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Executive summary

In April, the UK entered the second year of a six-year freeze in the cash value of income tax thresholds – a policy set to become the single biggest tax-raising measure since the 1970s. This is the latest in a long line of measures (by successive governments) that have hugely increased the scope of higher rates of income tax. In this report, we chart this transformation of the role played by top rates in the UK tax system over a 40-year period.

Key findings

1. The share of adults paying higher rates has increased enormously in recent decades. **In 1991–92 just 3.5% of UK adults paid the 40% higher rate** of income tax. By 2022–23 11% were paying higher rates, with that figure **set to reach 14% by 2027–28**. Of that 14%, **3.1% of adults will face marginal tax rates of either 45% or 60%** – only slightly below the share who paid the 40% higher rate at the start of the 1990s.

2. As a result, while **in the 1990s essentially no nurses and just 5–6% of teachers paid higher-rate tax**, income tax thresholds failing to keep up with average wages means that **by 2027–28 more than one in eight nurses and one in four teachers are set to be higher-rate taxpayers**.

3. Acceleration in the number of higher-rate taxpayers over the next five years is being driven by the government's freeze to income tax thresholds. By its final year (2027–28), this **freeze will represent the single most significant tax increase since Geoffrey Howe increased VAT to 15% in 1979**.

4. As a result of the freeze, **real household disposable income (RHDI) will be 1.4% lower by 2027–28** than would have been the case if the personal allowance and higher-rate threshold had been increased in line with inflation – **wiping out around a third of the growth in RHDI that households would otherwise have seen over the period of the freeze**.

1. Introduction

Last month marked the start of the new fiscal year, and the second year of a six-year freeze in the cash value of income tax thresholds – the personal allowance (£12,570), when income tax begins to be due, and the higher-rate threshold (£50,270), when individuals start to become liable for the 40% rate. By the time it has run its course, the freeze is set to represent the largest single tax-raising measure since Geoffrey Howe near-doubled the rate of VAT in 1979.[1] As a result, real household disposable income (RHDI) will, by 2027–28, be 1.4% lower than would have been the case if the personal allowance and higher-rate threshold had been increased in line with inflation – wiping out around a third of the growth in RHDI that households would otherwise have seen over the period of the freeze. In 2023–24 alone, the freeze is responsible for just less than a third of the 2% reduction in RHDI forecast by the Office for Budget Responsibility (OBR) at the Budget in March.[2]

The freeze, and the reduction of the threshold at which the 45% additional rate of income tax begins to be paid (from £150,000 to £125,140), represent the latest in a long line of policy choices that have seen an ever-growing share of UK adults pulled into paying the highest rates of income tax. In this report, we set out what these policies are likely to mean for the number of individuals subject to higher rates of tax in future years, placing these figures in the context of long-term trends.

[1] Office for Budget Responsibility's Policy Measures Database, 31 March 2023, available at https://obr.uk/data/.

[2] RHDI impacts are calculated using OBR forecasts of household disposable income and CPI inflation (see tables 1.13 and 1.7 respectively of the supplementary economy tables to Office for Budget Responsibility (2023)) and latest OBR costings of threshold freezes (see box 3.2 of Office for Budget Responsibility (2023)).

2. The broadening scope of higher rates

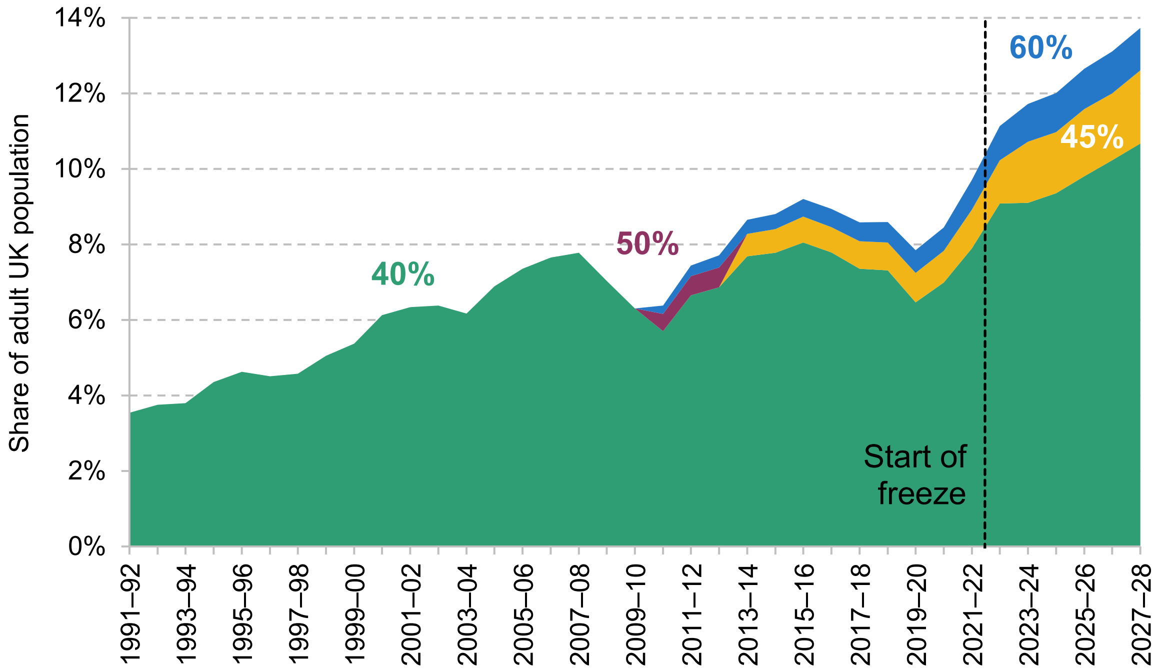
Since the mid 1970s, income tax thresholds have by default risen in line with inflation. Suspending these increases by freezing thresholds up to 2027–28 (as the government is now doing) means that, as individuals' incomes grow, an increasing number will find themselves pulled into paying higher rates of tax, even if their incomes have not grown sufficiently to keep up with inflation. In other words, individuals who become less well off in real terms over the next five years may nonetheless see themselves facing higher rates of income tax than at the start of the period. Overall, the combined effect of frozen or (in the case of the additional rate) reduced thresholds will see 2.5 million more taxpayers brought into the higher and additional rates of income tax by 2027–28 (the final year of the freeze; 2.1 million more will pay higher-rate tax and 0.4 million more additional-rate tax).

