

Assessing capacity to pay child maintenance: the UK formulae, paying parents and poverty

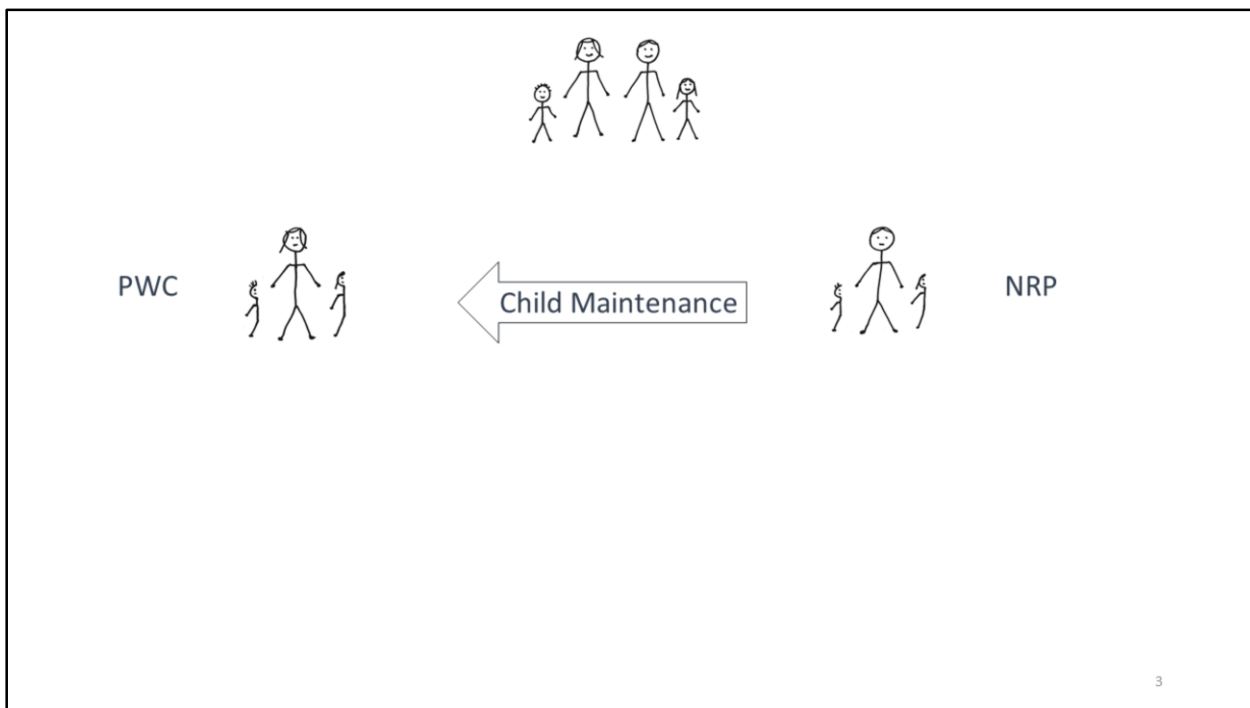
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About four years ago I received a 'phone call from a distressed mother. Her son, a loving and fully committed father who had always paid his way, was faced with a CSA (Child Support Agency) demand for an amount that he could not possibly pay. After paying child maintenance, housing costs and travel to work he was left with just £1 a day to live on (1.4 euro, 1.6 \$, 2 Australian \$). That 'phone call was the prompt for all that has followed.

My understanding has grown over the years and I want to share that understanding with you today. How and why has a situation arisen where parents on low income cannot afford to pay the calculated child maintenance amounts, can find themselves better off when out of work, and that working more hours leaves them with less money.

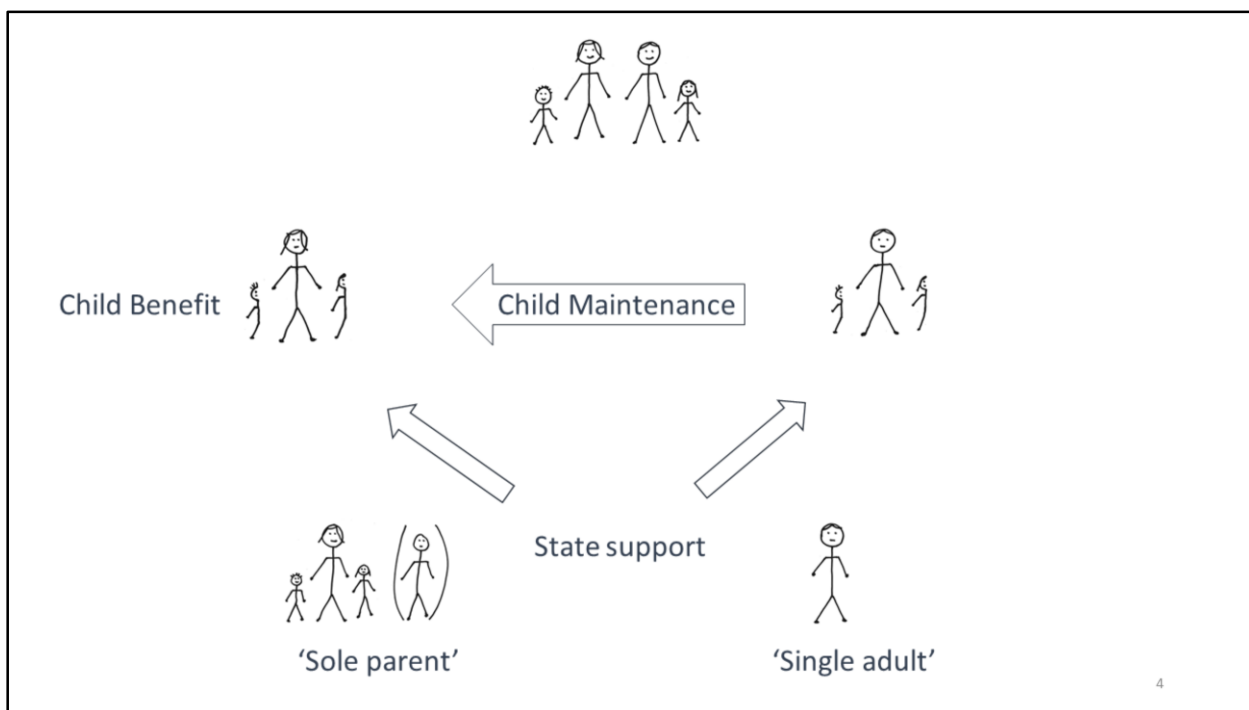
Questions

- Is it true that
 - maintenance amounts cannot be paid by parents on low income?
 - such parents can be better off out of work than with a job?
 - more hours in work can mean less money?
- If it is true, how and why has this happened?



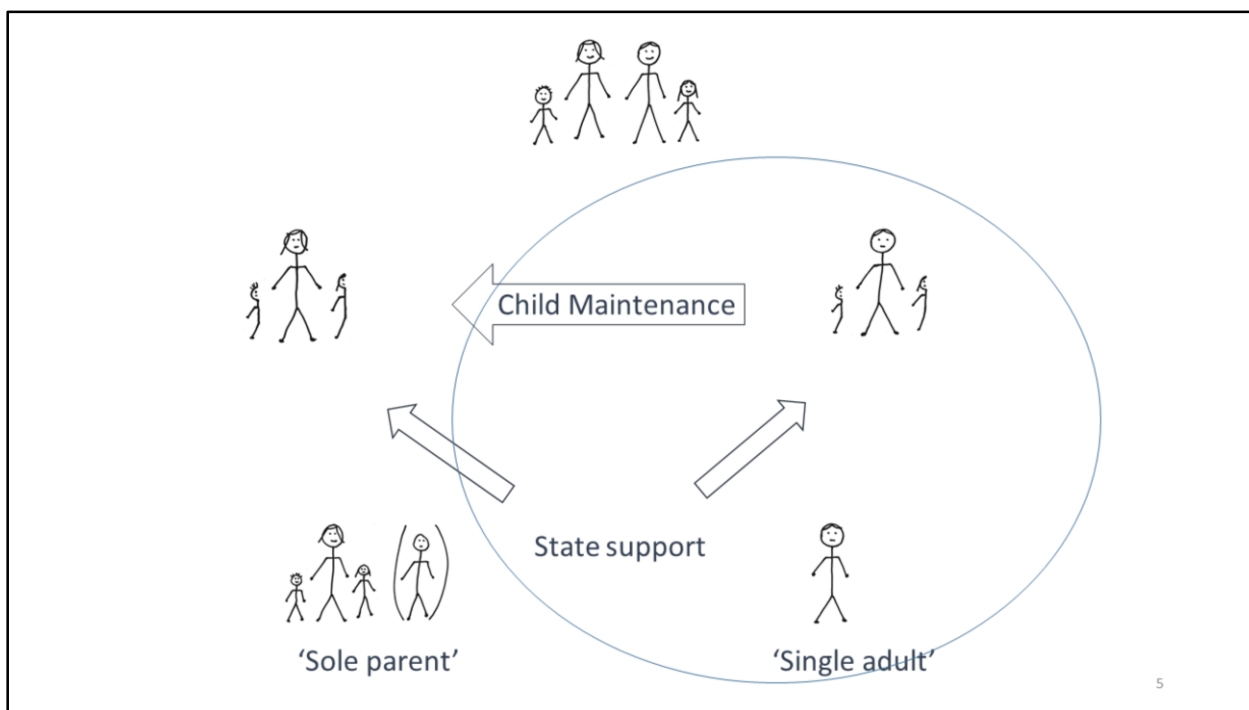
Relationships do break down and families separate. It is estimated that in the UK up to a third of children grow up in separated families. Research has shown that children do better if, following separation, they are able to have the support of both parents. The Government has invested in schemes to help separating parents achieve this.

Arrangements may involve the transfer of money. If this is through the current statutory scheme, then it flows from the parent with less 'care' to the parent with more. No account is taken of the income of the PWC.



