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Direct taxes and benefits

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Overview

- Income tax rises for the very rich
- Measures affecting businesses
- Benefits and tax credits
- Other changes

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Income tax rises for the very rich

- Personal allowance to be withdrawn in one stage (above £100k) instead of two (above £100k and £140k).
  - HMT says will raise £180m (on top of £1.2bn from two-stage version) in 2011-12
- Tax rate above £150k to be 50% in 2010-11, not 45% in 2011-12
  - Breaks manifesto commitment
  - HMT says will raise £800m (on top of £1.6bn from 45% version)
- Tax relief on pension contributions reduced above £150k
  - Gradually reduced from 50% at £150k to 20% above £180k
  - HMT says will raise £3.1bn
- This revenue is coming from relatively few people
  - 750k above £100k (2% of adults), 350k above £150k (1% of adults)

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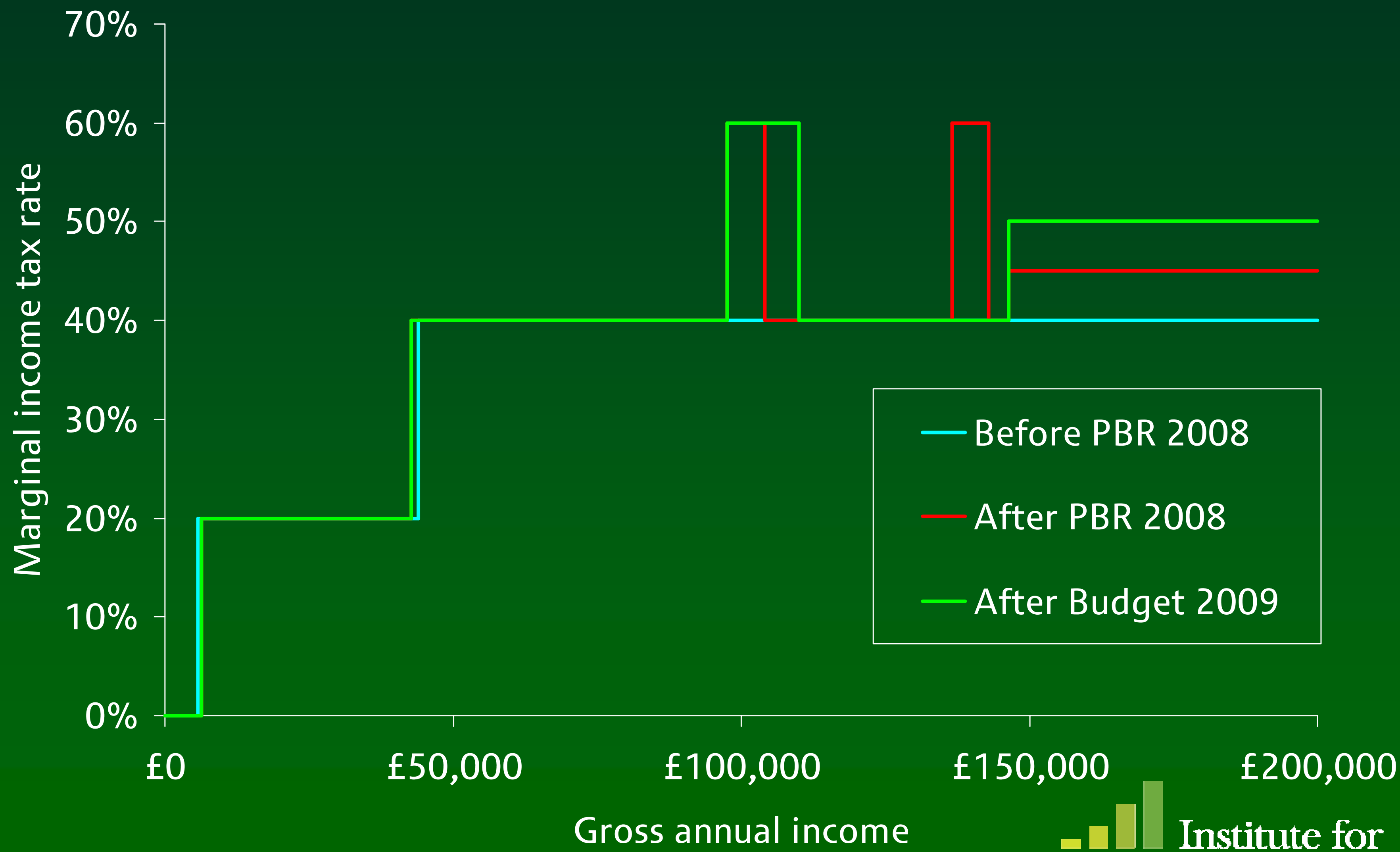
Income tax schedule, 2011-12



