Personal taxes and benefits

Stuart Adam

Outline

- Alcohol and fuel duties
- Income tax personal allowance and higher-rate threshold
- Capital gains tax
- ISA limit
- Lifetime ISA
- Help to Save
- Personal independence payment

Real duty on petrol

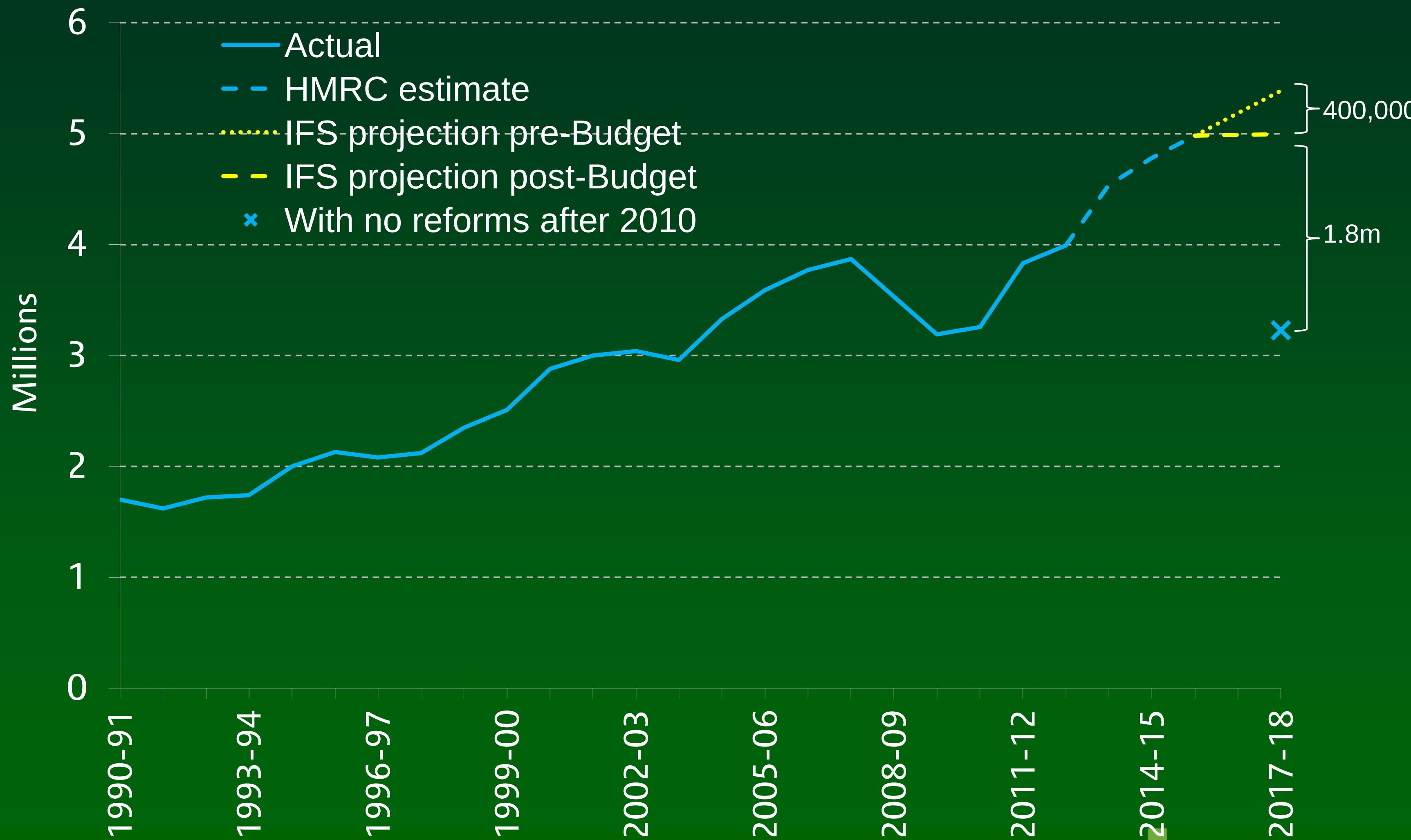
Pence per litre, Jan 2016 prices

Personal allowance and higher rate threshold

- Income tax personal allowance will increase to £11,500 in 2017–18, and higher-rate threshold to £45,000
  - vs. £11,200 and £43,600 under previous plans
  - Costs £2.5bn (making £15bn since 2010)
  - Basic-rate taxpayers gain £60, higher-rate £200 (if income <£122,400)
  - But remember 43% of adults have incomes too low to pay income tax

