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Hardship by design?

How to end unaffordable debt deductions

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Executive summary

Over £1 billion is taken from Universal Credit (UC) payments each year to repay advances and tax credit or benefit overpayments. Reducing this repayment burden would be an effective way to keep money in the pockets of low-income households facing an unprecedented cost-of-living crisis.

In this briefing, we look specifically at tax credit or benefit overpayments. Up to 25% of the UC standard allowance can be deducted automatically to repay tax credit or benefit overpayments (or 15% for claimants with earned income less than £60 per month). Currently around a million people have a deduction from UC made to repay an overpayment.

Deductions from UC for tax credit and benefit overpayments are often unaffordable and cause hardship. In a survey last year 98% of StepChange clients who had experienced a deduction for an overpayment had been unable to afford essentials as a result.[1]

We conducted analysis using budget data for StepChange clients receiving Universal Credit with a tax credit or benefit overpayment debt to understand which groups are most at risk of unaffordable repayments.[2]

Our findings indicate that the Department for Work and Pensions (DWP) cannot safely make automated deductions from those who are out of work or with low earnings without an unacceptably high risk of causing hardship:

- 49% of clients with a tax credit or benefit overpayment debt and no earned income have a negative budget (meaning they do not have sufficient income to meet expenses after budget counselling), with an average monthly budget deficit of -£55.
- Even for UC recipients with some income from employment, deductions have a high risk of causing hardship: 38% of clients with earnings below the work allowance had a negative budget.

Earnings are closely linked to whether clients with deductions for overpayments have a budget surplus or deficit. Stopping automatic deductions from UC for overpayments for those out of work would significantly reduce the risk of pushing claimants into hardship. For those in work, reducing the rate of deductions for overpayments would further safeguard against this risk.

The Department already applies discretion to reduce deductions below the maximum rate for some claimants. However, this approach is not effectively preventing hardship. The Department should instead support households through the cost-of-living crisis by pausing deductions for overpayments. In the longer term, it must more closely link these deductions to a claimant's ability to pay.

[1] Stepchange (2021), *The true cost of tax credit overpayments*

[2] Modelling and analysis based on a sample of 60,445 clients in receipt of Universal Credit - 9,848 with a tax credit or benefit overpayment debt. All clients went through a full debt advice session including a budget assessment in 2021

We recommend that DWP:

- Pause deductions for UC advances, tax credit and benefit overpayments at least until benefits are uprated next April
- End deductions for tax credit and benefit overpayments for claimants without earned income or income below the work allowance except where a detailed affordability assessment has been conducted and claimants consent to these deductions
- Reduce the maximum rate of deduction for tax credit and benefit overpayment deductions to 5% of the standard allowance, increasing from 0% to this rate incrementally as earnings increase

Using StepChange client data, we estimate that the changes would significantly benefit those affected:

- Stopping deductions for clients who are out of work leads to up to an estimated 23% fall in the proportion of single claimants aged 25 and over with a negative budget, while for couples over 25 the proportion would fall by nearly a third.
- Reducing the maximum rate of deduction for overpayment debts to 5% for claimants aged 25 and over with earnings over £1,000 per month would reduce the proportion in this group with a negative budget by nearly a third.

1. How do deductions from Universal Credit work?

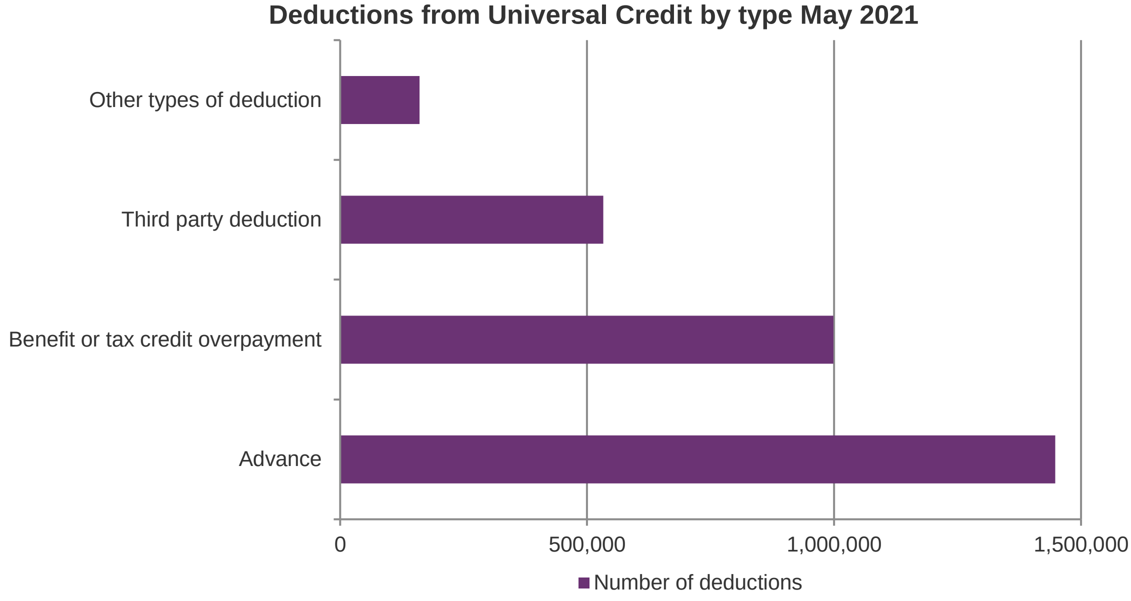
Deductions are made from Universal Credit (UC) to collect repayment of advances, utility arrears, benefit overpayments and certain other debts and obligations. Deductions can be made up to 25% of the standard allowance. In the case of overpayments, DWP applies a 15% maximum deduction until a claimant's earned income exceeds £60 per month.[3]

The maximum deductions for different claimant categories are listed below. A maximum of three deductions can be applied at one time with specific rates applied for different types of deductions. Deductions for utility arrears are made at a minimum of 5% while there is no minimum for benefit and tax credit overpayment deductions.