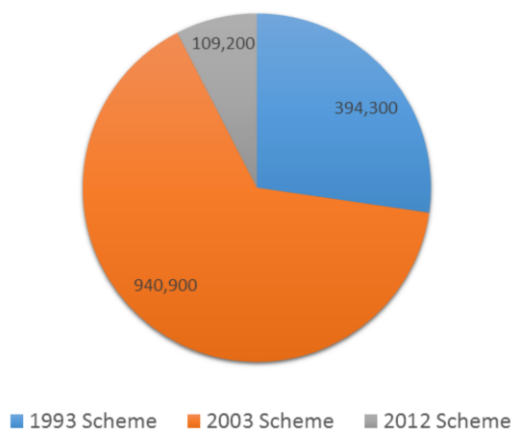
Most of the parents on the statutory schemes are on low income. State is likely to make up a considerable part of the family income when they are together. After they separate the PWC is treated as a 'sole parent' as regards state support, even if the care of the children is shared equally between the parents. In contrast, the NRP is treated as a single person.

No account of the Child Maintenance payments is taken when calculating the state support for the PWC or the NRP.



I'm looking today at the situation of an NRP on low income, paying maintenance on one of the statutory schemes and how these payments interact with the state welfare system.

Statutory Child Maintenance – three Schemes
1,444,500 parents [Feb/Mar 2015]



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There are THREE SCHEMES currently in operation in the UK – introduced in 1993, 2003 and 2012.

65% of the parents are on the 2003 Scheme; more than a quarter of the current cases are still on the 1993 Scheme. The 2012 Scheme opened in December 2012, initially in a restricted way, then to all new applications in November 2014. Closure of the 1993 and 2003 Schemes began in June last year and is expected to take about three years.

CASES ARE 'CLOSED' RATHER THAN 'TRANSFERRED'. Parents will be encouraged to work together to see if they can come to a 'private' or 'family' arrangement. The statutory child maintenance scheme remains as a 'fall-back' for those who are unable to agree. There are incentives for parents to sort out their own arrangements in the form of an APPLICATION FEE (£20) paid by the parent seeking child maintenance and COLLECTION FEES (4% for the receiving parent, 20% for the paying parent) if the payments are made through the CMS (Child Maintenance Service) rather than 'directly'.

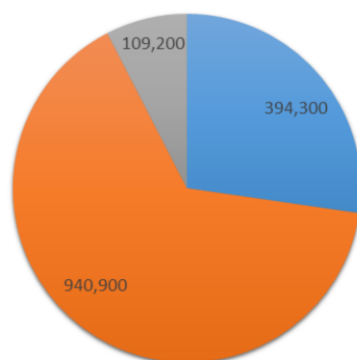
[Child Support Agency quarterly summary of statistics: March 2015](#)

[2012 statutory child maintenance scheme: Aug 2013 to Feb 2015 \(experimental\)](#)

Statutory Child Maintenance – three Schemes
1,444,500 parents [Feb/Mar 2015]

Two welfare systems

- Present system – includes tax credits, housing benefit ...
- Universal Credit (UC)



Different family situations

■ 1993 Scheme ■ 2003 Scheme ■ 2012 Scheme

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The situation is further complicated in that the welfare system that was introduced in 2003 is now gradually being replaced by Universal Credit.

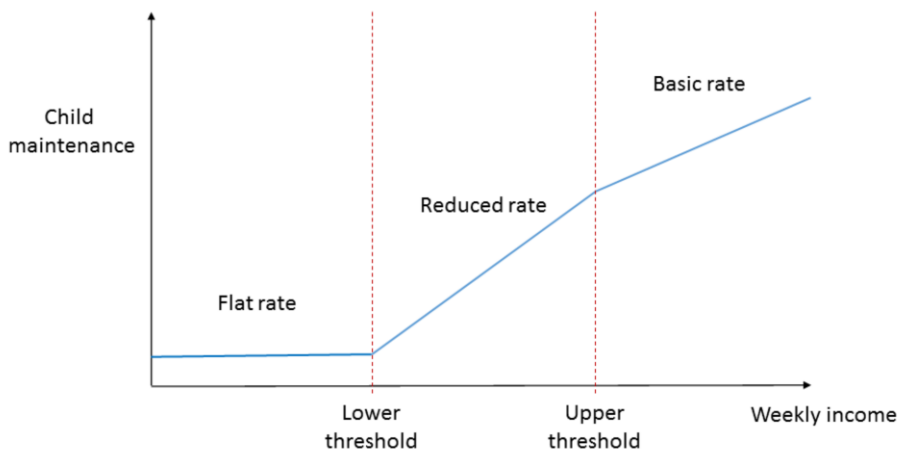
And, of course, there will be different family situations – the NRP may have a new partner and/or children.

I will consider just the 2003 and 2012 Schemes – these have the same essential structure.

Outline of presentation

- Structure of 2003 and 2012 Schemes
- Impact of 2003 Scheme (for un-partnered NRP)
 - In 2003
 - In 2015
- Changes produced by 2012 Scheme
- Changes produced by Universal Credit

Structure of 2003 and 2012 Schemes



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Weekly income - 2003 Scheme - NET income (including some tax credits)
2012 Scheme - GROSS (taxable) income.

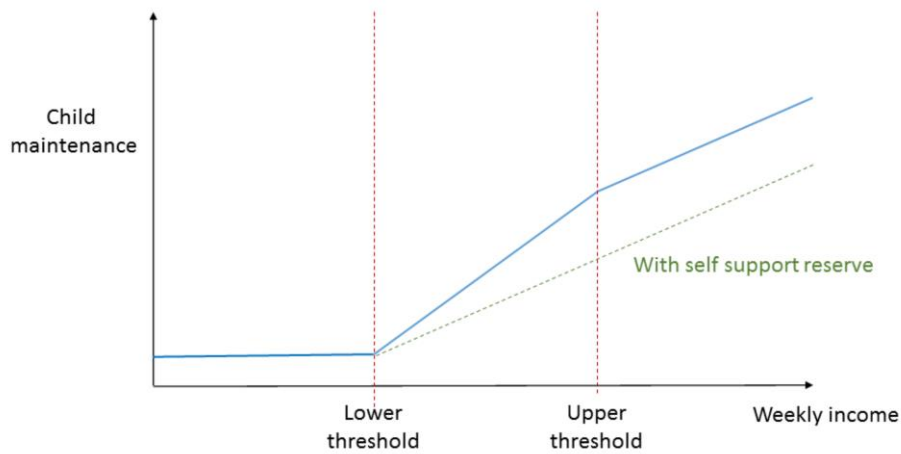
BASIC RATE - a percentage of the weekly income of the paying parent with different percentages for different numbers of 'qualifying children'
2012 Scheme percentages chosen to give maintenance amounts comparable with those of the 2003 Scheme.

FLAT RATE - a small fixed sum irrespective of the number of children.

REDUCED RATE - a 'catch-up' region - slope of the graph show that the maintenance payment increases quite rapidly in this region

Percentage in the Basic Rate is of the **WHOLE** income – there is no **SELF-SUPPORT RESERVE** or **ALLOWANCE**.

Structure of 2003 and 2012 Schemes



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A self support reserve and no “catch-up” region would produce lower child maintenance payments.

Underlying structure is crucial in what follows.

2003 Scheme

	Net weekly income	Maintenance
Nil rate	< £5	£0
Flat rate	£5 - £100	£5
Reduced rate	£100 - £200	£5 + 25, 35 or 45 % of income above £100
Basic rate	> £200	15, 20 or 25 % of income

The different percentages refer to 1, 2 or 3(or more) qualifying children

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Will not say anything about the choice of percentages (although there are interesting things to be said).

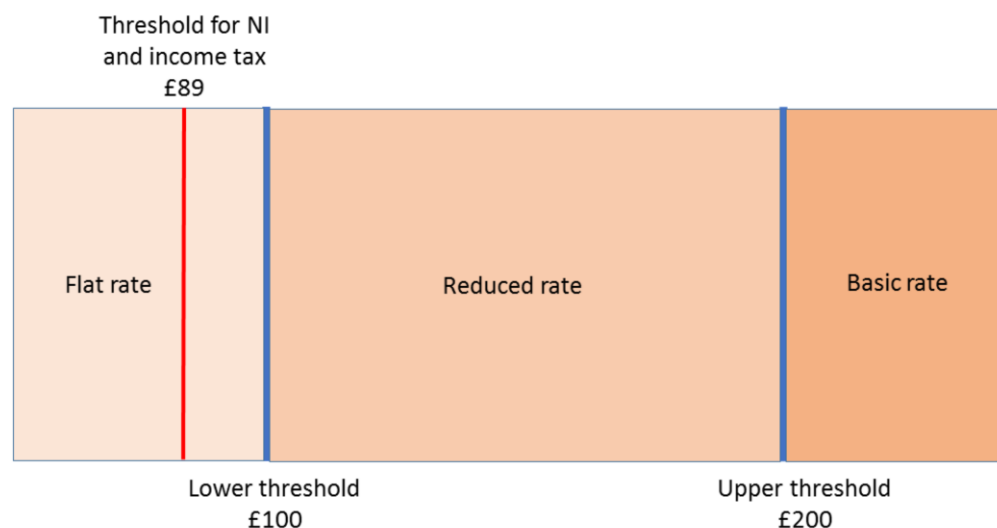
Two thresholds values of £100 and £200 given in the 1998 Green Paper - still in use day, 17 years on – and carried through into the 2012 Scheme.

Fixing of the threshold values is likely to cause problems

Many changes since 1998

Situation in 2003 ... problems go right back to then.

