Institute for Fiscal Studies

Universal Credit in Northern Ireland: what will its impact be, and what are the challenges?

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Preface

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Executive summary

- This is the first of two reports examining welfare reform and poverty in Northern Ireland, funded through a research call from OFMdFM in their remit as the department with policy responsibility for equality and social need in Northern Ireland. A subsequent report will produce projections of poverty rates for children and working age adults in Northern Ireland from 2010 to 2020 and investigate how these are affected by tax and benefit reforms, particularly Universal Credit.
- A major reform to the welfare and tax credit system, integrating six of the seven main means-tested welfare benefits and in-work tax credits for those of working age into a single programme, to be known as Universal Credit, is set to be introduced throughout the UK. This represents a significant simplification of the benefits system as a whole.
- Universal Credit will lead to a small reduction in aggregate benefit entitlements in both Northern Ireland and the UK as a whole. The total reduction in benefit entitlement as a percentage of income in Northern Ireland is slightly larger than in the UK as a whole. However, because Universal Credit is a simpler scheme, it is anticipated that take-up of means-tested support will increase as a result of its introduction, which in practice is likely to lead to higher total expenditure on benefits, despite the small reduction in entitlements.
- Although benefit entitlements will fall very slightly overall in both Northern Ireland and the UK as a whole, this disguises significant winners and losers from the reform. In Northern Ireland, around 9% of families will gain and 9% of families will lose from the introduction of Universal Credit, ignoring transitional protection. Both of these figures are larger than in the UK as a whole: as Northern Ireland is a relatively low-income part of the UK, more people are entitled to means-tested support, and hence affected by reforms to means-tested benefits.
- The main losers from Universal Credit's introduction will be: low-income couples where one person is aged above the female State Pension Age (SPA) and the other is aged below, who will no longer be entitled to the more generous Pension Credit; families with significant amounts of unearned income or capital, as these are treated more harshly in the Universal Credit means test than in the means tests for tax credits; and those on Disability Living Allowance claiming the severe disability premium in means-tested benefits, which will be abolished when Universal Credit is introduced. As receipt of Disability Living Allowance is higher in Northern Ireland than in the UK as a whole, this partly explains the slightly larger reduction in benefit entitlements in Northern Ireland.
- The main winners from the introduction of Universal Credit will be single-earner couples with children. This group will gain more from the introduction of Universal Credit in Northern Ireland than in the UK as a whole, mainly because gains are focused on those with lower incomes and incomes are lower on average in Northern Ireland.
- By increasing support for single-earner couples while reducing support for workless families on average, Universal Credit will strengthen the incentive

for one member of a couple to do paid work rather than none. Universal Credit also strengthens work incentives for single people without children.

- However, because means-tested support is withdrawn more quickly when the second member of a couple enters work under Universal Credit, the reform weakens the incentive for both members of a couple to be in paid work rather than just one. This effect is particularly acute in Northern Ireland, as lower average earnings levels mean that a greater proportion of single-earner couples are entitled to means-tested support, meaning that those not in paid work who have a partner in paid work are more likely to face withdrawal of Universal Credit if they were to enter paid work.
- By replacing a jumble of overlapping means tests with a single one, Universal Credit will go some way to ensuring overall effective tax rates cannot rise too high. Thus, some those who face the weakest incentives to increase their earnings under the current system will see their incentives strengthened. However, those previously not entitled to means-tested support who will become entitled to Universal Credit (mainly single-earners in couples with children) and those in two-earner couples tend to see weaker incentives to earn more.
- Two of the main advantages of Universal Credit, then, are that it simplifies the benefits system and rationalises work incentives. However, these benefits could be undermined by the decision to leave support for local taxes (Council Tax in Great Britain and domestic rates in Northern Ireland) outside Universal Credit. As domestic rates in Northern Ireland are lower on average than Council Tax in Great Britain, support for local taxation is a correspondingly smaller component of the overall benefit system in Northern Ireland, and so this issue is less important in Northern Ireland than in the rest of the UK. Nevertheless, keeping support for domestic rates separate from Universal Credit will definitely make the overall benefits system more complicated than it could be, and could lead to the reintroduction of the very high overall withdrawal rates that Universal Credit was supposed to eliminate. How much this happens in practice will depend on decisions made by the Northern Ireland Executive surrounding the design of the proposed rate rebate replacement scheme.
- The introduction of Universal Credit also raises issues around the administration of rate rebates. Currently, more than 70% of claimants of the rates component of Housing Benefit are ‘passported’ to a full rebate through receipt of other benefits that are being abolished when Universal Credit is introduced. There is no obvious alternative passport in Universal Credit that could be used to identify these people, and if they all had to go through a full means test to receive support, the burden on both claimants and administrators would increase substantially. Ways around this problem include merging the administration of Universal Credit and rate rebates, allowing claimants to claim both with the same form, or transferring information on Universal Credit claims to the appropriate authority responsible for the administration for rate rebates so that claimants would not have to submit the same information twice.
- Similar issues arise around other non-social security benefits that use a passport based on receipt of other benefits to identify who is eligible. The introduction of Universal Credit offers an opportunity for the Northern