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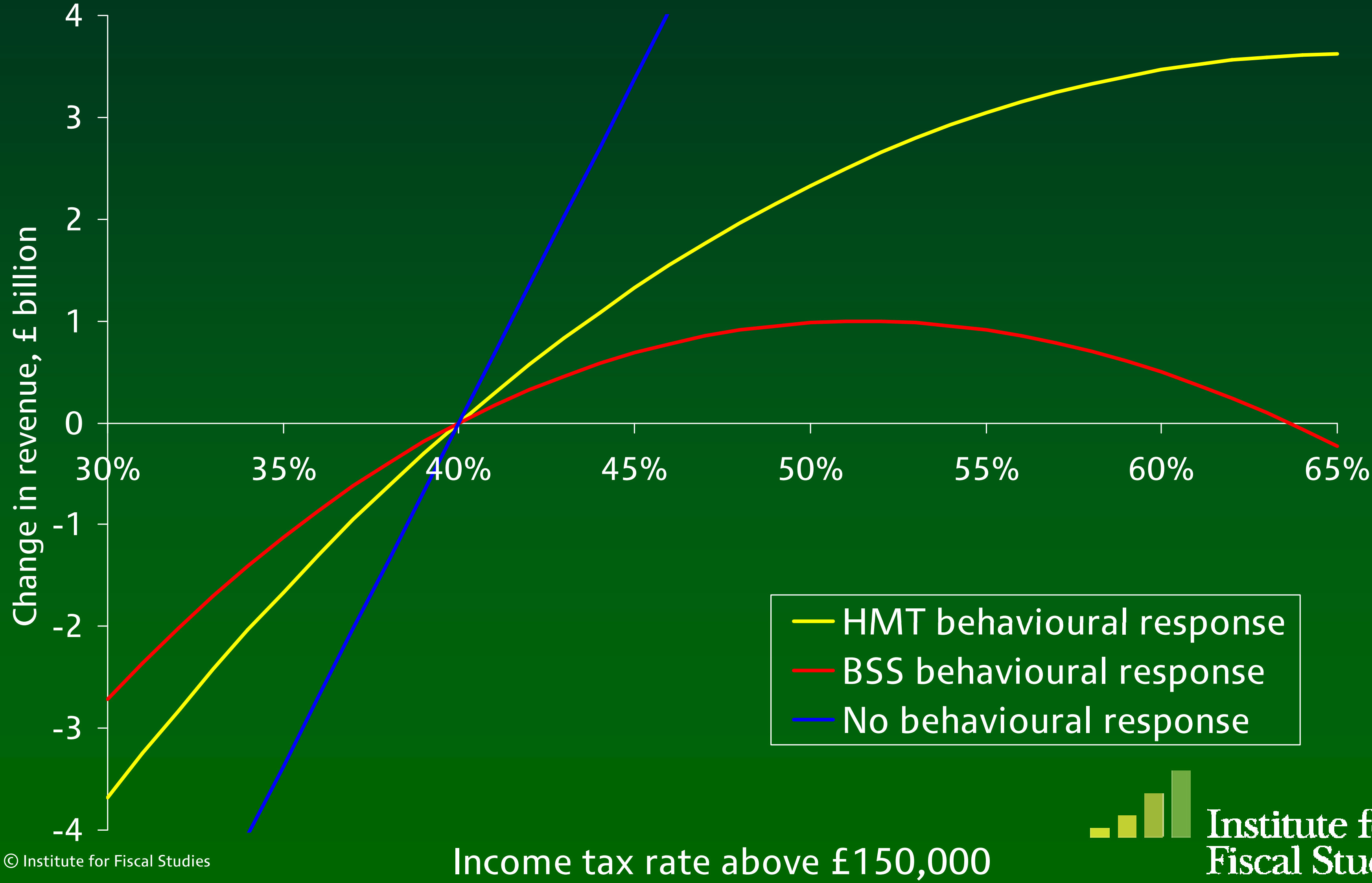
How much will the 50% rate raise?