Claim type	Standard overpayment deduction (15%)	Higher rate deduction (25%)
Single under 25	£39.80	£66.33
Single 25 and over	£50.24	£83.73
Couple both under 25	£62.47	£104.11
Couple one or both 25 or over	£78.86	£131.43

In November 2021 42% of UC claims had at least one deduction in place, with an average deduction of £61 each month. This is approximately 9% of the average monthly entitlement.[4] The bulk of these deductions were for advance payments and benefit or tax credit overpayments. Data from May 2021 suggests these deductions make up well over half of total deductions. Just under 2.5 million deductions were made for these debts in that month, a 44% increase since just before the Covid-19 pandemic in March 2020.[5]

[3] DWP (2022), Benefit Overpayment Guide, Appendix 4
[4] DWP (2022), Response to Parliamentary Question
[5] DWP (2021), Response to Parliamentary Question. This data release includes local authority (LA) overpayments. When referring to benefit overpayment or overpayment debt in this report we refer to those listed as 'prescribed payments' in Appendix 1 of DWP's Benefit Overpayment Guide which doesn't include LA overpayments. More recent data suggests LA overpayments make up a marginal number of these deductions so the impact on these figures is small.



Deductions can be a positive way for people to repay debts. Third party deductions for important bills like energy and rent can be a useful way for people to repay arrears and manage bill payments. **However, the current system does not effectively assess affordability or appropriately prioritise debt repayments and causes unnecessary hardship.**

How are priority and non-priority debts treated in deductions?

In debt advice, debts are separated into 'priority' and 'non-priority' debts. Priority debts are those that must be repaid, or the claimant will face unacceptable negative consequences, such as eviction for non-payment of rent arrears. Non-priority debts are those such as unsecured credit (loans and credit cards) where statutory protections mean that consequences will not be as severe as those faced for priority debts.

To achieve the best outcomes for those struggling with debt, repayments must be prioritised with debts such as rent arrears addressed first. The deductions system can undermine the interests of claimants because automatic deductions are made without any assessment of whether there are other repayments that should be prioritised to help protect the claimant against negative outcomes.

When a claimant has multiple deductions, a priority order is applied. However, this order prioritises repayment of UC advances over rent arrears and other priority debts.

Deductions from UC are also made without checking whether an individual has priority arrears being pursued outside the deductions system. This can lead to non-priority debts such as overpayments being prioritised over priority debt. As a result, claimants may face enforcement action or pursue potentially harmful coping strategies such as borrowing money to make repayments.

The rates of deduction for different types of debts also appear arbitrary when considered according to the logic of prioritisation. For example, deductions for utility arrears are made at a minimum of 5% of the standard allowance (reflecting the modest repayments providers seek from customers with low incomes) while claimants can face deductions of up to 25% for advance payments and benefit overpayments.

What is the impact of unaffordable deductions?

DWP's Benefit Overpayment Guide explicitly recognises that the current approach to deductions will cause hardship:

> *The recovery of an overpayment from any person in receipt of benefit is almost certain to cause some hardship and upset for them and their family.*[6]

The same guide contains a commitment to avoid 'undue' hardship.[7] In response to the rising energy prices DWP has suspended new third party deductions for ongoing fuel usage on account of the potential impact deductions could have on household budgets. In a letter to Ofgem the Secretary of State said that the potential increase in deductions could leave '*some DWP claimants without enough benefit award to meet other essential day-to-day needs.*'[8]

This suggests that DWP acknowledges it is desirable to avoid excessive deductions that cause an inability to meet essential day-to-day needs. Our research has shown that the current approach to deductions, not just third-party energy deductions, does exactly this.

Last September we published research into the experience of StepChange clients with tax credit overpayment debts that were being collected through deductions from UC. We found that in many cases individuals were not aware that they had an overpayment debt before money was taken from their benefit award. The lack of a proactive assessment of affordability meant that the deduction often pushed them into hardship. 98% of clients we surveyed had struggled to cover essentials because of the rate of deduction they experienced. Not only were many pushed into undue hardship, but some had to borrow to cover the shortfall, with 59% borrowing money to stay afloat.[9]

The Trussell Trust found that 47% of people visiting foodbanks in 2020 were in debt to DWP.[10] Attempting to understand the link between destitution and government debt, Trussell Trust conducted co-designed research where people who had visited food banks with experience of repaying these debts guided the findings and recommendations. Research participants identified overpayment deductions like those for tax credits and other benefits to be the most opaque, unexpected, and sudden. These deductions were most associated with feelings of anger and injustice as individuals felt they were not at fault for the overpayments. Alarmingly, these deductions were also identified as those with the highest impact, being the most likely to trigger crisis and destitution.[11]

People can call DWP to renegotiate their rate of repayment. However, we found that many were not aware they were able to, while for others even a single unaffordable deduction was enough to push

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[6] DWP (2022), Benefit Overpayment Guide, paragraph 5.72
[7] *Ibid*, policy statement
[8] DWP (2022), Letter to Ofgem
[9] StepChange (2021), *The true cost of tax credit overpayments*
[10] The Trussell Trust (2021), *The state of hunger: Year two main report*
[11] The Trussell Trust (2022), *Debt to government, deductions and destitution*

them into difficulty. In research we conducted into the consumer credit market earlier this year, 53% of respondents to our survey said they would be reluctant to approach their creditor for support if they experienced financial difficulty.[12] This reflects an anxiety people struggling with debt have about engaging with creditors when they fall behind. Trussell's research participants talked about the length of waiting time experienced when contacting government and feeling judged or disrespected when they did make contact. Both these practical and emotional barriers work together to deter people from reaching out for help.

