

Notional Entitlement – discussion document

March 2018

1. Further to our meeting on 9 March we have summarised the Notional Entitlement policy at **Annex A** to inform discussion at our next meeting.
2. In summary, HMRC simplified its approach to Notional Entitlement in Autumn 2016 following stakeholder consultation. This simplification improved the consistency of the application of Notional Entitlement. Following this change, the only remaining exceptions to consideration of Notional Entitlement were:
 - in cases of fraud in a previous year where a customer had been through the renewals process, or
 - where the customer had received Notional Entitlement in the past. As part of the simplification previous references to ‘negligence’ and ‘deliberate error’ were removed from staff guidance manuals.
3. A weekly scan of the tax credits system was introduced in Autumn 2016 to cross-check all awards which ended due to a change in the household composition against new awards to determine whether there has been a gap of more than 31 days between the two dates.
4. In communicating the simplification at the time we recognise that – by focusing on the changes we had made – the statement we shared with you in February 2017 was not wholly complete and did not reflect the distinction between Notional Entitlement offered in the current year and in the previous year in the cases relating to fraud.
5. This note:
 - Summarises revisions made to the Notional Entitlement policy in Autumn 2016 with reference to the previous communications; and
 - Provides the published definition of fraud for tax credits purposes (see **Annex C**) which relates to Notional Entitlement provided to claims in a previous year.
6. **As a next step we are keen to work with our stakeholders to clarify the rules on Notional Entitlement and improve guidance as appropriate.**

Annex A – Summary of Notional Entitlement Policy

1. Notional Entitlement is applicable where we find that someone has been making a single claim for tax credits, when they should have made a joint claim with their partner (or should have made a single claim having split from their partner), and the customer would have been entitled to tax credits had they claimed on the correct basis. Notional Entitlement is the process whereby HMRC identifies the amount the customer would have received had they claimed on the correct basis, and reduces the amount overpaid by this amount. The aim is to put the customer in the position they would have been in had they claimed correctly in the first place. They may also be charged penalties for their incorrect claim.
2. As we set out in our February 2017 message (**Annex B**), if we find out about a change in the adult composition of the household during the year it occurs, then HMRC will look at whether we can use Notional Entitlement to offset the overpayment caused by the change in the household. **We will do this regardless of the circumstances.** We will offer it proactively, and not wait for the customer to apply for it.
3. **Where we find out about a change in a previous year (PY), we will still offer Notional Entitlement in the vast majority of cases.**

Distinction between the current and previous year

4. We will not apply Notional Entitlement in the previous year if the customer has acted **fraudulently (i.e. where we have evidence that the customer has set out to mislead HMRC)**, or if the customer has been given Notional Entitlement in the past. By fraud we mean the HMRC published definition of fraud in respect of tax credits.
5. The change that was introduced in 2016 was that HMRC will take the view that where the undeclared change of household status took place during the current year, we will not consider this to be fraudulent.
6. This is because in deciding whether a customer has acted fraudulently, we take into account whether they have had the opportunity to consider their annual award at renewal. If they have had this opportunity, and nonetheless not corrected their award, then that is an indicator of fraud, to be considered alongside the other evidence gathered from the check.
7. If the award is wrong as a result of a change in household status during the current year, then the evidence is less strong, as the claimant has not gone through the renewal process. We therefore work on the basis that those cases where we correct household status prior to renewal are not fraudulent. This means we will apply Notional Entitlement for Current Year cases, provided the other requirements are met. Only where the change in household status was in the previous tax year, and has not been corrected, will HMRC withhold Notional Entitlement in cases of fraudulent behaviour or where it has been given in the past.
8. This does not extend to “negligence”, where the customer has merely been careless, and we will correct any references to “negligence” in guidance. Again HMRC will offer Notional Entitlement proactively where customers are eligible.
9. For the purposes of Notional Entitlement the current year (CY) is not restricted to a strict 12 months. CY can run for a period of up to 16 months, from 6 April in the tax year for which the customer makes

the claim until the first specified date (1SD – 31 July) in the following tax year. Until the customer finalises their award, HMRC will not consider that they have acted fraudulently.

