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The impact of tax and benefit changes announced in Budget 2011 and previously on households in London

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What's coming up

- Methodology
- Average losses from tax and benefit reforms for each region
- Drill down further for London:
  - Examine average losses by income quintile
  - And for different types of family

What are we trying to measure?

- Direct impact of tax and benefit measures on household incomes
  - As if they were implemented overnight
- This means that we assume that there is no behavioural response, and that reforms do not change pre-tax prices in the economy
  - More plausible in some cases than others (e.g. VAT, Housing Benefit)
- Obtain an average cash loss for households in each region, and express this as a percentage of the average household income for each region
- Tax and benefit system and reforms apply (almost) equally across the country
- Any differences between regions reflect differences in distribution of income, demographics, rent levels etc rather than deliberate policy decisions

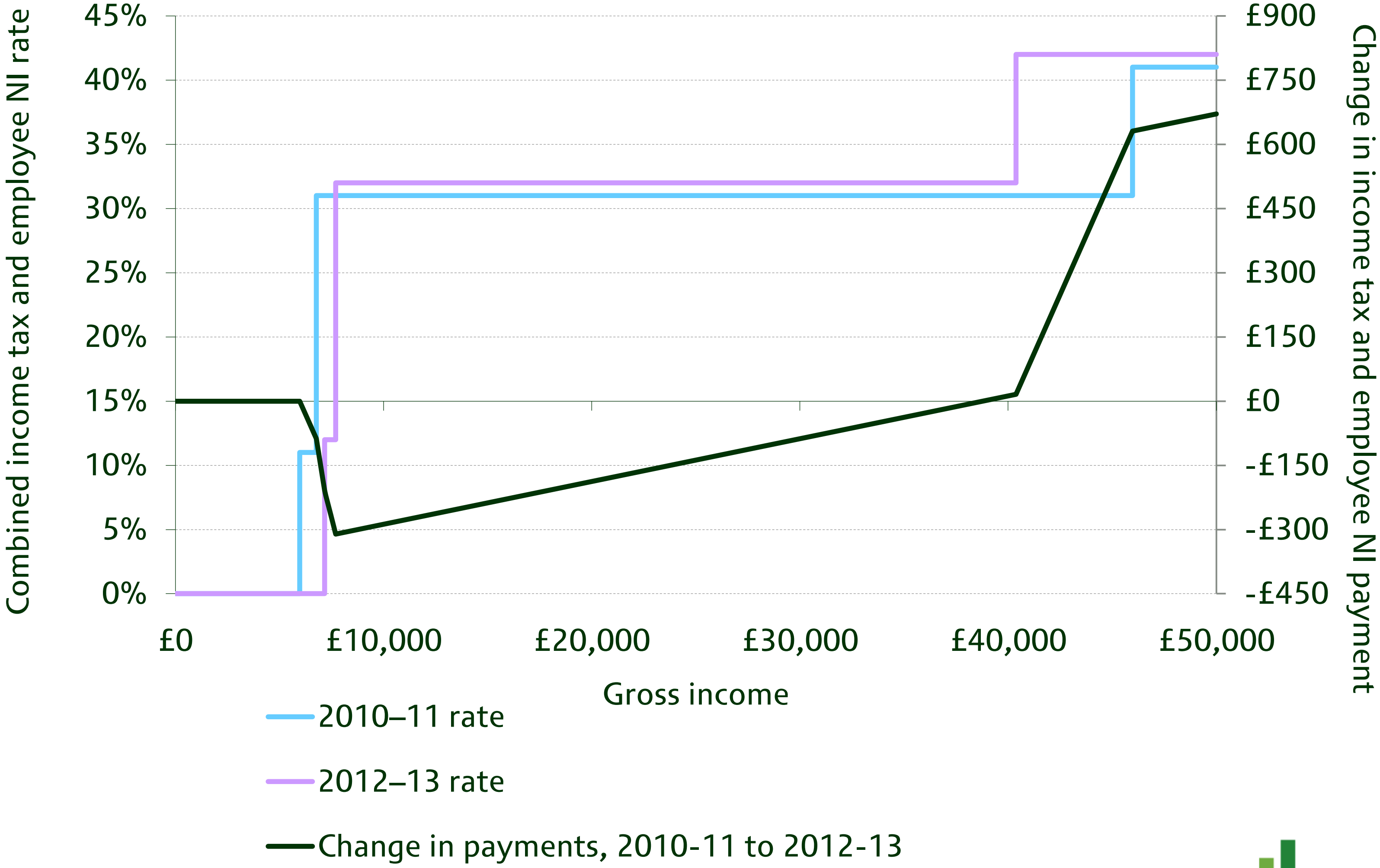
Pre-announced tax and benefit changes to be introduced 2010–2014