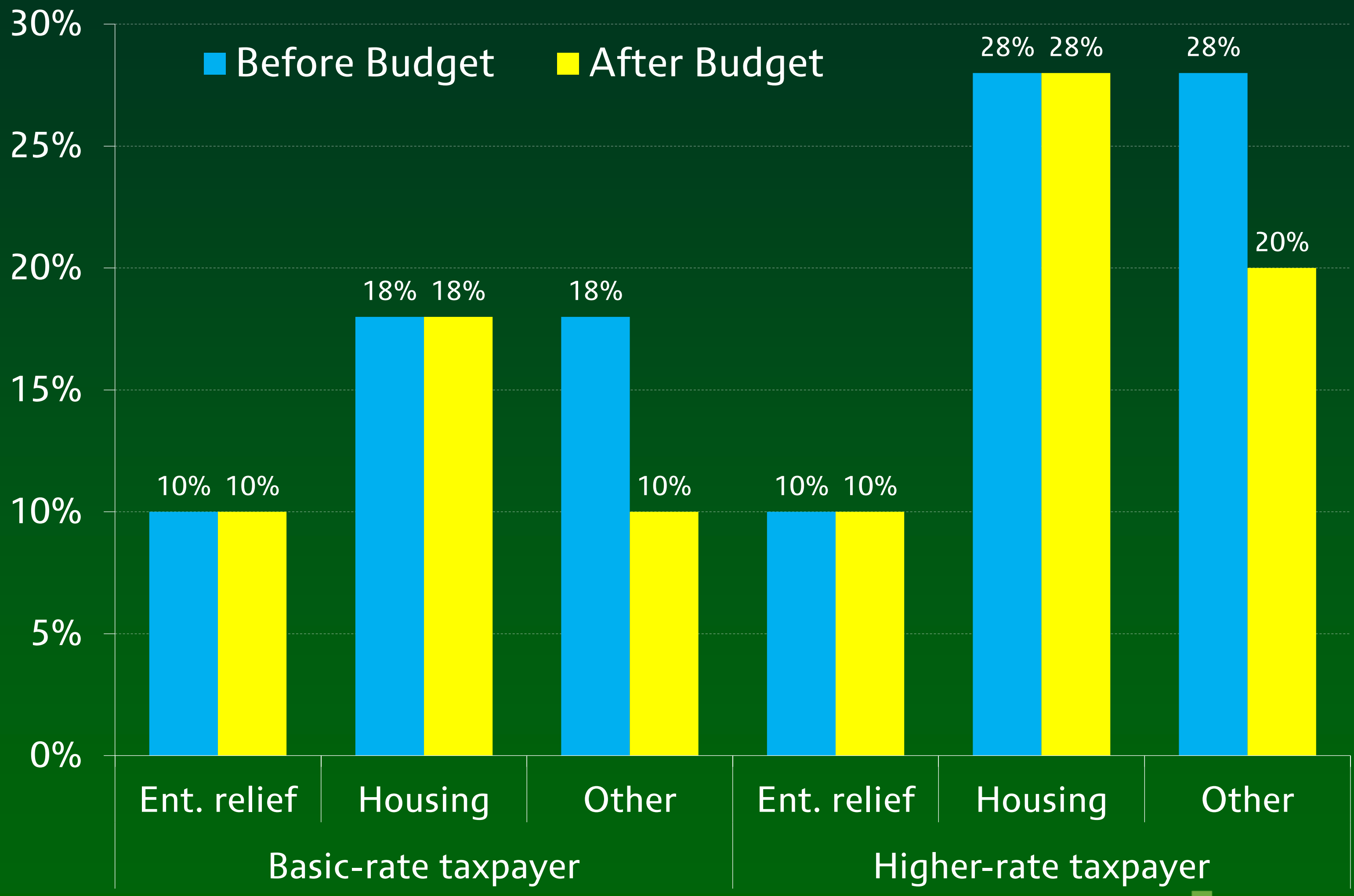
- Further discretionary increases needed to reach targets of £12,500 personal allowance and £50,000 higher-rate threshold by 2020–21
  - Additional cost of around £3bn

