



Institute for
Fiscal Studies

Tax and benefit changes, excluding those affecting mainly the very rich

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Outline

- Pre-announced reforms to be implemented this April
- Specific measures announced yesterday
 - Changes to income tax personal allowances
 - Change to income-related withdrawal of Child Benefit
- Estimated distributional impacts of reforms under coalition
 - By April 2012; by April 2014
 - By income; by household type
- *DISTRIBUTIONAL ANALYSIS IGNORES MEASURES LARGELY AFFECTING THE VERY RICH (MANY OF WHICH CAN NOT BE MODELLED ROBUSTLY)*

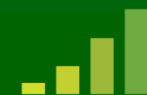
Big changes already announced for April 2012

- Income tax allowance up by £210 above indexation; higher rate threshold frozen
- (Funds for) council tax freeze in England
- CPI indexation for benefits/tax credits; now also use CPI for some direct tax thresholds. Implies 5.2% increase for those parameters.
 - Would have been 6.8% for most means-tested benefits
 - Would have been 5.6% for most other benefits and direct tax thresholds
- Other real cuts to tax credits and Child Benefit
- These, plus other changes, bring average net takeaway from tax and benefit reforms under coalition to date to £790 per household in 2012-13



Income tax allowance: more progress to £10,000

- In April 2013, would increase by £250 to £8355 under default indexation (for those aged under 65)
- Will instead increase by additional £850, to £9,205
 - Costs £3.3 billion in 2013-14
 - Basic rate taxpayers gain £170 per year
- Higher rate threshold lowered so higher rate taxpayers gain only £42.50
 - Creates another 325,000 higher rate taxpayers
 - 15% of taxpayers will face the higher (or additional) marginal rate in 2013-14 (was 3% in 1978-79)
- Additional cost of reaching £10k in 2015-16 is now £1.5 billion in that year (if higher rate threshold unaffected)



What does this achieve?

- Another 840,000 individuals taken out of income tax
- Biggest beneficiaries: families in upper-middle of income distribution
 - Many individuals in lowest-income families pay no income tax anyway
 - Two-earner families gain twice
- Strengthens work incentives for low-earners
- But why fixate on taking people out of income tax and ignore National Insurance (NI)?
 - Raising employee NI threshold (will be £7,592 per year in 2012-13) would reduce tax for even lower earners

The end of age-related income tax allowances

- Currently, those aged 65 and over have larger income tax allowances (£10,500 if aged 65-74; £10,660 if aged 75+)
 - Tapered away as income rises above £25,400
- From April 2013: available only to existing recipients; frozen until no higher than the allowance for others (then abolished)
 - HMRC: 4.4 million losers in 2013-14; average loss among losers of £83
 - Raises £1.2 billion per year by 2016-17
- Less impact than otherwise due to substantial increases in allowance for those aged under 65
 - But worst case: someone turning 65 in 2013-14 with income between £10,820 and £26,200 would lose £323 in that year
- A simplification

Withdrawing Child Benefit (CB)

- Government planned to withdraw all CB from any family containing higher rate income taxpayer from January 2013
- Two major issues with this:
 1. 'Cliff-edge': CB removed *entirely* when income crosses particular threshold
 2. CB entitlement would depend only on the income of higher-income person in family
- Government has chosen to tackle the first issue (the cliff-edge)
 - Those who were worried about issue 2 - the relative treatment of 1-earner/2-earner families – will still be worried

