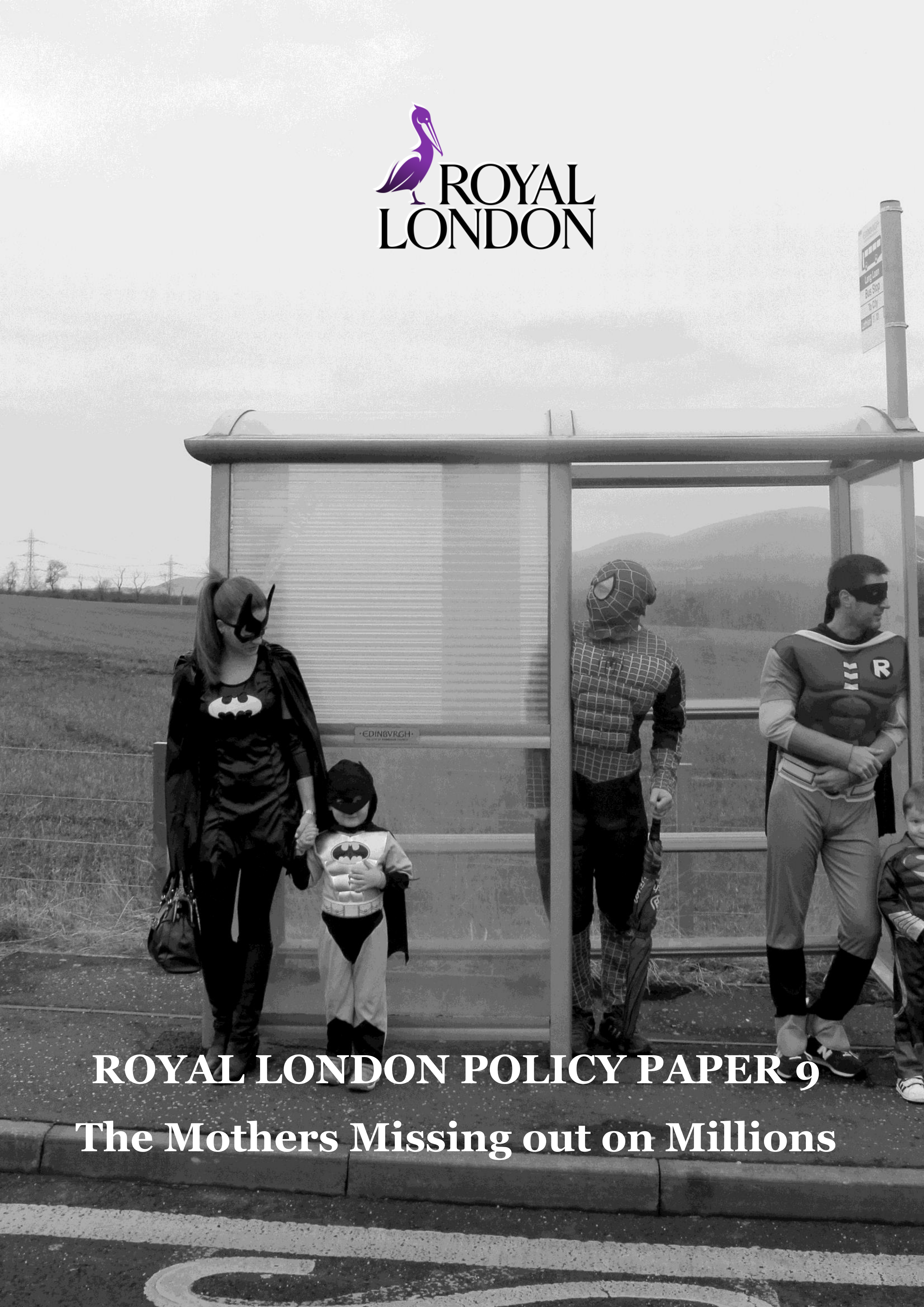
ROYAL LONDON



ROYAL LONDON POLICY PAPER 9

The Mothers Missing out on Millions

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THE MOTHERS MISSING OUT ON MILLIONS

Executive Summary

Since the late 1970s an important part of the National Insurance system has been protection for parents who take time out of paid work to bring up their children.

Prior to 1978, a year spent out of paid work created a gap in an individual's National Insurance record, with a knock-on effect on entitlement to state pension. Since that date, a variety of mechanisms has been in place to reduce the impact on an individual's pension arising from spending time at home with children. Today, parents receiving Child Benefit for a child under 12 are entitled to a National Insurance credit which puts them in just the same position as they would have been if they were in paid work and paying National Insurance contributions.