Number of higher- and additional-rate taxpayers



Source: HMRC statistics table 2.5, IFS calculations

Capital gains tax rates



Capital gains tax

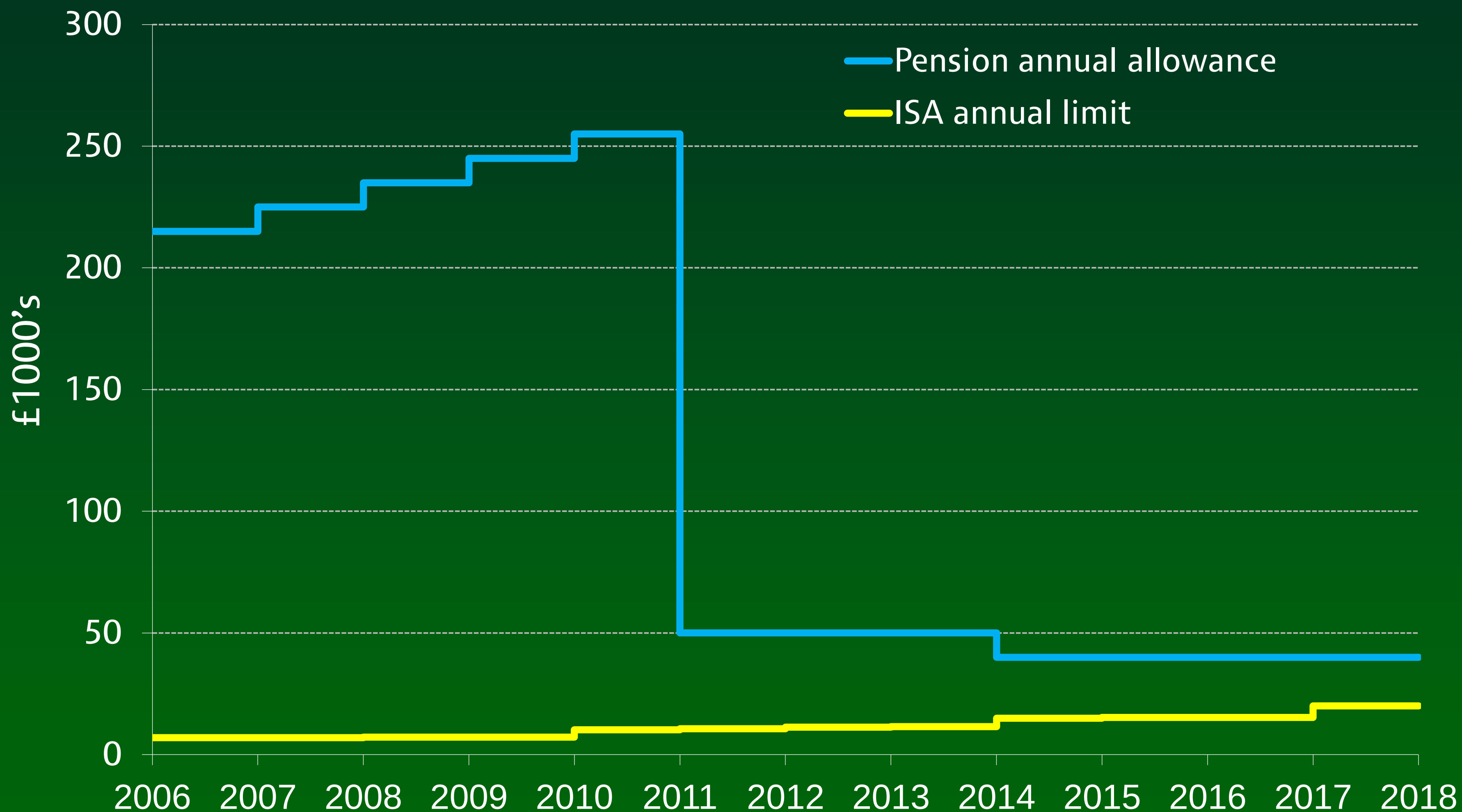
- ✓ Reduces disincentive to invest in (and to sell) relevant assets
  - Mainly shares and non-residential property
- ✓ Reduces differential between those assets and more tax-favoured ones
  - Owner-managed businesses, owner-occupied housing, pensions, ISAs
- ✗ Introduces differential between those assets and non-main housing
  - But probably less damaging than the differentials that are being reduced
  - ✓ And lower rate for shares than housing makes sense given corporation tax already paid (though lower rate for other assets doesn't)
- ✗ Increases incentive to convert income into capital gains
  - Though some vulnerable cases not affected – owner-managed businesses, carried interest
- ✗ Windfall giveaway for gains already accrued but not realised is rewarding decisions already taken
- ✗ Forgoes taxation of super-normal returns
  - Efficient to tax these heavily as the investment would still be worthwhile