The Government must work to change this perception, but it must also make changes to the way deductions work in recognition of the barriers to people making contact. It must build in better pro-active assessments of affordability, and more closely link deduction rates to people's circumstances.

How are deductions affecting budgets during the cost-of-living crisis?

Unaffordable deductions have the potential to cause even more harm in the context of the cost pressures households are currently facing. Inflation rose to 9% in May while the energy price cap is projected to rise to £2,800 in October. The Government has announced a welcome package of support to alleviate the pressure on households from rising energy bills.

However, inflation is driving price increases across a range of goods, and these increases are most keenly felt by those on low incomes.[13] With benefits not due to be uprated in line with current inflation rates until April 2023, households on low incomes are still facing a significant expenditure shock. Our current modelling suggests that clients receiving UC will still have an average monthly budget of -£77 once the Government's support package and inflation is factored into their spending.[14]

The Government's suspension of deductions for ongoing energy usage in response to surging fuel costs is welcome. However, these repayments make up a relatively small proportion of deductions from UC compared to advances and benefit overpayments.

Nearly £125 million was deducted from UC awards in November. Close to £100 million was deducted in that month for advance payments, tax credit and benefit overpayments alone.[15] This suggests that over £1 billion is deducted annually for government debts.

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[12] StepChange (2021), *Falling behind to keep up: the credit safety net and problem debt*

[13] The Bank of England Monetary Policy Report for May forecasts CPI inflation rising to 9% in Q2, peaking at 10% in Q4 2022; IFS (2022), Inflation hits 9% with poorest households facing even higher rates.

[14] Modelling based on an inflation rate of 10% and a £2,800 energy price cap

[15] DWP (2022), Response to parliamentary question

Deduction type	Deductions in November 21	Annual deductions
Advance payments	£56,672,000	£680,064,000
DWP benefit overpayment	17,493,000	£209,916,000
Tax credit overpayment	£23,848,000	£286,176,000
Total	**£98,013,000**	**£1,176,156,000**

At the start of the pandemic, deductions for benefit overpayments were suspended in recognition of the fact that this was a lever government could pull to alleviate pressure on households most at risk of income shocks.[16] Suspending deductions for advance payments and benefit overpayments would help soften the impact of the current crisis for over a million claimants experiencing these deductions.

2. What is wrong with the current system?

Suspending deductions through this period of instability would help alleviate some of the pressure caused by current price increases. However, in the longer term the system needs to be reformed so that rates of deduction are more aligned with people's ability to pay.

In the absence of a full budgeting assessment there will always be a risk of taking too much money from households. The Government has made positive steps to address this risk, reducing the maximum rate of deduction from 40% to 25%. The two maximum rates of deduction for benefit overpayments – 15% of the standard allowance for those earning less than £60 per month and 25% for those with higher earned income – also recognise the need to set the rate of deductions according to people's earnings.

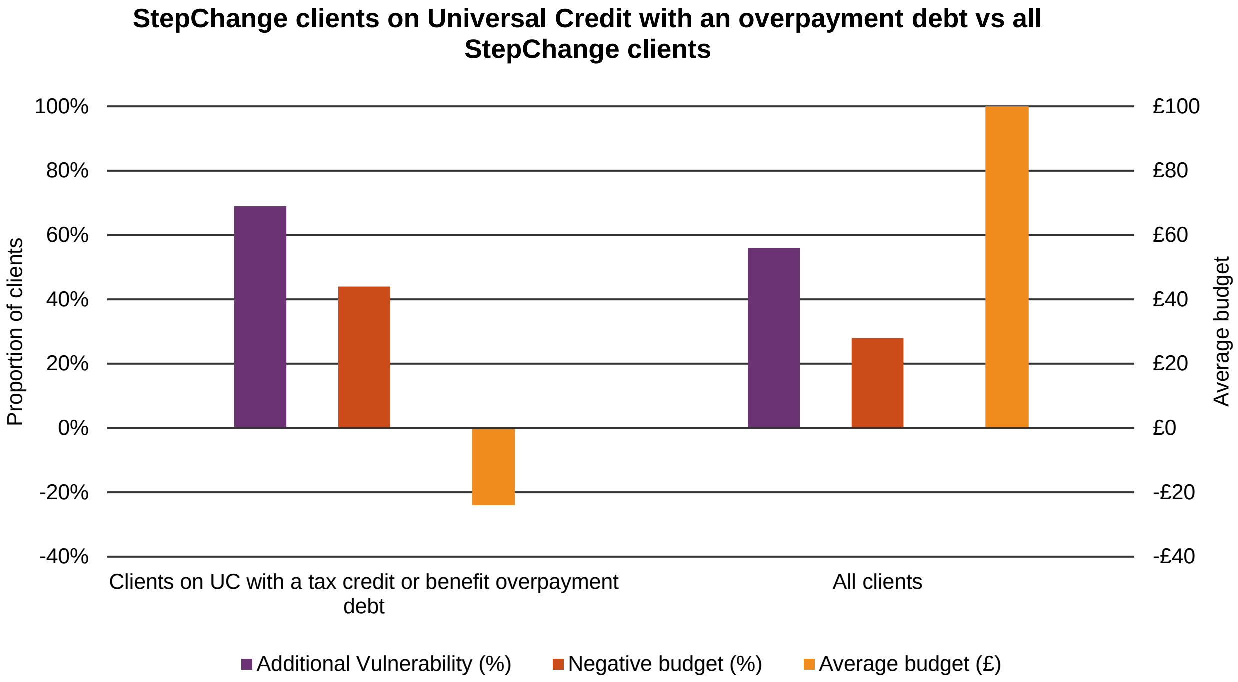
However, neither these rates nor the difference between them are proportionate to people's ability to pay. The current system means claimants with no wage can face a deduction of 15% for an overpayment. This is disproportionate given the low income of these claimants. Claimants then face a 66% increase in the rate of deduction once they are earning over £60. Closer analysis of StepChange client data shows how misaligned the system is to people's real budgets.

