

<b>Title:</b> Welfare Reform and Work Bill: Impact Assessment of Tax Credits and Universal Credit, changes to Child Element and Family Element  <b>Lead department or agency:</b> Her Majesty's Treasury / Department for Work and Pensions <b>Other departments or agencies:</b> Her Majesty's Revenue and Customs	<b>Impact Assessment (IA)</b>		
	<b>Date:</b> July 2015		
	<b>Stage:</b> Final		
	<b>Source of intervention:</b> Domestic		
	<b>Type of measure:</b> Primary legislation		
<b>Contact for enquiries:</b>			
<b>Summary: Intervention and Options</b>		<b>RPC Opinion:</b> Not Applicable	

Cost of Preferred (or more likely) Option			
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out?
£0m	£0m	£0m	No
			Measure qualifies as NA

**What is the problem under consideration? Why is government intervention necessary?**

The Government has made clear its objective of tackling the deficit and rebalancing the welfare state. Welfare expenditure is a significant driver of public spending and the Government is committed to delivering a more sustainable welfare system, including changes to tax credits, to put the system on a more sustainable footing.

The current benefits structure, adjusting automatically to family size, removes the need for families supported by benefits to consider whether they can afford to support additional children. This is not fair to families who are not eligible for state support or to the taxpayer.

**What are the policy objectives and the intended effects?**

The objective of these policies are to reform tax credits and Universal Credit to make them fairer and more affordable. They will ensure that the benefits system is fair to those who pay for it, as well as those who benefit from it, ensuring those on benefits face the same financial choices around the number of children they can afford as those supporting themselves through work. Encouraging parents to reflect carefully on their readiness to support an additional child could have a positive effect on overall family stability. The changes are part of a package which will deliver a more sustainable welfare system and return expenditure on tax credits to 2007/08 levels in real terms.

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**

Three options were considered:

- 1) Whether the measures should apply to all families in receipt of child tax credit and Universal Credit; or
- 2) Whether the measures should apply as flow measures; or
- 3) Do nothing.

The do nothing option is not sustainable. Option 2 was the preferred option as it ensures families would not have cash losses from the policy at the point of change. Entitlement will remain at the level for two children for households who make the choice to have more children, in the knowledge of the policy. This will result in fairness to claimants and to the taxpayer

**Will the policy be reviewed? It will/will not be reviewed. If applicable, set review date: Month/Year**

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	Micro No	< 20 No	Small No	Medium No	Large No
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)			Traded: N/A	Non-traded: N/A	

***I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.***

Signed by the responsible Minister:



Date: 20/07/2015

# Summary: Analysis & Evidence

## Policy Option 1

**Description:** Tax Credits and Universal Credit, changes to Child Element and Family Element

### FULL ECONOMIC ASSESSMENT

Price Base Year 2015	PV Base Year 2015	Time Period Years 5	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	High: Optional	Best Estimate: £0

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional	Optional	Optional
High	Optional	Optional	Optional
Best Estimate	1,020	N/A	4,455

#### Description and scale of key monetised costs by 'main affected groups'

By 2020/21, the costs of limiting support through tax credits and Universal Credit to two children will be £1,365m, and of removing the Family Element in Child Tax Credit and child premium in Universal Credit will be £675m. The main affected groups will be those currently in receipt of tax credits or Universal Credit who choose to have a first or a third or subsequent child after April 2017 and households with children who make a new claim to Universal Credit after April 2017.

#### Other key non-monetised costs by 'main affected groups'

It has not been possible to quantify the distributional effects in the tax credit system.

The assessment is only carried out over the period to 2020/21, transition will continue beyond this period and costs and benefits will continue to accrue beyond the period.

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional	Optional	Optional
High	Optional	Optional	Optional
Best Estimate	1,020	N/A	4,455

#### Description and scale of key monetised benefits by 'main affected groups'

Savings to the taxpayer are estimated to be £2,040m in cash terms on an annual basis by 2020/21. These savings will continue to rise in the future in line with the flow of new births and claims, and on the basis that families will make decisions based upon their ability to support their family.

#### Other key non-monetised benefits by 'main affected groups'

The assessment is only carried out over the period to 2020/21, transition will continue beyond this period and costs and benefits will continue to accrue beyond the period.

#### Key assumptions/sensitivities/risks

#### Discount rate (%)

3.5

A range of factors will determine the precise level of savings achieved from these measures, in particular the assumed level of new births and future family sizes. The rate of earnings growth amongst the affected groups will also play a role in determining the size of the overall claimant population in the two systems and hence the level of savings from the measures. Key demographic and economic assumptions have been agreed by HMRC and DWP with the independent Office for Budget Responsibility.

### BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 0	Benefits: 0	Net: 0	No	NA

## Evidence Base (for summary sheets)

### Problem and rationale for intervention

1. The Government has made clear its objective of tackling the deficit and rebalancing the welfare state. Welfare expenditure is a significant driver of public spending, and the Government is committed to delivering a more sustainable welfare system which is fair to those who pay for it, as well as those who benefit from it, including changes to tax credits to put the system on a more sustainable footing.
2. The current benefits structure, adjusting automatically to family size, removes the need for families supported by benefits to consider whether they can afford to support additional children. This is not fair to families who are not eligible for state support or to the taxpayer.
3. Tax credit expenditure more than trebled in real terms between 1999-00 and 2010-11, with total expenditure in 2014-15 estimated to be around £30 billion – an increase of almost £10 billion in real terms over the last 10 years.

### Policy objective

4. These policies are intended to reform tax credits and Universal Credit to make them fairer and more affordable. They will ensure that the benefits system is fair to those who pay for it, as well as those who benefit from it, ensuring those on benefits face the same financial choices around the number of children they can afford as those supporting themselves through work.
5. The changes are part of a package which will deliver a more sustainable welfare system. They will return expenditure on tax credits to 2007/08 levels in real terms.

### Do nothing option

6. The do nothing option is unfair to families who are not eligible for state support and to the taxpayer, and does not return welfare spending to a sustainable level.
7. Delivering welfare savings is a vital part of the government's deficit reduction plan. Had the Budget not announced significant welfare savings, steeper reductions in public service spending would have been required – or higher borrowing and debt, or higher taxes.

### Other options considered

8. In addition to 'do nothing' the Government considered whether the change should apply to all families in receipt of tax credits and Universal Credit. Recognising the impact this could have on families already in receipt of tax credits or Universal Credit, the Government decided to proceed with the proposed option. Entitlement will remain at the level for two children for households who make the choice to have more children, in the knowledge of the policy. In the case of new claims to Universal Credit it will apply to families who have been outside of the Universal Credit and tax credit benefit systems for the previous 6 months. This will result in fairness to both claimants and to the taxpayer.

### Child Tax Credit (CTC) and Universal Credit reforms

9. At the Summer Budget 2015, the Government announced the following reforms to CTC and child elements of UC:
  - Retain the same level of support provided for families through tax credits with 2 children, who then choose to have a third child or subsequent children. To achieve this, births of

third or subsequent children after April 2017 will no longer trigger increased entitlement to the Child Element of CTC;

- An equivalent change in Housing Benefit to ensure consistency between both benefits;
  - Providing the same level of support provided for families with 2 children receiving Universal Credit to those families with three or more children and who make a new claim after April 2017. To achieve this, third or subsequent children born after April 2017 will no longer trigger entitlement to additional support within Universal Credit. This will also apply to families who make an entirely new claim to Universal Credit from April 2017;
  - For households starting a family after April 2017 their tax credit entitlement will no longer increase to include a Family Element in addition to a child element. The equivalent increase in benefit in Universal Credit, known as the first child premium, will also not be available for new births or claims after April 2017;
  - In Housing Benefit, the increase in benefit entitlement for the family premium ceases for new claims from April 2016;
10. Changes to Housing Benefit do not require primary legislation and will be made through separate secondary legislation relating to the Social Security and Benefits Act (1992). This change is part of the wider package presented to remove the increased financial awards for households who choose to have children.
11. In order to protect vulnerable households the support provided to families with disabled children through the disability elements of CTC and the amount for a disabled child or qualifying young person in Universal Credit will not be affected by the changes.
12. The following groups will be exempt and will not be considered a new claim:
- those moving from tax credits to UC;
  - those claiming UC within 6 months of a previous claim to tax credits or UC; or
  - a lone parent already on UC forming a couple with a single claimant not on UC.
13. The Government will develop protections for women who have a third child as the result of rape, or other exceptional circumstances. Details will be set out following consultation with stakeholders.
14. The changes will not impact on the childcare element of Working Tax Credit or Universal Credit. In addition, Child Benefit will not be affected by the reforms. Families will still get Child Benefit in respect of every child and a higher amount for the first child. This is because the Government wants to ensure a fair start in life for children in all families.

## Exchequer and Claimant Impact

15. The savings from the tax credit measures are calculated using HMRC's Tax Credits Expenditure Forecast Model (TCEFM). The impacts are based on static modelling transposing the policy change on to a population that is modelled based on the current benefit system and claimants. There are no cash losers from this change, the differences are in entitlement under the new policy in the future.
16. Given that families are aware of the policy they may make the choice not to have (further) children. Therefore the numbers of families affected by the policy relates to this notional loss and is uncertain as behaviours may change to alter this number.
17. The model is run with and without the measures being applied to the relevant birth cohorts from 2017-18 onwards, families who have a third or subsequent child do not have an increase in benefit from a child element for that child. Cases of multiple births which breach the limit (e.g. a family with one child who has twins) are treated as a single birth for the purposes of the limit. The maximum notional entitlement in the child element is £2780 per child per year, for each third and subsequent child.