Capital gains tax policy-making

- Mr Osborne increased higher rate from 18% to 28% in 2010: reduction to 20% is almost complete reversal
  - The latest episode in an inglorious history of yo-yo-ing in CGT policy
  - Uncertainty is damaging for planning

- Yo-yo-ing reflects underlying tension between minimising disincentives to save and minimising avoidance opportunities
  - Requires strategic response
  - Mirrlees Review proposed a solution

Annual limits on saving in pensions and ISAs



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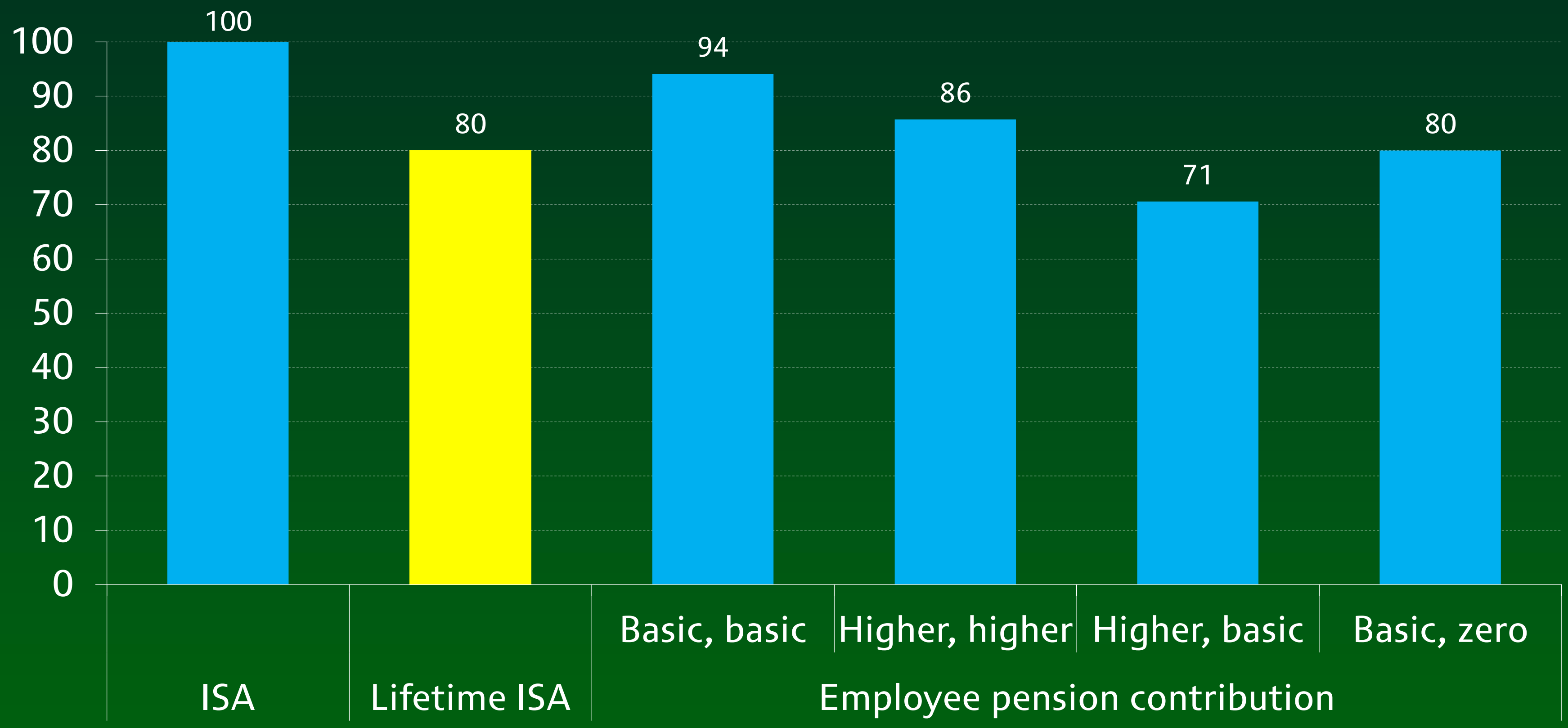
Lifetime ISA