In 2003

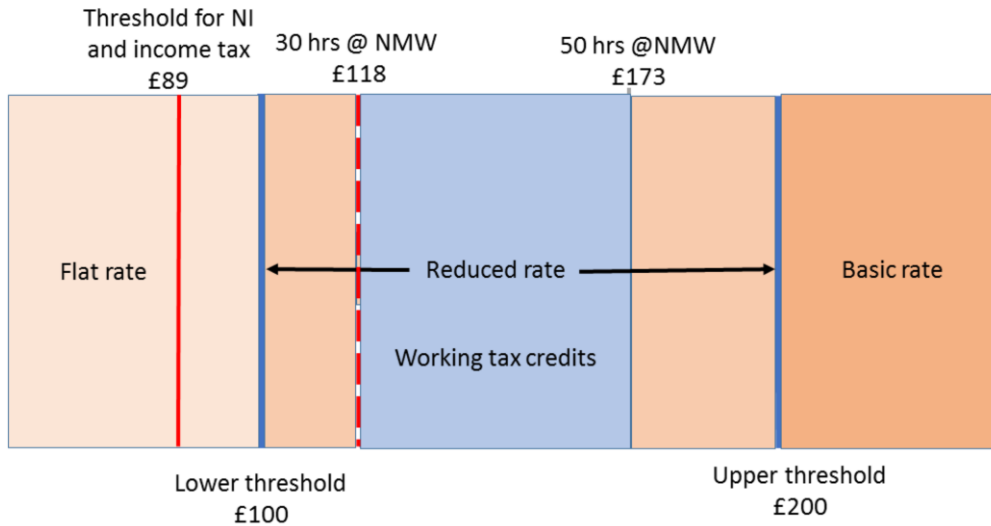


Two thresholds at £100 and £200 separating the 3 rates of child support

Also the threshold (£89) at which National Insurance and Income Tax (10 % starting rate) became payable

Add to this ...

In 2003



... a big blue region which covers more than half of the 'reduced rate' range.

Blue region shows the range of eligibility for Working Tax Credits - introduced in 2003 for single people over 25 working more than 30 hours a week.

NMW here stands for National Minimum Wage – this had been introduced in 1999. Blue region extends from 30 hours at NMW to 50 hours at NMW

[30 hrs at the NMW of £4.20 gives a gross income of £126 (the start of the 22% rate Income Tax) and a net income of £118.

50 hrs at NMW gives a gross income of £208 gross and a net income of £173.]

Let's look at the impact on the income of a paying parent ...

In the blue region - 30 and 50 hours at NMW - for every £1 earned, deduct

National Insurance	11p
Income Tax	22p
WTC withdrawal	37p
Child Maintenance (25, 35 or 45% of 67p)	17, 23 or 30p
Total deductions:	87, 93 or 100p

Gain to the non-resident parent: 13p, 7p or nothing

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Note that the child support payments DID NOT GO to the other parent, the 'parent with care' (PWC). In 2003 the PWC was allowed to keep the first £10 of any child support payments, the remainder being retained by the state. That £10 would have already been exceeded.

In the blue region - 30 and 50 hours at NMW - for every £1 earned, deduct

National Insurance	11p		
Income Tax	22p	⇒	to State
WTC withdrawal	37p		

Child Maintenance	17, 23 or 30p	⇒	to State
(25, 35 or 45% of 67p)			
Total deductions:	87, 93 or 100p	⇒	to State

Gain to the non-resident parent: 13p, 7p or nothing

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So in one way or another, for every £1 of additional income 87p, 93p or 100p would go to the state.

It is sometimes worth spelling things out.

2003 Scenario

Tom	Dick	Harry	all with 3 children
30 hrs	40 hrs	50 hrs	all at NMW

All with the same income?

No – the 2003 Scheme also deducts 45% of Tom and Dick's WTC

So Harry has more money than Dick who has more than Tom

but only because Tom and Dick keep only 55% of their WTC

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Tom, Dick and Harry would all have the same income were it not for one thing - the 2003 Scheme includes the WTC in the net income.

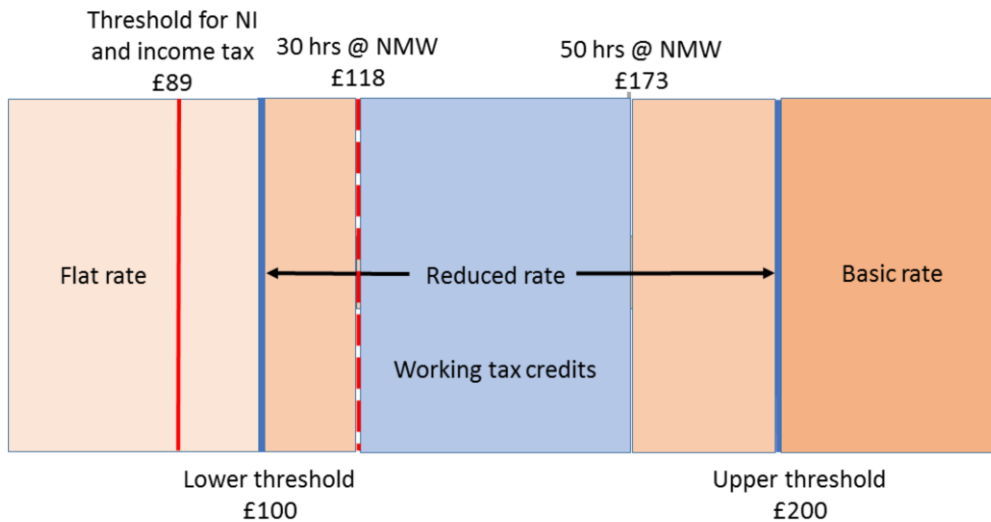
So 45% of the WTC entitlement of Tom and Dick is also taken.

We need to remember that WTC were introduced to reduce the poverty of those on low income.

Right from its introduction, the 2003 Scheme did not fit well with the welfare provision for low earners.

So what's the situation today? What has changed since 2003? Let's look again at that earlier slide.

In 2003



Since 2003 (to 2015-16 tax year):

NI - £89 a week) to £155

Income Tax personal allowance - £89 to £203

Blue region - through the region between the thresholds and almost out the other side

(now covers about 9 hours at NMW instead of 20)

What impact do these changes have on the income of the paying parent?

Impact on paying parent

- Consider a parent aged over 25 earning NMW £6.50 an hour
 - out of work
 - moving into work
 - then increasing the hours worked
- Assumptions made are the same as in the JRF 2014 MIS Report

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Will show you graphs of the weekly income for a particular situation - parent aged over 25 earning NMW £6.50 an hour out of work, moving into work, then increasing the hours worked, for different numbers of children.

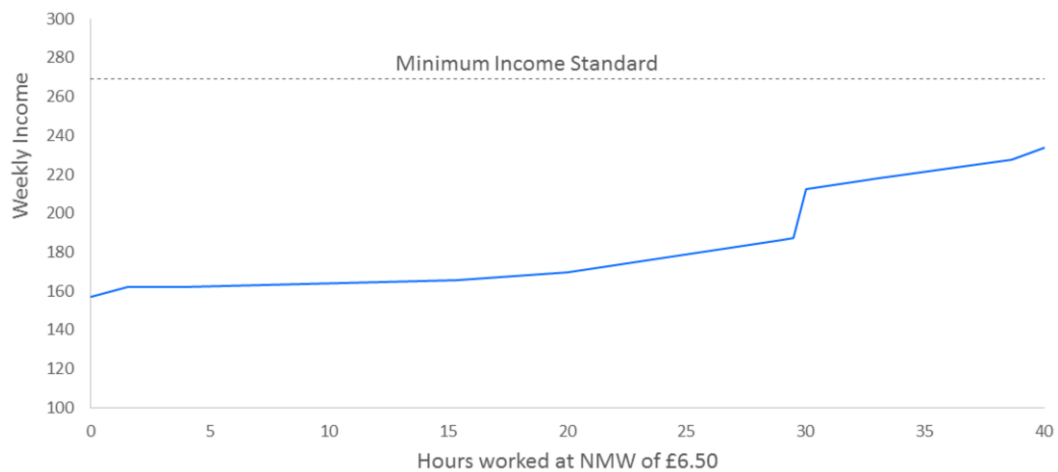
First, the situation for a single adult without any children.

To get such graphs, certain assumptions have to be made as regards rent and location. For simplicity, I have chosen the same scenario as that used in the 2014 MIS Report. Their model for a single adult assumes 1 bedroom social housing in central England, with a weekly rent of £71.20.

The data has come from the Minimum Income Calculator

www.minimumincome.org.uk supplemented by two benefit calculators www.entitledto.co.uk/benefits-calculator and benefits-calculator.turn2us.org.uk/ .
Links to the last two or on the DWP website www.gov.uk/benefits-calculators

Single adult on NMW - current welfare system – 2014-15 tax year



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Weekly income - net earnings plus welfare benefits

‘Minimum income standard’ (MIS) – the amount required to achieve an acceptable living standard - calculated annually for various household types for JRF by the Centre for Research in Social Policy at Loughborough University.

MIS calculations are the basis for the ‘Living Wage’ (outside London) which is now being strongly promoted.

The shape of graph explains the motivation behind the current welfare reforms and the introduction of the new system of Universal Credit. For this individual, there is little gain from moving into work (until he gets the boost of WTC at 30 hours).

When unemployed, this person receives the JSA (Job Seekers Allowance) of £72.40; he also has his rent paid through Housing Benefit (HB) and the majority of his Council Tax through Council Tax Support (CTS).

As he moves into work, JSA/IS removed pound for pound (after a £5 disregard).

Once that has all gone, HB is removed at 65p in £1 of additional earnings and CTS at 20p in £1.

When earnings reach £153 (about 23 ½ hours at NMW), he starts paying (NICs) at 12%. (In the case illustrated, CTS has now run out.)

When earnings reach £192 (about 29 ½ hours at NMW), he starts paying income tax (Tax) at 20%. (In the case illustrated, HB has now run out.)

At 30 hours he becomes eligible for Working Tax Credits - these are withdrawn at a rate of 41p in £1 (gross) and run out at about 39 hours.

All benefits have now run out, so the slope increases - only NI and tax are paid.

