayment debt is the third most common government debt type our clients face behind council tax and UC advance payments.

Debt type	Number of 2020 clients	Proportion of clients with government debt
Council tax	39,250	44%
UC advance	10,054	11%
HMRC Tax credit overpayment	**6,462**	**7%**

How does DWP collect this debt?

In 2014 DWP agreed to recover tax credit overpayment debt. At the time it was estimated that 7.8 million tax credit overpayment debts would pass from HMRC to DWP over the course of five years. The transfer is now planned to run until between 2025 and 2027.[10]

So far around £3 billion worth of tax credit overpayment debt has been transferred from HMRC to DWP. DWP is now collecting the bulk of this debt, with £2.4 billion still to be transferred from HMRC. Recoveries through UC have also increased significantly over the last few years up from £6.3 million in 2017 to £206 million in 2021.[11] As a result of the transfer, those receiving tax credits who have been migrated to UC now typically have any tax credit overpayment debt recovered through deductions from their UC claim, as may those who do not currently claim tax credits but have a past overpayment debt and begin to claim UC.

The benefits of transferring tax credit overpayment debt from HMRC to DWP listed in the original agreement between the two departments included a better experience for tax credit customers who would only have one department handling their debt and, for government, better recovery rates through the UC deductions framework.

Deductions from UC are used to collect a large range of debts. The system is based on decision logic and can therefore be a very efficient way to collect money owed, but a lack of flexibility means it can also be a source of hardship.

Client Story

"I am living on £118 a week with three children. I had to stop going to post-traumatic stress disorder treatment as I can't afford to go. I still don't know why they are only paying me £118.

They are taking £100 per month leaving me needing the foodbank and struggling with utilities.

I am a single mum and have lost my part-time job. Financially I don't have enough. We depend on the Universal Credit which is not enough for feeding my children as I can't afford the electric and gas bill."

Although DWP uses attachments of earnings and direct payments to recover debts, deductions from Universal Credit are the most common form of collection experienced by StepChange clients with tax credit debts. The deductions system involves a proportion of an individual's standard allowance being deducted up to a maximum of 25% of the allowance. For those without earned income whose debts are not fraud related the maximum is 15%.

The deductions framework prioritises debts to be recovered according to a priority order. Where more than one deduction is applied, the interaction between different deductions may be complicated. The priority order begins with deductions for fraud and conditionality sanctions, followed by advances and 'last resort' deductions like rent and gas before 'social obligation' deductions including council tax. Tax credit overpayment debts are 19th in the priority order.

If an individual feels the rate of deductions are unaffordable, they can contact the department to request a re-consideration on grounds of hardship. Individuals must contact the department and complete an income and expenditure assessment with an official who has discretion over whether to reduce the repayment rate.

[10] DWP & HMRC (2014), Memorandum of Understanding Between HMRC Benefits & Credits, HMRC Debt Management & Banking and the Department for Work & Pensions (DWP) For The Universal Credit Debt Transfer Process

[11] House of Lords (2021), Question for Department of Work and Pensions

How does this system compare with best practice?

Affordability

The most important element of good debt management is ensuring repayments are based on an accurate assessment of repayment affordability. Failing to do this can push individuals into hardship, make it harder for them to repay existing debts, and tip them still further into debt as they are forced to turn to coping mechanisms like high-cost borrowing to cover shortfalls.

DWP's system for collecting tax credit overpayments through its deductions framework involves only a limited assessment of whether an individual has an earned income or not. Those with earned income can face deductions of 25% of the standard allowance for non-fraud related overpayments while those without income can face a 15% deduction. This is much higher than the 5% cap on third-party deductions for things like debts to utility companies.

Given the profile of people facing collections on their tax credit overpayment debt, even this lower rate will often leave individuals facing hardship.

The average tax credit overpayment debt owed by StepChange clients is £2,329 and the average total government debt balance is £3,857.

38% of these clients have a negative budget, which means that their minimum expenses are greater than their income.

