The complicated transition to universal credit

Personal tax

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It is no longer possible to claim tax credits. We provide an update on the complicated transition to universal credit.

Key Points

What's the issue?

It is no longer possible to make a brand new tax credits claim. Instead, those needing financial support must claim universal credit or pension credit (depending on their age).

What does it mean for me?

Tax advisers who have clients claiming tax credits need to be aware of the situations where a universal credit claim may be triggered and the plans to migrate tax credit claimants across to universal credit.

What can I take away?

A better understanding of the transition from tax credits to universal credit and how it will potentially impact clients.

Universal credit is replacing six legacy benefits including working tax credit and child tax credit. It is administered by the Department for Work and Pensions (DWP). HMRC states that it is no longer possible to make a brand new claim for tax credits. Instead, people will need to claim universal credit or pension credit (depending on their age). The only exception to this is for certain people who are granted backdated refugee status.

Single claimants who have reached state pension age and couples where both partners have reached state pension age cannot claim universal credit but may be able to claim pension credit instead. Mixed age couples (where one partner has reached state pension age and the other has not) usually have to claim universal credit, unless the couple were claiming housing benefit under pension age rules on 14 May 2019 and certain conditions are met. In that case, they can choose whether to claim universal credit or pension credit.

Universal credit: a summary

Universal credit is fundamentally different to tax credits. Some of the main differences are:

- Universal credit is assessed and paid monthly, unlike the annual tax year assessment period for tax credits.
- There are no working hours thresholds in universal credit, as there are in working tax credit. Universal credit is for those both in and out of work.
- The income rules have some significant differences. Perhaps the main one is that universal credit is calculated on net income (after tax and NIC and qualifying pension contributions), whereas tax credits are based broadly on gross income (less qualifying pension contributions). In universal credit, unearned income reduces the amount of the award pound for pound. Some claimant groups have a work allowance so earnings below that do not affect their award. Beyond that, 55% of earned income over the work allowance reduces the award. Overall, the amount you get is based on your income and circumstances.
- Universal credit has conditionality rules. This means that, with some specific exceptions, claimants (including both members of a couple) will be expected to look for work until their earnings reach, in most cases, 35 hours at the national minimum wage.
- Universal credit has capital rules, meaning that it is not available to those with capital of £16,000 or more. Capital between £6,000 and £16,000 attracts a tariff income by adding £4.35 of monthly income for each £250 (or part thereof) in excess of £6,000. By comparison, tax credits do not take account of capital, but any return on the capital is treated as investment income (except for the first £300 of household income from savings and certain categories of other income, which is disregarded).

Existing tax credit claimants

Those already claiming tax credits can continue to renew their claims, add new elements to existing claims and add working tax credit to a child tax credit claim and vice versa. These are not counted as brand new claims.

Existing tax credit claimants will be affected by universal credit if they:

- **Choose to claim universal credit:** Some people are better off getting universal credit than tax credits. It is possible to voluntarily claim universal credit. Claimants should seek advice from a welfare rights specialist before choosing to leave tax credits for universal credit, as there are many issues to consider aside from which benefit is better financially, as the universal credit rules are different to tax credits.

- **Have a change of circumstances:** If a tax credit claimant has a change of circumstances that ends their tax credit award, they will need to claim universal credit (or pension credit) for ongoing financial support. Similarly, if their circumstances change such that they need additional financial support, for example help with their rent, in most cases they will need to claim universal credit instead of housing benefit. When the universal credit claim is made, any tax credit award will end.
- **Fail to renew an existing tax credits claim:** If a tax credit claimant fails to renew their tax credit claim under the normal renewals process (or misses the 30-day grace period deadline and the good cause provisions do not apply), they will have to claim universal credit (or pension credit) to get continued financial support.
- **Are moved across to universal credit by the DWP or HMRC:** Over the next couple of years, the DWP will contact legacy benefit claimants asking them to claim universal credit. This is the formal migration exercise and will involve the DWP sending claimants a migration notice. This will tell them to make a claim for universal credit by a certain deadline and notify them that their existing legacy benefits will terminate (either at the point they make the universal credit claim or after the deadline passes if they have not made a claim).