Figure 1 shows this process explicitly, charting the changing share of the adult UK population paying the higher and additional rates of income tax. This is further broken down by the rate of tax that individuals pay on an additional £1 of income (the marginal rate of income tax). In addition to the 40% and 45% (50% between 2010–11 and 2012–13) marginal rates at which higher- and additional-rate income tax is charged, some taxpayers also face a marginal rate of 60%. This results from the fact that, since April 2010, taxpayers with an income in excess of £100,000 not only pay 40p of tax for each additional £1 they earn, but also see their tax-free personal allowance reduced by 50p. This £100,000 limit has been frozen in cash terms since its introduction, a fact that has seen an ever-greater share of the population having at least some of their personal allowance withdrawn.

During the 1990s and 2000s, the higher-rate threshold generally went up by inflation, but not as fast as earnings, meaning that more and more people were steadily dragged into higher-rate tax. The coalition government then cut the threshold in nominal terms in every year between 2011–12 and 2015–16, again increasing the number of higher-rate taxpayers – something that was only partially reversed by the Conservative governments elected in 2015 and 2017. The six-year freeze we are now in the midst of is set to push up further still the share of the population paying higher-rate tax, which on current forecasts will hit 14% (7.8 million) of UK adults by 2027–28 – quadruple the 3.5% (1.6 million) that did so in 1991–92. That means that, with 38 million adults (67%) set to pay income tax in 2027–28, 20% of taxpayers will be paying the higher rate. The result is that, for the 40% rate to impact the same fraction of people as it did in 1991, the higher-rate threshold would need to be nearly £100,000 in 2027–28 – almost double its actual level of £50,270.

As Figure 1 makes clear, the increasing number of higher-rate taxpayers is only part of the story. By 2027–28, 3.1% of adults (1.7 million) will be paying a marginal rate of either 60% or 45% – only slightly below the share of adults who paid the 40% higher rate at the start of the 1990s.