Impact of typical deductions repayment for an average StepChange client with tax credit overpayment debt[12]

38 months – average time to repay tax credit overpayment

-£46.60 – average disposable income after deduction

[12] Based on a 15% overpayment deduction for a single claimant aged 25 or over with no additional earnings

We surveyed StepChange clients to better understand the effect of current tax credit overpayment collection practices. Over three quarters of respondents did not have an affordability assessment, with nearly nine in ten (88%) finding that a payment was then taken which they could not afford.

Consequences of unaffordable deductions[13]

- **98%** found it difficult to cover essentials
- **59%** forced to borrow to cover essentials
- **62%** found it difficult to afford essentials for children
- **46%** considered leaving their accommodation

This experience is typical of people facing DWP deductions generally. In a survey we conducted last year looking at the deductions system across all debt types, 93% of people affected by deductions had experienced some financial difficulty or hardship as a result.[14]

People can make a hardship appeal to DWP to seek to renegotiate their repayment rate if they feel it is unaffordable. Individuals are usually able to have the terms of their repayment adjusted. Two thirds of clients were able to reduce the rate of repayment while only one in ten were unable to renegotiate. However, many are unaware they can appeal. Over a third of survey respondents were unaware they could ask for a reduction in their repayment rate.

Even for those who do renegotiate, the lack of a proactive assessment and the precarity of many people's circumstances can mean that even a month or two of unaffordable repayments can push someone into severe hardship. The high rate of success among our clients demonstrates that the automated approach to deductions is causing harm. We assume that every client that comes to StepChange for debt advice is financially vulnerable. DWP should start with the assumption that those on UC are unable to afford deductions at the normal rate.

Case Study

> "Because of my poor mental health at that period, it took me nearly six months to get the courage to phone them. During that time I was having to borrow money to buy food because my monthly budget was already in minus figures before they started taking the £67 from my UC. When I called the overpayments team the guy was very understanding and reduced the deductions to £5 per month temporarily."

There are examples of better practice within government. HMRC uses slightly more data on people's household income to link the rate of deduction to an initial assessment of circumstances. This system is far from perfect, as it is only based on income rather than a more comprehensive assessment of circumstances and has a very high maximum repayment rate. However, it demonstrates the scope for linking repayment more closely with ability to pay using data acquired in the benefit application process.

[13] StepChange (2021), Survey of clients with tax credit overpayment debt collected through UC, base 53

[14] StepChange (2020), Problem debt and the social security system

Repaying tax credit overpayments through a reduction in tax credit award

Household income	Reduction in tax credit award
£20,000 or less and receiving maximum tax credits	**10%**
£20,000 or less and receiving less than the maximum tax credits	**25%**
More than £20,000	**50%**

DWP has a wealth of data with which to assess household circumstances including the information captured in someone's original UC claim. Recently published proposals for the Warm Home Discount Scheme in the energy market include extensive use of DWP data to identify and automatically enrol eligible households according to the benefits they receive and an approximation of household energy costs.[15] Similar data could be used to adjust repayment rates.

Debt advice practitioners distinguish between 'priority' and 'non-priority' debts. Priority debts are those, such as rent arrears for a property in which the client lives, that must be repaid or there may be serious negative consequences (in this case eviction). In deducting repayments from UC, DWP chooses the relative priority of a debt without regard to the consent of the claimant or the relative importance of the debt to that claimant; for example, whether repayment will cause hardship or displace the repayment of other priority debts and have serious negative consequences. Debt recovery through UC must also be seen in a context in which social security payments are made at below subsistence levels.[16]

As DWP itself notes in its guidance on deductions, any deduction is likely to cause hardship and distress.[17] This means DWP (and wider government) must be extremely careful—much more so than is presently the case—in recovering debts through social security payments. There must be adjustment to the rate of repayment based on an assessment of affordability. The system should also allow for low token payments to be made by those unable to make repayments on non-priority debts like tax credit overpayments and the maximum deduction for these non-priority debts should be aligned with other third-party deductions at 5%.