Ireland Executive to consider the rationale for providing benefits in kind rather than in cash and, if these benefits should continue to be provided, whether their provision should be means tested or offered universally. For those benefits that it was decided to retain as means-tested benefits in kind, the most obvious solution would be to give these benefits only to families with incomes below a certain threshold. This would, however, create 'cliff edges' that would make some people worse off after a pay rise. A longer-term solution would be to allow claimants to choose which benefits in kind they wish to receive, and make a deduction against that claimant's Universal Credit award which would depend on their income. This would be more administratively complex, but would avoid the 'cliff edges' inherent in alternative approaches.

- In short, the UK Government and Northern Ireland Executive have taken a welcome big and radical step forward by proposing the introduction of Universal Credit. But many of the advantages it will bring could be undermined by the decision to keep support for local taxes separate from Universal Credit. Decisions to be made by the Northern Ireland Executive around the design of a rate rebate replacement scheme and other non-social security benefits will therefore be crucial in determining the extent to which these benefits are realised.

CHAPTER 1
Introduction

A major reform to the welfare and tax credit system, integrating six of the seven main means-tested welfare benefits and in-work tax credits for those of working-age into a single programme, to be known as Universal Credit, is set to be introduced throughout the UK. The Welfare Reform Act (2012) received Royal Assent on 8 March 2012, allowing the UK Government to introduce Universal Credit in England, Scotland and Wales. Although social security is a devolved matter in Northern Ireland, in practice retaining 'parity' with Great Britain is an attractive option for the Northern Ireland Executive, as the UK Government has only agreed to meet the costs of benefits in full if parity is maintained.[1] Therefore, the Northern Ireland Executive has proposed that Universal Credit also be introduced in Northern Ireland: the Welfare Reform Act (2012) was introduced in the Northern Ireland Assembly on 1 October 2012 though has still not completed its Committee Stage at the time of writing. This is the first of two reports examining poverty in Northern Ireland and the impact of welfare reforms on poverty, funded through a research call from OFMdFM in their remit as the department with policy responsibility for equality and social need in Northern Ireland. This report reviews the arguments for the introduction of Universal Credit and uses microsimulation methods to examine how it will affect benefit entitlements and financial work incentives in Northern Ireland. A subsequent report will produce projections of poverty rates for children and working age adults in Northern Ireland from 2010 to 2020 and investigate how these are affected by tax and benefit reforms, particularly the introduction of Universal Credit.

The main advantages of Universal Credit are that it will simplify the benefit system and will rationalise work incentives by replacing a jumble of overlapping means tests with a single one, ensuring overall effective tax rates cannot rise too high. However, although Universal Credit will integrate most forms of means-tested support into a single payment, others will remain outside. Most important of these are the rates component of Housing Benefit, a means-tested social security benefit that offers families support with their domestic rates bills. Other forms of means-tested non-cash support also exist. Keeping these outside Universal Credit could undermine both of the main benefits of its introduction, namely greater simplicity and rationalising work incentives. We therefore examine how the Northern Ireland Executive can make these schemes work alongside Universal Credit most effectively.

