

Press Release

Couple 'penalties' in tax and benefit system are widespread, but almost impossible to eliminate

The majority of people in the UK would receive more financial support from the state if they were single (or told the authorities they were single) than if they were married or part of a cohabiting couple, according to new research, *Couple Penalties and Premiums in the UK Tax and Benefit System*, published today from the Institute for Fiscal Studies and funded by the Nuffield Foundation.

Two adults can almost certainly save on living costs by living together, but unlike some past research, this study does not try to measure the overall benefits or costs to living as a couple compared with living apart. This study's findings cannot tell us whether couples would be better off living apart than living as a couple. It simply measures how net state support varies by family situation. Whether the tax and benefit system is currently fair to couples compared with single adults, or whether it would be any fairer if there were fewer or more couple penalties, is in the eye of the beholder.

So-called 'couple penalties' in the tax and benefit system arise chiefly because much state support is means-tested against the joint income of a couple, rather than an individual's own income. Existing couple penalties could be reduced, and some couple premiums created, by increasing benefits and tax credits for couples or cutting them for single adults. But eliminating all couple penalties and premiums in the tax and benefit system can be done only by assessing all benefits, tax credits and taxes against an individual's circumstances. Unless benefit rates for single adults are cut, the cheapest way of doing this would cost around £34 billion a year, and doing so would introduce new distortions that might be worse than those that would be removed. A companion piece of work asks whether couple penalties and premiums in the tax and benefit system would change under the tax and benefit proposals in the three main parties' manifestos.

The report reviews existing evidence on whether couple penalties and premiums distort behaviour, and finds that they do, but only in small ways, encouraging a few people to make fraudulent claims for benefits or tax credits, and perhaps encouraging a few people to live apart rather than together.

What are couple penalties and premiums and how does this study measure them?

The study measures couple penalties and premiums in the tax and benefit system by calculating the change in entitlements to benefits and tax credits, and in liability to taxes, that occurs when a couple divorce or stop living together as husband and wife. It does not measure how net income or living standards change when a couple splits up. It looks at the couple penalty or premium in the tax and benefit system for around 14,000 couples in a representative sample of the UK population. It also estimates the hypothetical couple penalty or premium in the tax and benefit system facing around 15,000 single adults were they to marry or live with a partner. The report identifies a couple penalty in the tax and benefit system when net state support (i.e. state benefits less tax liability) rises when a couple splits up. Net state support can also fall when a couple splits up, and the study calls this a

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‘couple premium’. If net state support does not change when a couple splits up, then the tax and benefit system is neutral towards relationship status.

Why do couple penalties and premiums arise?

So-called ‘couple penalties’ in the tax and benefit system arise chiefly because much state support is means-tested against the joint income of a couple. This means that, when two people live together, their entitlement to support might not be the same as if they lived separately. For example, an adult with no income of their own would not be paid benefits or tax credits if married to a millionaire, but would if he or she lived alone. By contrast, taxes and benefits that depend only upon the individual taxpayer’s or claimant’s own circumstances never lead to couple penalties or premiums.

Couple **penalties** in the current UK tax and benefit system arise mostly through income support, jobseeker’s allowance, pension credit and child tax credit. There are three different causes:

- The clearest case of a couple penalty in the tax and benefit system arises because these benefits provide support to single adults with no income of their own, but take all or most of it away if they live with a partner with an income, because the benefits depend upon the combined income of the couple.
- Another set of penalties in the tax and benefit system exist because, for most means-tested benefits, the maximum entitlement for a couple is less than twice that for a single adult.
- A final set of penalties and premiums in the tax and benefit system arises if couples live in different households after splitting up (or before marrying) caused by parts of the system that are explicitly designed to assist with certain living costs, such as housing benefit and winter fuel payments. Because a couple can make savings on rental costs and heating compared with two single adults, those benefits that support living costs are consequentially worth less to them. For example, housing benefit for those who rent privately is designed around the assumption that a couple need spend no more in rent than a single person.