Recommendations

Deductions should be set according to an assessment of an individual's circumstances using data available to DWP

DWP should reduce the level of the maximum deduction to 5% for tax credit and other benefit overpayments

To safeguard against harm there should be a new token payment minimum deduction of £1 a month for those who can't afford repayments

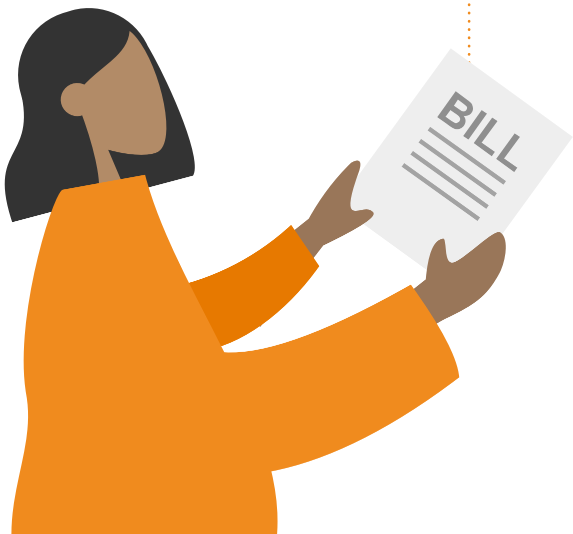
[15] Department for Business, Energy & Industrial Strategy (2021), Warm Home Discount: Better targeted support from 2022

[16] Joseph Rowntree Foundation (2021), Our social security lifeline: Is it strong enough?

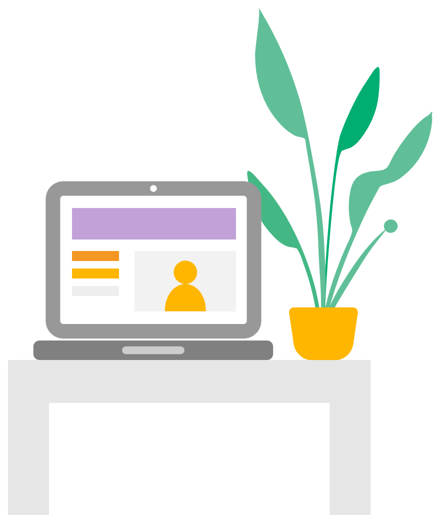
[17] Department for Work and Pensions (2019), Benefit overpayment recovery guide, p37 paragraph 5.72

Write off and Remission

It is also notable that only one of 55 survey respondents who faced deductions for a tax credit overpayment and answered a question on debt write off had had their debt completely or partially written off. Given the typical size of overpayment debts and the relative vulnerability of many StepChange clients, this demonstrates the extremely limited scope for write down in the current system. In 2019-20 just ten UC recipients had their debts waived on the grounds of hardship.[18]



If based on a thorough assessment of affordability which allowed space for individuals to build up financial resilience while repaying their debt, it is likely that clients we see with tax credit overpayment debt would be facing repayment schedules of more than ten years. Other areas of government generally restrict repayment periods to ten years or less. If an individual's circumstances have not improved during that time the rest of the debt can be written off. HM Treasury's policy statement for the Statutory Debt Repayment Plan (scheduled to be introduced in 2024), for example, sets a ten-year limit of the repayment term.[19] Individual Voluntary Arrangements (IVAs) involve an element of write off agreed by creditors with repayments running for 5 or 6 years.



The long history of tax credit overpayments means that many of the debts being pursued relate to claims made many years ago. In fact, in 2019 only 29% of overpayment debt related to claims made after 2016.[20]

As debts are being passed across to DWP, people find these extremely old debts suddenly being collected through deductions. The lack of data shared between the departments often means DWP is unable to explain how the debt was incurred. This is a particular problem for debt advisors helping clients with Debt Relief Orders (DROs). Advisors are unable to obtain necessary information from DWP to set up a DRO, while the process of putting a client onto a DRO can be the trigger for demands for historic tax credit debts that can push clients out of eligibility for the debt solution after the long administrative process of setting one up has already been completed.