This report is structured as follows. Chapter 1 gives an overview of the current system of means-tested benefits and tax credits in the UK, and the rationale for the introduction of Universal Credit. It also explains some of the key issues the UK Government had to confront having decided to integrate several benefits and tax credits, and outlines how entitlements to Universal Credit will be set, comparing this with the current set of means-tested benefits and tax credits. Chapter 2 gives a quantitative assessment of the impact of Universal Credit on household incomes and on measures of financial work incentives. Chapter 4 outlines the operation of rate rebates – the one major means-tested benefit which is not being incorporated into Universal Credit – and sets out some possible options for reform that can be considered by the Northern Ireland Executive, and in Chapter 5 we discuss the options for reforming other non social security benefits. Finally, Chapter 6 summarises and concludes.

[1] We note that the current UK coalition government has announced many other changes to the benefit and tax credit system, which together will reduce welfare spending for the UK as a whole by £20 billion/year by 2015–16, but in this report we take those other changes as given: our analysis assesses the impact of the Universal Credit reform alone, rather than the overall changes to benefit entitlements and work incentives as will be experienced by families and individuals over the next few years. In a separate report for OFMdFM, we will project measures of income poverty in Northern Ireland through to 2020, including the impact of these welfare changes.

1.1 What are the reasons behind the introduction of Universal Credit?

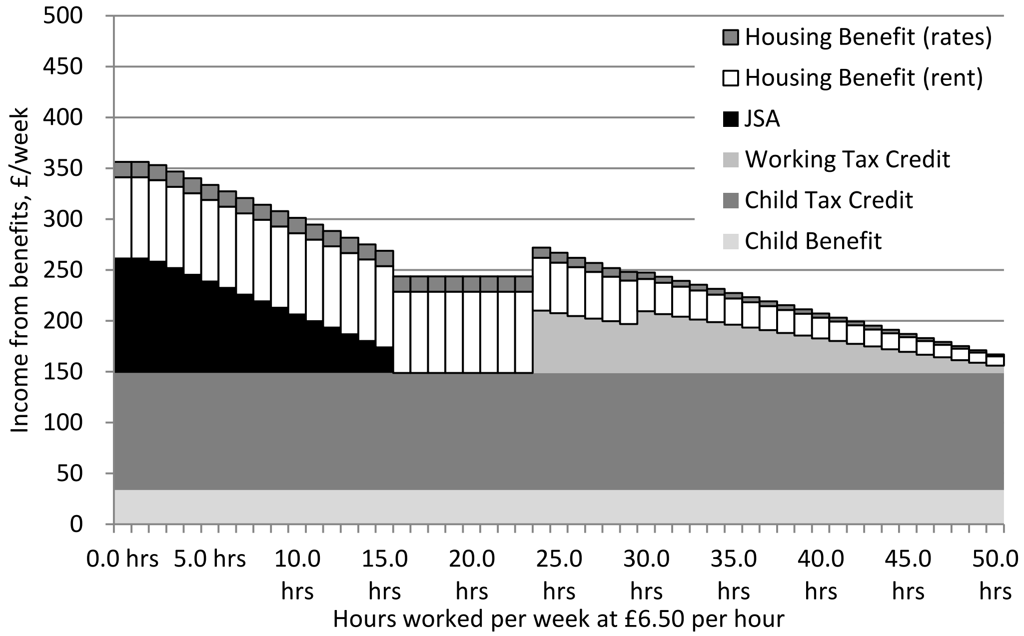
In November 2010, the current UK (Conservative–Liberal Democrat coalition) Government set out plans to integrate and simplify all means-tested welfare benefits and in-work tax credits into a single programme, to be known as Universal Credit and to be phased in from October 2013.[2] The UK Government hopes that this will make it easier for claimants to claim benefits, make the gains to work more transparent, and reduce the amount spent on administration and lost in fraud and error.