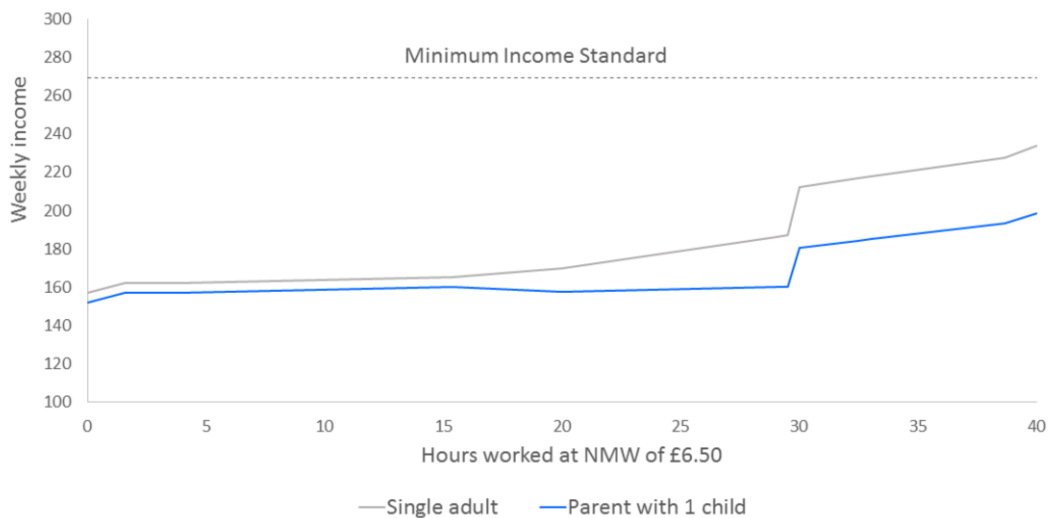
Now let's add child maintenance to this picture. Where do the £100 and £200 thresholds come?

The £100 threshold comes just above 15 hours at NMW (15.38) (where the curve is still almost flat)

Below that point the parent pays the flat rate of £5, beyond it the 'reduced rate'.

For 1 Child ...

... and parent paying for 1 child – 2003 Scheme

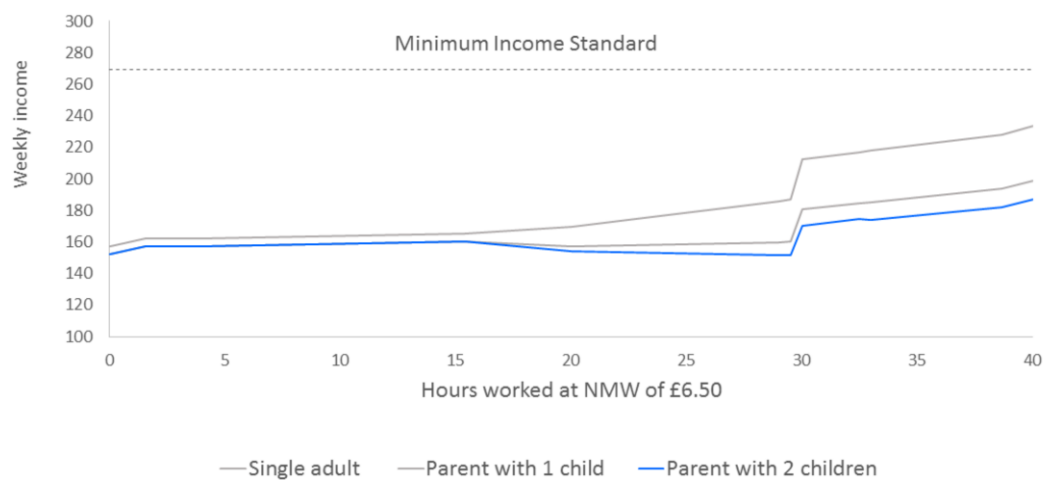


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At 30 hours, Working Tax Credits lift the net income above the £200 threshold - the parent then pays the 'basic rate'

For 2 children ...

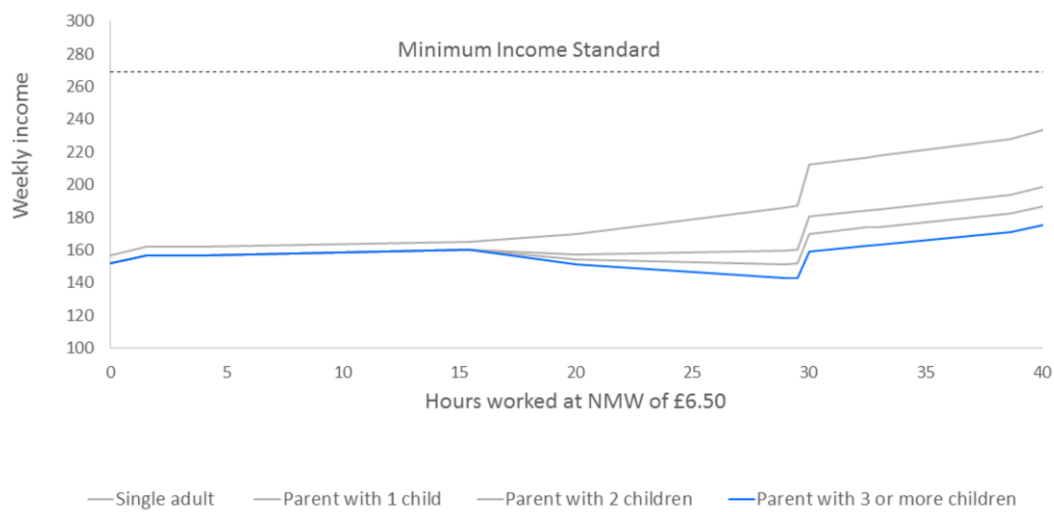
... for 2 children



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... and for 3 children

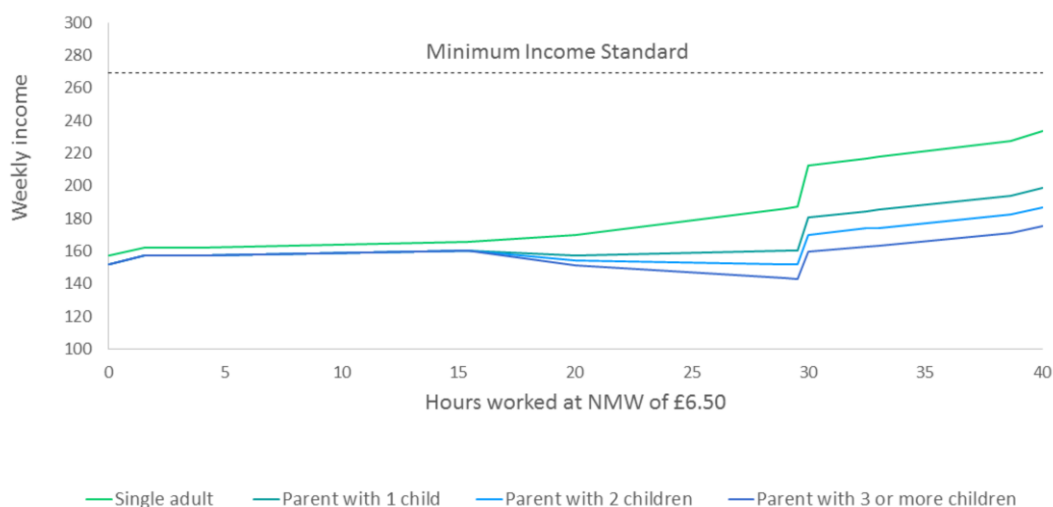
... and for 3 (or more) children



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Putting it all together

... and all together



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The message comes is clear - no gain for work followed by a drop in income once past the £100 lower threshold.

Similar curves can be produced for other incomes, for example hours worked at the 'living wage' (£7.85 outside London). Workers earning more than about £8 an hour are never entitled to any WTCs (so there would be no 'bump').

NB: These curves assume that the parent is claiming all the benefits to which he is entitled. Many of those in work do not claim their HB entitlement. And HB is only available for those in rented accommodation – those paying a mortgage get nothing. So the situation can be worse than that given here.

There is another way of looking at the situation which can help clarify the problem ...

A different approach

Marginal Tax Rate (MTR)

- simply put, how much a worker keeps of each extra £1 earned
- the withdrawal of benefits is not a tax but has the same effect
- similarly for child maintenance payments

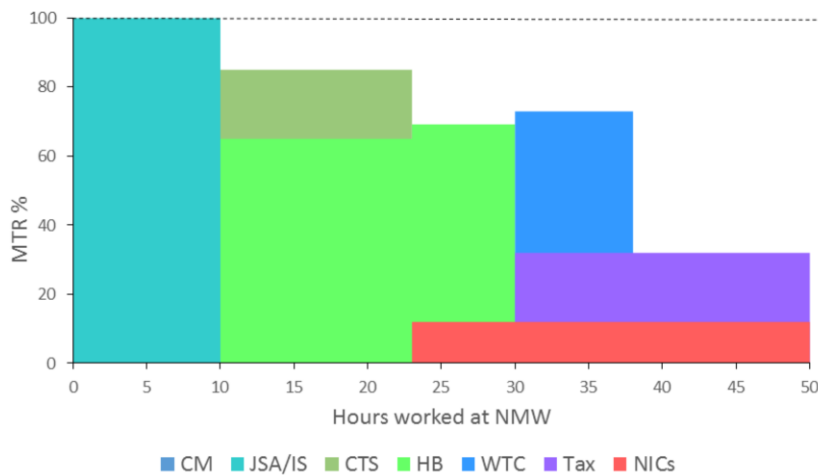
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... and that is to draw profiles of the Marginal Tax Rate (MTR). Simply put, the MTR shows how much a worker keeps of each extra £1 earned. The withdrawal of benefits is not, of course, a tax but it has the same effect. Similarly for child maintenance payments.

We continue with the same model situation as before and start with the single person.