- Key tax changes are
  - 1ppt increase in all NI rates (from April 2011)
  - Increases in income tax allowance and employee's NI threshold
  - Reduction in real value of higher rate threshold
  - Restriction of tax relief on pension contributions
- Key benefit changes are
  - Use of CPI rather than RPI/Rossi index to uprate benefits
  - Withdrawal of child benefit from higher-rate taxpayers
  - More aggressive means-testing of tax credits
  - Cuts to housing benefit
  - Time-limiting contributory ESA for work-related activity group
  - New disability test for DLA recipients

What changed in the Budget?

- Personal allowance will rise to £8,105 in April 2012
  - Would have been £7,865 if increased in line with RPI in usual way
  - No change in higher rate threshold this time, so everyone on £8k-£116k benefits by £48 a year

Income tax and employee NICs changes



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  - But pre-announced freeze in higher rate threshold in 2012 offsets this gain for higher rate taxpayers, and increases number of higher rate taxpayers by 500,000
  - Further freeze planned for 2013 increases number by another 300k
- Increasing allowance to £10,000 in 2015–16 would cost £4.1 billion a year if done in this way (i.e. with higher rate taxpayers benefiting)
  - If it was done without higher-rate taxpayers benefiting, would only cost £3.1 billion
  - Though 500,000 more higher-rate taxpayers that way
  - Some of the lower cost comes about because more families would lose child benefit (saving of £200 million on child benefit)

RPI vs. CPI (1)

- From April 2012, the following will be indexed with CPI each year
  - Employee and self-employed NICs threshold
  - Class 2 and 3 NICs flat rates
  - Capital gains tax threshold
  - ISA limit
- But other thresholds will still be increased in line with RPI until the end of this Parliament
  - Employer NICs threshold
  - Age-related allowances and married couples allowance for pensioners
  - Amount of savings income taxed at the 10p income tax rate
- Other changes during this Parliament still going ahead
  - Personal allowance going up at least in line with RPI
  - Freezes in higher rate threshold and inheritance tax threshold

RPI vs. CPI (2)

- Using CPI rather than RPI will mean these thresholds will increase less quickly than they otherwise would have done
- Loss from CPI indexation of employee NI threshold partly offsets gain from higher income tax allowance
  - Will be £240/year lower than would otherwise have been by 2014–15
  - Increases employee NICs payments by £28/year
- Change will raise £1 billion a year by the end of the Parliament
- Increases over time, and increases pace of fiscal drag
- Ambition to increase duty rates in line with CPI too when fiscal position allows

