

## Press Release

# Low-income households with children and the very rich have lost the most from coalition's tax and benefit changes

The coalition government has implemented a set of tax changes which, broadly speaking, have left middle income households better off and have hit high income households. Accompanying benefit changes have reduced the incomes of poorer working age households and reduced the incomes of most families with children.

Taking these tax and benefit changes as a whole, they have reduced the incomes of low-income households with children and the very richest households by the most as a percentage of income. By contrast, middle to higher income working age households have escaped remarkably unscathed on average; those without children have actually gained from the changes.

These are two of the main results from a new IFS Election Briefing Note on the impact of tax and benefit changes on household incomes being published today with funding from the Nuffield Foundation.

In the face of a fiscal consolidation aimed at reducing unsustainable government borrowing, households' incomes were bound to be reduced. The previous government had already implemented tax rises in April 2010, particularly aimed at those on the highest incomes. It had also announced a series of tax rises to come in after the 2010 election. In this briefing note we focus on the distributional impact of those tax and benefit changes implemented after the 2010 election (including those that had been announced by the previous government) where gains and losses can be assigned to particular households relatively precisely. These include most changes to the benefit system and changes to income tax, National Insurance Contributions (NICs) (including employer NICs), VAT and excise duties. Households lose an average of £489 a year from these changes. Including those tax rises introduced in April 2010 increases this average loss to £810 per year.

(Note that these figures significantly understate the overall effects of the consolidation on households. We cannot assign some of the revenue from tax rises and benefit cuts implemented since May 2010 to specific households. We also do not attempt to look at the effect of cuts to public service spending.)

This average loss conceals considerable variation between households at different income levels and between different types of household. Key differences for working-age households include:

- Low-income households with children lose the most as a percentage of their income from changes implemented by the coalition. This is mainly because of cuts to means-tested benefits and tax credits.
- The richest tenth of households also lose out significantly. Indeed they are found to have lost out the most – in both cash terms and as a proportion of their income – if we include in our analysis the tax rises

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*IFS analysis relating to the 2015 General Election has been funded by the Nuffield Foundation.*



### Embargo

**Under embargo  
00.01 Friday 23 Jan 2015**

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introduced in the April 2010 Budget immediately before the coalition came to office.

- Middle-income, working-age households without children have gained from the coalition's changes. They have gained significantly from the coalition's large increases in the income tax personal allowance and are much less affected by benefit cuts than other groups.
- The picture is different for middle and higher income families with children whose loss of tax credits and child benefit has more than offset the effect of income tax cuts.
- Households in London have lost more on average than households in other parts of the UK. This is both because many of the highest-income households are in London, and because London's low rates of owner-occupation and high rents mean that households in London are particularly affected by cuts to housing benefit.

The situation for pensioner households is different. They have not benefited from the big increase in the income tax personal allowance, nor have they lost so much from cuts to means tested benefits and tax credits. How they have been affected overall depends critically on how we define a "reform".

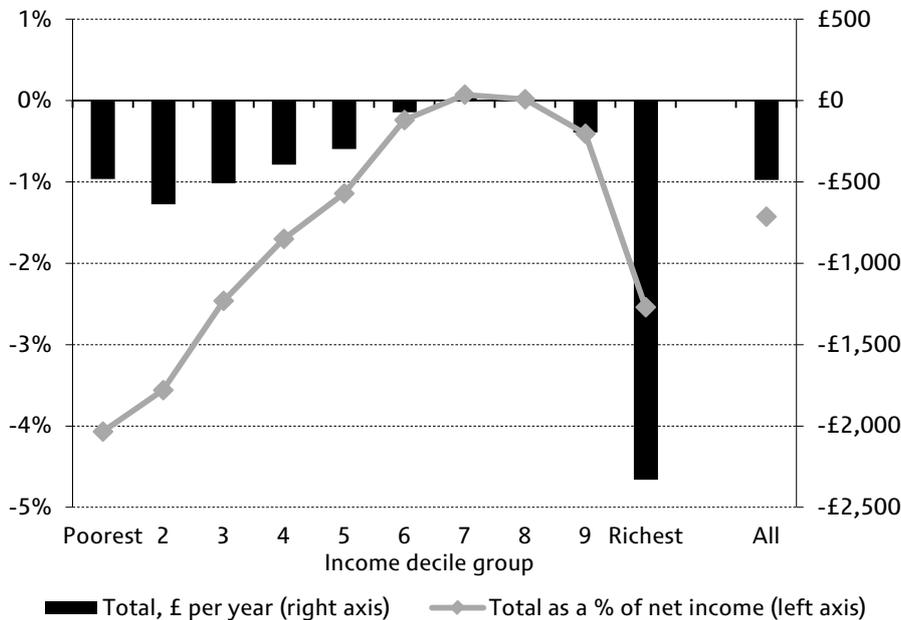
- Compared to an 'unchanged policy' baseline where the tax and benefit system had been uprated according to the default rules in place in May 2010, reforms have left pensioners relatively unaffected on average. Losses resulting from the increase in VAT have largely been offset by the fact that the basic state pension has been "triple locked" – rising by the higher of earnings, inflation as measured by the Consumer Prices Index (CPI) and 2.5% – rather than the default of earnings indexation announced by the previous government.
- If instead you compare pensioner incomes with what they would have been had the basic state pension (and other parts of the tax and benefit system) risen in line with the CPI then they have actually lost just as much as working-age households. Compared to this baseline the triple lock is somewhat less generous, and it is therefore not enough to offset the VAT rise.

Importantly changes to the tax and benefit system don't just affect incomes, they affect work incentives. By cutting benefits for non-working families and increasing the personal allowance, the coalition has significantly strengthened financial incentives to work on average for most groups. However, cuts to in-work benefits have undermined this effect for lone parents and people with children who have a partner who is not in paid work.

James Browne, a senior research economist at IFS and a co-author of the report said: "How much different households gain or lose from tax and benefit reforms depend partly on whether you look only at those introduced by the coalition or include all changes that have been introduced since the start of the fiscal consolidation in 2010. It also matters how you define a 'reform'. But whichever way you cut it, low-income households with children and the very richest households have lost out significantly from the changes as a percentage of their incomes. Increases in the tax free personal allowance have played an important role in protecting middle-income working-age

households meaning that those without children have actually gained overall.”

**Figure: Impact of tax and benefit reforms introduced between May 2010 and May 2015 by income decile**



Note: Income decile groups are derived by dividing all households into 10 equal-sized groups according to net income adjusted for household size using the McClements equivalence scale. Assumes full take-up of means-tested benefits and tax credits.

Source: Authors' calculations using TAXBEN run on updated data from the 2012–13 FRS and 2012 LCFS.

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#### Notes to Editors:

1. 'The Effect of the Coalition's Tax and Benefit Changes on Household Incomes and Work Incentives' by James Browne and William Elming will be published on Friday 23<sup>rd</sup> January 2015. For embargoed copies of the report or other queries, please contact: Bonnie Brimstone 020 7291 4818 / 07730 667013, [bonnie\\_b@ifs.org.uk](mailto:bonnie_b@ifs.org.uk)
2. The Nuffield Foundation is an endowed charitable trust that aims to improve social well-being in the widest sense. It funds research and innovation in education and social policy and also works to build capacity in education, science and social science research. The Nuffield Foundation has funded this project, but the views expressed are those of the authors and not necessarily those of the Foundation. More information is available at <http://www.nuffieldfoundation.org>
3. Support from the ESRC through the Centre for Microeconomic Analysis of Public Policy (CPP) is gratefully acknowledged.