MTR profile under current welfare system - 2014-15 tax year

Single adult



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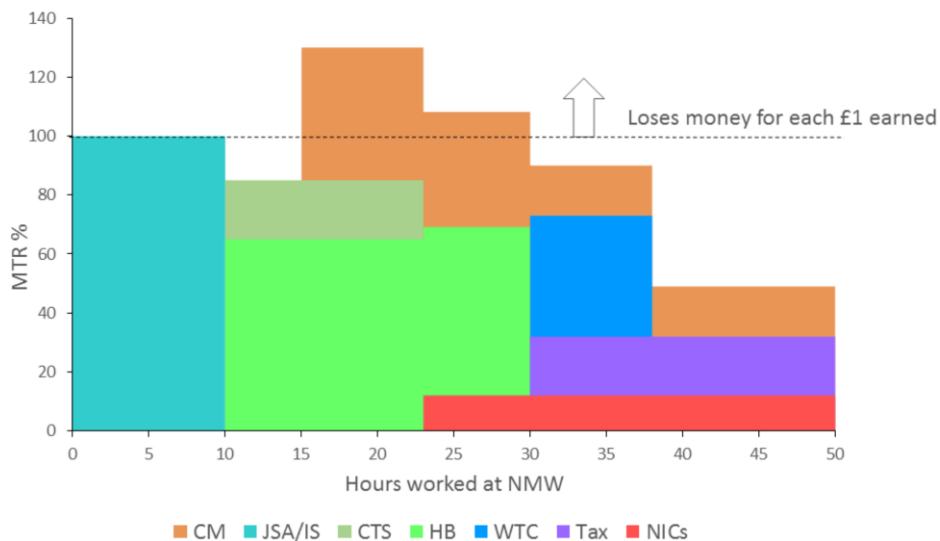
MTR goes from 100% to 85% (65 + 20) to ...

At 30 hours the MTR becomes temporarily negative with the addition of tax credits. [In our model situation, HB had run out by then. If it had not the WTC might have brought it to an end.]

As WTC's are withdrawn the MTR is 73%, after about 38 hours it reduces to the 'standard' 32%.

Add the child maintenance - the reduced rate starts just past 15 hours, the basic rate at about 30 hours. We'll look just at the case of 3 children.

... with child maintenance for 3 children - 2003 Scheme



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First for the 2003 Scheme.

The MTR profile shows clearly why the parent loses money as his working hours increase beyond 15 hours.

The MTR becomes significantly greater than 100%.

[The reduced rate for 3 children takes 45% of additional net earnings, so add 45 to 85 to get 130%,

for 2 children takes 35%

..... 120%,

for 1 child takes 25%

..... 110%.

Beyond 30 hours for 3 children add 17% (25% of 68)]

MTR profiles provide a convenient way of seeing the effect of the new 2012 Scheme.
Are things better on that?

2012 Scheme

	Gross weekly income	Maintenance
Nil rate	< £7	£0
Flat rate	£7 - £100	£7
Reduced rate	£100 - £200	£7+ 17, 25 or 31% of income above £100
Basic rate	> £200	12, 16 or 19 % of income
Basic rate plus	> £800	As basic rate then 9, 12 or 15% of income above £800

The different percentages refer to 1, 2 or 3(or more) qualifying children

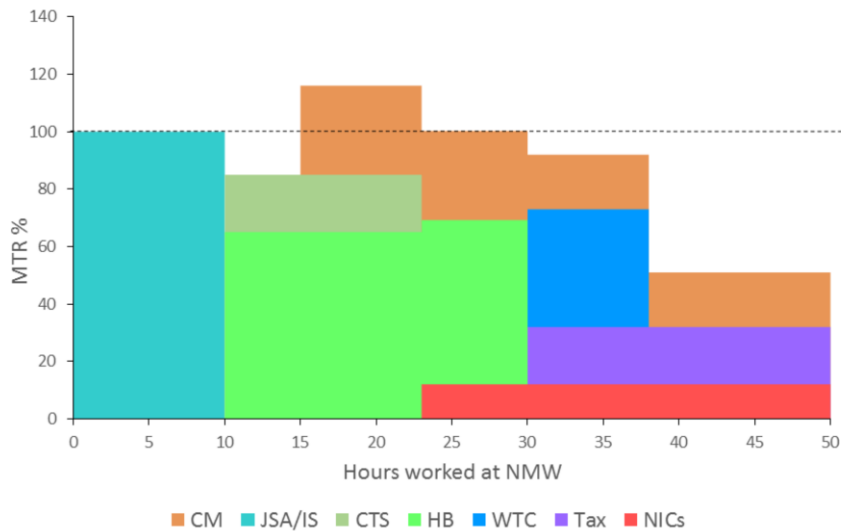
27

The percentages in the basic rate are chosen so that the results are similar to those of the 2003 Scheme.

Smaller percentages of gross income mean lower maintenance amounts when little or no Tax is paid.

Let's look at the MTR profile.

MTR profile under current welfare system - 2014-15 tax year -
child maintenance for 3 children - 2012 Scheme



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This is better than under the 2003 Scheme— the 2012 Scheme uses gross earnings rather than net income with smaller percentages so gives smaller maintenance amounts when little is paid in NICs or Tax. But the problem remains with an MTR that is more than 100%.

[Gross income means the additions are simple – for 3 children add 31 -> 116%,
for 2 children add 25 -> 110%
for 1 child add 17 -> 102%.]

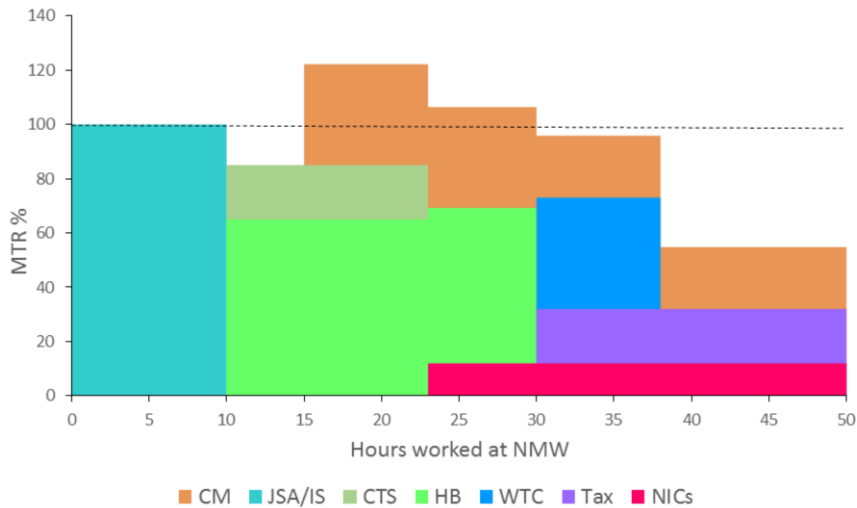
But we need to take this a step further.

The CMS has a different emphasis to the CSA – it wants parents to cooperate and make their own arrangements as regards financial support for the children. The 2012 Scheme is there for those parents can't agree. Even then the parents who use the CMS are encouraged to use 'direct pay'. There are 'incentives' to do so.

Fees are charged for those using the collection service – 4% for the receiving parent, 20% for the parent who pays.

The MTR then looks like this.

... 2012 Scheme + 20% collection fee



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The parent gets hardly any benefit from 38 hours work.

[85% + 20.4, 30.0, 37.5% = 105.4, 115.0, 122.5% for 1, 2, 3+ children]

[Another step could be taken but I'll not pursue it here.]

In the MTR profiles some features are fixed – NIC's, Tax, JSA/IS and (for NMW) the WTC.

But others are not. The profiles here were for an adult in social housing in Central England. Private sector rents are higher, other areas of the country are more expensive.

So the Housing Benefit may extend way beyond the range shown.]

Where now?

So far - parents earning NMW on present welfare system

2003 Scheme  Graphs of weekly income

 MTR profiles



2012 Scheme

2012 Scheme with 20% collection fee

How do things change under Universal Credit?

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Universal Credit (UC)

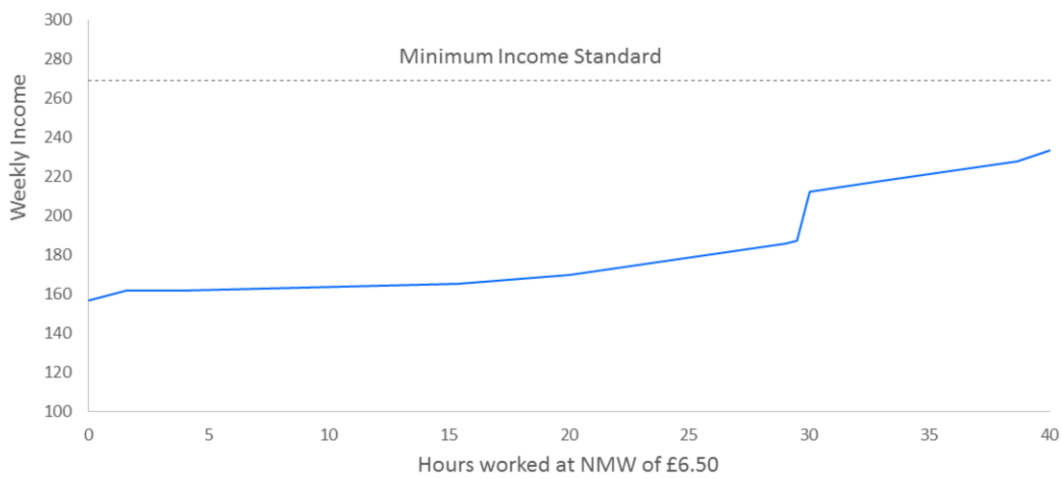
- Simplified welfare system
- One single payment
- Withdrawal rate of 65p for every £1 of extra net income
- Intention
 - People will always be better off in work than when unemployed
 - Working more hours will lead to a higher income

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Recall our previous slide ...

Previously:

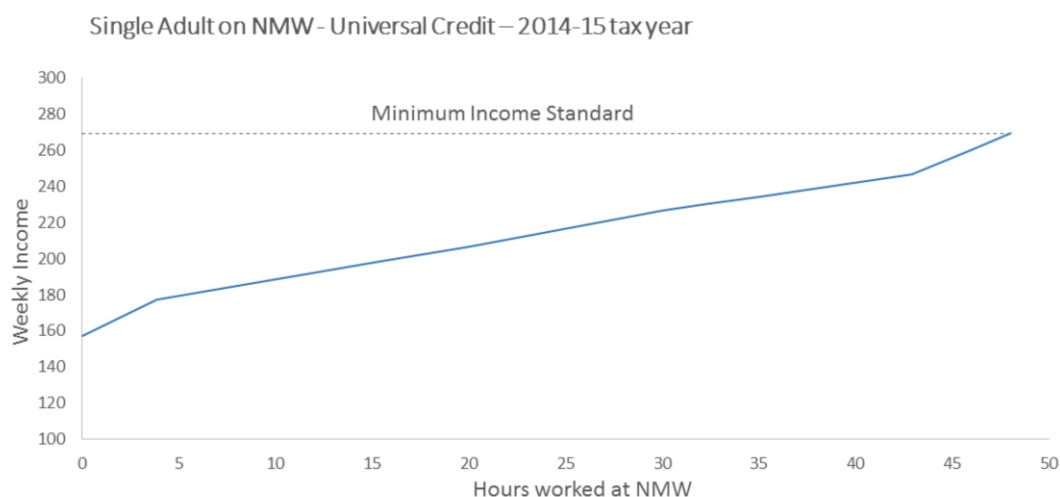
Single adult on NMW - current welfare scheme – 2014-15 tax year



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This gives the weekly income for a single adult under the present welfare system.