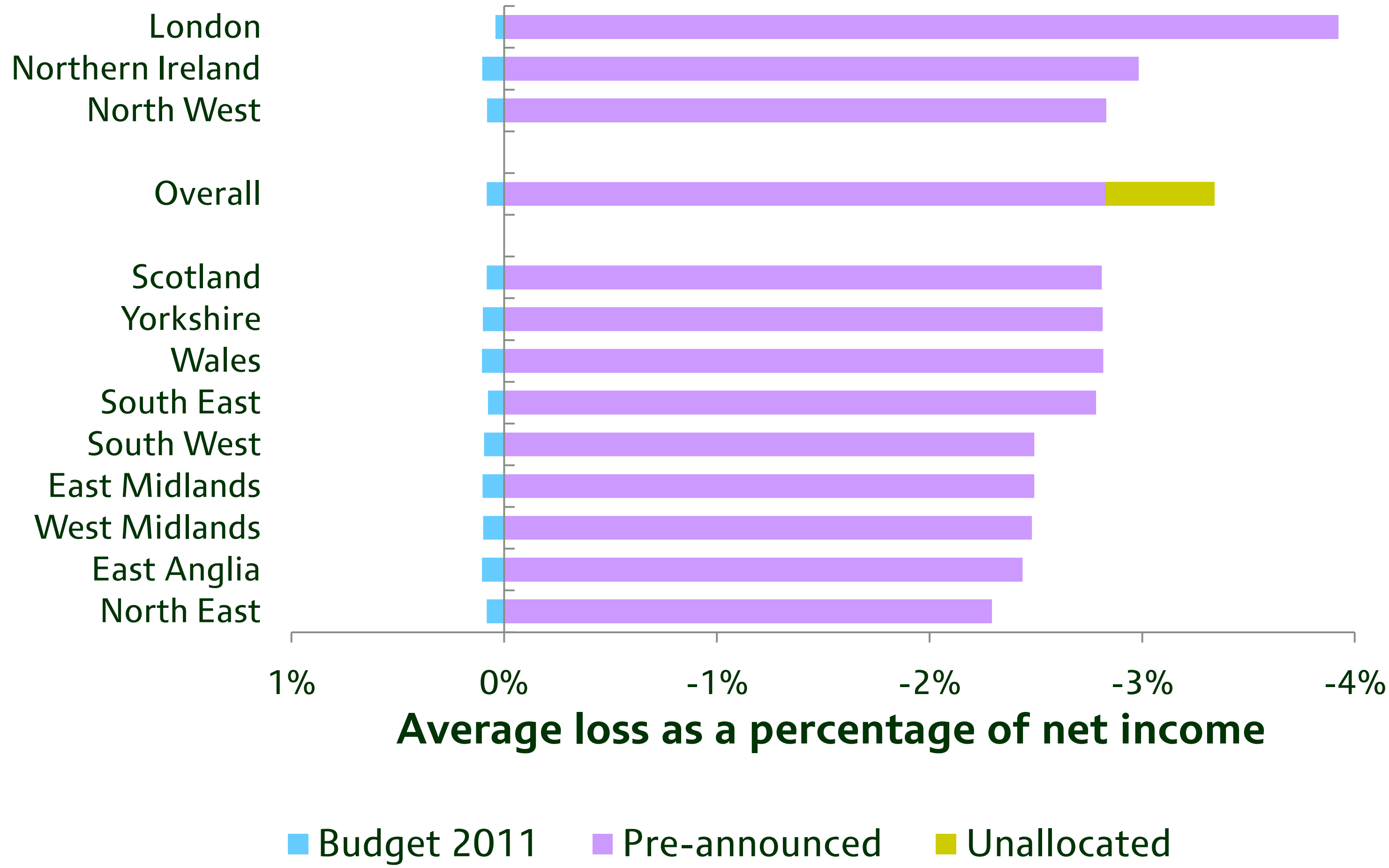
NICs contracted-out rebates

- NICs rates are reduced for people who ‘contract out’ of S2P into a private pension scheme
  - From April 2012, available for defined benefit (DB) pensions only
  - Two thirds of DB scheme members are public sector
- Size of the rebate is reviewed every 5 years to reflect relative value of S2P
- Government Actuary suggested 3 options in February
- Government chose the biggest revenue-raiser
- So rebate will fall in April 2012
  - From 1.6% to 1.4% for employees
  - From 3.7% to 3.4% for employers
- Raising £0.6bn
  - £250m from employees, £350m from employers

How do we calculate losses from tax and benefit changes?

- IFS tax and benefit microsimulation model, TAXBEN can calculate precise tax liabilities and benefit entitlements under ‘unreformed’ and ‘actual’ tax and benefit systems in most cases
- Cannot measure the impact of some reforms on particular households precisely, e.g.
  - Time-limiting contributory Employment and Support Allowance
  - Stricter disability test for Disability Living Allowance
  - Changes to the way in which in-year income changes affect tax credit awards
  - Localisation and reduction in spending on Council Tax Benefit
- This is because of limitations in the FRS data we use
- We think that we can roughly estimate the distributional impact of these reforms
  - But still some reforms (mainly to corporate tax) that we can’t allocate