- HM Treasury says £2.4bn
- Huge uncertainty about how much people will reduce their taxable income in response
  - Work less, retire earlier, emigrate, contribute more to pension or charity, convert income to capital gains, incorporate, invest in tax avoidance, …
  - This is vital for the effect on revenues
  - Government’s assumption not unreasonable
- £2.4bn also ignores any effect on consumer spending
  - Even if HMT are right about responsiveness of income, indirect tax revenues could fall by up to £1.5 billion
  - May show up elsewhere in revenue forecasts
- This reform alone could actually cost money
  - But cutting tax relief on pension contributions makes 50% rate harder to avoid
  - Not included in these costings: part of estimate for pension measure

Revenue raised by income tax rates above £150,000, excluding effect on indirect taxes



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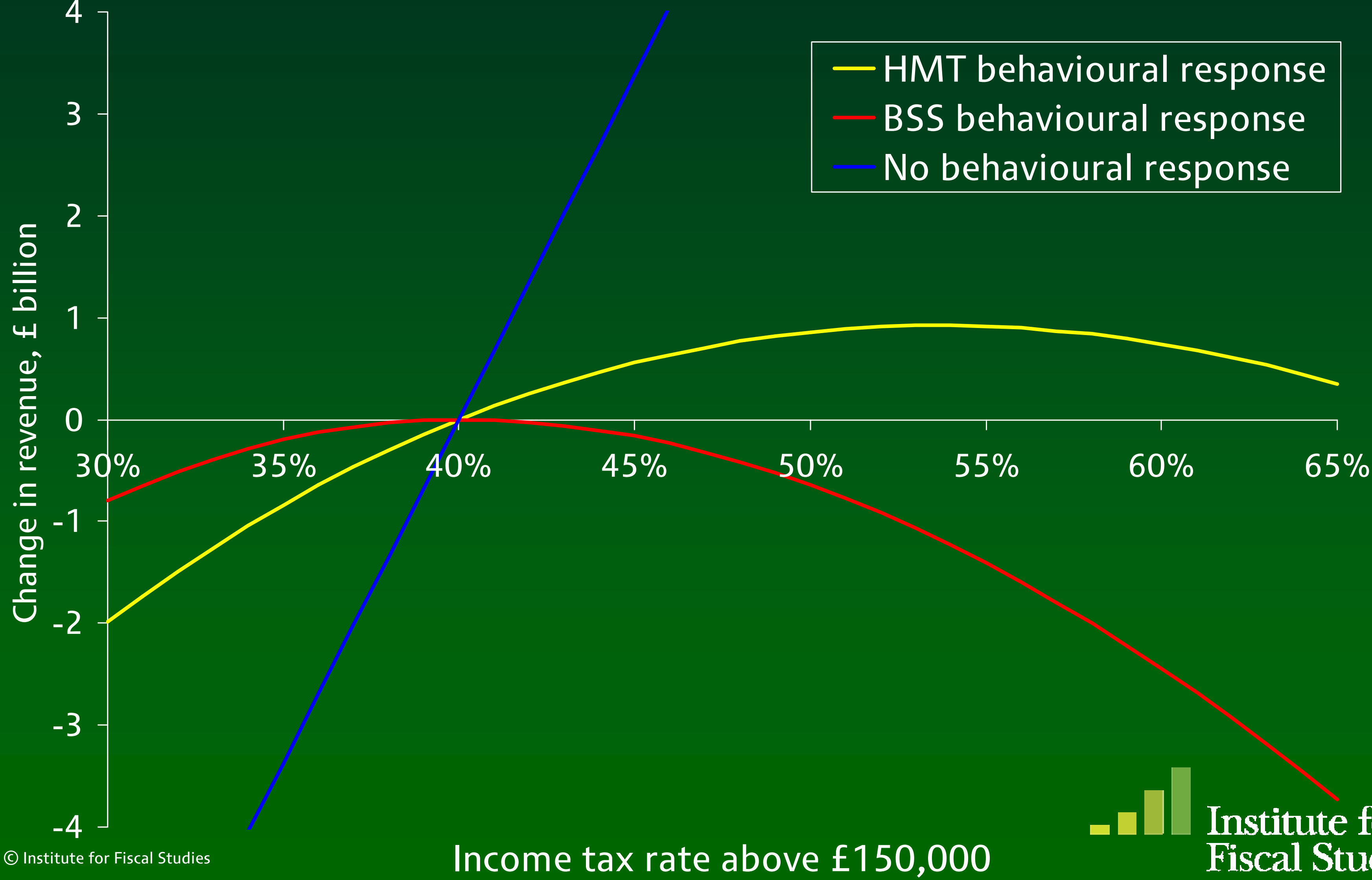
Revenue raised by income tax rates above £150,000, including effect on indirect taxes



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Tax relief on pension contributions

- Tax relief currently given at taxpayer's marginal rate
  - Reducing taxable income by £1 saves 40p if higher rate, 20p if basic rate
- Government wants to end this for those on very high incomes from 2011-12:
  - Relief at new 50% rate @ £150,000…
  - Falls by 1% for each £1,000 of income…
  - Until relief only 20% if income exceeds £180,000
  - i.e. above this level, levy a 30% tax on income paid into a pension
  - HMT says will raise £3.1bn in 2012-13
- Big incentive to make contributions before 2011-12
- So limit relief to £20,000 p.a. contributions until then
  - Or existing regular contributions if higher
  - Only if income above £150k