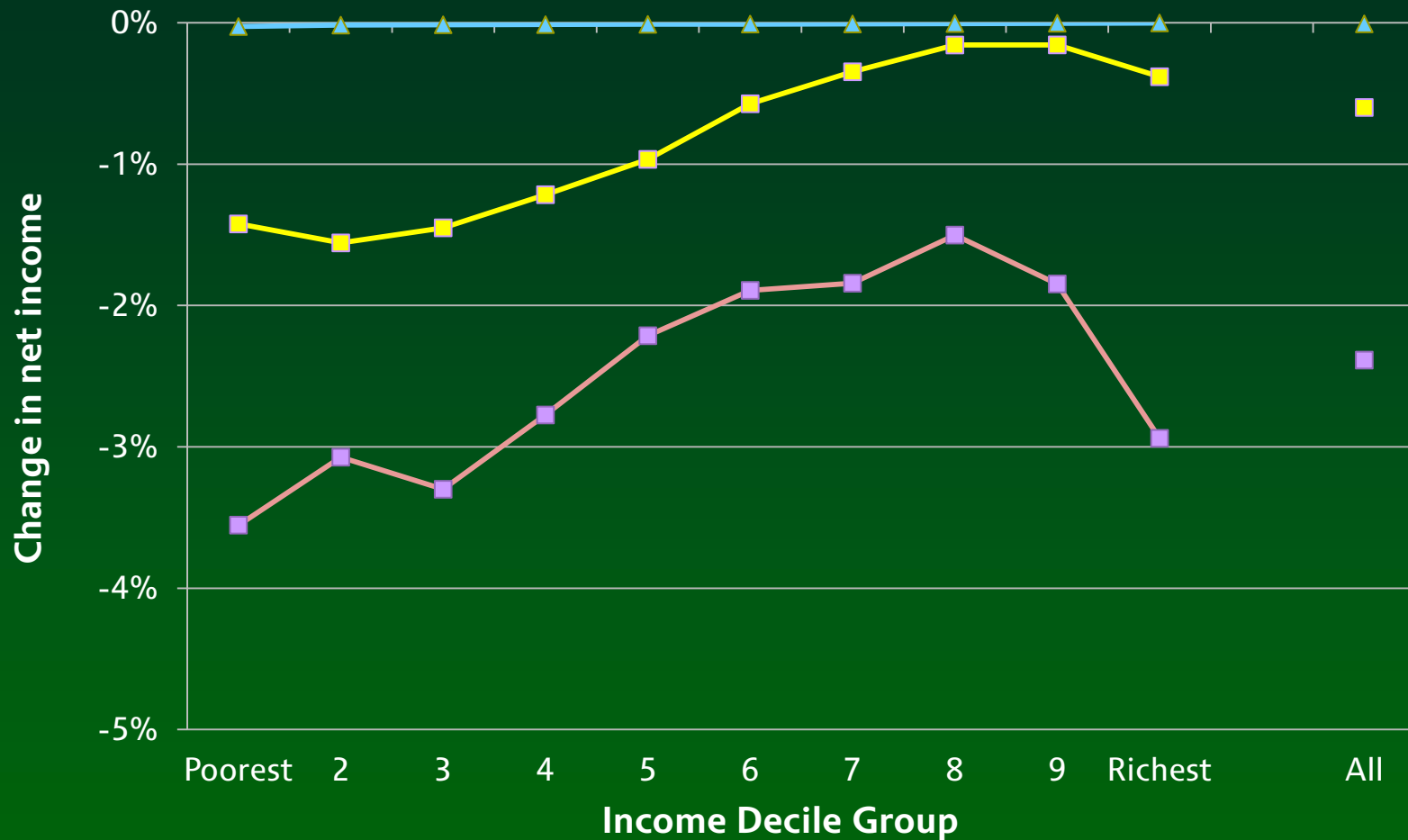
Walking away from the cliff-edge

- CB will now be withdrawn from families containing an individual with income $> £50,000$ (rather than £42,475)
- Crucially, will be withdrawn *gradually* as income rises
 - Will lose 1% of CB for every £100 by which income exceeds £50k
 - In cash terms, you lose CB at a faster rate as income rises if you have more children (receive more CB)
 - Adds about 11/18/24 percentage points to your effective marginal tax rate between 50k and 60k if you have 1/2/3 children
 - All CB exhausted when income reaches £60k