The government has said that, under the formal migration exercise, no one should be financially worse off at the point they move to universal credit from legacy benefits. This commitment is given effect through transitional protection. The main point to note here is that those who choose to make a claim for universal credit or who move to universal credit due to a change of circumstances will not get transitional protection.

Transitional protection includes a transitional element added to the universal credit award and a transitional capital disregard. This is only available to those who are moved across by the DWP or HMRC. The only exception to this is for those who have a severe disability premium in certain legacy benefits (not tax credits), who may qualify for a transitional severe disability premium element if they claim universal credit outside of the formal managed process.

Managed exercise

The DWP started testing the managed process in Great Britain in July 2019. It was ;suspended in March 2020 due to the pandemic. The work resumed in May 2022 and, at the time of writing, the DWP has been sending out notices to small numbers of claimants in different areas to test the processes.

Numbers are expected to gradually increase until migration is complete by the end of 2024. Regulations have also been laid in Northern Ireland for a mirror process to take place.

In summary, the legislative process for ;the managed exercise involves the DWP ;sending a letter (‘migration notice’) to ;a legacy benefit claimant asking them to ;make a claim for universal credit. They ;have three months to do so, although this can be extended in certain circumstances.

If a universal credit claim is not made within the time specified in the letter, legacy benefits (including tax credits) will be terminated at the end of the period. If ;a ;universal credit claim is made within the specified period, the DWP must determine whether the transitional capital disregard applies or a transitional element is to be included in a universal credit award before they make a decision on the claim.

Transitional capital disregard

Normally, anyone with capital over £16,000 is not entitled to universal credit. There is no corresponding rule in tax credits and so it is entirely possible that tax credit claimants may have capital over £16,000.

Broadly, under the managed migration process, tax credit claimants are protected from the capital ceiling in universal credit for up to 12 assessment periods from the date of their universal credit claim. This only applies if the claimant had capital exceeding £16,000 on migration day (which is the day before the first day on which the claimant is entitled to universal credit in connection with that claim). The disregard means that any capital over £16,000 is ignored for up to 12 ;assessment periods both in determining whether the financial conditions for universal credit are met and in calculating the amount of the award. However, any capital between £6,000 and £16,000 is not disregarded and will still attract tariff income.

Transitional element

Broadly speaking, the DWP will compare the amount a person receives through their legacy benefits with the amount they would receive from universal credit using the same income and circumstances.

However, the way that transitional protection is calculated is complex. The exercise uses a ‘total legacy amount’ and an ‘indicative universal credit amount’ in the calculation of transitional protection. These amounts may or may not be the same as the claimant actually receives in legacy benefits and/or will receive in universal credit, although in some cases they could be similar.

If the amount from the ‘total legacy amount’ is more than the ‘indicative universal credit amount’, the difference is calculated and added to the universal credit award. Importantly, the DWP will compare **all** legacy benefits that a person may be receiving, not just tax credits.

Any transitional element awarded is not permanent. It will be eroded when there are changes to the underlying universal credit award; for example, where additional elements are added or there are increases to elements. Certain changes of circumstances can also bring an end to the transitional element.

Finalising tax credit claims

If a universal credit claim is made in a tax year in which there is a tax credit award, then tax credits will be finalised using the ‘in-year finalisation’ process. Most tax credit claimants are familiar with the usual end of year finalisation process. After the end of the tax year, HMRC usually asks the person to declare their income for the year that has just finished (either as an estimate or actual figure) and then the final amount of the tax credit award can be calculated. For many self-employed claimants, an estimate will be provided by the 31 July renewal deadline. An actual figure will be given by the following 31 January, once the information is available from their tax return.

However, under the in-year finalisation process, HMRC will finalise tax credit awards during the year. Claiming universal credit will cause a tax credit award to terminate. This should be automatic, but it is still sensible for claimants to contact HMRC if their award does not end. As soon as this happens, HMRC will send out in-year finalisation forms to allow them to finalise the claim for the period from 6 April to the termination date.