To understand how the reform works, and why it was thought necessary, one needs to understand a little about the current system of means-tested social security benefits for working-age adults in the UK. One way to characterise this is that the UK has:

- separate, mutually exclusive, benefits providing income-replacement to non-working families, or income top-ups to working families[3]; and
- separate but not mutually exclusive means-tested benefits providing help with a family's extra costs; these can overlap with both each other and the income-replacement benefits.[4]

The main perceived problems are the way that these benefits and tax credits overlap and interact with each other, and the way that a family whose circumstances change has to move between different benefits and tax credits. This is illustrated for a specimen family in Figure 1.1.

Figure 1.1 Current system of welfare entitlements for an example family



Note: The entitlements are based on an assumed couple with two children. Only one person in the couple is in work, and they can choose how many hours to work at a given wage rate, £6.50 per hour. The family has no disabled members and no unearned income. Their Local Housing Allowance (LHA) or eligible rent is £80 a week, and their domestic rate liability is £15 a week.

In particular, the UK Government argues that this leads to the following faults:

[2] The original announcement was Department for Work and Pensions (2010a), with the thinking developed in Department for Work and Pensions (2010b). Claims of Universal Credit will not start in Northern Ireland until April 2014.

[3] There are: Jobseeker's Allowance (JSA), intended for unemployed people; Employment and Support Allowance (ESA), intended for those too ill or disabled to work at the present; Income Support (IS), intended for other people, mostly lone parents with young children, who are not working and not expected to look for work; Working Tax Credit (WTC), intended for people who are in work but have a low family income.

[4] These are Child Tax Credit (CTC), Housing Benefit (HB) and Council Tax Benefit (CTB).

- Having separate, mutually exclusive income-replacement benefits for families who are not in work is inefficient (for claimants and administrators).
- Having separate benefits for those who are working fewer than 16 hours and for those who are working 16 or more hours adds an unwelcome barrier to those trying to move from not-in-work (or from "welfare") to work, and this particularly affects those with volatile working patterns.
- Having overlapping benefits (i.e. instances where families are receiving more than one means-tested benefit) can be confusing for claimants, particularly when the rules for determining entitlements mean that the benefits interact.[5] Such interactions make the overall impact of the means-tested benefit system opaque, and create opportunities for claimants to be inconvenienced by delays in the calculation of entitlements by official bodies.
- The inefficiency (for administrators) and confusion (for claimants) that arises by having overlapping benefits is particularly acute when they are administered by different authorities. In Northern Ireland, the Social Security Agency administers JSA, ESA, and IS, HM Revenue and Customs (HMRC) administers tax credits, and the Northern Ireland Housing Executive administers HB; this means that claimants need to report their circumstances to more than one organisation (it also means that claimants could strategically report different information to different organisations).

Summary

The UK currently has a benefit system that has multiple different out-of-work benefits, support for low earners provided through tax credits and various benefits that assist poorer families with housing costs and the costs of children. This can mean that families have to claim benefits from three different government agencies and face the withdrawal of multiple benefits over the same range of income, creating very high effective marginal tax rates. In the next section, we will see how the design of Universal Credit simplifies the system, making it easier for claimants to navigate, and rationalises work incentives.

1.2 Overview of the key features of Universal Credit[6]

The UK Government plans that Universal Credit will replace most means-tested welfare benefits and in-work tax credits designed for working-age adults. As already noted, the key exception is Council Tax Benefit in Great Britain and the rates component of Housing Benefit in Northern Ireland. These are being kept outside Universal Credit, and responsibility for design will instead lie with local authorities in England and the devolved administrations in Scotland, Wales and Northern Ireland. The UK's main non-means-tested benefits will not be superseded by Universal Credit, and means-tested support for families where all adults are over the female state pension age (rising from 60 to 65 over this decade) is not directly affected by the reform. Other forms of in-kind means-tested support will also remain; these are discussed in Chapter 5.