Child Benefit: consequences of policy change

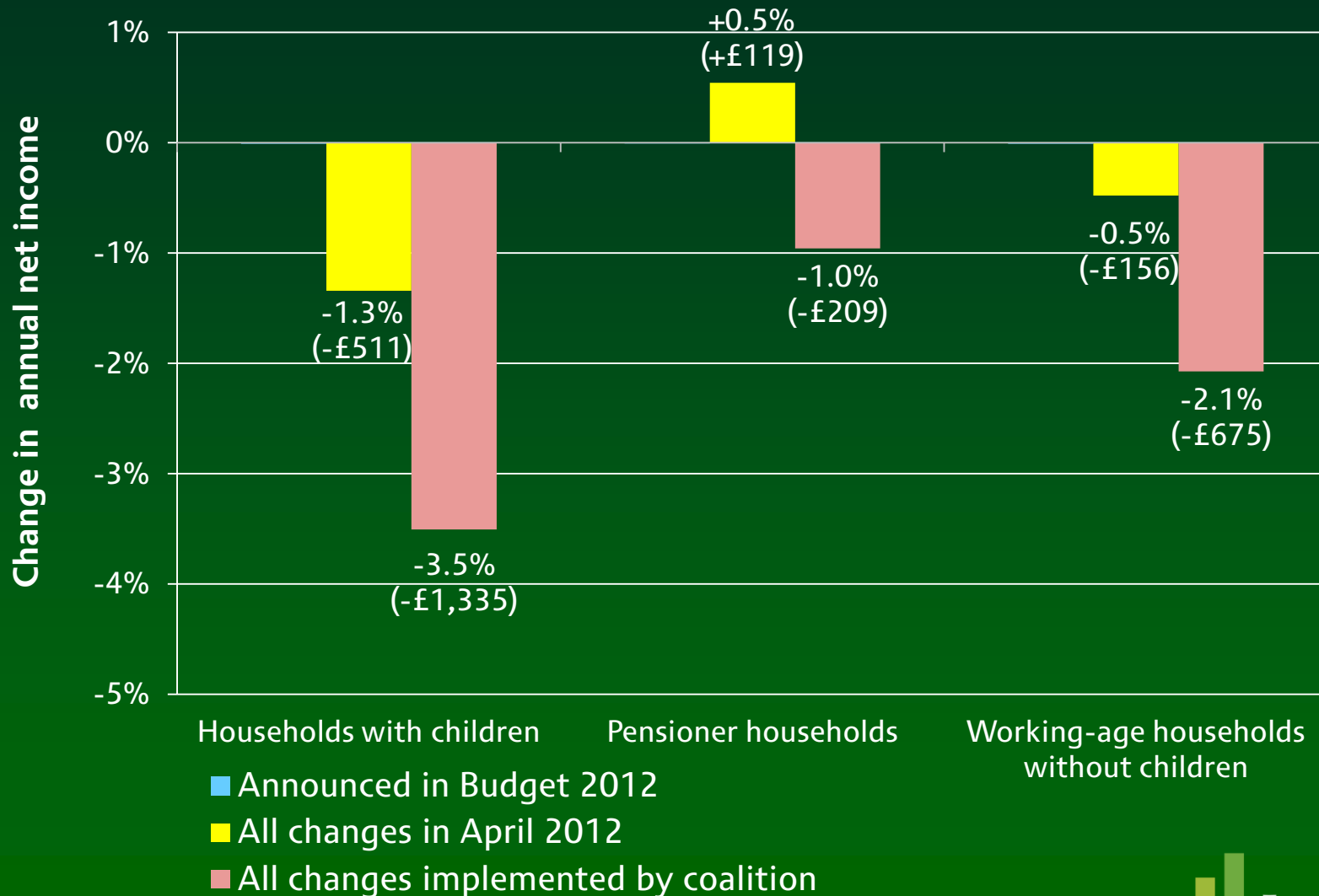
- Treasury expects new policy to raise £1.5 billion in first full year, compared to £2.2 billion under original policy
- Of 1.6 million families losing CB under original plan, we estimate:
 - 700k still lose all CB; 400k lose only *some* CB; 500,000 retain all CB
- *Gradual* withdrawal means people cannot have lower net income after pay rise (unless they have 8 or more children!)
 - Improvement over very undesirable feature of previous policy