How do deduction rates compare with StepChange client budgets?

The most striking finding when looking at StepChange client data is the precarity of clients in receipt of UC with tax credit or benefit overpayment debts. They are much more likely to be facing an

[16] DWP (2020), Recovery of benefit overpayment suspended. This action was also taken because of the need to move staff into other UC teams to deal with the surge in new applications

additional vulnerability to their financial difficulty and more likely to have a negative budget compared to our clients overall.[17]

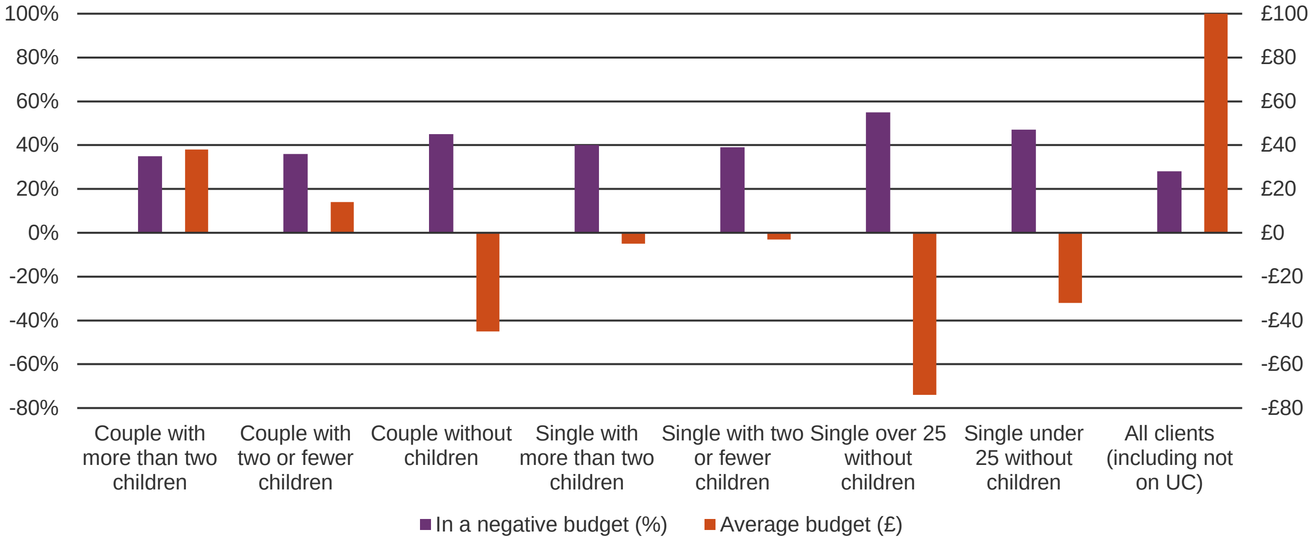


Clients receiving UC with overpayment debts are over 50% more likely to be in a negative budget than clients overall. Their average monthly budgets are £124 lower than the average StepChange client. Over two-thirds have an additional vulnerability, such as mental or physical health problems, along with their financial difficulties compared to just over half of clients overall.

UC entitlement is determined by household type. Using these categories to segment StepChange clients with tax credit or benefit overpayment debts in receipt of UC reveals significant variation between groups. The makeup of someone's households has important implications for their budget.

[17] This is when, after a budgeting assessment with a professional debt adviser, someone's monthly income does not cover their essential expenditure.

Budgets of StepChange clients on Universal Credit with an overpayment debt by household type



Households with children have a lower proportion in a negative budget than the 41% average for the sample overall. This may reflect the higher UC entitlement for households with children. Single households with children are in the most precarious position of those with children, with two in five small single parent households facing a negative budget.

Interestingly, older single households without children have the most stretched budgets among this cohort. Over half are in a negative budget facing a near £75 deficit even when just accounting for essentials. These UC claimants could be identified as a group least able to afford deductions.

86% of older single StepChange clients on UC with an overpayment debt also had no wage income. Closer analysis suggests that client wage income is the best predictor of budget surplus or deficit and the most fruitful characteristic DWP could use to apply a different approach to deductions.

The effect of earnings

The amount someone earns is the biggest predictor of budget surplus or deficit among clients on UC with overpayment debts. This makes intuitive sense and is implicitly recognised by DWP in the separation of those with earned income and those without for overpayment deductions. But the budgets of our clients show that the current approach to deductions doesn't account for the hardship faced by people with low incomes.

Budget profiles of clients on Universal Credit with a tax credit or benefit overpayment by monthly wage income

There is a 33 percentage point gap between the proportion of clients in a negative budget earning less than £60 and those earning over £1,500 a month. This demonstrates the link between earnings and a more stable financial situation, justifying DWP's current approach of reducing the maximum deduction for those with very low or no earnings.

However, the picture for clients in the lowest band is one of extreme hardship. Nearly half of clients in this group is in a negative budget at the time of advice meaning that they are already at risk of experiencing hardship. Taking 15% of their standard allowance is not proportionate to their ability to pay and risks deepening hardship for these households. Their budget information already includes any UC deductions, so the table below demonstrates that a 15% deduction is likely to have pushed these households into a deficit.