- Similar to 2005 Conservative manifesto proposal
- Accounts can be opened by 18-40-year-olds from April 2017
- Contributions count towards ISA limit; like ISAs, no tax on returns
- While aged 18-50, government will add 25% to up to £4,000 of contributions each year
  - So over 32 years, max £32,000 top-up on £128,000 of contributions
- Can withdraw from age 60, or earlier to buy 1st home for <£450,000
  - If withdraw earlier for other purposes, 5% charge + lose the top-up
  - Though will consult on possibility of withdraw-and-replace option

Contribution required to match 100 saved in ISA

By marginal tax rate in work and in retirement



- Employer pension contributions still more generously treated
- Can gradually shift money from lifetime ISA to pension from age 60
  - Benefit from lifetime ISA top-up *and* pension tax-free lump sum

Lifetime ISA

- Clear rationale for encouraging saving for retirement
  - Though less so when use of money from age 60 unrestricted
- Less clear rationale for encouraging saving for a home more than other pre-retirement consumption
  - OBR expects it to increase house prices by 0.3%
- Expect lots of shifting existing savings to new vehicle
  - In 2013, 3.2m under-45s had more than £3,000 in ISAs
- Big winners: basic-rate taxpayers who can transfer existing savings
  - And higher-rate taxpayers saving for 1st home
- Little detail on what government expects
  - Cost, take-up, new saving *vs.* shifting existing funds,…
  - Potentially expensive

‘Help to Save’

- New savings vehicle introduced from April 2018
  - For individuals in families on working tax credit (or universal credit in work)
  - Can save up to £50 a month
  - Government adds 50% to contributions after 2 years, then repeats for another 2 years’ contributions (so max top-up £1,200)
  - 3.5 million individuals will be entitled to this subsidy under UC
- Some low-income families may under-save
  - But some already save: over half of those eligible either own their home, or have more than £1,500 of financial assets, or already save ≥£10 a month
  - And for some, sensible not to (particularly if low income temporary and/or can borrow if necessary)
- Key issue is whether those who use Help to Save will be the under-savers

‘Help to Save’

- Similar to Saving Gateway programme
  - piloted by last Labour govt; evaluation team included IFS researchers
  - due to be rolled out shortly after the 2010 general election
- Cancelled by coalition government in June 2010 because it “was not affordable given the need to reduce the deficit”
- What did IFS say at the time?

Impact

Coalition Government's abolition of Saving Gateway justified by IFS research

Date: 01 June 2010

Contacts: Carl Emmerson , Matthew Wakefield and Gemma Tetlow

IFS researchers showed that many lower income people already have some financial assets and that those without often appear to have good reasons for not saving. The Saving Gateway ¬– a policy to encourage lower income people to save by offering them a government "match" on any saving – risked being an expensive way of generating few new savers and little new savings. We recommended a pilot scheme be conducted to find out whether or not the policy would be effective.

The IFS evaluation of this scheme found no evidence of an increase in overall savings and limited evidence of account holders reducing their spending. The June 2010 Budget announced that the planned national rollout would be cancelled.

Funded by

HM TREASURY HM Treasury

Related publications

01/06/2003
Journal Articles
Increasing support for those on lower incomes: is the Saving Gateway the best policy response?