Let's see what happens under Universal Credit.



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That looks much better – a single adult is better off in work than when unemployed and working more hours gives more income.

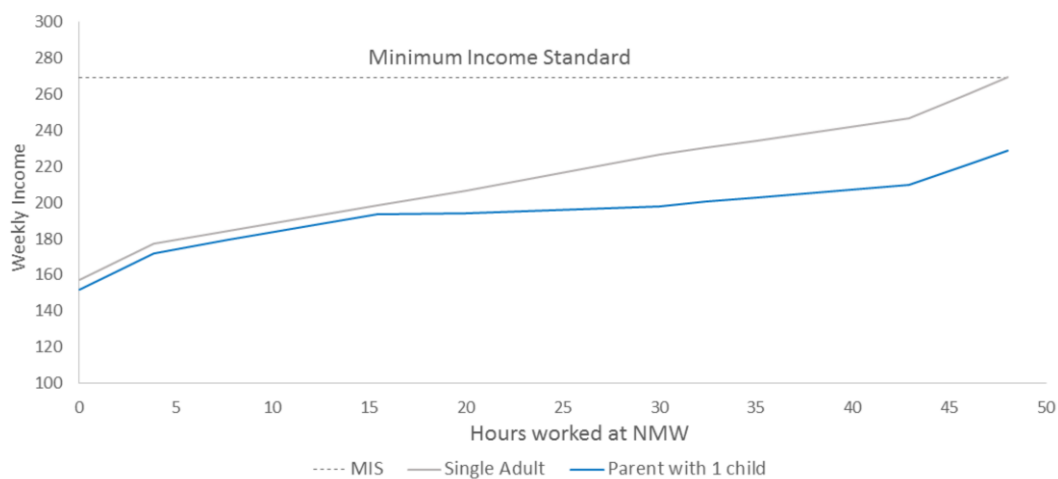
A single adult can earn £25 without loss of benefit, then UC is withdrawn at 65% of net income.

In our model situation UC runs out after about 43 hours at NMW.

But what happens if we add child maintenance? Again, we use the 2003 Scheme.

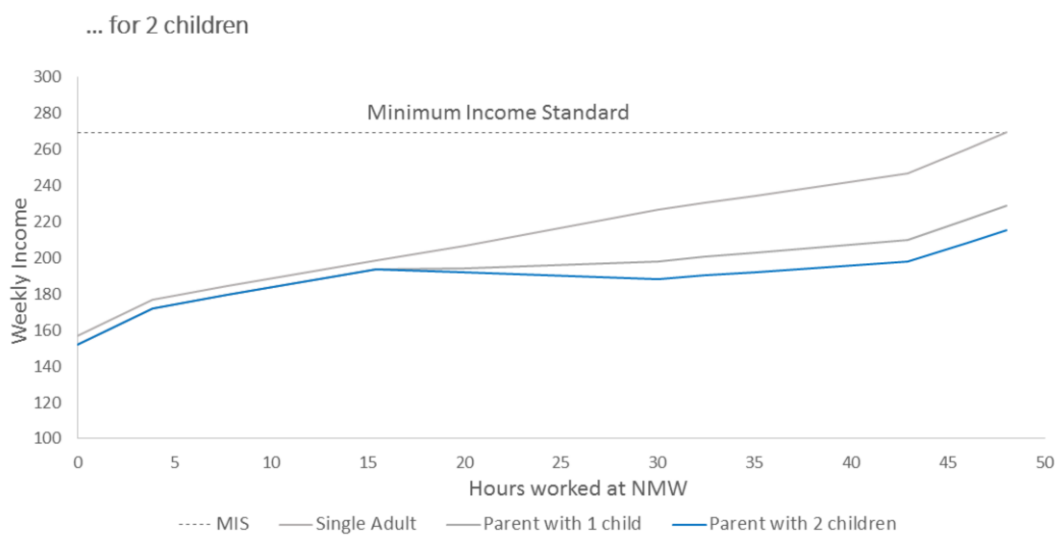
For 1 child ...

... and parent paying for 1 child – 2003 Scheme



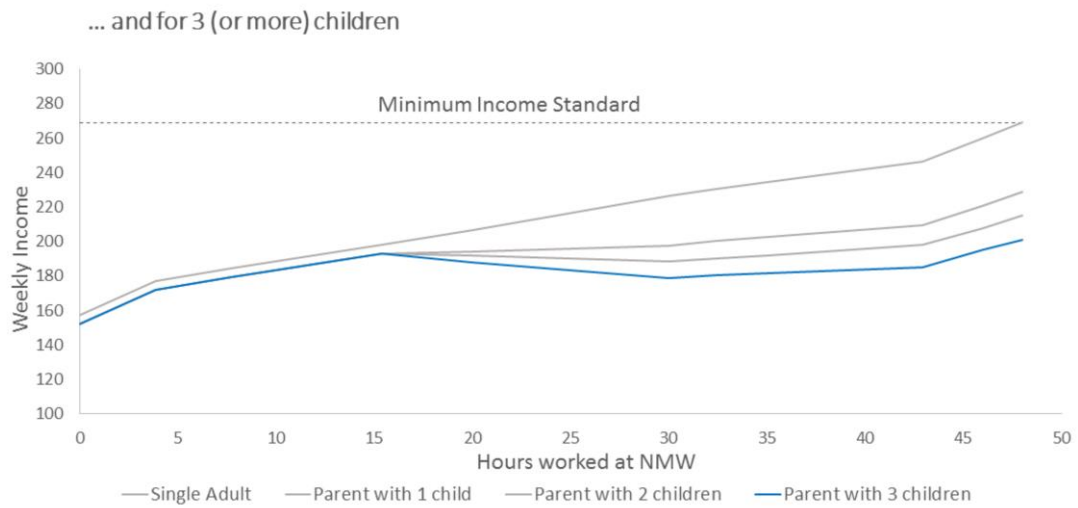
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And for 2 children ...



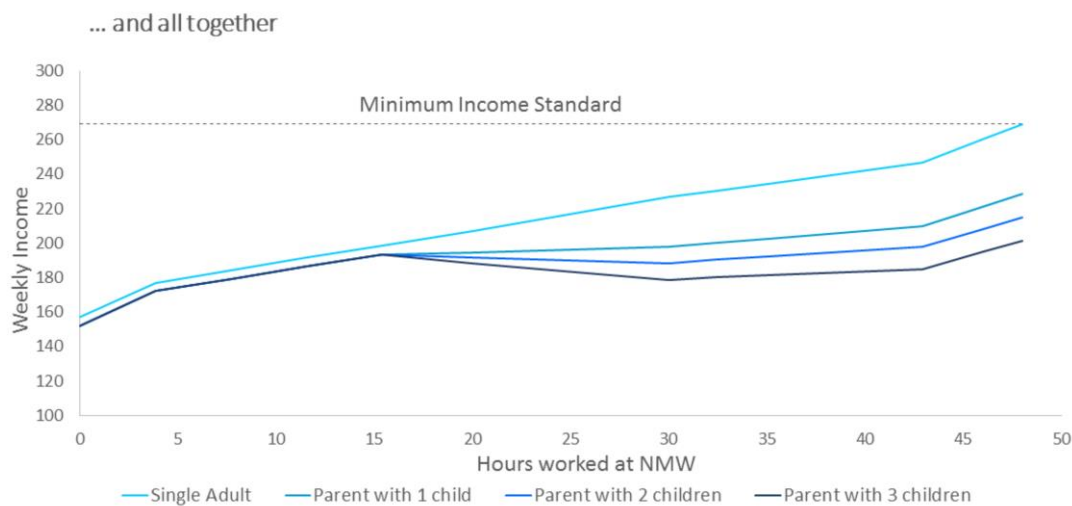
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And for 3 (or more)



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And all together



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Oh dear!

The parents ARE better off than they were under the previous welfare system. BUT this gain occurs before they reach the £100 lower threshold. After that the parent has little to gain and one with 3 children loses significantly.

The problems continue until UC runs out - at about 43 hours in this model situation. At that stage the parent paying for 3 children has £9 less than he had after 15 hours.

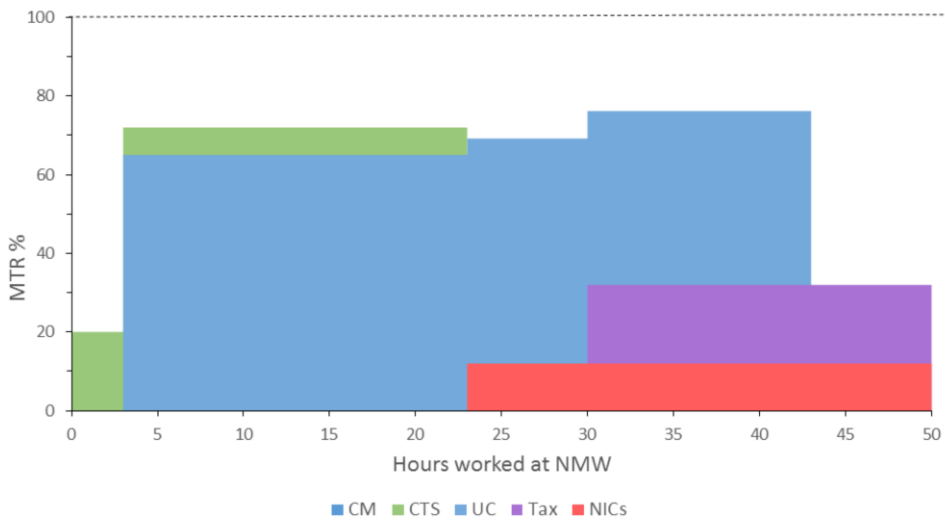
For higher rents UC would continue much further.