Claim type	Average monthly budget of StepChange clients on UC with an overpayment earning less than £60 a month	Standard overpayment deduction (15%)
Single under 25	-£6.49	£39.80
Single 25 and over	-£64.85	£50.24
Couple both under 25[18]	-£22.03	£62.47
Couple one or both 25 or over	-£44.00	£78.86

15% cannot be safely deducted from these households without a high chance of causing or increasing hardship. The profile of StepChange clients also suggests that current deduction rates are unsafe for people with lower levels of earnings. Nearly two in five (38%) of clients earning less than the higher UC work allowance of £573 are in a negative budget.[19]

Clients on these low incomes can face a maximum deduction of 25%. The table below demonstrates how this rate of deduction deepens budget deficits.

Claim type	Average monthly budget of StepChange clients on UC with an overpayment earning between £60 and £573 per month	Higher rate deduction (25%)
Single under 25	£19.88	£66.33
Single 25 and over	-£11.03	£83.73
Couple both under 25	Sample too small	£104.11
Couple one or both 25 or over	-£21.45	£131.43

[18] Figure should be treated with caution due to small sample (24 clients)

[19] The work allowance is the amount that claimants can earn before their Universal Credit payment starts being reduced (tapered). Claimants with responsibility for a child or limited capability to work are eligible for a work allowance. Those receiving housing support are entitled to a work allowance of £344. We have used the higher allowance of £573 which is granted to those who do not receive housing support. This is used as an indicative amount DWP has deemed appropriate as a buffer for some claimants before entitlement is reduced.

Even for households with some earned income the current staggering of deduction rates does not reflect their ability to pay and risks causing undue hardship.

Unaffordable deductions also reduce the work incentives that UC was meant to improve in the benefits system.[20] According to DWP's Benefit Overpayment Guide the higher rate of deduction is enforced after someone's monthly earnings exceed £60. This means a single person over the age of 25 working on the living wage would face a 25% deduction (alongside the UC taper which reduces entitlement by 55p for every £1 earned) once they start working more than six hours a month. The increase of the deduction from 15% to 25% means they would be worse off taking on anything less than an additional nine hours of work each month.

Could the system be changed?

We have previously recommended that the Government reduce the rate of deduction and make better use of data to proactively adjust repayment rates according to household circumstances.

Other parts of government already conduct case segmentation, using data to isolate the cases where individuals have the means to repay. HMRC was able to introduce systems of customer segmentation very quickly at the start of the pandemic, sorting tax debts into types and customer categories before tailoring its collection approach accordingly.[21] HMRC also staggers the rate at which it recovers money from tax credit claims according to income. While its system is far from perfect (failing to account for expenditure and applying high rates of deduction), it is a more sophisticated use of data to link repayment rate to an assessment of means than the current methods applied by DWP.

Given the wealth of data available to DWP, which already allows it to reduce the rate of deduction for those without earned income, we believe there is a duty to better utilise this data to make nuanced adjustments in rates of deduction.

We know from discussions with DWP that it is difficult to make changes to the digital infrastructure behind the deductions system. The separation of third party, advance payment and overpayment deductions also means that changes in one area will not resolve system-wide problems.

However, deductions for non-priority benefit and tax credit overpayment debts sit with DWP debt management. This means deductions are less affected by the wider UC IT systems which can present barriers to change. DWP's Benefit Overpayment Guide set deduction rates for overpayments at a maximum rather than requiring a minimum deduction like third party deductions.[22] This means debt management teams could apply lower rates without needing to change regulations.

There is also a simple fairness case for making changes to these deductions. Overpayments will have been incurred by those who, at the time of their claim, were assessed as needing support from tax credits or benefits. In the case of tax credits, overpayments were an in-built feature of the system while the challenge of negotiating the benefits system generally will mean that, in non-fraud cases,

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[20] DWP (2012), Universal Credit Impact Assessment, 'Universal Credit will substantially improve work incentives'
[21] Public Accounts Committee (2022), Oral evidence: HMRC's management of tax debt, HC953
[22] DWP (2022), Benefit overpayment recovery guide, p. 80

overpayments will have been inadvertent. There is an added duty with these debts, therefore, to ensure that design features of benefits do not compound problems that they were intended to solve.

3. Modelling a different system

We propose that people on UC with no or low income should not face deductions for non-priority debts like benefit overpayments.[23] The current rate of 15% is unaffordable and causing undue hardship. Deductions should only be applied when households begin earning at least above the work allowance, with all households – not just those currently eligible for a work allowance – granted this earnings buffer before deductions are applied.

Once earning above the work allowance, the rate of deduction should increase incrementally, reflecting principles applied elsewhere in government and fulfilling the Government's obligation to adjust its approach according to people's circumstances. We have proposed incrementally increasing the rate of deduction from 2.5% to 5% for those with earnings of £1,000 per month or more. This is an illustrative approach which could be fine-tuned with closer analysis of household budgets.

The maximum rate of deduction for overpayments should be reduced to 5%, aligning with the rate currently taken for non-priority utility debts. This would increase the length of repayment for some claimants but would be in line with established practice in responsible and sustainable debt collection. The Government should consider limiting repayment periods to ten years, as it is proposing for Statutory Debt Repayment Plans (SDRPs). Debt that would take longer to repay should be written off.

Earnings per month	Benefit overpayment deduction rate
No wage or earning up to £573	£0
Earning between £573 and £1000	2.5% of standard allowance
Earning over £1000	5% of standard allowance

Applying this system to the UC claimant categories would mean claimants facing the following deductions according to their income:

[23] The Government is proposing to class all debts owed to central government as priority debts in its consultation on Statutory Debt Repayment Plans.