Notional Entitlement and penalty regime

10. Following the recommendation in the 2017 Adjudicator's Report that HMRC should make increased use of the penalty regime we have taken steps to distinguish the Notional Entitlement process from the process for determining whether a penalty should be imposed. In the majority of cases compliance activity would have uncovered the change in household composition that necessitated the end of the award. We would only determine whether a penalty should be applied once all compliance activity has been concluded. The amount of penalty imposed would depend on whether or not there was evidence that the customer's behaviour was fraudulent. There is discretion to impose a lesser penalty on the grounds of late notification in cases where the household breakdown occurs in the current year, as such cases would not be treated as fraudulent. In contrast consideration of Notional Entitlement would be conducted once a new award had been made in the correct capacity. All cases with potential eligibility to Notional Entitlement are referred for consideration. However, if there had been evidence of fraud found as a result of the compliance activity conducted on the previous award Notional Entitlement would not be granted.
11. When HMRC applies Notional Entitlement, we are using the discretion we have in law to not collect an overpayment where legally we could. It is not appropriate to use this discretion in cases where a customer has knowingly misled HMRC, or where they have previously been given an opportunity to put their claim on the right footing but decided not to.
12. We recognise that there is a balance to be struck in creating an ethos of ensuring that customers receive the correct entitlement, promptly reporting a change while at the same time also demonstrating that HMRC will not accept the deliberate misuse of public funds. The changes to the Notional Entitlement in 2016 go a significant way to deliver this, by ensuring that any change of household reported before renewal will be considered for Notional Entitlement, regardless of behaviour.

Definition of fraudulent

13. HMRC's definition of fraud in the context of tax credits is detailed in the published Claimant Compliance Manual and is reproduced in **Annex B**.

References to Notional Entitlement Policy

14. Notional Entitlement is covered in HMRC's Code of Practice 26 (COP26): *"If you've started a new claim we may consider reducing the amount that you have to pay back. We'll work out how much you would have been paid in your new claim if you'd told us about the change on time and take that amount off your overpayment."* Whilst COP26 does not refer to fraud or fraudulent behaviour, the text states that Notional Entitlement is at HMRC's discretion.
15. Additionally, guidance about withholding Notional Entitlement is given in the Claimant Compliance Manual extracts of which can be found on GOV.UK. We are currently in the process of removing the reference to 'negligent' behaviour in all our guidance.
16. The Adjudicator made reference to HMRC's change in Notional Entitlement Policy in their 2017 report. The discussion with the Adjudicator's Office and their subsequent report focuses on the Current Year process. The Previous Year process remains as originally intended, in that we do not consider Notional Entitlement in cases of fraudulent or repeated behaviour.

Annex B – Statement provided to BCCG on 16 February 2017

Notional entitlement was introduced a number of years ago. It is clear that, since its introduction, HMRC has moved further away from the original policy intent of the notional entitlement measure in terms of:

- the classification of “deliberate error”;
- administering Notional Entitlement in a proactive environment with the intention to reduce Debt;
- inconsistencies in when Notional Entitlement is applied.

We have now revisited that intent and, with effect from Autumn 2016, HMRC will ensure that the application of Notional Entitlement is applied to any overpayment which has occurred due to a change in the adult composition of the household in the current year – regardless of why the customer had not told us. HMRC will also be pro-active in applying the Notional Entitlement criteria, as opposed to the current practice of relying on a request from the customer. In addition, we will explain about Notional Entitlement in the letter we send to the customers who are changing their household makeup when we close their previous claim to Tax Credits.

A scan is now in place which cross-checks all house-hold breakdowns with the National Insurance Numbers (NINOs) on all new claims to ensure we capture and test all customers with potential eligibility.

Annex C – HMRCs definition of Fraud for tax credits purposes

This guidance is published in the claimant compliance manuals, intended for HMRC staff use, extracts of which can be found on GOV.UK at <https://www.gov.uk/hmrc-internal-manuals/claimant-compliance-manual/ccm10750>

Penalties and interest: incorrect claims - meaning of fraudulent behaviour

Where an over-claim arose from an error which was the result of fraudulent or non fraudulent behaviour we will charge a penalty *[Withheld]*

An over-claim will be treated as fraudulent or non fraudulent behaviour where one of the following errors is made in a pre award, post award or enquiry case *[Withheld]*

- Claiming for a fictitious child or children, or the wrong number of children.
- Claiming for child care costs when no childcare is paid for.
- Claiming (on a new claim or renewal) that a child is in full-time education when they are already working.
- Claiming to be working when the customer is not working; or claiming to be working over 16 or 30 hours when the customer does not work those hours, has not done so in the recent past and has no intention of doing so.
- Claiming for the disability element when the customer is clearly not entitled.
- Understatement of income where there was no basis for the amount of income declared.
- Omission of a source of income.
- Any other wrong declarations where the information concerns the customer's own circumstances which they can be reasonably expected to know; for example, claiming as a single person when it was clear that a joint claim should have been submitted, such as being married with no reason to think that the claim should have been anything other than a joint claim.

See [CCM10755](#) for examples of fraudulent or non fraudulent behaviour.

If you have determined the behaviour is fraudulent or non fraudulent or/and you are using an S17 notice to finalise one year and set initial payments for the CY see [CCM10810](#)

[Withheld]