However, because this is happening during the tax year, new rules were introduced to measure income for that part-year period. There is a two step process:

- Firstly, HMRC will find the part-tax year income (as defined in regulations). For most types of income, this will be the income actually received in the part tax year, but there are special rules for calculating self-employed income.
- The second step involves using that part-tax year income to calculate a notional current year income which is then compared to the previous year income, applying the relevant income disregards.

The outcome of this process is that tax credit claimants may end up with unexpected overpayments or underpayments of tax credits because it uses pro-rated part-year figures.

For the self-employed, the rules are complex. Most self-employed people are accustomed to using the figure from their tax return as their annual self-employed income for tax credits.

Under the in-year finalisation rules, the legislation says that the individual's self-employed income is the 'amount of the actual or estimated taxable profits attributable to that part tax year'.

These actual or estimated taxable profits are called the 'relevant trading income' and are calculated by reference to the basis period ending during the tax year in which the claimant made, or was treated as making, a claim for universal credit. The actual or estimated figure for the basis period is divided by the number of days in the basis period to get a daily figure, which is then multiplied by the number of days in the part tax year on which the trade was carried on. This figure will then feed into the calculations explained above.

However, not everyone will know their actual profit figure for the basis period at the point they move to universal credit. In ;such cases, the individual will need to estimate their income for that period. The ;legislation does not give any indication of how an estimate is to be calculated, nor does it say what happens if the estimate is wrong.

The TC603URD guidance notes (see bit.ly/3Ejek1h) state that a realistic and reasonable estimate should be provided. HMRC suggests that the claimant keeps a note to show how the estimate was made. The guidance notes explain the relevant steps for doing the calculations. Advisers not familiar with in-year finalisation should ensure that they read the guidance, given the large difference as compared to the usual finalisation rules.

Unlike the normal end of year finalisation process, which allows claimants to provide an estimate and then confirm an actual figure by the following 31 January (the second specified date), this is not possible in the in-year finalisation process. The figure given initially is the figure that will be used to calculate the final award. It cannot be changed unless under enquiry powers or appeal.

Example: Tax credits in-year finalisation

This example demonstrates the calculation of self-employed profits.

Mason has a basis period covering 1 May 2021 to 30 April 2022. He claims universal credit on 1 November 2022. His profit for that basis period was £10,000. Mason's relevant trading income (his part year income from self-employment) will be:

£10,000/365 x 209 = **£5,726.02**

Pensioners

As yet, it is not clear what will happen to those tax credit claimants who have reached state pension credit age and who cannot claim universal credit. We expect a similar process to move those claimants to pension credit, but it should be noted that the pension credit rules are very different to tax credits. There are no equivalent elements to working tax credit.

Self-employment and universal credit

Finally, the rules for the self-employed in universal credit are very different to tax credits. Advisers with clients claiming tax credits should ensure they are familiar with the universal credit rules and the key differences. For example, universal credit works on a cash basis and self-employed claimants must report their income and outgoings (as defined by universal credit legislation) after the end of each monthly assessment period.

In addition, universal credit has a 'minimum income floor'. Where the minimum income floor applies, those who earn beneath it will have their actual income ignored. Instead, the minimum income floor figure (in many cases 35 ;hours at the national minimum wage, less notional tax and NI) will be used in the calculation of their universal credit claim.

Universal credit does not work particularly well for self-employed individuals who have fluctuating income and expenses through the year. LITRG's website (see www.revenuebenefits.org.uk) has more detail on how universal credit works for the self-employed.

Although outside of the scope of this article, note that those with their own limited companies may be caught by 'look-through' provisions in universal credit, which means that they are effectively treated as self-employed and the company structure is ignored. This means the minimum income floor may apply to them as well.

Conclusion

The transition from tax credits to universal credit is complicated. Tax advisers with self-employed clients who claim tax credits are likely to be familiar with the tax credit rules, as they largely mirror the tax system. The move to universal credit means that advisers need to understand when a claim to universal credit may be triggered, how tax credits awards are finalised when someone moves to universal credit, and what happens when their clients will eventually be moved.

This is a constantly changing area and it is likely that there will be further adjustments as the DWP slowly increases numbers in the managed migration process.