[For Reading with rent at the 30th percentile, UC would continue up to 70 hours at NMW.]

MTR profiles can again be produced.

MTR profile under Universal Credit - 2014-15 tax year

Single adult



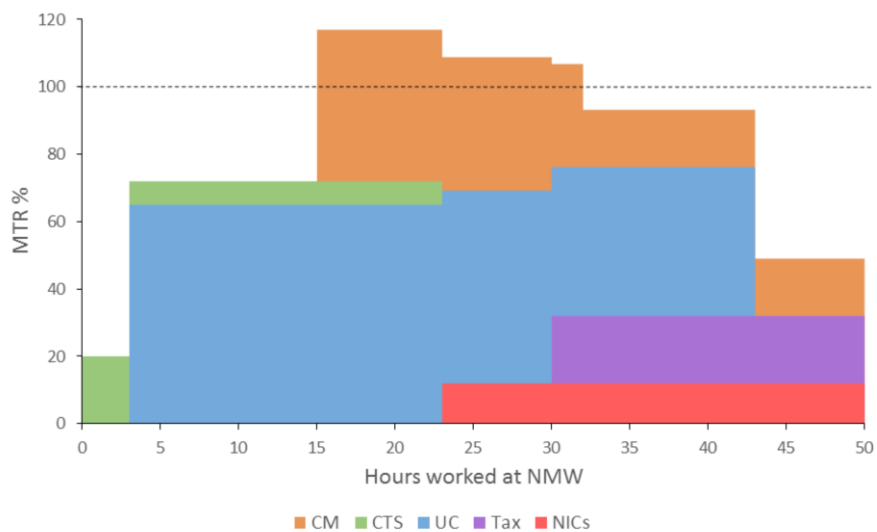
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A much simpler picture than under the previous welfare system and with an MTR significantly less than 100%. We understand why a single adult does much better.

Ignoring the Council Tax Support (which is a small amount in comparison with UC), the MTR goes from 0 to 65% to 76.2%

Maintenance payments can be added. Again we look at the case of 3 children, first on the 2003 Scheme ...

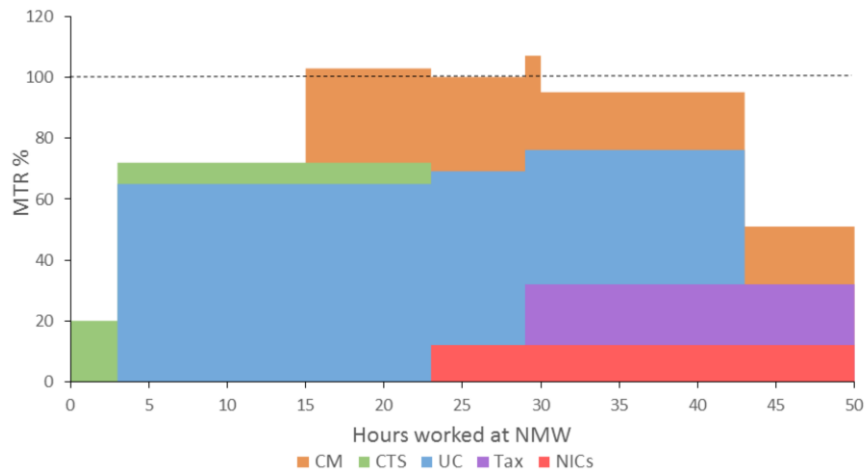
... with child maintenance for 3 children - 2003 Scheme



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Then on the 2012 Scheme ...

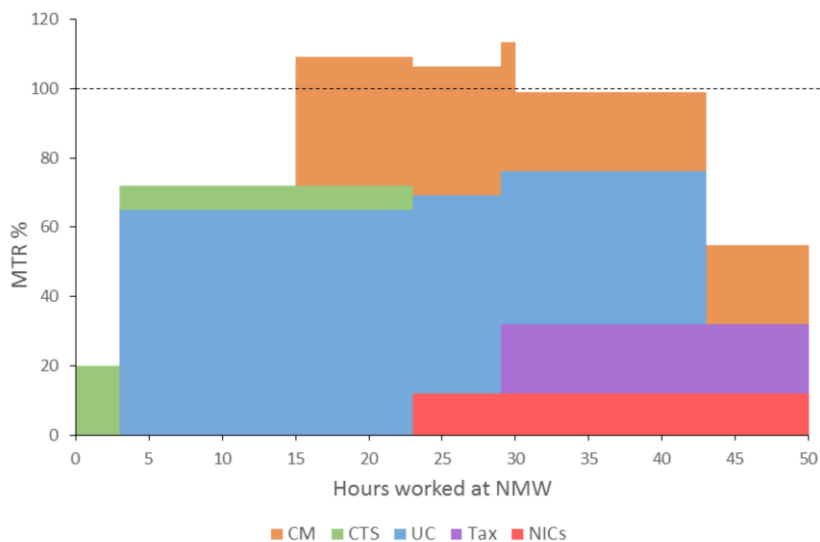
... 2012 Scheme



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And then the 2012 Scheme with 20% collection fee

... 2012 Scheme + 20% collection fee

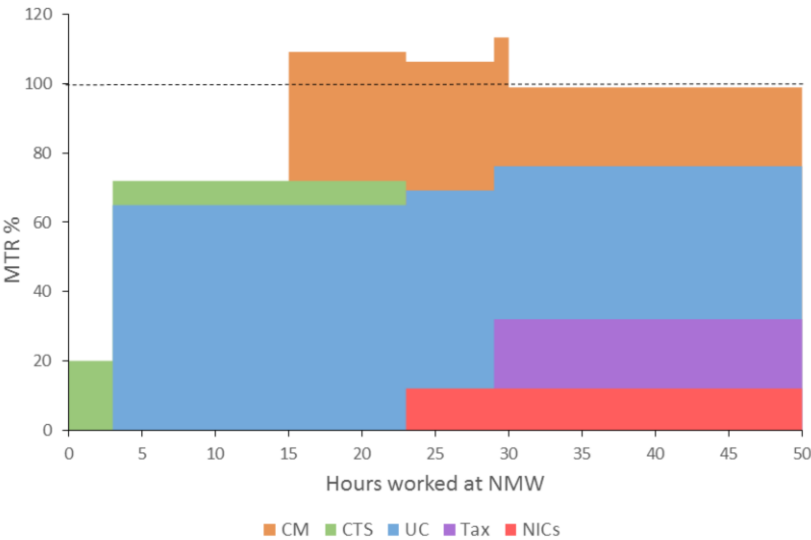


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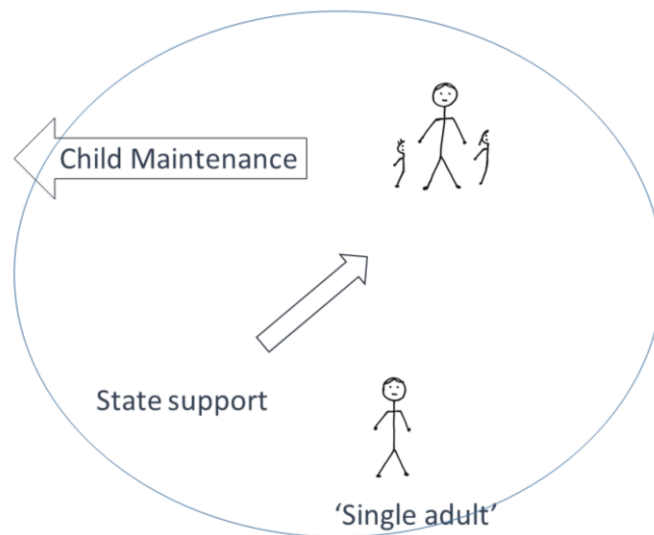
And higher rents would extend the range of Universal Credit

For the 2012 Scheme with collection fee...

Higher rent ... 2012 Scheme + 20% collection fee



Summary



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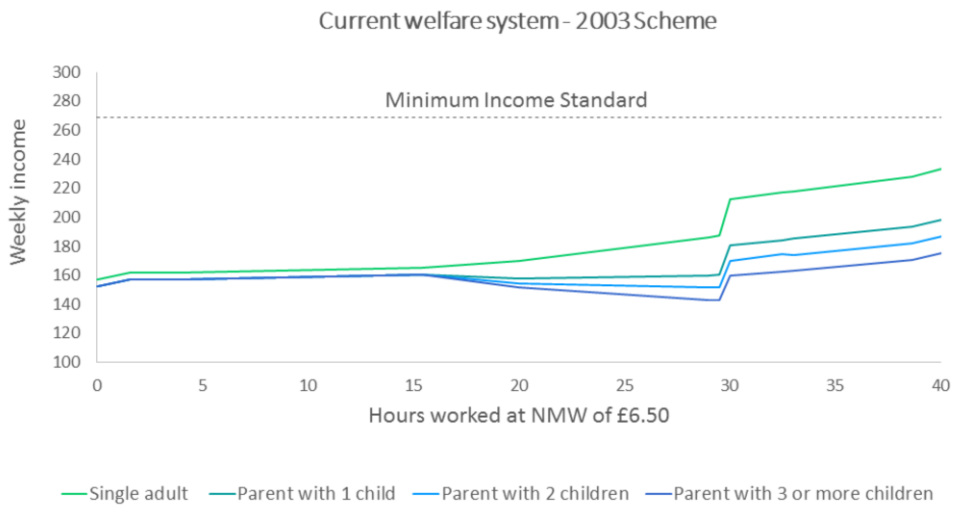
We've covered a lot of ground.

I started today with a personal story of a caring, committed father and child support payments that could not be met.

I've tried to show you how this situation could have come about.