However, a recent change in the rules around Child Benefit has put that protection at risk for tens of thousands of parents, overwhelmingly mothers[1], and the numbers at risk are rising every year.

In January 2013, a new rule was introduced which reduced entitlement to Child Benefit for those whose income (or whose partner's income) was over £50,000 per year. In particular, those with income over £60,000 faced a 'High Income Child Benefit Tax Charge' which wiped out the cash value of any Child Benefit in payment.

If Child Benefit continued in payment as before but with the tax charge being collected from the tax code of the Child Benefit recipient or their partner, this would have had no knock-on effect on National Insurance credits. But instead two things have happened:

- Large numbers of existing Child Benefit recipients have 'renounced' their Child Benefit; by Summer 2015 this figure had risen to just under half a million;
- Growing numbers of mothers just starting a family are choosing not to claim Child Benefit in the first instance;

In the former case, transitional rules mean that mothers who were previously receiving Child Benefit can continue to get National Insurance credits towards their state pension, even if they have 'opted out' of Child Benefit. But for the latter group, unless the mother builds up a year of NI Contributions through paid work or some other credit (eg for being a carer or signing on as sick or unemployed) they will miss out on a year

[1] Whilst help is available to a small number of fathers where they are the Child Benefit recipient, around 95% of those affected are mothers. For brevity, we refer to 'mothers' in the rest of this document.

of NI Contributions. And being one year short at the end of your working life could cost nearly £5,000 in missing state pension rights through the course of a typical retirement.

Looking at lost pension rights in 2014/15 and 2015/16 combined, we estimate that around £278 million in state pension rights have potentially been lost. We also estimate that around 125,000 mothers were missing out during 2015/16. As the policy has not changed since then, there is no reason to suppose that the problem has not continued to grow. We therefore estimate that by the end of the current financial year more than half a billion pounds in state pension rights could be at stake.

Urgent action is needed by the authorities to restore NI credits to these women. Otherwise, decades of progress in tackling the relative disadvantage of mothers in the state pension system risks being lost.

Introduction

Entitlement to a state pension is based on an individual's record of National Insurance Contributions. When the modern National Insurance system was created after the Second World War, it was based on an assumption that men would be the primary breadwinners. Whilst it was true that if women were in paid work they could build up their own contribution record, it was assumed that in most cases they would be financially dependent upon their husbands.

Over the years, it became clear that women who were not in paid work because they were bringing up children were missing out on the chance to build up a full state pension in their own right. So, with effect from 1978/79, a new system of 'Home Responsibilities Protection' (HRP) was introduced. In broad terms, people receiving child benefit (overwhelmingly women) were awarded HRP which reduced the target number of contributions which they needed to build up a full state pension in their own right. In 2010 the system was changed to one of 'national insurance credits', where years spent bringing up children under 12 counted as full 'qualifying years' towards the state pension.

The systems of HRP and National Insurance credits did a great deal to boost the pensions of women who spent time out of paid work bringing up children. One of the advantages of the system was that it was automatic – recipients of child benefit were automatically awarded HRP or credits on their National Insurance record without having to make a separate claim[2].

However, in 2013 there was a change to the rules around eligibility for Child Benefit which has had an unintended knock-on effect on take-up of Child Benefit and hence National Insurance credits. As a result, growing numbers of women are missing out on credits and potentially losing large amounts in state pension rights.

In this paper we describe the issue, estimate the scale of the problem and call for government action to avoid going back to the days when women lost out on state pension rights simply because of time spent raising their family.

[2] In fact, there is some evidence that the matching of data between the Child Benefit computer and the National Insurance computer was in some cases incomplete, so some women missed out on their HRP.

1. The High Income Child Benefit Tax Charge

Until January 2013, Child Benefit was paid on a non means-tested basis. Whether you had a high household income or a low income, Child Benefit was paid at the same rate. But in January 2013 a new system was introduced known as the 'High Income Child Benefit Tax Charge'. Under these rules, if an individual or their partner has an annual income in excess of £50,000, there is a tax charge in respect of their Child Benefit. The rate of the charge is 1% of the amount of Child Benefit received for each £100 in excess of £50,000. So, for example, someone with an annual income of £50,200 would face a tax charge of 2% of their Child Benefit. It follows from this arithmetic that someone with annual income of £60,000 (or more) has a tax charge equal to the whole of their Child Benefit. An estimated 1.2 million families were expected to be impacted by the change according to HMRC figures.