Impact of changes taking effect by April 2012

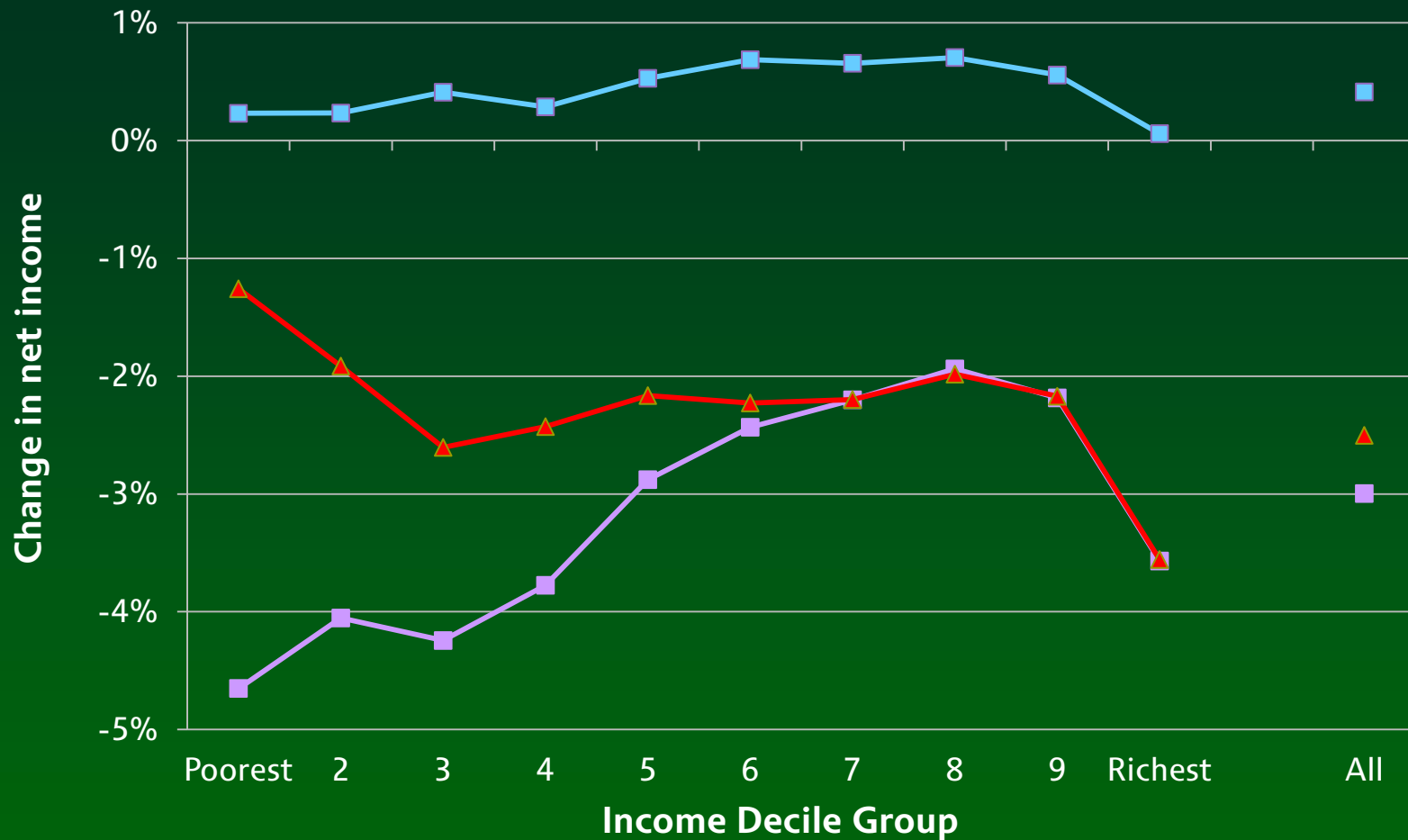


- ▲— Announced in Budget 2012
- All changes in April 2012
- All changes implemented by coalition