We've looked at the situation of a parent on low income paying child maintenance

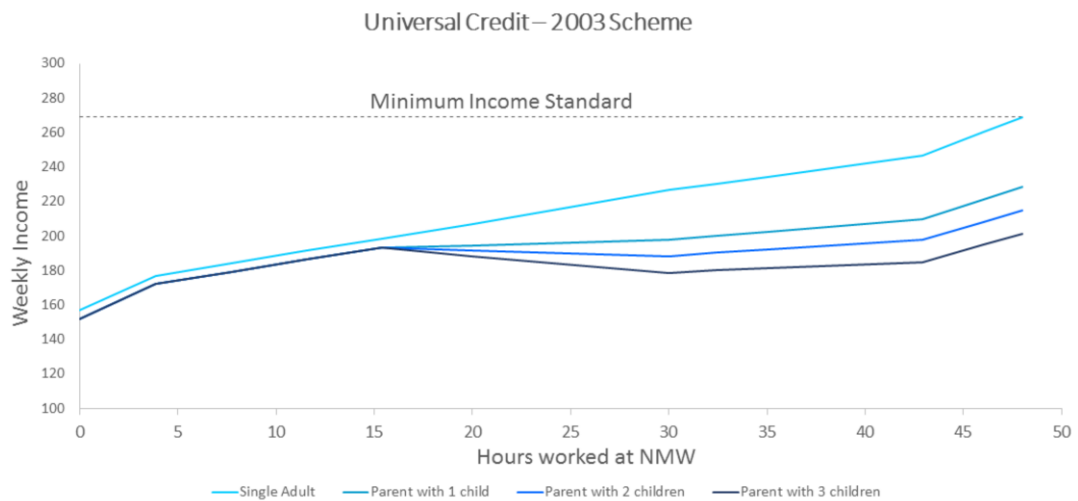
Summary



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... and seen that on the current welfare scheme they would be better off when unemployed ...

Summary



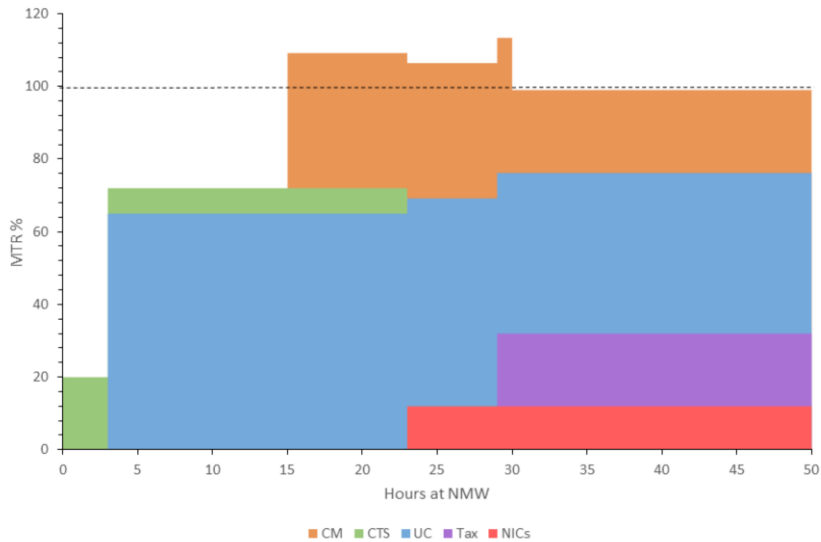
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.... and that under Universal Credit they lose money once they pass the £100 threshold.

MTR profiles under Universal Credit show the problem in a simple way ...

Summary

MTR profile - higher rent, 3 children, 2012 Scheme + 20% collection fee

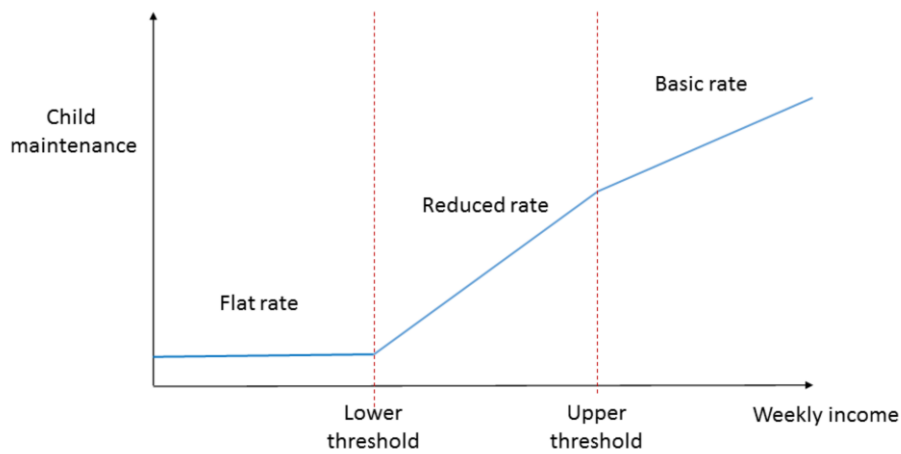


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We have seen that MTR profiles demonstrate the problem in a simple way with MTRs above or close to 100%.

Summary

Structure of 2003 and 2012 Schemes



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The problems arise for the structure of the 2003 and 2012 Schemes, fixed thresholds and interaction with welfare support.

Questions

- Is it true that
 - maintenance amounts cannot be paid by parents on low income? Yes
 - such parents can be better off out of work than with a job? Yes
 - more hours in work can mean less money? Yes
- If it is true, how and why has this happened? It has happened because of the
 - structure of the 2003 and 2012 Schemes
 - fixed threshold values
 - interaction with welfare support

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PWC



NRP

Children do better when both parents remain involved in their lives.

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Extra slides below

Once past £100 (before tax is due) for **every £10 earned**, UC is reduced by £6.50

2003 Scheme

PWC gets £2.50, £3.50 or £4.50

NRP gets £1.00, nothing or loses £1.00

2012 Scheme

PWC gets £1.70, £2.50 or £3.10

NRP gets £1.80, £1.00 or 40p

2012 Scheme with collection fees

CMS gets 41p, 60p or 74p

PWC gets £1.63, £2.40 or £2.98

NRP gets £1.46, 50p or loses 22p

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Council Tax Support is organised at a local level and varies between authorities. If we ignore this we have results which can be applied across the country. It is instructive to see what happens to the money earned by the NRP.

Once past £200, for **every £10** earned:

NI takes £1.20, Tax £2.00, UC is reduced by £4.42 - total £7.62

2003 Scheme

PWC gets £1.02, £1.36 or £1.70

NRP gets £1.36, £1.02 or 68p

2012 Scheme

PWC gets £1.20, £1.60 or £1.90

NRP gets £1.18, 78p or 48p

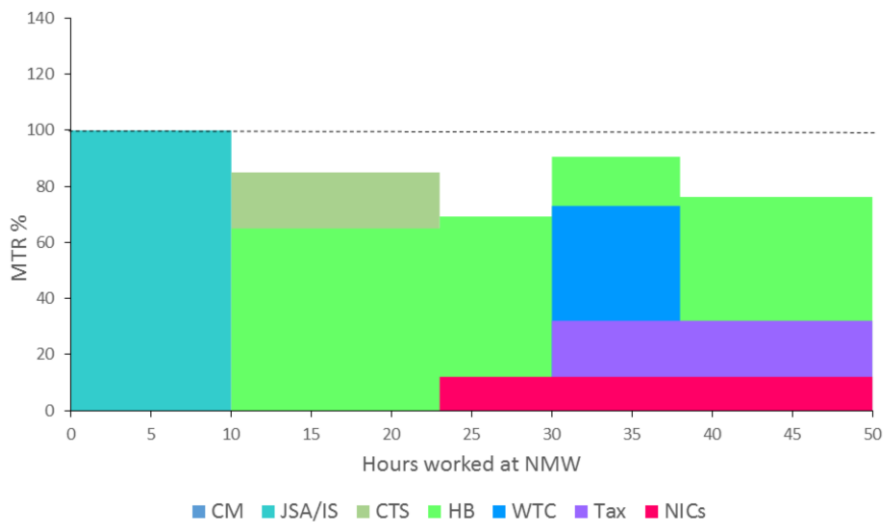
2012 Scheme with collection fees

CMS gets 29p, 38p or 46p

PWC gets £1.15, £1.54 or £1.82

NRP gets 94p, 46p or 10p

... for higher rent - single adult



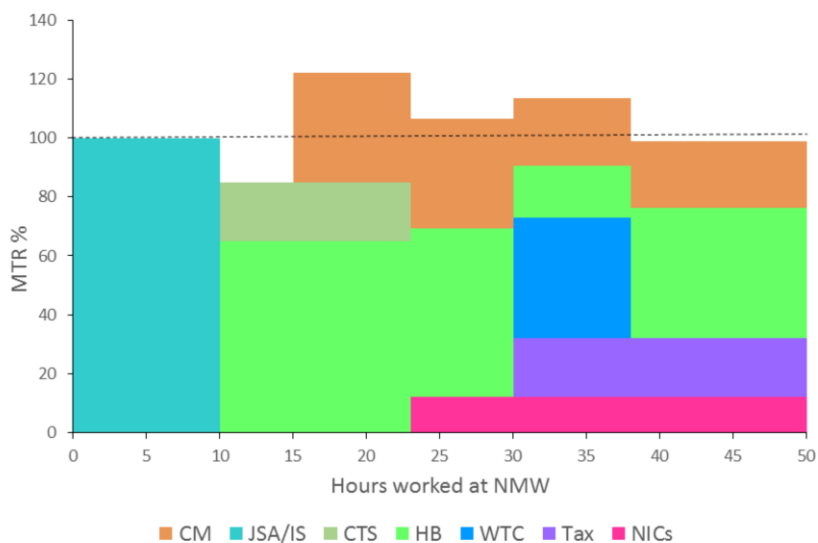
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Recall earlier comments – Slide 29 - the Housing Benefit may extend way beyond the range shown there.

[For a person in Reading paying the 30th percentile rent, Housing Benefit would continue to 60 hours at NMW.]

There is a corresponding impact on the paying parent – I show just the case of the 2012 Scheme with 20% collection fee.

... with child maintenance for 3 children - 2012 Scheme + 20%



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This speaks for itself. A parent in receipt of Housing Benefit does not gain anything from being in work.