18. Households who would have previously had an increase in benefit from a new award of family element of Child Tax Credit will not see this happen from 2017-18 onwards. The maximum notional entitlement is £545 per year per family.
19. The estimates are produced on a "marginal cost" basis in respect of the transition between tax credits and Universal Credit. The savings are calculated on the basis that the tax credit system continues to exist through to 2020-21, with any additional savings arising from Universal Credit added to the tax credit savings. This is in line with standard tax credits/Universal Credit forecasting methodology which has been agreed with the Office for Budget Responsibility.
20. The static impact of applying the policy to the flow of new claims in Universal Credit is estimated by forecasting the number of affected benefit units using DWP's INFORM model<sup>1</sup> with volumes adjusted to be consistent with those in HMRC's Tax Credits Expenditure Forecast Model (TCEFM)<sup>2</sup>. These estimates are uncertain due to potential behavioural change and represent the households who will no longer see an increase in entitlement that they would have prior to this policy change.
21. This results in estimated tax credit and Universal Credit volumes as follows:

**Table 1: CTC and Universal Credit caseload impacted**

000s	2017/18	2018/19	2019/20	2020/21
Families limited to 2 children for child element of CTC and UC	160	350	510	640
Families no longer entitled to family element/first child premium in tax credits and UC	270	680	970	1,180

22. There are complex interactions between these savings from these measures and other measures announced in Summer Budget 2015. The savings estimates assume that the uprating freeze and the benefits cap have already been implemented, but the other measures announced (including changes to the taper rate and income threshold in tax credits) have not. The order in which policy measures are assumed to be implemented has been determined by methodological reasons.
23. The measures also interact with other policies such as existing HMRC operational measures, tax credits debt recovery and the existing Housing Benefit policy regime. The costs of these interactions have been calculated and are included in the figures below. The savings below and the caseloads from the preceding table are not on a directly comparable basis due to the complex nature of the interactions.

**Table 2: Exchequer savings as a result of changes to CTC, Universal Credit and equivalent changes in Housing Benefit**

£m	2016/17	2017/18	2018/19	2019/20	2020/21
Limit child element to 2 children for new births in tax credits and new claims in UC	0	315	700	1,055	1,365
Remove family element/first child premium in tax credits and UC, and the family premium in Housing Benefit, for new claims	55	220	410	555	675

<sup>1</sup> INFORM is a dynamic micro simulation model based on data from the systems which administer DWP benefits, Housing Benefit and Tax Credits

<sup>2</sup> The TCEFM is a micro-simulation, computing and comparing case level tax credits entitlement under the baseline with a reformed tax credits system. The static costing is the change in modelled tax credits entitlement across the complete sample (grossed) under the baseline and reformed systems.

## Longer term impact

24. If households continue to make the same choices about whether to have a family and family size as they do currently it is estimated that, once the policy is fully rolled out, approximately 3.7million households will have a lower rate of payment than would otherwise have been the case.
25. These are notional losses as changes will only apply to children born after 6 April 2017, and in Universal Credit where there are families making a new claim after this date. No one will see a fall in the cash they are receiving as a benefit payment as a result of these changes.

## Behavioural assumptions

26. The primary purpose of the Government's welfare policies is to help people move into sustained employment, whilst ensuring the system is fair to both recipients and non-recipients. The policy which limits the child element of CTC and Universal Credit to two children means that families on benefits will have to make the same financial decisions as families supporting themselves through work. In practice people may respond to the incentives that this policy provides and may have fewer children. There is no evidence currently available on the strength of these effects although the Institute for Fiscal Studies found a relationship between support for children in the benefit system and childbearing<sup>3</sup>.

## Distributional analysis

27. The policy has the impact of redistributing income from Universal Credit / tax credit recipients to the Exchequer (i.e. society as a whole). The policy therefore has distributional impacts.

## Impact on protected groups

28. Households that include someone with a protected characteristic (as defined by the Equality Act 2010) will be affected by this policy if they receive one or more of the affected benefits. Overall those groups who are more likely to be in receipt of affected benefits are more likely to be affected by this policy change.
29. The Universal Credit payment is made to the benefit unit, however on an individual basis women may be more likely to be affected than men. Around 90% of lone parents are women, and a higher proportion of this group are in receipt of CTC. Therefore they are more likely to be affected, in the absence of behavioural change.
30. Of households currently in receipt of any welfare benefit those which contain someone with a disability are less likely to have children, relative to those households which do not. Therefore of households in receipt of welfare those containing someone with a disability are less likely to be affected.
31. Ethnic minority households may be more likely to be impacted by these changes. This is because they are, on average, more likely to be in receipt of these benefits, and on average have larger families.

## Life Chances

32. The new Life Chances legislation (incorporated into the Welfare Reform and Work Bill) proposes to remove a number of the legal duties and measures set out in the Child Poverty Act 2010 and to place a new duty on the Secretary of State to report annually on children in workless households and the educational attainment of children. This is because evidence shows these to be the two main factors leading to child poverty now and in the future (respectively).

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<sup>3</sup> <http://www.ifs.org.uk/wps/wp0809.pdf>

33. The proposed changes enhance the life chances of children as they ensure that households make choices based on their circumstances rather than on taxpayer subsidies. This will increase financial resilience and support improved life chances for children in the longer term.