Families in this situation have three main options:

a) They can continue to receive child benefit but with the high earning partner paying the tax charge; in other words, the amount paid by the state to one partner in Child Benefit is clawed back in whole or in part through a tax charge on the high earner;

b) They keep a live claim to child benefit but at a 'zero rate'; the purpose of this is to continue to qualify for National Insurance credits; new claimants can tick a box on the application to apply for a 'zero rate' of child benefit;

c) They can decide when starting a family not to bother claiming Child Benefit in the first place; it is the growing number of mothers in this group who are of most concern;

Table 1 shows the number of former Child Benefit recipients who had taken the second option and opted out as at August 2013, 2014 and 2015. Given that HMRC estimates a total of around 1.2 million families affected by the policy, the August 2015 figure suggests an opt-out rate of around 41%.

Table 1: Child Benefit recipients who opted out in August 2013, 2014 & 2015

	Number of families opting out
August 2013	396,980
August 2014	475,740
August 2015	492,695

Source: HMRC Child Benefit Statistics, various years

HMRC publish annual estimates of the number of children in the population and the number of children for whom Child Benefit is in payment. Chart 1 shows this information for each year from 2012 (before the change was introduced) through to 2015 (the latest year for which figures are available). These statistics are as at August each year.

Chart 1a): Number of children in population and number receiving Child Benefit: 2012

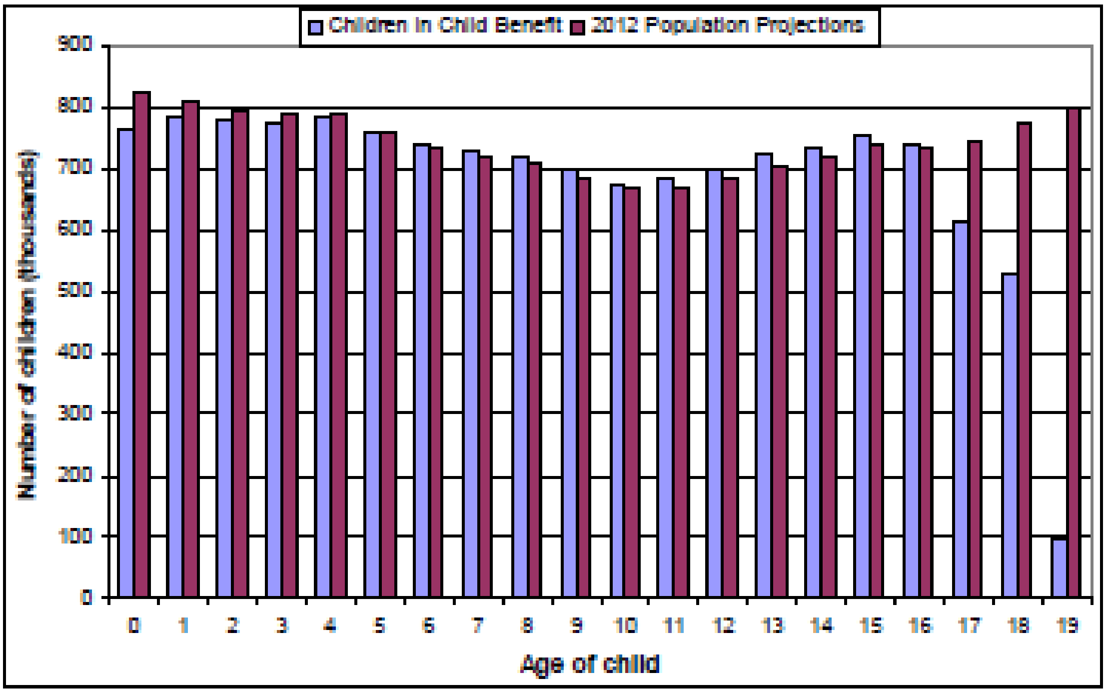


Chart 1b): Number of children in population and number receiving Child Benefit: 2013

