

PSCC Decisions – Classification of Tax Credits

Background

The Public Sector Classification Committee (PSCC) was asked to consider the classification of tax credits in anticipation of proposed reform of the tax credit system.

The intention to introduce two new tax credits, the Working Tax Credit and Child Tax Credit, was announced in Budget 2000. Following public consultation, the Tax Credits Bill was introduced to, and is currently being considered by Parliament. The rates and the thresholds for the new tax credits will be announced in Budget 2002. The introduction of the new tax credits is planned for April 2003.

This classification decision is based on information in the Bill and will be reconsidered if there are any relevant amendments to it. The decision on classification has been announced now, since it will affect economic forecasts included in Budget 2002.

Household Tax Credits

The Tax Credits Bill provides for the introduction of two new tax credits: the Child Tax Credit and the Working Tax Credit. These will replace a mixture of tax credits (Working Families' Tax Credit, Disabled Person's Tax Credit and the children's tax credit) and social benefits (the New Deal employment credit for those aged fifty or over and the child and family elements of both Income Support and income-based Jobseeker's Allowance).

ONS's Public Sector Classifications Committee has decided that both the proposed new tax credits will be classified as:

- negative taxation for the amounts where the credit is less than or equal to the tax liability of the household; and as
- public expenditure for the amounts that exceed the liability.

Both the Working Families' Tax Credit and the Disabled Person's Tax Credit are classified as social benefits rather than tax reduction in National Accounts because they are not an integral part of the tax system. Both evolved from certain social security benefits and continue to share features with the social security system. The period of assessment for entitlement is not aligned with the period of assessment for tax. Similarly, the length of awards is not aligned with the tax year. Awards remain fixed for six months after an initial assessment, and do not change relative to the level of income as income tax does. Many of the underpinning definitions, such as those for "households" and "families" continue to be based on social security definitions.

The proposed new tax credits will be fully integrated into the tax system. The measure of income will be more closely aligned with the measure of income used for tax purposes, and entitlement will be based on annual income in a tax year. Entitlement and payments will adjust during the year to reflect changes in income and circumstances. Social security definitions of households and families will no longer be used. Instead, the new credits will use the same definition of "couples" that is now used for the married couples' allowance, the children's tax credit and elsewhere.

No retrospective revision of the classification of Working Families' Tax Credit is needed.

The classification decision is consistent with that worked out by OECD and supported by IMF. Eurostat's National Accounts Working Party agreed the OECD work in June 2001.

National Accounts classification of other tax credits, such as MIRAS, are unchanged

For more information on the new tax credits see
www.inlandrevenue.gov.uk/consult_new/new_tax_credit.htm

Corporation Tax Credits

Corporation tax credits are currently available for spending by small and medium sized enterprises on research & development and on cleaning up contaminated land. In both cases companies may claim enhanced relief: 150 per cent of what they spend instead of the usual 100 per cent. Companies that have no net tax liability can claim a payable tax credit. The public sector classification committee has decided that these should be classified as follows:

- payable tax credits will be treated as public expenditure, as a government payment of a capital grant in the case of land contamination and as a subsidy on production for research & development;
- if companies pay net tax, or have refunds that are lower than the enhanced part (e.g. that covering the additional 50 per cent enhancement of the expenditure), the non-enhanced part will be a tax relief and the enhanced part will be public expenditure.

The new corporation tax credits proposed in the 2001 Pre-Budget Report, such as the Research & Development Tax Credits for larger corporations, will be classified in the same way if they are introduced.

For more information on the Research & Development Tax Credits for small and medium sized enterprises see www.inlandrevenue.gov.uk/r&d/index.htm

National Statistics

The processes that National Statistics uses to determine sector classifications support the National Statistics' Code of Practice. The objectivity of statistical methods are assured, with criteria adopted based on international best practice and on advice of experts from within and outside of government. Decisions and the reasons for them have been made publicly available and announced in advance of the release of any statistics, or forecasts of any statistics, based on them.

Future Classification Decisions

The ONS will in future be making public all non-confidential decisions made by the Public Sector Classification Committee. These will be publicised in a section on the Public Sector Accounts page of the National Statistics website www.statistics.gov.uk . This service is expected to start in the summer.