Average loss by region from reforms to be in place by 2012–13



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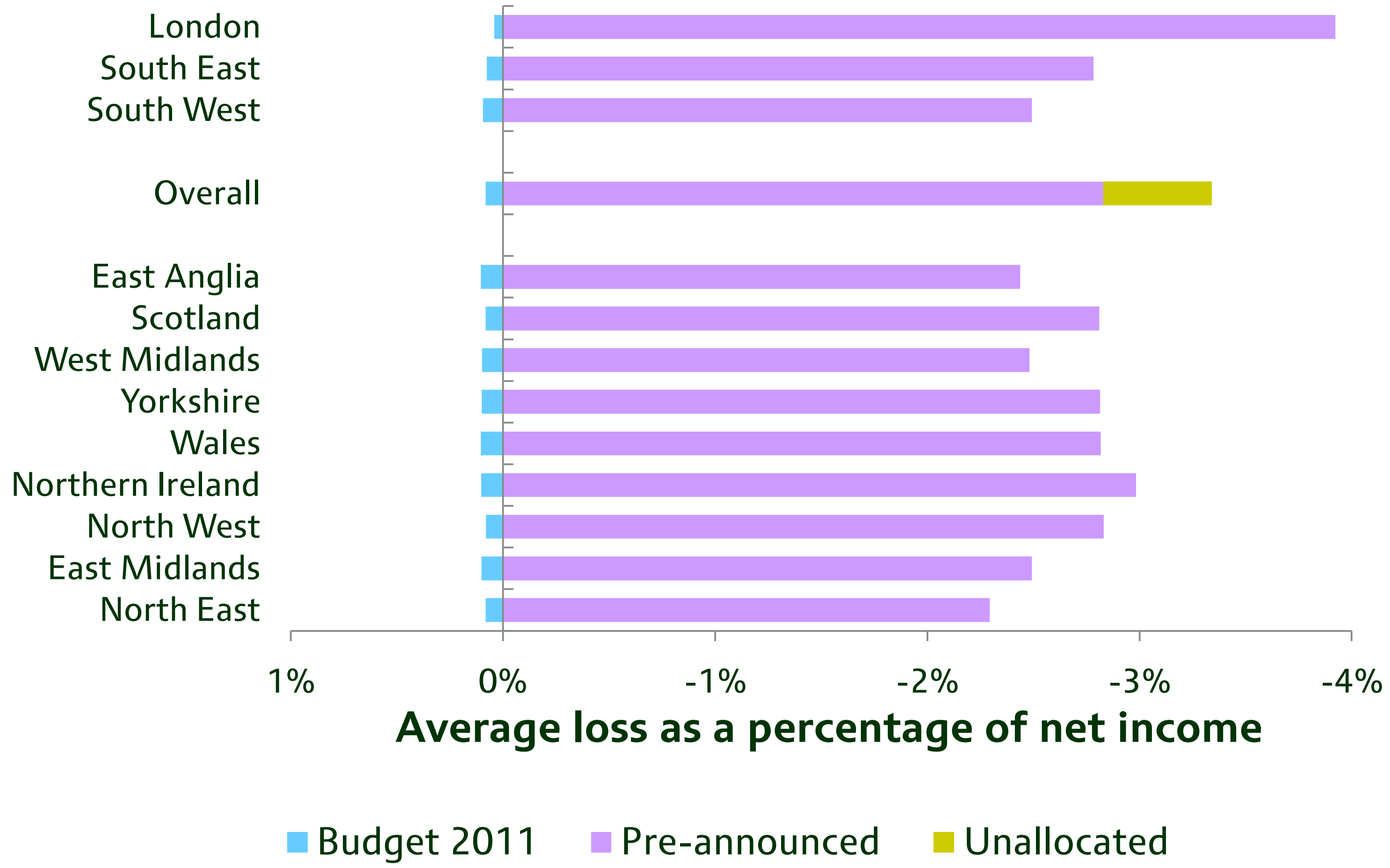
Average loss by region from reforms to be in place by 2012–13 (ranked richest to poorest)