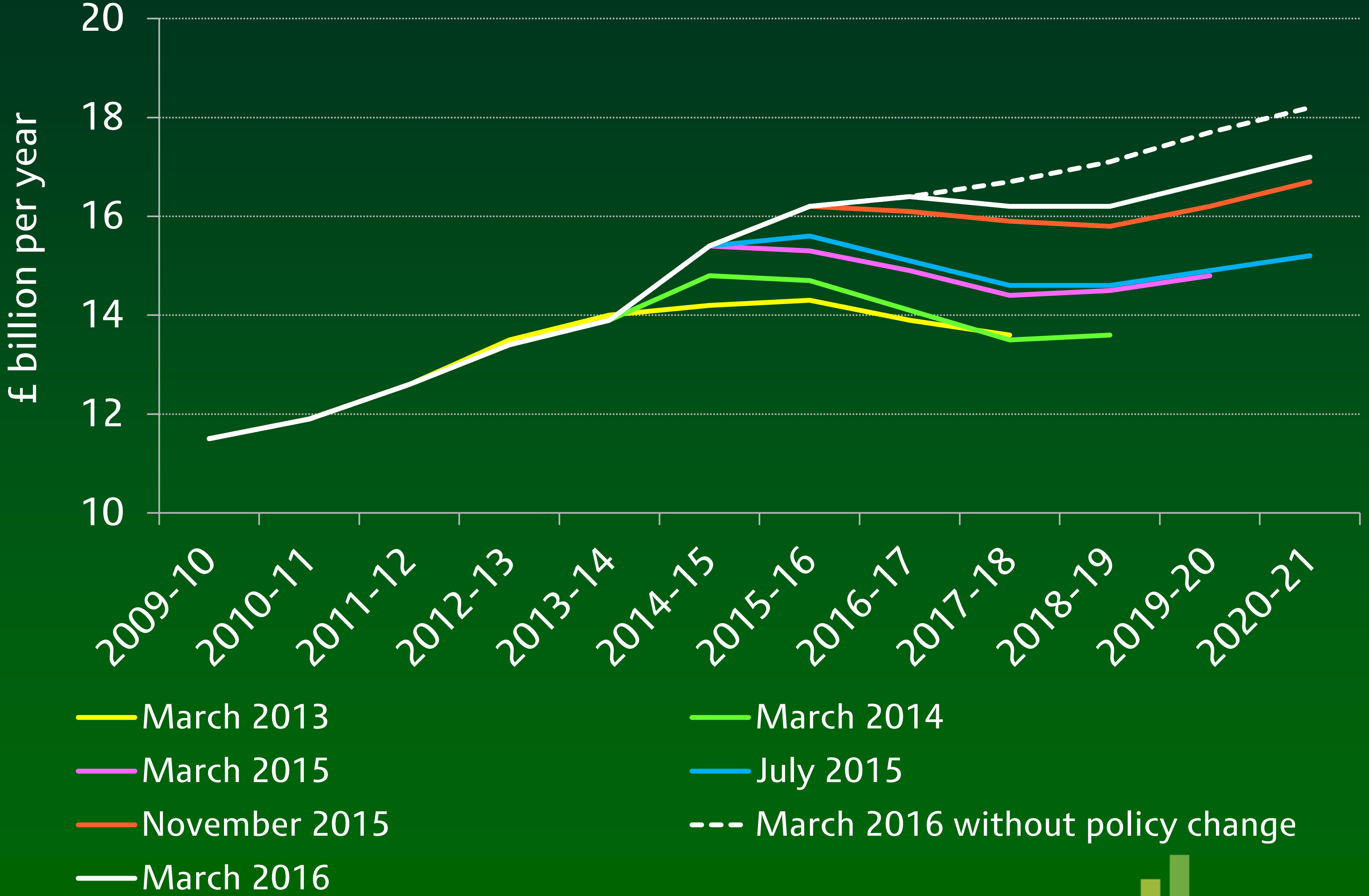
30/05/2007
External publications
Final evaluation of the Saving Gateway 2 pilot: main report