Universal Credit will be administered by the Department for Social Development (DSD) in Northern Ireland, in contrast to the current system where HMRC manages tax credits, DSD administers means-tested benefits, the Northern Ireland Housing Executive (NIHE) pays housing benefit for tenants, and the Land and Property Services (LPS) oversees the system of domestic rates relief for owner-occupiers. While parity is being maintained in most aspects of Universal Credit, there will be more flexibility in

[5] For example, entitlements to WTC currently depend in part upon a family's earnings, and entitlement to HB depends in part not only on a family's earnings but also directly on its entitlement to WTC; this complexity and confusion is compounded by the fact that entitlements to WTC and HB each depend upon a different measure of earnings.

[6] The best single source at the time of writing on how Universal Credit might work is Child Poverty Action Group (2012a). This discussion is informed by the Universal Credit regulations and explanatory memoranda published by the Department of Work and Pensions (see http://www.dwp.gov.uk/policy/welfare-reform/), the explanatory memorandum to the Bill currently passing though the Northern Ireland Assembly (see http://www.niassembly.gov.uk/Assembly-Business/Legislation/Primary-Legislation-Current-Bills/Welfare-Reform-Bill/The-Welfare-Reform-Bill---Explanatory-and-Financial-memorandum/) and the Welfare Reform Act (2012) as passed by Parliament (see http://services.parliament.uk/bills/2010-11/welfarereform.html).

Northern Ireland as regards who within a family Universal Credit will be paid to, and at what frequency these payments will be made. DSD Minister Nelson McCausland recently announced that, following discussions with the UK Department of Work and Pensions, an option will exist to split Universal Credit payments between household members; such payments could be paid twice monthly, rather than monthly as is being proposed for the rest of UK; and the housing cost element of Universal Credit will be paid directly to landlords rather than claimants.[7]

An important aspect of Universal Credit, which we ignore in our quantitative analysis, will be the conditionality regime. The UK Government has said, in effect, that families who report low earnings, and which contain an adult who it considers is capable of working (or working longer hours), will be subject to conditionality. Although it is not clear how this will operate, these families will be obliged to seek to increase their earnings, backed up with sanctions as in the current regime for JSA. It looks like the eventual system will extend some form of conditionality to more families than are currently affected. For example, under Universal Credit couples without children will have to report joint earnings equivalent to two full-time minimum wage workers to escape any conditionality; under the current regime, such families could not be subject to conditionality provided one person worked at least 30 hours a week.

Maximum entitlements

Universal Credit will resemble a negative income tax administered at the family level, with entitlements depending on family circumstances and family resources, and no explicit dependence on whether a claimant family is in work or not. Each family who claims will be entitled to a personal amount with additional amounts for children and those with disabilities, and those in rented accommodation will receive an additional amount (to reflect their housing costs). The UK Government has said that it will set these additional elements in a way that means that most out-of-work welfare claimants with no other sources of income or savings will see their entitlements to benefits unaffected by the move to Universal Credit. This means that the personal amount will be higher for couples than for single people (though not twice as high), and lower for some young people. The housing component will be similar to HB, and the amounts for child additions will be based on the current rates of CTC. However, there will be changes to maximum benefit entitlements for some families. Some of these will arise because the UK Government intends to simplify disability premiums when Universal Credit is introduced in a way that will be revenue neutral overall, but will create winners and losers among those with disabilities. But there will also be substantial changes to (usually reductions in) welfare entitlements among couples where one person is above and one below the female pension age (which is rising from 60 to 65 over this decade): such families can currently claim the generous pension credit, but will in future have to claim Universal Credit, where the adult aged below the pension age could in principle be subject to conditionality.

Treatment of income

Under Universal Credit, earned income will be subject to a taper rate of 65%, but this taper will apply to earned income after income tax and National Insurance (social security) contributions (NICs) have been deducted. This means that the effective withdrawal rate will depend upon the tax and NIC rate faced. For example, an individual earning less than the income tax threshold who earns an additional pound will pay no more tax or NICs and lose 65p of Universal Credit, but an individual liable for National Insurance and paying income tax at the main rate of 20% who earns an additional pound will have to pay an additional 20p in income tax and 12p in NICs and will then lose 65% of the remaining 68p of additional net earnings (which comes to 44.2p) in Universal Credit, making a total effective marginal tax rate (EMTR) of 76.2%. (However, if the reformed CTB is withdrawn over the same range of income as Universal Credit, it is likely that EMTRs could be in excess of 80% for some individuals receiving Universal Credit.) Characterising EMTRs under the current system is much more difficult (as the system

[7]See http://www.northernireland.gov.uk/news-dsd-221012-tailoring-welfare-reforms.

has non-integrated overlapping tapers), but these can rise to over 90% for those receiving multiple benefits or tax credits.