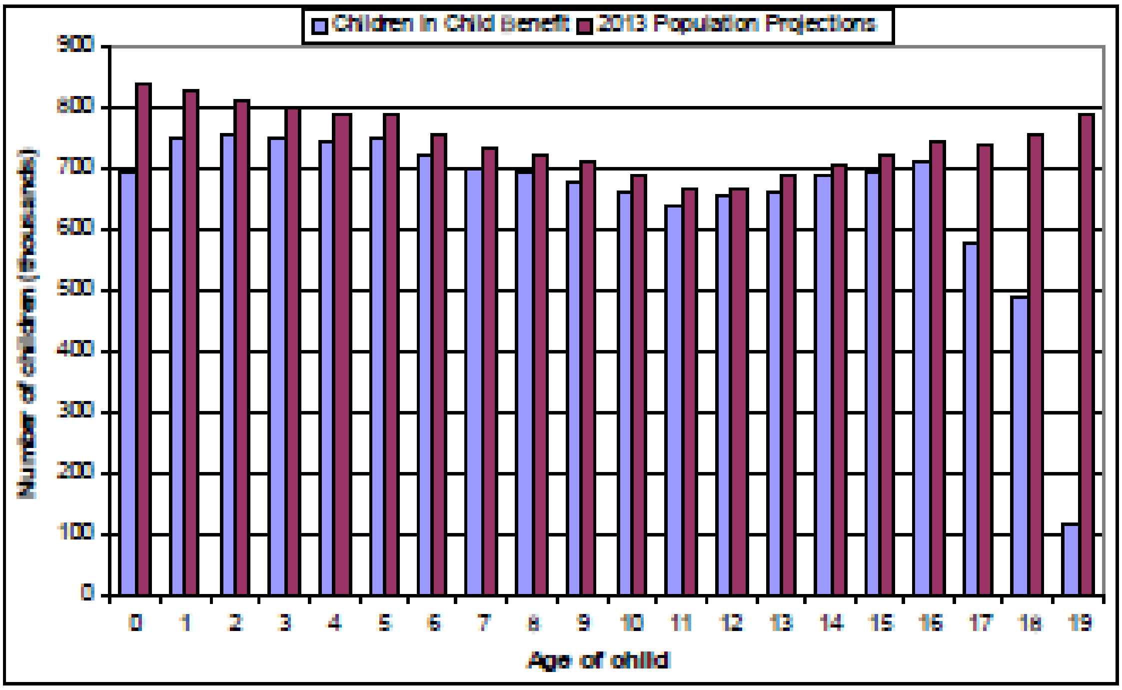


Chart 1c): Number of children in population and number receiving Child Benefit: 2014

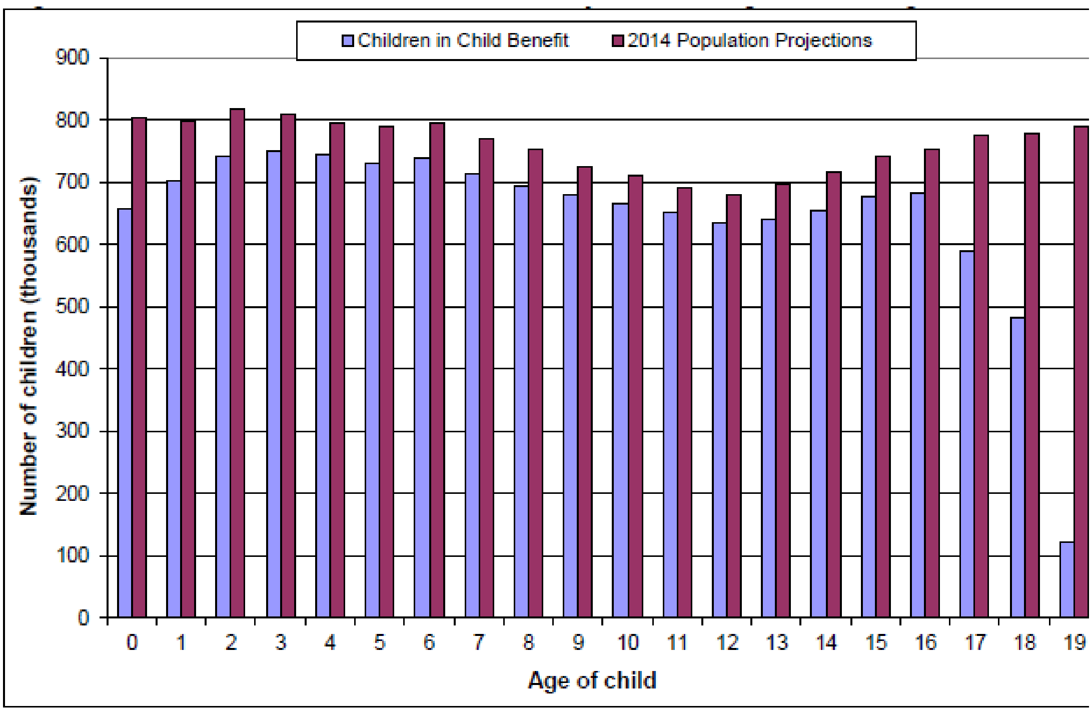
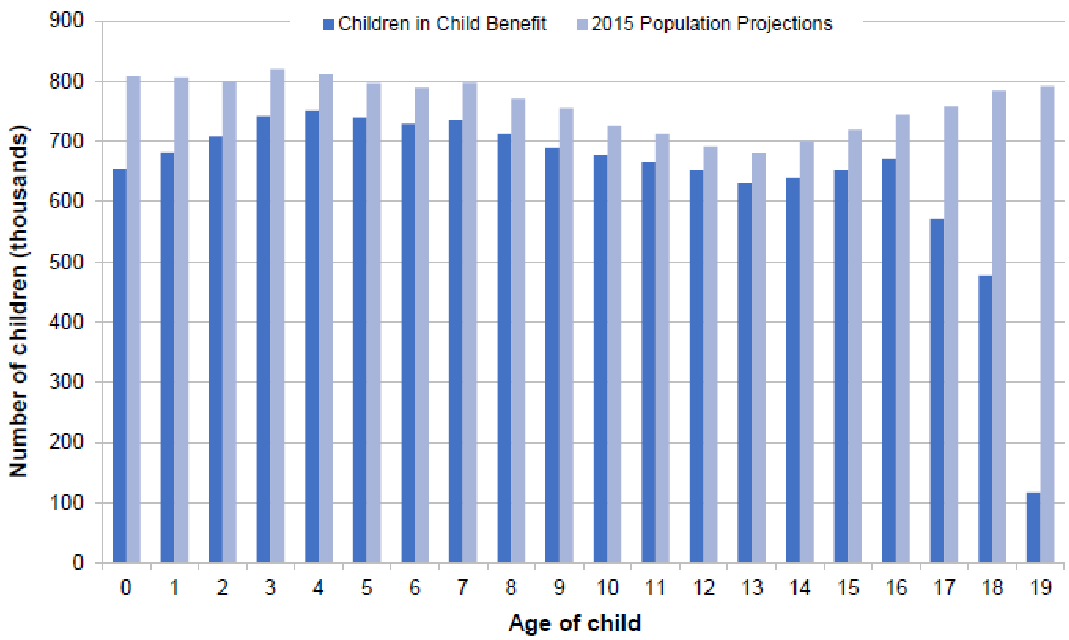