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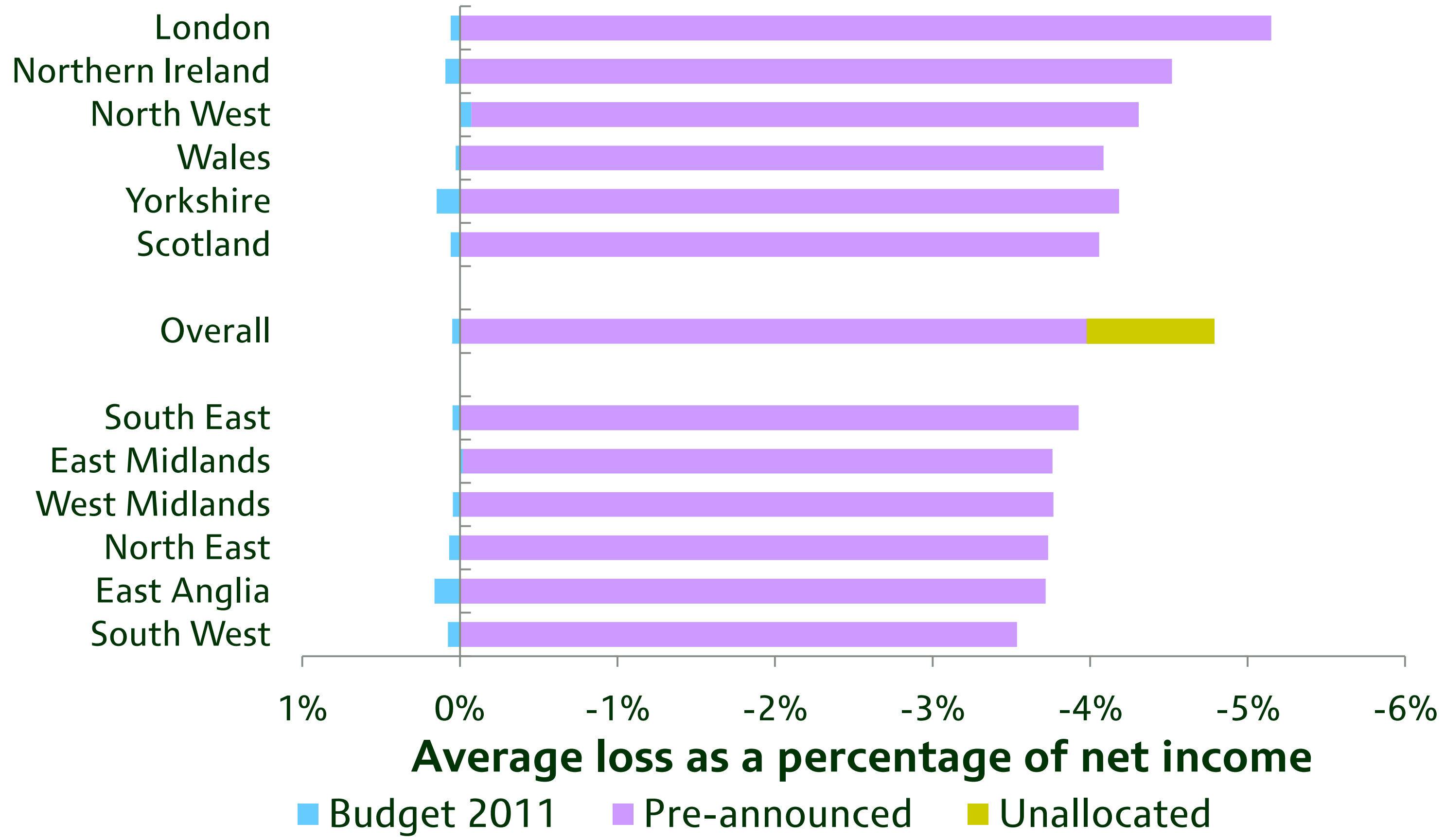