There will be an earnings disregard that depends on family circumstances.[8] The disregards will be lower for families claiming help with rental costs. Having lower earnings disregards for those receiving help with rental costs prevents Universal Credit entitlements from extending too high up the earnings distribution (this is achieved under the current system by having a higher effective withdrawal rate for those receiving help with rental costs through HB).

Most unearned income other than interest income (which has a special treatment, see below) will not be subject to a disregard at all, and will reduce entitlement to Universal Credit pound-for-pound. This is mostly identical to the current treatment of such income under the means-tested welfare benefits, but it is a stricter means test than under tax credits where unearned income is currently subject to, at most, a 41% taper. As a result, current claimants of tax credits who rely on unearned income (e.g. out-of-work lone parents receiving large amounts of maintenance payments for themselves) can potentially lose considerably from the Universal Credit reform.

Special rules will apply to those with savings or investment income: instead of taking into account the actual amount of investment income, a claimant's savings will be used to calculate an imputed income.[9] Savings of less than £6,000 will be ignored, and if savings exceed £16,000, then a family will lose all entitlement to Universal Credit. This treatment of investment income is also identical to the way that means-tested benefits (IS, income-based JSA and ESA, HB, and CTB) currently operate, but it is much more harsh than the current treatment of such income in tax credits, where investment income below £300 per year is ignored altogether, and investment income above £300 per year, as well as all other unearned income, is subject to, at most, a 41% taper.

1.3 Impact on specimen families

As described above, the current set of benefits and tax credits are not integrated, or even all aligned with each other. Moving from a system of independent, unaligned benefits and tax credits to a sensible integrated system is impossible without creating winners or losers.[10] Before we move on to show how Universal Credit affects incomes on average, we show here the impact on some specimen families.

Figure 1.2 shows the budget constraint for a low-waged single adult aged over 25. Such a person will be better off under Universal Credit if they work for less than 30 hours a week (because the withdrawal rate in Universal Credit will be lower than those in the current out-of-work means-tested benefits). Between 30 and 39 hours a week they will be marginally better off under Universal Credit, while above 39 hours they will be unaffected by the reforms (as their earnings will be too high for them to receive benefit payments in either system). Under the existing system, there is a sharp jump in benefit

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[8] These earnings disregards turn out to be important parameters in Universal Credit. Since the UK Government has said it will set the basic entitlement to Universal Credit at levels that match entitlement to the current set of out-of-work benefits, and that there will be only one withdrawal rate for earnings in Universal Credit across all family types and all ranges of earnings, it follows that the only way in which in-work incomes can be varied across different family types is by changing the earnings disregards.

[9] For savings between £6,000 and £16,000, an income of £1 a week will be imputed for every £250 of savings in excess of £6,000 (i.e. savings of £7,000 will lead to an imputed income of £4 per week).