Chart 1d): Number of children in population and number receiving Child Benefit: 2015



Source: *Child Benefit Statistics: Geographical Analysis*, HMRC various years

Chart 1 shows very clearly how the implementation of the High Income Child Benefit Tax Charge has affected families. There are three distinct phases:

a) In August 2012, before the policy was implemented, there was a very close match between the number of children up to age 16 in the population and the numbers for whom child benefit was payable; the principal gap is for new-borns, where there is sometimes a lag between a child being born and a successful claim for child benefit being made; apart from this, there is almost complete coverage of the nation's children below school leaving age by the child benefit system;

b) In August 2013, seven months after the policy was introduced, there is a marked shortfall at all ages between the number of children for whom child benefit is payable and the number of children in the population; this reflects the numbers 'opting out' of child benefit as shown in Table 1; the gap is more marked for younger children, which may reflect the fact that those expecting to be in the system for many years thought it worth opting out;

c) In August 2014, and even more clearly in August 2015, the shortfall between children in the population and children on Child Benefit becomes more marked for the youngest children, namely those born since the policy was implemented in January 2013;

This latter trend is likely to reflect higher income families having their first child who decide that it is not worth claiming child benefit in the first place if the benefit is all going to be clawed back through tax. Indeed, HMRC acknowledge that this is the case where they say:

"The low number of children at ages 2 or younger is likely to be because families subject to the High Income Child Benefit charge, whose first child was born since January 2013 would have had a choice between either registering for Child Benefit and then opting out or not registering to begin with. These figures suggest that some of these families may have chosen not to register after learning about the High Income Child Benefit charge". [Source: HMRC: Child Benefit – Geographical Statistics 2015]

Chart 1 shows that we always should expect a small shortfall between the number of younger children on child benefit and the number of younger children in the population, and that this is particularly marked for the number of new-borns. But the shortfalls in 2013, 2014 and particularly 2015 are greater than would be expected in the pre-reform data. By comparing the actual shortfall in the data for 2014 and 2015 with the expected shortfall, we can estimate how many young children are not appearing in the Child Benefit count because their parent did not make an initial claim.