[18] House of Commons Question (2020), Question for Department for Work and Pensions

[19] HM Treasury (2019), Breathing space scheme: response to policy proposal

[20] APPG on Universal Credit (2019), What needs to change with Universal Credit

Case Study

"I had no idea I was being paid too much (than the tax credit estimate), still to this day have no idea how I built such a large debt. I was scraping by picking up ad hoc forklift driving work, not regular work, I needed tax credits to get by. I'm a single dad getting no help from my daughter's mother. I told the truth with every claim and update but now have a 10 year debt hanging over me."

This treatment of historic debts stands in contrast to legacy debts in financial services where debts can be statute barred if no action is taken on them within a defined period. In England, Wales and Northern Ireland the Limitation Act places a six-year limitation period on debts after which a lender cannot take court action.[21] Financial Conduct Authority (FCA) rules enhance this restriction, stating that if a lender has not contacted the individual during the limitation period creditors should not pursue the debt.[22]

There is no policy to write off historic tax credit debt. However, large scale remission of debts is not unheard of in government. As part of its 2011/12 debt strategy HMRC remitted tax credit debts where, following HMRC's consultation with the NAO, it was deemed that the costs involved in further collection activity outweighed the potential recoveries, though this was before the introduction of UC. These debts were all over 3 years old and considered inactive, this resulted in remissions totalling £1.2bn. Although HMRC do not use age of debt as a factor when considering remission, adopting a consistent limitation period would apply a principle of fairness accepted in the commercial sector to those with tax credit overpayment debt.

[21] Limitation Act (1980)

[22] FCA Handbook (2019), CONC 7.15.4

Recommendations

Historic tax credit overpayment debts over six years old should be written off.

DWP should follow HMRC practice and write down overpayment debts which, after an affordability assessment, will take over ten years to repay.

Vulnerability

57% of clients we see with tax credit overpayment debt have an additional vulnerable characteristic. However, DWP has only limited systems to identify vulnerability or adjust its approach in response to vulnerabilities through UC.

The department has an affordability/hardship flag for individuals with deductions in place where a lower rate of repayment has been agreed due to financial hardship. Individuals are also able to disclose vulnerabilities through their UC journals or when contacting the Department.

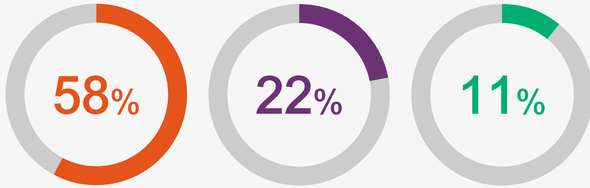
Requiring people to come forward to disclose vulnerabilities (rather than using data or proactively offering users the opportunity to disclose vulnerabilities) means many do not, while current policies are not flexible enough to sufficiently respond to the challenges vulnerable individuals face. Two in five clients (42%) in a survey we conducted last year who had a physical or mental vulnerability did not make the DWP aware of their vulnerability. Of those that did, less than one in four felt the department took account of these circumstances. Overall less than in one in ten clients with a vulnerability felt they were treated fairly by DWP.[23]

Client Story

> "I just need help so much. I am really stressed out and cannot cope anymore and thinking of taking my own life because I can't be bothered with all this debt and anxiety.
>
> I couldn't eat properly and I have to as it affects my diabetes, so it made me stressed about having no food.
>
> As a single parent in a low income household I suffered with depression and suicidal thoughts."

[23] Due to small sample sizes in our tax credit overpayment client survey these stats are drawn from a client survey on government debt conducted last August. These respondents had a debt collected by DWP but not necessarily a tax credit overpayment debt collected through deductions from UC

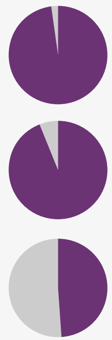
Failure to identify or account for vulnerabilities[24]



58%	22%	11%
made DWP aware of their vulnerability	felt DWP took account of their vulnerability	felt they were treated fairly

Failing to respond appropriately to individual vulnerabilities can have serious consequences for those facing government debt collection. Mental health issues can be compounded and worsened by negative experiences while others are forced to increase their use of support services.