Figure 1. Adult UK population by marginal rate of income tax

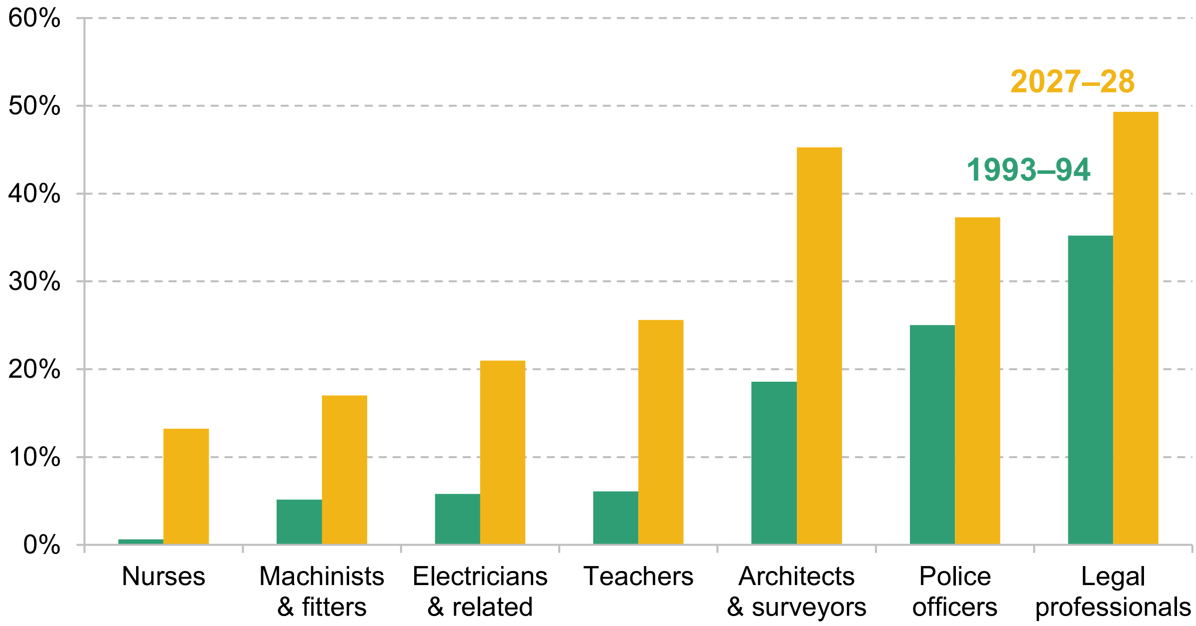


Note: Figures for 40% and 45% marginal tax rates include Scottish taxpayers who pay the Scottish higher and additional rates (which in 2023–24 are 42% and 47% respectively). Figures for 60% include all Scottish taxpayers on the personal allowance taper (whose effective marginal tax rate is 63%). Analysis assumes that the Scottish higher-rate threshold remains frozen until 2027–28. Adult population is defined as UK population aged 16+. It should be noted that figures for 2020–21, 2021–22 and 2022–23 are projected HMRC estimates based upon the 2019 to 2020 Survey of Personal Incomes using economic assumptions consistent with Office for Budget Responsibility (2022).

Source: Figures for higher- and additional-rate payers prior to 2023–24 are taken from table 2.1 of HM Revenue and Customs (2022). Forecasts of higher- and additional-rate payers from 2023–24 onwards are taken from box 3.2 of Office for Budget Responsibility (2023). Number of taxpayers paying 60% marginal rate is calculated using the Survey of Personal Incomes 2010–11 to 2019–20.

Figure 2 gives a more concrete sense of the kinds of workers who are being brought into higher-rate tax. It shows the shares of employees in selected occupations paying higher-rate tax in 1993–94 and in 2027–28 (on current forecasts). Data limitations mean that these figures should only be taken as indicative, but they are nonetheless instructive (see notes to the figure). In the early 1990s, essentially no nurses[3] and only about 5–6% of machinists, electricians and teachers paid higher-rate tax. In other words, higher-rate tax was reserved only for the very highest paid in these occupations. But by 2027–28, more than one in eight nurses, one in six machinists and fitters, one in five electricians and one in four teachers are set to be higher-rate taxpayers. Among police officers, architects and surveyors, and legal professionals, we also see significant increases in the share paying higher-rate tax over time, with almost half of the latter two groups expected to be paying higher-rate tax in 2027–28.

Figure 2. Estimated share of employees in selected occupations who pay higher-rate tax



Note: 2027–28 figures calculated by using 2022–23 data and uprating earnings to 2027–28 terms using the OBR earnings forecast in Office for Budget Responsibility (2023) (applying the overall earnings forecast to both private and public sector workers). We classify an individual as paying higher-rate tax if their gross earnings are above the higher-rate threshold (accounting for differences in the higher-rate threshold for those of different ages, in 1993–94, and differences by nation, in 2027–28 – assuming that Scotland continues to freeze its higher-rate threshold). This classification will be incorrect in cases where the individual has unearned income that, together with earnings, puts their total income above the higher-rate threshold; and in cases where various allowances and deductions (such as pension contributions) reduce their taxable income below the higher-rate threshold. Equivalent calculations for 2027–28 using Office for National Statistics (2022) give similar results, although a modestly higher number for nurses (around 20%, rather than 13%). ‘Electricians and related’ refers to the Standard Occupational Classification group named ‘electrical and electronic trades’. ‘Teachers’ consists of primary, secondary, special needs and further education teachers. We use data for 1993–94 as that is the first full fiscal year when earnings data were collected in the Labour Force Survey. We select these occupations because the sample size is large enough and the definition of the occupation sufficiently consistent over time.

Source: Authors’ calculations using Labour Force Survey, 1993–94 and 2022–23.

[3] It should be noted that here, and throughout, ‘nurses’ refers to all nursing professionals, including midwives and community nurses.

3. Conclusion

In the space of 40 years, higher rates of income tax will have gone from a feature of the tax system reserved only for the top few percent, to one that impacts a far more substantial proportion of the population, drawing in a sizeable fraction of people working in jobs not typically thought of as very highly paid – such as nurses, teachers and electricians. Increasing the scope of higher tax rates to encompass a larger share of the population is not necessarily undesirable – choices in this area reflect the government's priorities around work incentives and redistribution. However, freezing thresholds and allowing the tax system to be arbitrarily shaped by the vagaries of inflation rate fluctuations is not a sensible way to make tax policy. Moreover, the fourfold increase in the share of adults facing a 60% marginal tax rate between 2010–11 and 2023–24 (with further increases forecast) is part of an unwelcome proliferation in marginal income tax rate 'spikes' for those with high incomes that has occurred over the last decade. The withdrawal of child benefit for those earning above £50,000 and of the free childcare entitlement for those earning above £100,000 (to give just two examples) both create marginal tax rates well in excess of 40% for those affected and risk generating distortions and inefficiencies in taxpayer behaviour.

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