Couple **premiums** in the tax and benefit system are caused by the few remaining non-means-tested benefits that pay extra amounts for adult dependants, such as the state pension and incapacity benefit, and by the married couple’s allowance for those born before 1935. Also, two adults can usually save on council tax by living together rather than apart.

The tax and benefit system will be **neutral** for a couple if neither adult would be entitled to benefits or tax credits as a single adult. This is more likely to occur for well-off adults than for those with low incomes. It is also more likely to occur for working-age couples without children than for those with children or those aged 60 or over, because means-tested benefits and tax credits are less generous for them than for those with children or those aged 60 or over.

How extensive are couple penalties and premiums in the UK tax and benefit system?

Using its definition of couple penalties and premiums that ignores any differences in living costs between single adults and couples, the study finds that 68% of existing couples in the UK face a couple penalty in the tax and benefit system, 27% face neutrality and 4% face a premium. The average (mean) penalty or premium in the tax and benefit system (i.e. counting premiums as negative penalties) is a penalty of £45 a week. For 1 in 10 couples, the couple penalty in the tax and benefit system is at least 20% of their net income.

Working-age couples with children are the most likely to have a couple penalty (95%), followed by pensioner couples (81%) and then working-age couples without children (41%). Pensioners are the most likely to have a couple premium (9%), followed by working-age couples with and without children (3%). The average (mean) penalty or premium in the tax and benefit system is a penalty of £85 a week for couples with children, £39 for pensioner couples and £13 for working-age couples without children.

The figures above reflect couple penalties and premiums that are purely due to the relationship between two adults. Many things change when couples form or split, but a change in living arrangements and housing is perhaps the most obvious. If adults in couples form new single-adult households after splitting up, then the average couple penalty from the tax and benefit system rises by £7 a week, because average entitlement to housing benefit rises, more than offsetting the higher council tax bills that the now-single adults will be liable for, on average.

The study finds that couple penalties and premiums for existing single adults are similar to those for existing couples.

How have tax and benefit changes altered couple penalties and premiums?

Overall, tax and benefit reforms since 1997–98 have increased the average (mean) size of penalties in the tax and benefit system by over 50% if ‘no reform’ is taken to mean that benefits and tax allowances grow in line with average earnings, and by over 100% if ‘no reform’ is taken to mean that benefits and tax allowances grow in line with price inflation. They have increased the chance that a couple faces a penalty in the tax and benefit system, increased the chance that a couple faces neutrality and reduced the chance that a couple faces a premium.

These changes have three main causes, which act in different directions:

- In 1997–98, income tax provided a couple premium for married couples through the married couple’s allowance. This was scrapped for almost everyone in 1999-00, reducing premiums or increasing penalties for married couples.
- In 1997–98, the higher rate of child benefit for lone parents provided a near-universal couple penalty for those with children. This one-parent benefit has now been scrapped, reducing penalties for couples with children.
- The expansion of means-tested benefits and tax credits, particularly for low- and middle-income families with children and for pensioners, has increased the incidence and size of couple penalties in the tax and benefit system (at the same time as it has reduced rates of poverty amongst children and pensioners).

Couple penalties and premiums and the parties’ manifestos

In a companion piece of work to this (see note 2), IFS researchers have estimated the impact of the three main parties’ tax and benefit proposals on couple penalties and premiums in the tax and benefit system. In general, these impacts are very small, because the parties are proposing only small changes to jointly-assessed taxes and benefits. The fraction of couples facing a couple penalty in the tax and benefit system would not change under government plans for a toddler tax credit, and would fall very slightly under Conservative and Liberal Democrat plans (by 1 and 2 percentage points respectively). The average penalty would fall very slightly (by 0.2%) under the Conservative plans, rise very slightly (by 0.4%) under Labour’s plans, and rise by a little more (by 3.1%) under the Liberal Democrats’ plans.