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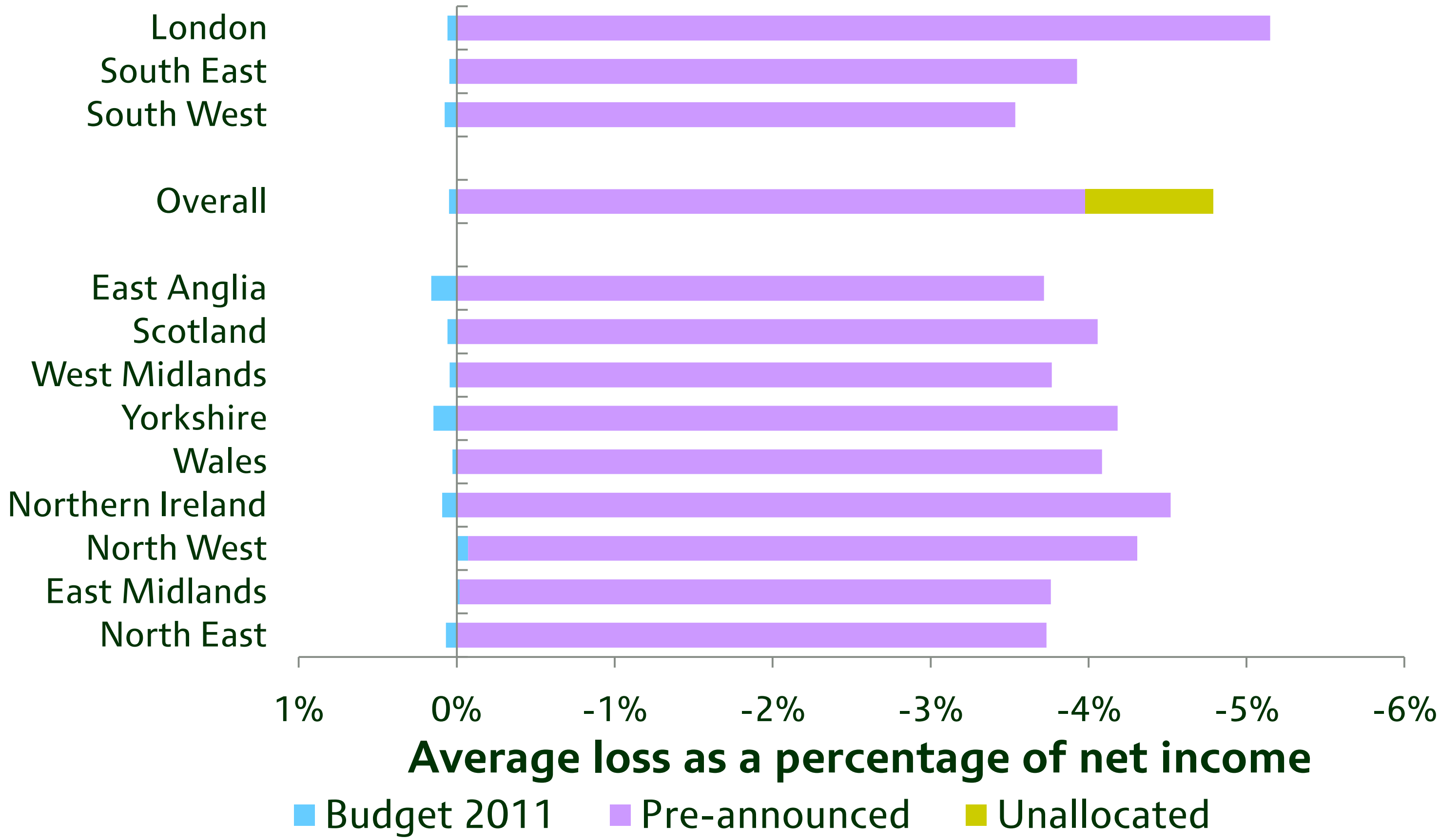