http://www.ifs.org.uk/centres/cpp/impacts/446

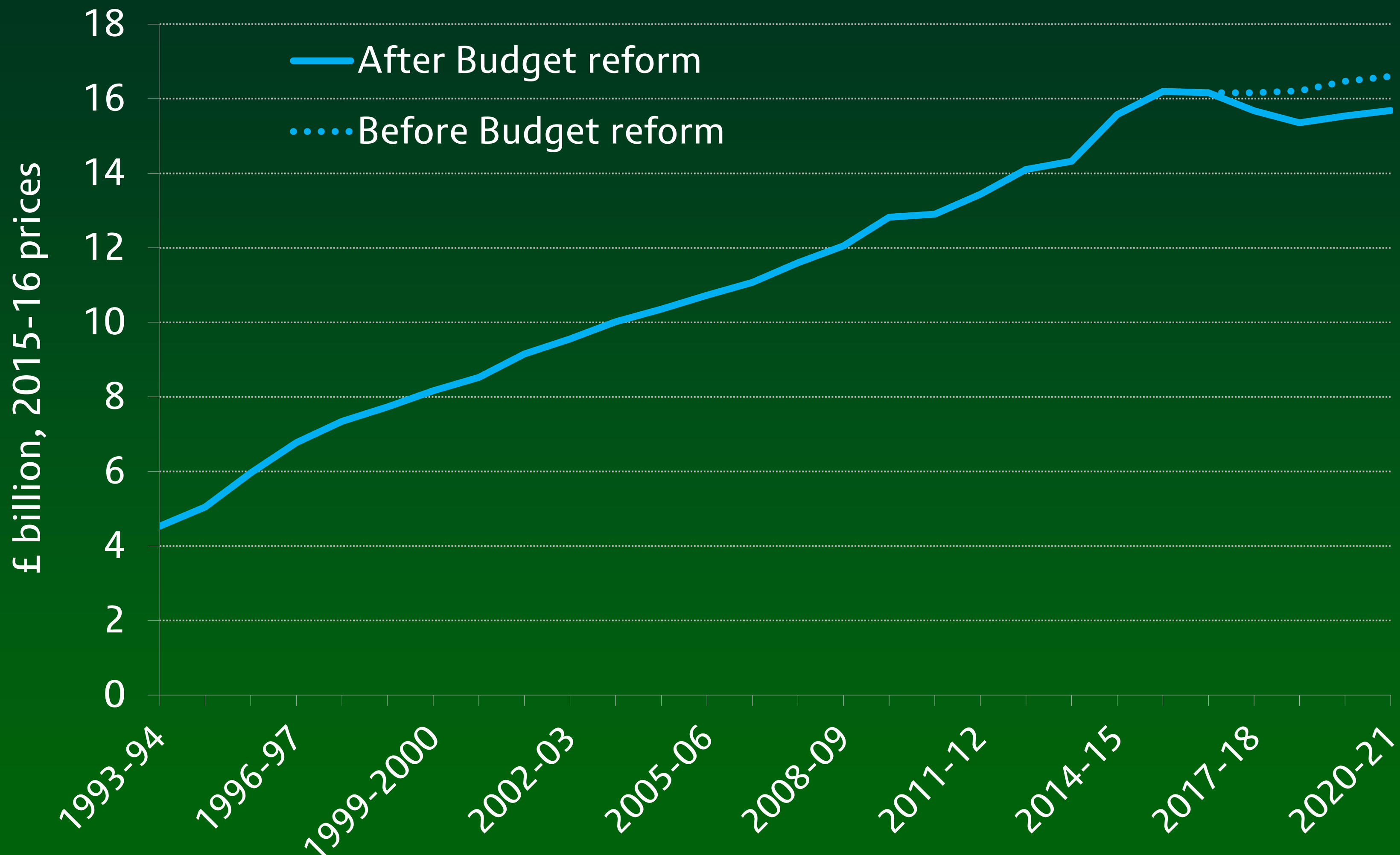
Personal independence payment (PIP)

- Cut to new disability benefit for working-age people (replacing DLA)
  - Saves £1.3bn in long run
  - OBR says 370,000 people lose, implying average loss of £3,500 a year
  - Out of 2.4m recipients when PIP fully rolled out
- More than offset by increase since Nov in forecast spending
  - Latest in a long line of upward revisions by the OBR

OBR forecasts for spending on DLA/PIP



Real-terms spending on DLA/PIP



Conclusions

- Winners
  - Alcohol drinkers, drivers, income tax payers, savers
- Losers
  - Sugary drinkers, some disabled people
- Some old themes
  - Personal allowance up, fuel duties down, benefits cut, more tax-privileged non-pension savings, housing demand fuelled
- Change of direction on CGT rates
  - In its way, also an old theme…
- Biggest changes are to treatment of savings
  - Reforms might reward existing savers more than generating new saving