The consequences of failing to account for vulnerabilities[25]



98% increased stress

94% increased anxiety/depression

49% increased use of mental health service

[24] StepChange (2021), Survey of clients with debts to government organisations, base 173

[25] StepChange (2021), Survey of clients with tax credit overpayment debt collected through UC, base 53

Given the disproportionately vulnerable nature of clients with tax credit overpayment debts, it is vital that DWP's approach to identifying and accommodating the needs of vulnerable individuals represent best practice.

Yet debt management teams across government can lag behind other regulated sectors in their approaches to vulnerability. The FCA, Ofgem and Ofwat have all launched comprehensive vulnerability strategies in recent years. These set out clear expectations for firms in identifying and responding to vulnerabilities and monitor the effectiveness of debt management teams among regulated services and firms.

Ofgem's vulnerability strategy calls on firms to make better use of smart data to identify vulnerable consumers without the need for self-identification.[26]

There are a wealth of proxy data points available to DWP that could be used to identify vulnerable individuals, those with limited capability for work for example. This data could be better shared across government using the powers in the Digital Economy Act (DEA) so that all debt management teams could be prepared to adjust processes for an individual before making contact.[27] A data sharing agreement of this kind between HMRC and Manchester City Council looking at households with council tax arrears demonstrates how this approach can be effective. Using the data received Manchester City Council was able to target more robust enforcement towards households identified as 'not-paying' while using more delicate approaches for households showing signs of hardship.[28]

[26] Ofgem (2019), Consumer vulnerability strategy 2025, Outcome 1.cs

[27] The Digital Economy Act 2017, Part 5

[28] ICO (2018), Manchester City Council and HMRC Digital Economy Act Data Sharing Pilot

Client Story

"There was no understanding of health conditions or the fact that I misunderstood the wording of the paperwork. I found the situation overwhelming and I wasn't able to deal with it."

"I think that before taking such a big deduction from benefits they should at least send some communication informing you and find out if it's affordable. When you have problems with anxiety or depression it's much easier to respond to a communication to make an arrangement in advance than it is get in touch off your own back because you didn't know that they planned to take it."

"The government don't realise that having depression or anxiety is a health risk and don't realise how it affects people in different ways. I'm on medication, I have good days and bad days where it gets too much for me to deal with."

The FCA's vulnerability guidance requires firms to embed the needs of vulnerable consumers into the process of product and service design. It suggests holding forums with target consumer groups, testing new services and products, and changing them according to their needs.[29]

The rigidity of DWP's deduction system is not producing positive outcomes for vulnerable individuals and would benefit from a consultative process of re-design. The FCA also expects financial services firms to ensure they have the expertise to deal with vulnerabilities. This is an area the Vulnerability Subgroup of the Cabinet Office Fairness Group has made some progress with by recently publishing a vulnerability toolkit for government debt management staff. This includes several protocols like 'IDEA' (impact, duration, experiences, assistance) which are intended to help officials identify vulnerability and respond to disclosures.[30]

Sector regulators also require firms to gather management information to hold them to account on the adequacy of their support for vulnerable individuals. For example, Ofwat's recent proposed metrics for assessing companies included a measure on the number of customers contacted by the company about eligibility for vulnerability assistance options.[31] These performance metrics should help shift culture within debt management teams.

Recommendations

DWP should use data available to the department to identify vulnerable individuals and use the DEA powers to share this data with debt management teams across government.

Staff should be trained to deal with vulnerabilities and given the flexibility to respond with meaningful adjustments.

DWP should seek to consult with vulnerable individuals to tease out the key problems with UC and deductions for people with additional needs.

Debt management teams should be required to report on performance metrics related to the identification of vulnerable individuals and the implementation of support measures.