Claimant earnings	Single under 25	Single 25 and over	Couple both under 25	Couple one or both 25 or over
Less than £573[24]	£0	£0	£0	£0
£573-£1,000	£6.63	£8.37	£10.41	£13.14
Over £1,000	£13.27	£16.75	£20.82	£26.29

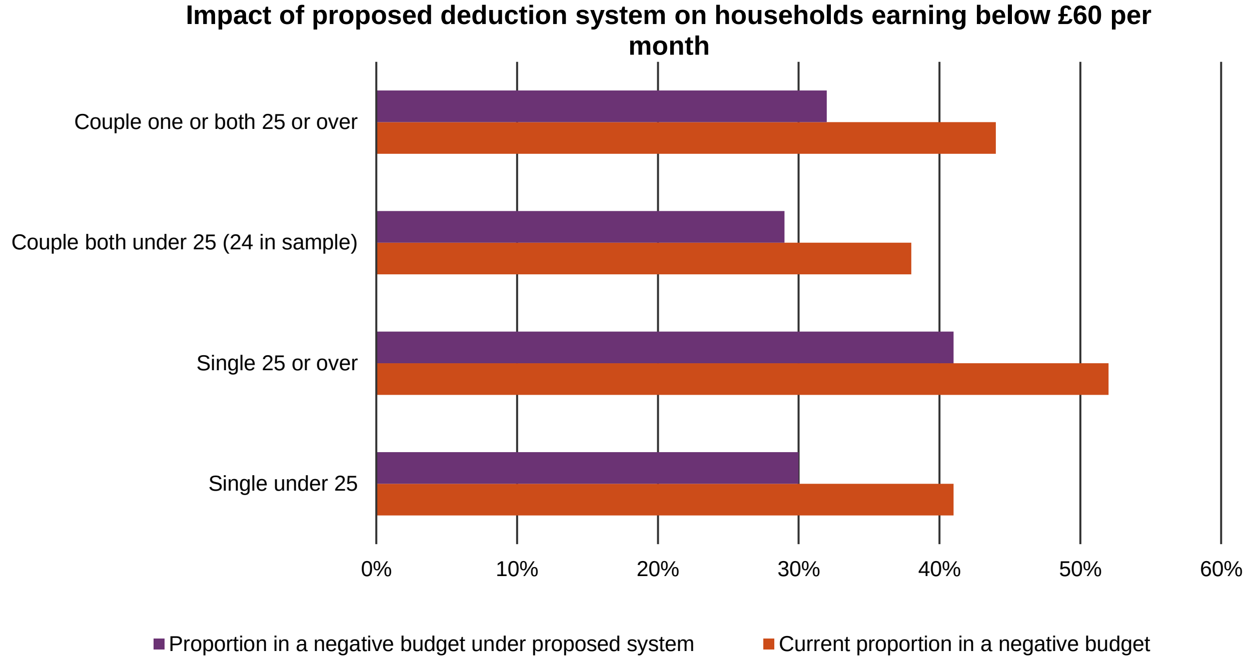
Modelling the impact of these changes is difficult as claimants will likely be experiencing more than one deduction. Reducing the amount taken for benefit and tax credit overpayments may lead to deductions further down the priority list being applied. However, around a third of claimants with a benefit or tax credit overpayment deduction only have this deduction. While the changes would not resolve the hardship caused by the deductions system, they would reduce the hardship caused directly by deductions for overpayments.

How would this system reduce hardship?

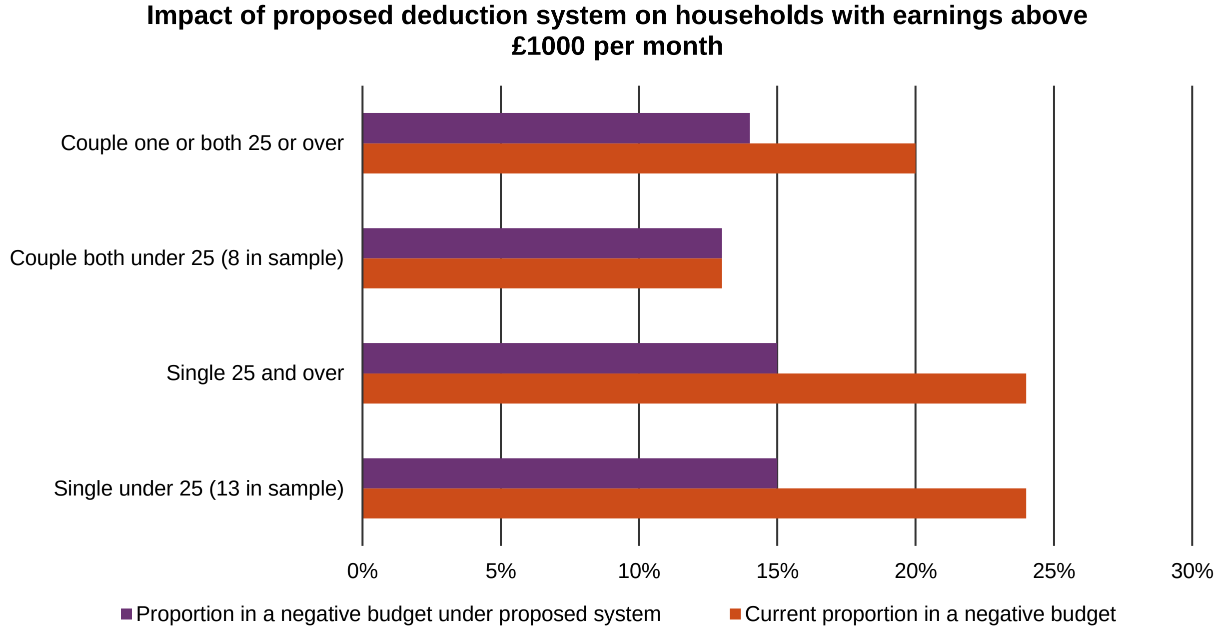
Our modelling suggests the beneficial impact of reducing hardship experienced by StepChange could be considerable. **We estimate the proportion of single claimants over 25 in a negative budget would fall by over a fifth, while for couples over 25 it would fall by nearly a third.**

These figures also demonstrate that for households out of work this change to deductions will not be enough to address the scale of hardship currently faced. A significant proportion of all households would remain in a negative budget. This shows just how damaging the current system of taking 15% of the UC standard allowance can be.