Looking first just at 2015, Table 2 shows the actual numbers of children receiving child benefit and the estimated numbers in the population. We then apply the following steps:

- Looking at data from before 2013 we can see that there was normally a shortfall of around 15,000 between the numbers on child benefit and the numbers in the population; so part of the shortfall can be ascribed to this factor;

- Also looking at data from before 2013, we see that there is a general shortfall of a further 40,000 or so among parents of new-borns who don't necessarily claim child benefit the instant a child is born;

- Looking at the numbers who had been in the system and actively opted out when the 2013 reforms were introduced, we can estimate that roughly 50,000 children in each age were removed from the count by parents opting out;

- Combining these three numbers, even if every new mother claimed her child benefit, we would expect a shortfall of very roughly 65,000 in each single year of age, and that is broadly consistent with the shortfalls of 58,000-78,000 shown for the children aged 3,4 and 5;

- However, something different has happened for the children born after January 2013 when the new rules were introduced; from the above analysis we would expect a shortfall of around 65,000 among 1 year-olds and 2 year-olds, and around 105,000 among 0 year-olds; but the actual shortfall is much larger than this and the difference is likely to be new parents not claiming for the first time[3]. The final column suggests a total of 135,000 children in families who may be missing out on child benefit through the lack of an initial claim;

Table 2: Number of children receiving child benefit and numbers in population 2015 (thousands)

2015 Age	Child Benefit	Total Popn	**Shortfall**	Normal Shortfall	Impact of opt-outs	**Total expected Shortfall**	**Unexplained Shortfall**
0	654	808	**154**	55	50	**105**	**49**
1	681	806	**125**	15	50	**65**	**60**
2	709	800	**91**	15	50	**65**	**26**
3	742	820	**78**	15	50	**65**	
4	752	811	**59**	15	50	**65**	
5	739	797	**58**	15	50	**65**	

[3] To reassure ourselves that these numbers are broadly accurate, we can look at the children aged 3,4 and 5 who cannot have been affected by 2015 by new parents post January 2013 not applying for child benefit. According to our analysis, we would expect there to be a shortfall of 15,000 children in each age group between the numbers on child benefit and the numbers in the population, and an additional 50,000 shortfall due to opt outs, or a cumulative shortfall of 195,000 for the three age groups taken together. And this is precisely what we find. The total actual population of children aged 3-5 is 2.428 million, and the child benefit population is 2.233 million, a difference of exactly 195,000. This offers us some reassurance that the *additional* shortfall for children aged under 3 is due to a factor which only applies to that age group, namely the fact that these children were all born after the introduction of the High Income Child Benefit Tax Charge.

We do however have to make one adjustment to get from these numbers of children to the number of mothers potentially missing out on National Insurance Credits.

The adjustment is to avoid double counting families with two young children (ie two children under 3) who would count twice in the table above but come from the same family. Analysis of the latest Family Resources Survey suggests that for every 1000 children aged under 3 there are approximately 925 mothers (i.e. stripping out multiple births and families which have two children relatively close together). This means that our 135,000 children probably come from around 125,000 families.

In Table 3, we repeat the analysis for 2014, noting that a failure to claim Child Benefit by a new parent post January 2013 would only be expected to affect the parents of new-borns and one year-olds.

Table 3: Number of children receiving child benefit and numbers in population 2014 (thousands)

2014 Age	Child Benefit	Total Popn	**Shortfall**	Normal Shortfall	Impact of opt-outs	**Total expected Shortfall**	**Unexplained Shortfall**
0	658	805	**147**	55	50	**105**	**42**
1	704	799	**95**	15	50	**65**	**30**
2	742	819	**77**	15	50	**65**	
3	751	810	**59**	15	50	**65**	
4	744	796	**52**	15	50	**65**	
5	732	789	**57**	15	50	**65**	

If we take the 72,000 children shown in the final column and apply the same ratio as before, we can assume that they come from around 66,000 families.

2. Numbers losing state pension rights

A woman who chooses not to claim Child Benefit when starting a family does not necessarily damage her state pension rights. The main reason for this is that if a she is earning more than the Lower Earnings Limit for National Insurance Contributions (currently £5,824 per year) in a single job – or the equivalent from self-employment - she will build up a qualifying year towards her state pension. In this case, not claiming child benefit will not affect her pension position[4].

To work out how many of the women who have not claimed Child Benefit have thereby forfeited state pension rights, we need to exclude those who are earning enough to build up a qualifying year towards their state pension.

We have limited data on those who have not yet initiated a claim, but we do have data in the 2014-15 Family Resources Survey[5] on the earnings of women who reported that they have renounced Child Benefit. Given that these women have children of all ages not just under 3s, we might reasonably expect a higher proportion of them to be in paid work. So by using an estimate based on the women who opted out we will derive a conservative estimate of the scale of the problem.