[29] FCA (2021), Guidance for firms on the fair treatment of vulnerable consumers

[30] Fairness Group (2020), Vulnerability toolkit

[31] Ofwat (2017), Delivering Water 2020: Our final methodology for the 2019 price review Appendix 1: Addressing affordability and vulnerability

Communication and Complaints

It can be many years after making an initial claim that people find they have been overpaid and need to repay money. This makes it important for government departments to communicate clearly with individuals so that they understand how they have come to be in debt. Given the demographic of those with debts, good communication is closely linked to having effective systems of identifying vulnerability and payment difficulties. This is so that interventions can signpost to appropriate support.

The experience of our clients suggests that in many instances communication does not provide sufficient information. People are left confused about why they owe money, how it will be recovered and what help is available.

Communications about UC deduction[32]

Over half of respondents (59%) to our survey were not aware that deductions were to begin before they started

63% said the information about the details of the overpayment was not clear

50% were aware of the form recovery would take

Just one in three were clear about how much and how frequently money would be collected

This reflects Child Poverty Action Group (CPAG) evidence that information sent to claimants was unclear to the point of illegality, with key details about the claim and appeals system being indecipherable or left out of communications entirely.[33] Given the financial circumstances of those facing tax credit overpayment debt, this kind of uncertainty can have dangerous consequences as even minor financial miscalculations can leave them in severe difficulty.

Client Story

James had initially been paying £36 per month direct from his wages. He lost his job in March 2020. The only letter he received was shortly after claiming UC to say that repayments from benefits were cancelled during the pandemic and DWP would get in touch about repaying his debt at a later date. DWP then began deducting £67 per month from his UC without sending any communication that they would be taking it, or what the amount would be.

[32] StepChange (2021), Survey of clients with tax credit overpayment debt collected through UC, base 64

[33] Child Poverty Action Group (2019), Computer says 'No!' Stage One: Information provision

One of the issues that seems to drive problems with government communications on tax credit debt is the data that is shared by HMRC with DWP. While a TC1131 letter from HMRC usually notifies individuals of an overpayment, there is only authorisation for limited amounts of information to be shared between departments.[34]

While HMRC will have sent letters notifying individuals of their overpayment, it is evident that many individuals do not pick these up and only come to be aware of an overpayment when they experience deductions from UC. When someone makes a UC claim and they have a tax credit overpayment debt, DWP can only see the amount owed, tax credit award end date and basic identification details. Without more details about the specific errors in the claim, DWP is unable to provide the information which would help individuals better understand why they find themselves owing money. This absence of information exacerbates the harm that can be caused by bad debt collection practices.

In a survey of clients with government debt we conducted last year, of the 27% who did not receive notification about collection activity on their debts, 82% experienced a significant negative impact on their mental health compared to 53% of those who were notified.[35]

Poor communication reduces the effectiveness of DWP forbearance and wider support. In last year's government debt survey two thirds of respondents were not signposted to free debt advice by DWP. In our survey of clients with tax credit overpayment debt, over a third were not even aware they could renegotiate their rate of deduction through a hardship appeal. This chimes with evidence published by CPAG which suggests individuals are dissuaded or diverted from raising reconsideration of their Universal Credit claim. This included people finding themselves being gently dissuaded, scepticism about evidence provided of true income, or being asked to provide unreasonable amounts of evidence as part of the reconsideration process.[36] Once again government practices are below best practice standards. DWP staff should deal sympathetically with those that contact them and should be asking about financial or other difficulties individuals may be facing to signpost or transfer to available support.

The FCA requires firms to inform and refer customers facing payment difficulties to free debt advice services.[37] This is combined with the more sophisticated requirements in its handbook on early identification of consumers in financial difficulty and its expectations on signposting vulnerable consumers to appropriate support. This regulatory framework makes it more likely that consumers in financial services in need of support will be identified and then directed to the support they need than those facing government debt collection.[38]

Elsewhere close partnerships between debt advice providers and regulated firms and services allow for warm referrals. For example, StepChange partners with Mental Health UK and can pass clients directly to them when advisers identify severe issues, while the charity has also recently established a partnership with Trussell Trust to refer clients experiencing food poverty to food banks. Government systems should be set up so that individuals can be directly transferred to appropriate support at any point of contact.