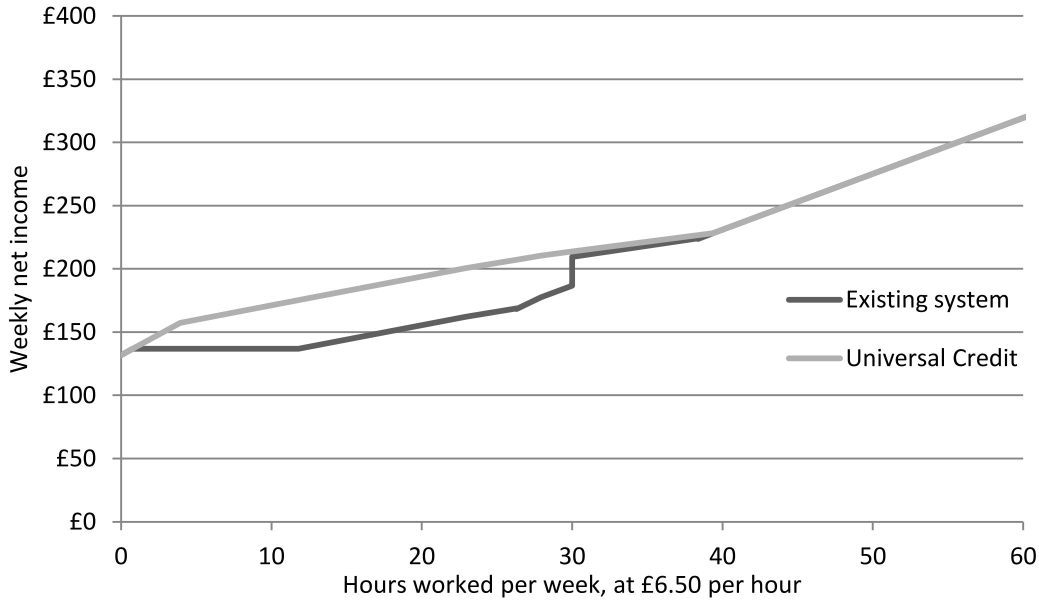
[10] Some of the examples of the lack of integration or alignment are as follows:

- the relationship between the claimant's age, family type, and maximum entitlement is different for the benefit system and the tax credit system;
- the definitions of earned income is different in the benefit system and the tax credit system;
- the treatment of financial capital differs within the benefit system, and between the benefit system and the tax credit system;
- the number of hours a week that need to be worked to be entitled to in-work benefits varies between family types within the tax credit system;
- the combined marginal effective tax rate faced by recipients of benefits or tax credits depends upon the combination of benefits and tax credits to which they are entitled;

Many of the reasons that particular families win or lose under Universal Credit can be traced back to the way the UK Government decided to resolve these inconsistencies.

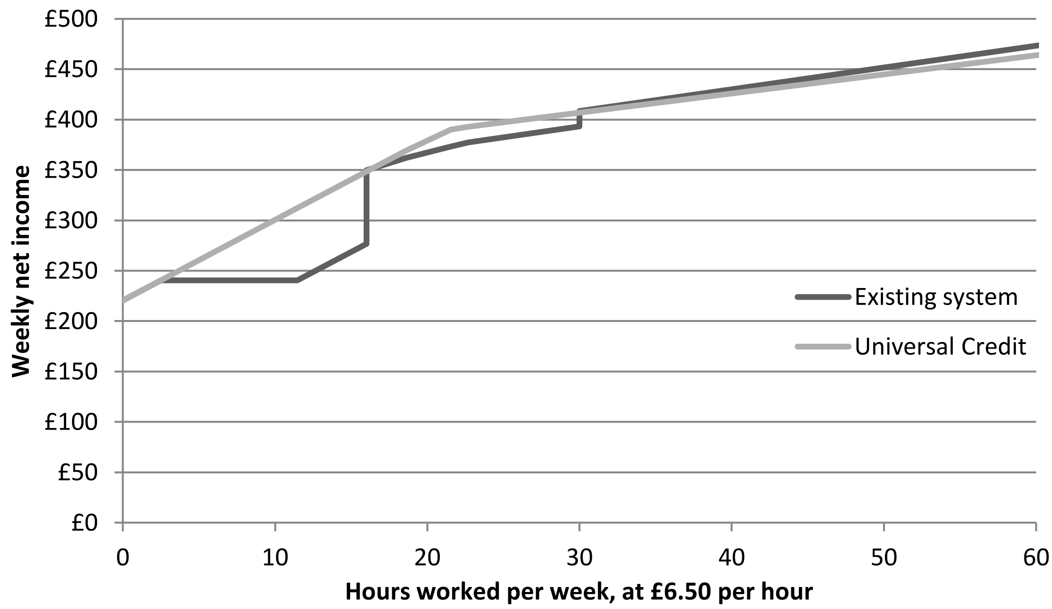
entitlements when weekly working hours reach 30: a result of the eligibility requirements of Working Tax Credit for those without children.[11]

Figure 1.2. Budget constraint under Universal Credit for an example single adult



Notes: based on an assumed single adult: he can choose how many hours to work at a given wage rate, £6.50 per hour; their eligible rent is £60 per week; and they have no disability and no unearned income.