Based on the women in the 2014/15 FRS who said they had renounced child benefit because of the High Income Child Benefit Tax Charge, we estimate that around 70% nonetheless manage to build up a qualifying year of National Insurance through employment or self-employment income above the minimum necessary level.

Table 4 shows the impact of applying these proportions to our earlier estimates of mothers who may not have applied for Child Benefit owing to the High Income Child Benefit Tax Charge. Note that we are using the August point estimate as a proxy for the whole financial year.

Table 4: Estimated number of families not claiming opting Child Benefit who are missing out on National Insurance Credits

	Total number of families opting out	*Less those building up a qualifying year through work*	**Numbers missing out on NI credits**
2014/15	66,000	*-46,200*	**19,800**
2015/16	125,000	*-87,500*	**37,500**

[4] A small number of women who do not claim Child Benefit may have high earning partners but may themselves be claiming Jobseekers Allowance, Employment Support Allowance or Carers Allowance and may get credits towards their pension through this route. However, the overlap between couples with children with one earner on more than £60,000 and a spouse on JSA or ESA is assumed to be small enough to ignore at this stage.

[5] *Department for Work and Pensions, National Centre for Social Research, Office for National Statistics. Social and Vital Statistics Division. (2016). Family Resources Survey, 2014-2015. [data collection]. 2nd Edition. UK Data Service. SN: 7753,* http://dx.doi.org/10.5255/UKDA-SN-7753-2.

3. How much state pension are these women losing?

The full rate of the new state pension is currently £155.65 per week, based on 35 'qualifying years' of National Insurance Contributions and credits. A woman who does not get NI credits whilst she is bringing up children therefore potentially loses 1/35 of her state pension. Obviously we do not know for sure that she will not acquire 35 qualifying years in the rest of her working life, so it is possible that failing to claim NI credits will have no impact on her final pension. These estimates should therefore be regarded as upper limits on the amount of state pension rights which these women may be losing. But clearly the longer she continues to forego NI credits, the more chance there is that she will be doing damage to her state pension record.

Assuming that a woman ends up with 34/35 of a state pension rather than 35/35, she will lose 1/35 of the full rate of £155.65 or £4.47 per week or £231 per year. This is explained more fully in the case study box.

Example: Impact of a missing year of National Insurance Credits

Maria is a graduate who started paid work in her early 20s and works into her mid to late 50s. She spent around 18 months at home when her baby was born. Later in life she cuts back on her paid work and spends some time looking after her elderly mother. She doesn't earn enough in those later years to pay (or be credited with) National Insurance Contributions and she isn't spending enough hours each week as a carer to get carer's credits. As a result, the later years in her working life are not 'qualifying' years towards her state pension. Excluding the full financial year spent at home with her baby, Maria therefore builds up 34 qualifying years towards her pension.

Option 1. Maria claims Child Benefit and her husband pays the tax charge or she claims Child Benefit and opts for a zero rate award

Maria gets a year of National Insurance credits for her full financial year at home with her baby. This means she has 35 qualifying years and can draw a full state pension of £155.65 per week.

Option 2. Maria does not claim Child Benefit

The year at home with the baby is a 'gap' in her National Insurance record, so Maria is entitled to only 34/35 of a full pension or £151.20 per week. The loss of £4.45 per week is around £231 per year or just under £5,000 over her 21 year retirement.

We assume that a woman of child bearing age will have a state pension age of 68 (under current legislation). The ONS estimates that a 68 year-old woman today will live for a further 21 years, though obviously there is a strong chance that today's young mothers will have a much greater life expectancy. However, to err on the side of caution, we will use 21 years as the basis for our calculations.

If a woman foregoes £231 per year in state pension for a total of 21 years, she will lose £4,851 in total. Applying this figure to our estimates in Table 4 gives the following total potential losses:

Table 5: Potential total loss in state pension rights

	Total numbers missing out on NI credits	Amount of state pension lost
2014/15	**19,800**	£96m
2015/16	**37,500**	£182m

As Table 5 shows, the amounts potentially being lost in state pension rights are significant and rising. Over the last two years £278m in state pension may have been lost by women as a by-product of the High Income Tax Charge. If the rate of growth continues into the current financial year (which is likely as another cohort of new mothers decides not to make a claim) the loss in 2016/17 would be another £268m, making a grand total of £546m by the end of this financial year.

As we have made clear above, some of these women will not lose out because they will build up other qualifying years at other times in their working life. On the other hand, as also noted above, Table 5 only shows data for the first two full years of operation of the new scheme and there is no reason to think that the amounts missed out will not have continued to rise in 2016/17. We can therefore say with some confidence that by the end of this financial year several hundred million pounds of pension rights have been lost by women as a direct consequence of the High Income Child Benefit Tax Charge.