[34] DWP & HMRC (2014), Memorandum of Understanding Between HMRC Benefits & Credits, HMRC Debt Management & Banking and the Department for Work & Pensions (DWP) For The Universal Credit Debt Transfer Process

[35] StepChange (2020), Client survey base 294

[36] Child Poverty Action Group (2019), Computer Says 'No!' Stage Two: Challenging Decisions

[37] FCA Handbook (2019), CONC 7.3.7A

[38] Money Advice Trust (2020), Levelling up: The case for reforming government debt collection, graph on p. 46 shows that National Debtline advisers find DWP much worse at identifying support needs than commercial creditors

Similar disparities with FCA standards are seen in the promotion and accessibility of DWP complaints procedures. Individuals can complain to DWP online, by phone, in person or in writing. If the complaint is not resolved satisfactorily individuals can contact the complaints resolution manager, who will contact individuals within 15 working days to resolve the complaint or outline how long they expect resolution to take. Finally, if an individual is still not happy, they can escalate to the independent case examiner who independently reviews cases and can ask DWP to correct mistakes.

In cases where people feel they have been unfairly treated avenues for redress are not well promoted and people's experience with them are often negative. Only 2 in 5 respondents to our government debt survey who felt they had been unfairly treated by the DWP made a complaint.

Client Story

"I have not heard anything from any of them."

"It was a waste of time. I was basically ignored and shouted over."

"They were not interested in my complaint. I complained through my advice provider but they didn't get anywhere."

These standards would not be accepted in regulated markets. For example, the FCA places stringent requirements on firms to make consumers aware of ways to make a complaint. The FCA's dispute regulations include clear provisions requiring firms to display complaints information and ensure consumers are aware of processes:

FCA Handbook DISP 1.2 Consumer awareness rules

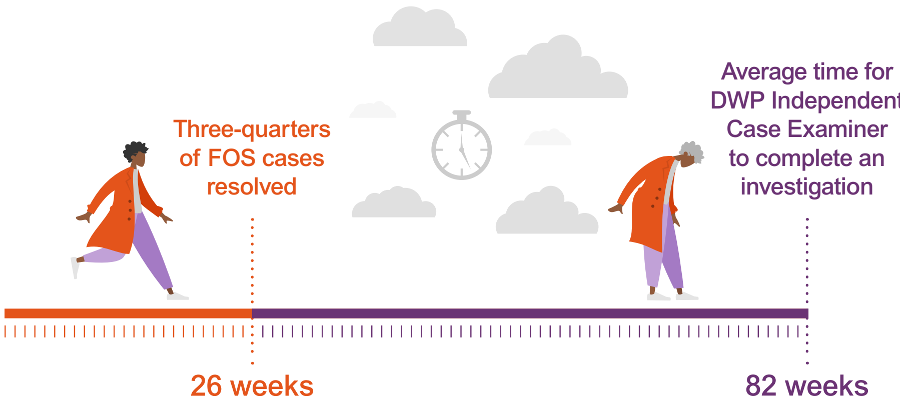
DISP 1.2.1

(4) provide information to eligible complainants, in a clear, comprehensible and easily accessible way, about the Financial Ombudsman Service including the Financial Ombudsman Service's website address:

(a) on the respondent's website, where one exists; and

(b) if applicable, in the general conditions of the respondent's contract with the eligible complainant.

In last year's survey of clients with government debt, over 75% of those who had made a complaint to DWP were unsatisfied with how the department dealt with it. The fact that only one in three respondents had then escalated their complaint to the DWP independent case examiner suggests that there is either a lack of clarity about how to advance complaints or a lack of faith in them being resolved effectively.



This lack of faith is not unfounded. In the first six months of 2019 it took an average of 18 months for the independent case examiner to complete an investigation.[39] Again, this performance would not be tolerated in the commercial sector where last year the Financial Ombudsman Service (FOS) resolved three-quarters of cases within 6 months.[40]

[39] House of Commons Question (2020), Question to DWP

[40] Financial Ombudsman Service (2020), Annual reports and accounts for the year ended 31 March 2020

Recommendations

Data sharing agreements should be established so that DWP is able to communicate full details of how a tax credit overpayment was incurred. Communications should also clearly explain how deductions will work. Messages should be tested with key demographics to ensure they will be understood.