That other work also analyses the Conservative Party’s ambition to “end the couple penalty for all couples in the tax credit system”. It concludes that a literal

interpretation of this ambition would require assessing tax credits on an individual's own income, and cost £18 billion a year, vastly extending the scope of means-tested tax credits. Increases in the working tax credit for couples with children would reduce couple penalties for couples with children, but would introduce new couple premiums, and would still leave the vast majority of couples with children facing a couple penalty in the tax and benefit system.

Should – and can – couple penalties and premiums be eliminated from the tax and benefit system?

Couple penalties and premiums are undesirable if they distort behaviour – unless governments are deliberately trying to encourage people to live as couples or single adults – or if they are unfair.

Couple penalties do distort behaviour, but only in small ways. The government's own figures show that it is incorrectly paying out around £650 million a year in benefits and tax credits to some couples who are claiming state support as lone parents, and the pay-off to concealing the presence of a second adult would disappear if there were no couple penalties in the benefit and tax credit system. And existing studies have suggested that family formation decisions may be affected by couple penalties and premiums in the tax and benefit system, although the evidence is not overwhelming and any impacts are likely to be small. Policies that reduce couple penalties in favour of neutrality – such as moves towards individual assessment of benefits – would reduce these tax distortions, but policies that replace couple penalties in the tax and benefit system with couple premiums would create new tax distortions and incentives to behave fraudulently.

Existing couple penalties could be reduced, and some couple premiums created, by increasing benefits and tax credits for couples or cutting them for single adults. But eliminating all couple penalties and premiums in the tax and benefit system can be achieved only by assessing all benefits and tax credits on the basis of the individual's characteristics, not those of the couple. This would mean that a single adult with no income of his or her own would be paid benefits even if married to a millionaire. This would cost at least £34 billion a year at current levels of benefits and tax credits for single adults, although the subsequent behavioural response would increase the cost, because many more individuals would be receiving means-tested benefits or tax credits, weakening incentives to work. There are many ways of making this reform revenue neutral; if it were done by cutting benefits and tax credits for single adults, it would transfer £13.5 billion a year from single people to couples, and lead to the bottom four income decile groups losing, on average, and the top six gaining, on average.

Two adults can almost certainly save on living costs by living together, but whether the tax and benefit system is currently fair to couples compared with single adults, or whether it would be any fairer if there were fewer or more couple penalties, depends on one's view of fairness. One could take a strict view that the tax and benefit system should treat similar individuals similarly, disregarding whether they live alone or in a couple. Under this view, the current system is not fair, and should be replaced by an individualised tax and benefit system (which would then have no couple penalties and premiums). Alternatively, one could take the view that the amount of support an adult receives from the state should take into account whether he or she is living alone or with a partner, and the income of any partner. Under this view, those aspects of the current tax and benefit system that cause couple penalties – such as assessing support against the combined income of a couple, and setting benefit rates for couples at less than twice those of single adults – are not necessarily unfair. However, the current tax and benefit system is inconsistent in its approach, paying out benefits and tax credits according to family circumstances but levying income tax according to an individual's income. This inconsistency probably reflects the impossible task governments have when pursuing multiple objectives with the tax and benefit system.

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Notes to Editors:

1. The report, *Couple Penalties and Premiums in the UK Tax and Benefit System*, by Stuart Adam and Mike Brewer, is published today and is available at <http://www.ifs.org.uk/bns/bn102.pdf>. Worked examples of couple penalties and premiums in the tax and benefit system can be found in Annex B of the report.
2. Also being launched today by IFS is an analysis of the three main parties' policies for families and children, which includes an assessment of how proposed tax and benefit reforms will affect couple penalties and premiums. <http://www.ifs.org.uk/bns/bn103.pdf>.
3. This project is being supported by the Nuffield Foundation (grant number OPD/37693). IFS election analysis is being supported by the Nuffield Foundation (grant number OPD/36607). Ongoing financial support from the ESRC Centre for the Microeconomic Analysis of Public Policy at IFS (grant number RES-544-28-5001) financed research upon which much of this analysis is based. 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>.
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