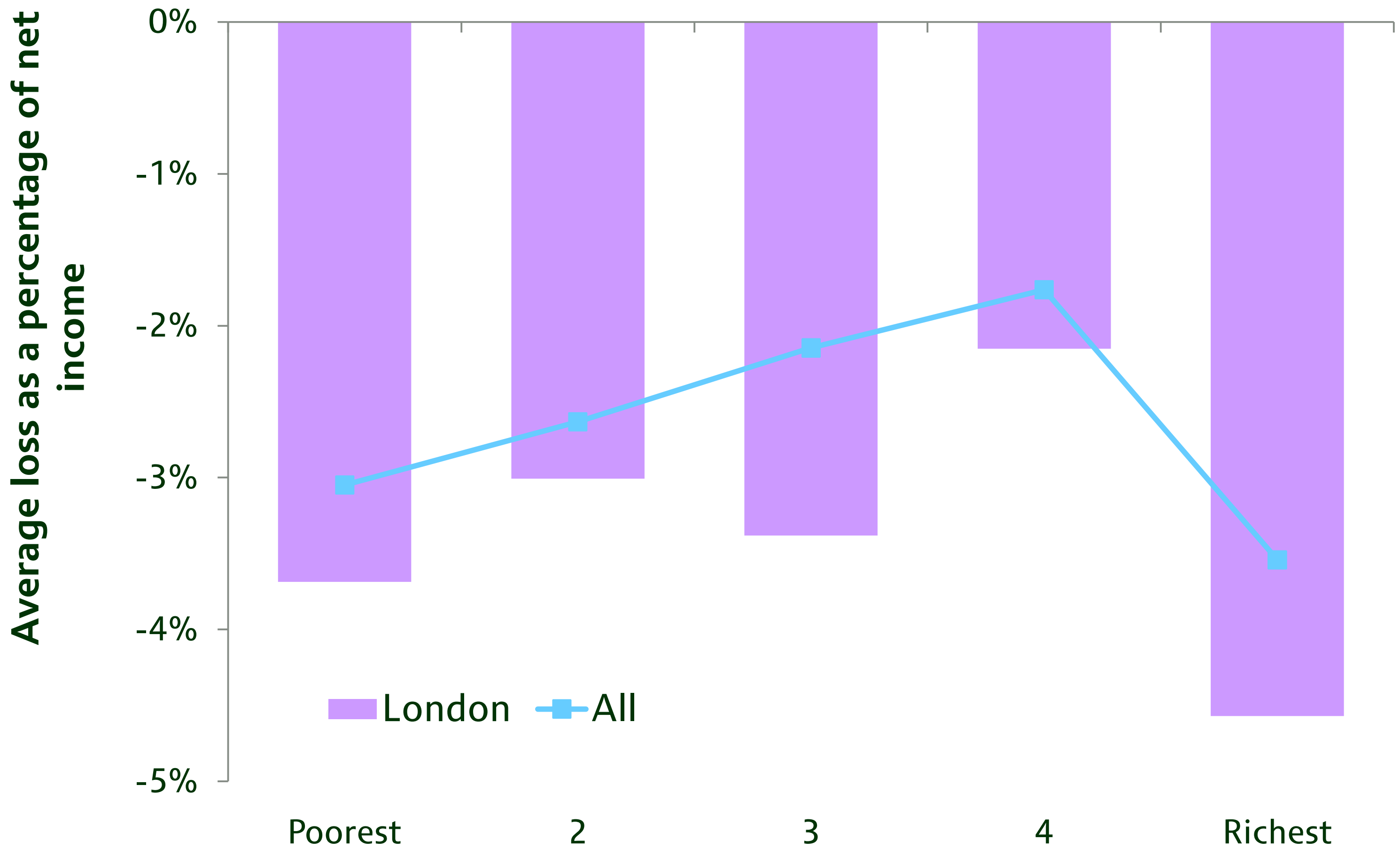
Average loss by region from reforms to be in place by 2014–15 (ranked richest to poorest)