Individuals should be signposted to free debt advice or appropriate third party support when identified as having additional needs or being at risk of financial difficulty.

Debt management teams should be receptive to contact from those facing deductions and deal with them sympathetically.

Complaint policies should be clearly advertised and accessible with cases dealt with promptly.

How can things be improved?

Many of the improvements identified in this report would not require legislation. Tweaks to decision logic in computer systems to reduce repayment rates, utilising existing legislative powers to facilitate data sharing and testing communications with key demographics could vastly improve the deductions system.

DWP often responds to calls for change by citing the challenges of making changes to the computer system that UC relies on. However, in the last two years the maximum rate of deduction has been reduced from 40% to 25% which suggests change is possible. Given the scale of hardship currently caused, there should be sufficient political will to overcome such an obstacle.

Summary of recommendations

The rate of deductions should be determined following an assessment of affordability using data available to DWP. The maximum deduction for tax credit overpayments should be reduced to 5% and there should be a new minimum deduction of a £1 token payment.

Tax credit overpayment debts more than six years old should be written off while debts that will take long than ten years to repay should be written down.

Individuals with vulnerabilities or at risk of financial difficulty should be proactively identified using proxy data from within DWP and across government. These individuals should be signposted or passed directly to specialist third party agencies or internal support teams with appropriate adjustments made to collection practices.

DEA powers should be used to transfer more information from HMRC to DWP on how tax credit overpayments were incurred so that people can be properly informed about their debt. Communications should be tested with key demographics so that information is clear.

Legislative change?

Reform of government debt collection practices are being seriously considered following the Cabinet Office call for evidence last summer. There is a widespread recognition of the need for change. One proposal that has been strongly backed by advice sector organisations is a government debt management bill which was first raised by the Centre for Social Justice (CSJ).[41]

Long-standing problems with deductions and wider government debt management practices suggest some external pressure is required to initiate the needed culture change. The absence of a consistent framework of principles and conduct for government debt teams compared with the more stringent regimes in regulated markets needs to be addressed to level up government practices across the board.

A government debt management bill could provide the impetus. While this bill has not been fully formed, putting the Fairness Principles contained in the DEA onto a statutory footing has been a consistent element of calls for legislation.

Combined with an adequately empowered body to hold government organisations to account, these principles could replicate the frameworks seen in regulated markets and raise standards across the board. These would add external pressure to instigate some of the changes in practice above as well as raising standards more broadly.

- The Fairness Principles include clear expectations on assessing circumstances and individual ability to pay. If properly enforced they could force reform of approaches that cause hardship like the current deductions system

- The principles also begin to establish minimum standards on identification and response to vulnerabilities. Combined with management information requirements around key metrics, legislation could facilitate the necessary data sharing and establish the incentives to drive improvement in approaches to vulnerability

[41] CSJ (2020), Collecting dust: A path forward for government debt collection

Methodology

This report is based on StepChange client data and two surveys of StepChange clients.

We analysed data held on clients who completed a telephone or online debt advice session with StepChange and owed money to a government organisation in the twelve months April 2020-2021 – 89,899 clients.

We conducted a survey of clients between 21 May and 4 June 2021. The survey was sent to a sample of clients who had a tax credit overpayment debt. We received 162 responses. 73 respondents had had their overpayment collected by DWP through deductions from Universal Credit.

We also conducted a survey of clients between 20th August and 8th September 2020. This survey was sent to a sample of clients who owed money to a government organisation. We received 402 responses, 137 of whom had been in debt to the DWP in the last two years.

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About StepChange

StepChange Debt Charity is the UK's leading debt advice charity, working towards a society free from problem debt.

We help hundreds of thousands of people each year deal with their money worries and take back control of their lives.

Our service is free and we never judge.

Read our online information about how to deal with **tax credit overpayments**.

Get in touch:

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StepChange Debt Charity