Implementing this is hard

- Employer contributions to a defined-benefit pension are an IOU
  – Promise to pay X% of final salary each year from age 65 until death
- Currently ignore IOU: just tax income when eventually received
- Government wants to value the IOU and levy 30% tax on it as well
- But how do we value the IOU?
  – Or divide overall employer contribution between scheme members?
  – What will final salary be? How long will the person live? How much is £100 in 30 years' time worth today? Etc.
  – Currently attempted for a few people, but very rough and complex

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Implementing this is hard

- The Government explicitly recognises this difficulty
  - Hence delay for consultation
  - Interim anti-forestalling measure entails similar difficulty
    - £20,000 cap on contributions eligible for relief requires valuing contributions
- Consultation cannot solve the underlying problem.
- The Pensions Commission went further:

"… the only practical way to limit tax relief to higher earners in order to distribute it to lower earners, would be to reduce the value of the £1.8 million limit" on the final capital sum in pension

(2nd Report of Pensions Commission, p.321)

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Is it a good idea?

- Should raise substantial revenue from a few very rich people.
- Higher-rate relief only ‘unfair’ and ‘an anomaly’ above £150k?

Income tax relief on pension contributions, 2011

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Is it a good idea?

- Should raise substantial revenue from a few very rich people.
- Higher-rate relief only ‘unfair’ and ‘an anomaly’ above £150k?
- Unfair at all? Higher-rate taxpayers do get more relief on contributions, but also pay more tax on pension income
  - May not have such high income in retirement
  - But will £180,000-earners really pay basic-rate tax in retirement?
- Complexity counter to welcome simplification, A-day April 2006
  - It wasn’t the best policy on A-day in 2006
  - It wasn’t the best policy for the Pensions Act 2008
- Yet another pension reform: not the stable policy environment to help long-term planning for retirement
- Undesirable distortions to behaviour…

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Income tax relief on pension contributions, 2011

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How might people respond?

- Many ways to reduce contributions subject to low relief
  - Change work patterns
  - Save less: spend earnings now rather than when retired
  - Save in other forms: ISAs? Earlier mortgage repayments?
  - Do pension saving at another time
    - before earnings that high – especially when in £100k to £113k band!
    - retire mid-year so earn <£160k in final year and get higher-rate relief
  - Employer does more of individual's pension saving
  - Lower-earning spouse does more of couple's pension saving
- These responses generally increase revenue in short term
- But if less money goes into pensions, will collect less tax on pension income in future years

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Measures affecting businesses

- 40% first-year allowance for plant and machinery investment in 2009-10
  - Already 100% for first £50,000; this is double usual level above that
  - Costs £1.6bn this year, though much will be clawed back later
- More generous loss carry-back rules continued for a second year
  - Losses can be offset against profits from past 3 years, not just 1 year
  - Costs around £0.3bn, though again some clawed back later
- Strategic Investment Fund
  - Costs £750m over 2 years
- Usual raft of anti-avoidance measures
  - Raises £0.4bn in 2011-12

Benefit changes

- Winter Fuel Payments kept at 2008 level for 2009
  - Were due to fall back by £50 for 65-79 year olds, £100 for 80+
  - One-off cost of £600m
- Pension credit means test to disregard £10,000 rather than £6,000 of capital from November 2009
  - Worth up to £8 a week for low-income pensioners with non-pension savings
  - Costs £130m
- Child Tax Credit increased by £20 per child per year in April 2010
  - Nowhere near enough to meet target of halving child poverty
  - £4.2bn required, only £140m found
- Bit more spending on Social Fund, Child Trust Fund and ISMI

Other measures

- Stamp duty holiday extended
  - Threshold to fall back from £175k to £125k in January, not September
  - Costs one-off £90m
- ISA limit increased from £7,200 to £10,200
  - From October 2009 for those aged 50+, April 2010 for everyone else
  - Costs £60m in 2011-12
- Betting taxes reformed
  - Revenue-neutral
- More spending on employment measures
  - £1.7bn more over 2 years for JobCentre Plus
  - £1.2bn over 2 years to guarantee 6 months' work/training for 18-24s on JSA for a year, from October
- Support for house-building
  - Costs £600m over 2 years

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Conclusions

- Big tax rises for very rich
  - Hope to raise a lot of revenue from a small number of people
  - Cannot tell whether combined policies will raise as much as hoped
  - Pension tax relief restriction questionable in principle and difficult in practice
- Other direct tax and benefit measures are mostly small
  - Some broadly sensible stimulus to investment
  - Little new money to reduce child poverty
- Measures on the spending side more significant
  - Subsidies for employment, investment and house-building