[24] For those who receive housing support the allowance would be £344



For those on higher incomes the impact is also pronounced, although results are affected by smaller sample sizes. The potential impact is largest for older single households who we found to be in the most challenging financial circumstances. Reducing the rate of deduction for these households could reduce the proportion in a negative budget by a third.



Looking specifically at single claimants aged over 25 without children (the group we found to be facing the most challenging financial circumstances) demonstrates the potential this system has for reducing hardship.

Single clients aged over 25 with no children on UC with an overpayment debt

Wage income	Current average budget surplus / deficit	Proportion with negative budget	New average budget surplus/deficit	New proportion with negative budget
No wage or earning below £60	-£82.36	57%	-£32.12	44%
Earning between £60 and £573	-£56.57	53%	£27.16	37%
Earning between £573 and £1000	-£46.51	44%	£28.75	33%
Earning over £1000	£79.85	38%	£146.86	27%

This tiered approach to deductions greatly reduces the proportion of out-of-work clients in a negative budget. Allowing households to earn up to the work allowance before deductions apply leads to a 30% reduction in the proportion of those on the lowest incomes in a negative budget. Again, there would still be a substantial proportion at all levels in a negative budget: an estimated two in five of those without wage income. This reaffirms the fact that the current approach of applying deductions to these households is compounding widespread hardship and the urgent need to make the hardship appeal system more accessible.

Clients with earnings over £1,000 per month have a higher average surplus under this system. When individuals have earnings above this threshold, DWP may encourage use of the self-service system it is currently trialling. This would allow claimants to pay back money more quickly if they chose to do so. **However, given that the system does not consider the debts an individual may be repaying outside of deductions these surpluses should not be seen as justification to take more of their entitlement.** Unless a full budgeting session is conducted, deduction rates for non-priority debts should be limited to avoid repayments for these debts making individuals unable to repay priority arrears.

Looking at couple households with two or fewer children reinforces the potential benefits of these changes.

Couple clients aged over 25 with two or fewer children on UC with an overpayment debt

Wage income	Current average budget surplus / deficit	Proportion with negative budget	New average budget surplus/deficit	New proportion with negative budget
No wage or earning below £60	-£44.60	43%	£34.26	30%
Earning between £60 and £573	£24.13	27%	£155.56	19%
Earning between £573 and £1000	£62.98	31%	£181.27	22%
Earning over £1000	£150.43	19%	£255.57	16%

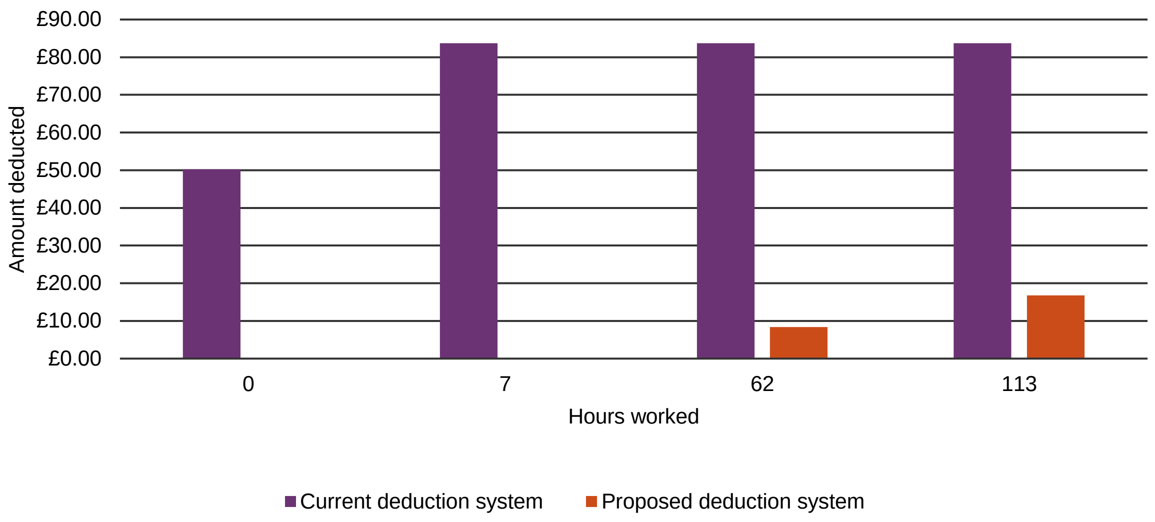
The changes lead to an estimated 30% reduction in the proportion of out-of-work households in a negative budget. All income groups would, on average, move into a positive budget. (A slightly larger proportion of households in the middle-income band of this cohort are in a negative budget than those on the lowest earnings. This is likely due to relatively small sample sizes of just under 100 clients for these groups).

How would this system improve work incentives?

The system would also support work incentives by allowing claimants to keep more of their income. The chart below demonstrates how much more income a single individual aged 25 or over with an overpayment deduction would be able to keep working increased hours at the minimum wage.

Under our proposed system this individual can hold onto much more of their additional earnings. Ending deductions before earnings exceed the level of the current work allowance removes the disincentive to take on more than six hours work claimants with these deductions currently face. The system we propose leaves them over £75 better off after their first 61 hours of work.