Summary

- Households in London lose more on average than those in any other region from reforms to be in effect by 2012–13
  - London has more of the UK's very richest households. They are particularly affected by the restriction of tax relief on pension contributions from April 2011 announced by Labour (but implemented in a different form by the coalition)
  - London is a high-rent area and so is particularly affected by cuts to Housing Benefit
- The Budget did not affect this assessment
- This is still true if we look at all reforms to 2014–15, but other regions catch up
  - Benefit cuts from 2013 hit poorer regions harder than London
  - Northern Ireland has a particularly large number of DLA recipients
    - We assume that DLA recipients in each region are equally likely to lose entitlement
- But much of what appear to be differences between regions are in fact differences between income groups...

Average loss as a percentage of income by UK income quintile, reforms to 2012–13



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Average loss as a percentage of income by UK income quintile, reforms to 2014–15

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Average loss as a percentage of income by household type, reforms to 2012–13

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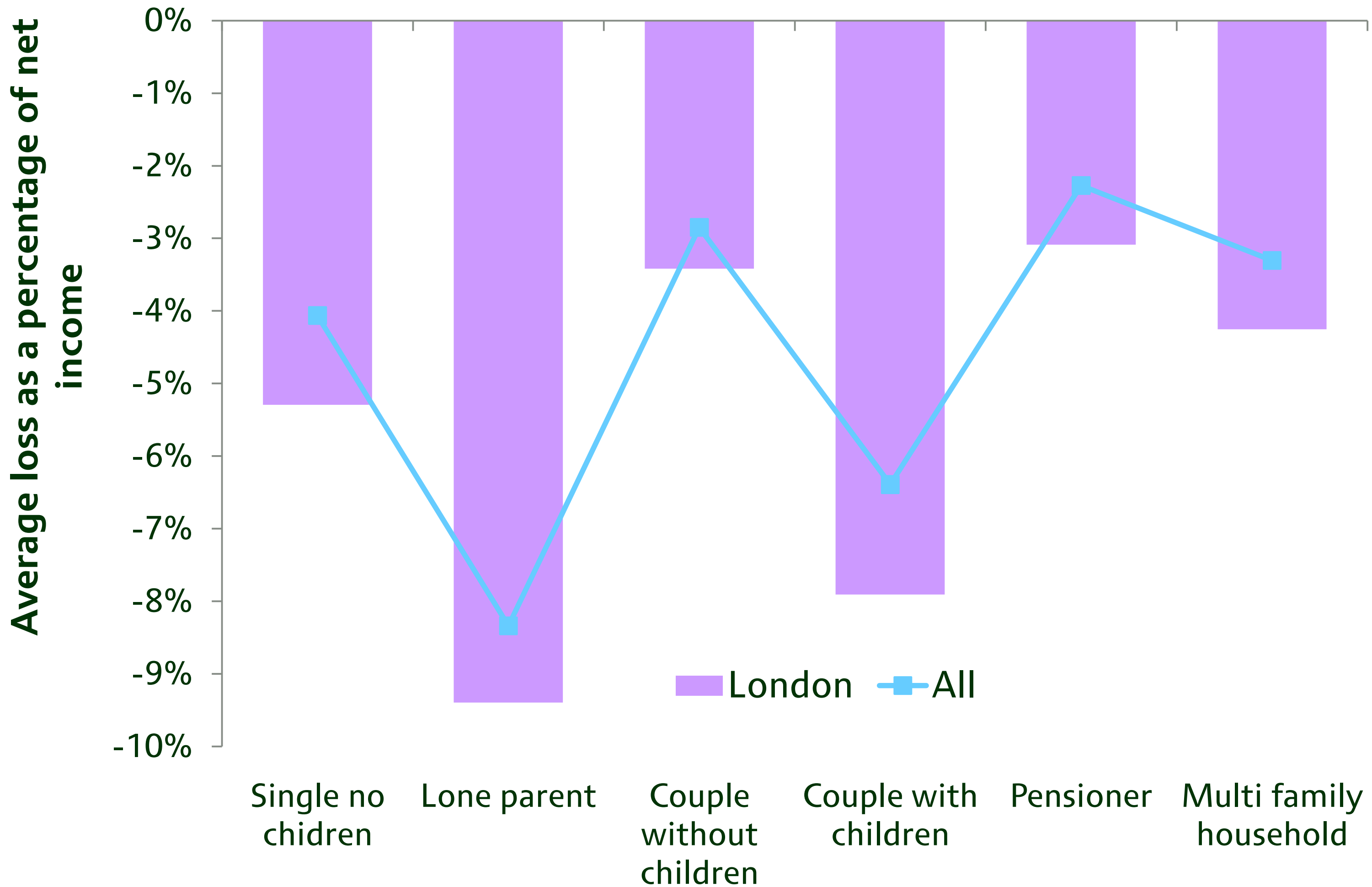
Average loss as a percentage of income by household type, reforms to 2014–15



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Summary

- Much of the overall difference between London and the rest of the UK is caused by differences in the income distribution
  - More very rich households in London
- Single-person households and couples with children in London lose more as a proportion of income than their counterparts in the rest of the UK
  - These are the household types with the biggest concentration of the highest earners in London
- At the other end of the income scale, cuts to housing benefit likely to affect London more than other areas of the UK