4. Impact on women's independent incomes

Where a child is raised in a two-parent family, Child Benefit is paid by default to the mother. Roughly 95% of all Child Benefit recipients are women. In the majority of couples affected by the High Income Child Benefit Tax Charge, it is the father who is the higher earner and who would be liable for the tax charge. In households where Child Benefit continues to be in payment and where the higher earning partner pays an equivalent tax charge, the new rules simply reduce the income of the father and have no impact on the income of the mother. But in households where the Child Benefit has been 'renounced' (or never claimed) it is a different story.

If a mother who was previously receiving Child Benefit decides to renounce her entitlement in order to prevent her partner from facing a tax charge, then the immediate impact of the charge will fall on the mother, who may well be the lower earner of the couple. With opting out now happening on a large scale, this is starting to be a significant issue.

MRC provides data on the numbers of families who have opted out of Child Benefit and the number of children in those families. This allows us to calculate the total amount of Child Benefit being foregone by those who have opted out. Table 6 shows our estimates for 2013, 2014 and 2015 of the total amounts by which the income of these mothers has fallen as a result of 'renouncing' Child Benefit.

Table 6: Estimated amounts of Child Benefit lost by mothers who opt out of Child Benefit receipt (annual equivalents)

	Annual amount lost
2013/14	£631m
2014/15	£749m
2015/16	£771m

Source: Author's calculations based on HMRC data on families opting out of Child Benefit

Taking these three years together, it would seem that mothers have lost around £2 billion to date as a direct result of the High Income Child Benefit Tax Charge. This does not include those mothers who have recently started a family and have never initiated a Child Benefit claim, which is a large and growing group. Clearly we cannot know what financial flows have happened within the household when the Child Benefit claim was cancelled, but in terms of *independent* income, this measure has had a seriously detrimental effect on large numbers of mothers who may not themselves have a high personal income.

5. Conclusions and Policy Recommendations

The introduction of 'Home Responsibilities Protection' and National Insurance Credits were an important step in protecting the pension rights of mothers. It would therefore be a seriously retrograde step if this system were to be significantly undermined as a by-product of the High Income Child Benefit Tax Charge.

Whilst efforts have been made to ensure that mothers are aware of the impact of missing out on child benefit, the system is clearly not working. Assuming that the High Income Child Benefit Tax Charge remains a feature of the system, we recommend that HMRC seeks to identify new mothers who have not (yet) claimed Child Benefit for the first time and encourages them to claim. This may involve working with registrars who could communicate to new parents the value of National Insurance credits and the potential cost of not claiming Child Benefit. We would also encourage those individuals who have never claimed Child Benefit to make a claim, even if it is of no short-term benefit to them.

Without these steps, some of the significant progress that has been made in improving the relative position of women in the state pension system could be reversed.

APPENDIX: Regional Breakdown

We do not have reliable regional figures for the number of new mothers not claiming child benefit for the first time due to the High Income Child Benefit Tax Charge. However, HMRC does publish a breakdown of the number of families opting out of Child Benefit in each nation of the United Kingdom and in each region. Because the factors leading someone to renounce child benefit are essentially the same as those which would lead someone not to claim child benefit in the first place, it seems reasonable to assume that the regional spread of the 'opt-outs' would be a good guide to the regional spread of the mothers not claiming child benefit in the first place.

On this basis, Table A1 shows the approximate amount of money in each nation and region which is being lost by women who are missing out on NI credits.

Table A1: Amount of lost pension rights by new mothers not claiming child benefit by region

	2014/15	2015/16	Total
England	**£85m**	**£162m**	**£247m**
North East	£2m	£4m	£6m
North West	£7m	£13m	£20m
Yorks & Humber	£5m	£9m	£14m
East Midlands	£5m	£10m	£15m
West Midlands	£6m	£11m	£16m
East	£13m	£24m	£36m
London	£18m	£34m	£52m
South East	£23m	£44m	£68m
South West	£7m	£12m	£19m
Wales	**£2m**	**£4m**	**£6m**
Scotland	**£7m**	**£14m**	**£21m**
Northern Ireland	**£1m**	**£2m**	**£4m**
UK	**£96m**	**£182m**	**£278m**

Given that the High Income Child Benefit Tax Charge applies only to those where a family member is earning over £50,000 per year, it is not surprising that there is a strong geographical concentration in the impact of this tax charge. For example, in 2015/16 a total of £182m in pension rights is lost across the UK but over £100m of this comes from just three regions – London, the South East and the East of England.