Impact of changes taking effect by April 2012



Impact of changes taking effect by April 2014



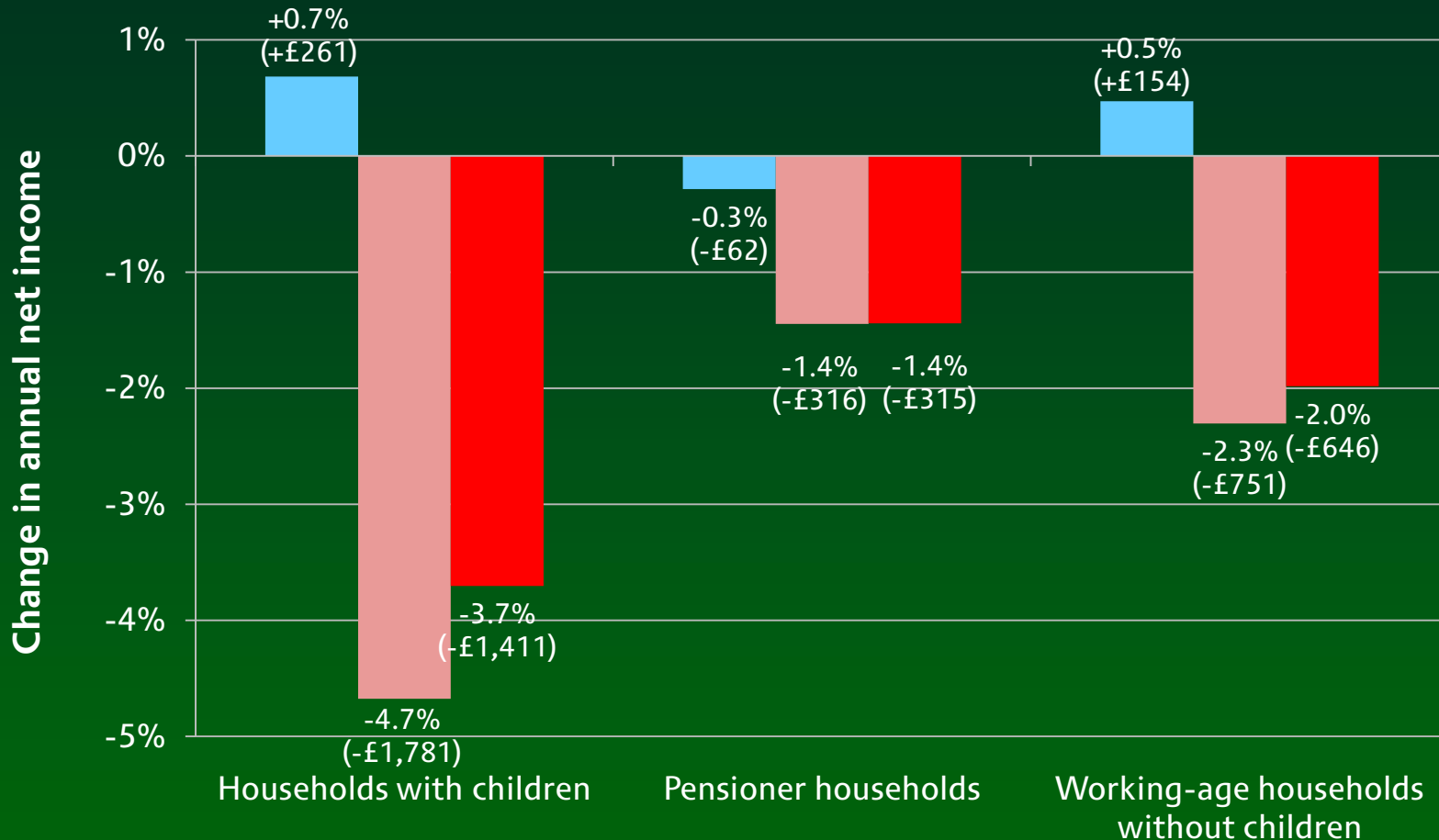
—■— Announced in Budget 2012

—■— All changes implemented by coalition, ignoring Universal Credit

—▲— ...or assuming Universal Credit fully in place

Note: ignores measures affecting mainly the very rich

Impact of changes taking effect by April 2014



■ Announced in Budget 2012

■ All changes implemented by coalition, ignoring Universal Credit...

■ ...or assuming Universal Credit fully in place