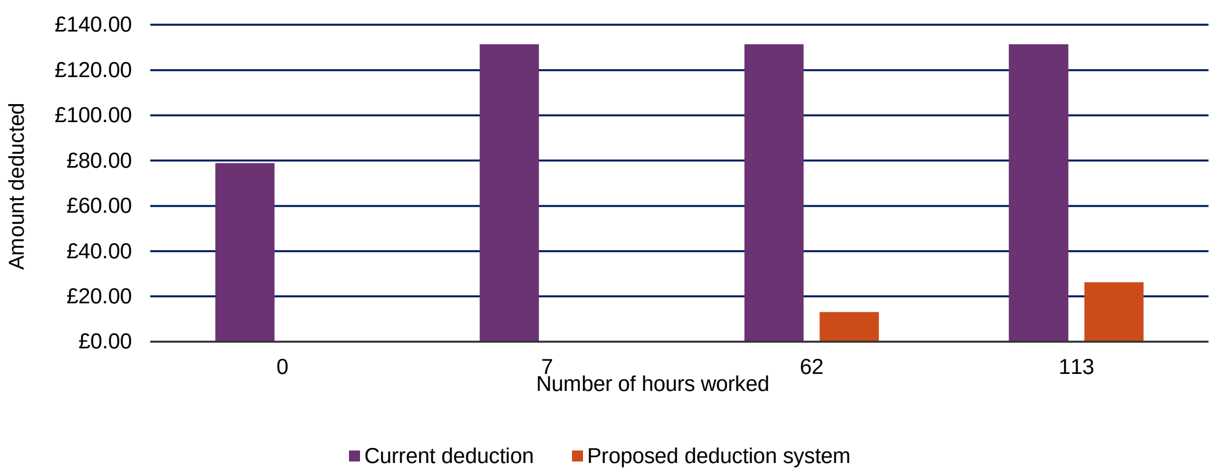
Overpayment deduction for single claimant aged 25 or over



As their earnings increase over the proposed earning buffer, the improvement versus the current system reduces. However, even after hitting the maximum 5% rate after working 113 hours, our proposed deduction regime leaves them £67.01 better off. The slow staggered increases mean the impact on work incentives are much smaller than under the current system. At worst, claimants would only ever be worse off taking on two extra hours as the deduction rate increases more slowly.

For couple households the impact would be just as pronounced. The households could be £131.43 better off with one individual working up to 61 hours a month. Even for those working close to full time over 112 hours per month, they would keep just over £100 more of their UC if they only had an overpayment deduction. The biggest increase in reduction they would face would be £13.14, much lower than the £52.57 increase they currently experience when they begin earning more than £60 in a month.

Overpayment deduction for couple (aged 25 or over) with two or fewer children



The case for change

In the context of the cost-of-living crisis, deductions for non-priority government debts should be suspended. Suspension of these deductions would alleviate inflationary cost pressures for over a million households in receipt of UC experiencing these deductions. This suspension should remain in place at least until next April when benefit levels will be uprated, and we will be through the winter months when households will be facing the highest energy costs.

DWP should use this pause to redesign the deductions system for tax credit and benefit overpayment debts. The financial circumstances of households on UC who are out of work or on low incomes are such that even a single deduction at current rates can push them into destitution and force them to borrow to make ends meet – risking a spiral of debt. The best way to reduce this risk under the automated deduction system is to adjust rates so they better reflect and are more closely linked to household means.

The Government is currently consulting on regulations for SDRPs. Under current proposals, UC advances will be non-eligible debts. Given the exclusion of these debts from the Government's most prominent new debt support scheme, it is even more important there is action to link the deductions system to a measure of affordability.

Greater effort must also be made to make households aware of their ability to renegotiate their rate of repayment regularly at every touch point they have with the UC system alongside steps to tackle the negative perceptions people have about creditor support. Many households are unaware of their ability to renegotiate, further increasing the risk that the current approach will leave households in hardship they cannot recover from.

We therefore recommend that DWP:

- Pause deductions for UC advances and tax credit or benefit overpayments at least until benefits are uprated next April
- End deductions for tax credit and benefit overpayments for claimants without earned income or income below the work allowance except where a detailed affordability assessment has been conducted and claimants consent to these deductions
- Reduce the maximum rate of deduction for tax credit and benefit overpayment deductions to 5% of the standard allowance, increasing from 0% to this rate incrementally as earnings increase
- Ensure the process to reduce deduction rates is promoted and accessible to claimants

These changes will not end the hardship currently caused by deductions made to UC. Historically low level of support delivered through the benefit system means that any deduction risks pushing households into hardship. Income also only gives a partial picture of household circumstances, which is why best practice debt management involves a full budgeting assessment before setting repayment rates. Most households facing deductions for benefit and tax credit overpayments will also have additional deductions. Nevertheless, these changes would be a first step in reducing the risks of making deductions without a budgeting process and begin to link the system with household means.

The system we propose would clearly reduce the rate at which the Government is able to recover benefit overpayment debt. We believe this impact can be reduced with positive communications to households indicating the amount they owe and allowing them to utilise self-serve systems in cases where they wish and feel able to pay back their debt more quickly.

The deduction system is an efficient method of recovery for government but ignores the costs of causing hardship and compounding debt problems through poor design and excessive collection rates. The National Audit Office found that the Government has no estimate of the extent to which problem debt results in increases costs to taxpayers and estimated that the increased use of public services caused by problem debt costs close to £1 billion.[25] The Trussell Trust's findings on the link between debts to DWP and destitution should focus policy makers' minds on the additional public and social costs of the Government's approach.

Our proposed changes would reduce the risk of UC claimants being pushed into hardship and reduce disincentives to take on more hours of work in the current system. This would prevent public costs being incurred elsewhere while supporting individuals to remain economically active.

[25] NAO (2018), *Tackling problem debt*