Figure 1.3. Budget constraint under Universal Credit for an example lone parent with two children



Notes: based on an assumed lone parent with two children who can choose how many hours to work at a given wage rate, £6.50 per hour, and has no housing costs, no disability and no unearned income.

[11] The figure suggests that Universal Credit may weaken the incentive for single adults with low potential wages to do full-time work, but the UK Government has also announced that single people without children will be subject to conditionality until they are earning 35 times the minimum wage each week (Department for Work and Pensions 2011a).

Figure 1.3 shows the budget constraint for a lone parent with two children. The figure illustrates how Universal Credit removes many of the kinks in the existing system that result from the hours rules in WTC, the interaction between different benefits and the simultaneous withdrawal of benefits. As a result, the net impact of the reform varies by hours worked in a complicated way but, in general:

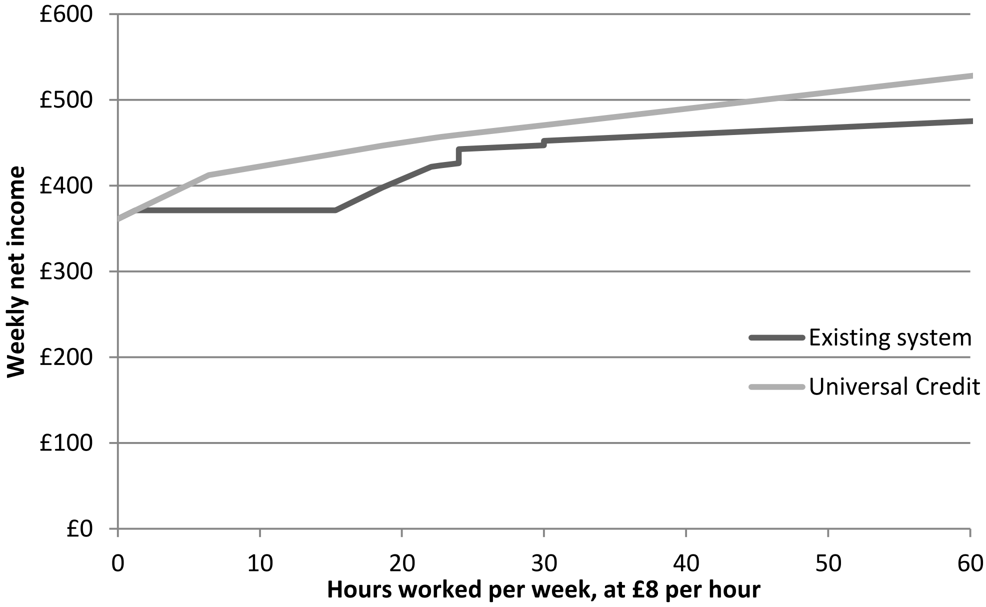
- If the lone parent works for less than 16 hours a week, they will be better off under Universal Credit than under the current system. This is mainly a result of the substantial earnings disregard in Universal Credit, at about £170 per week without rental costs. In contrast, in the current system, they would face a 100% marginal effective tax rate if they worked for less than 16 hours a week, after a £20 a week disregard.
- If the lone parent works for between 16 and 29 hours a week (and is therefore entitled to WTC under the current system), they are slightly better off under Universal Credit than the current system.
- If the lone parent works for 30 or more hours a week, they will be slightly worse off under Universal Credit, as the maximum entitlement to tax credits in the current system exceeds their entitlement to Universal Credit at these levels of earnings. Furthermore, the combination of withdrawal of Universal Credit, income tax and NICs gives rise to a marginal effective tax rate of 76.2%, which is higher than the combined rate of 73% in the current system, and so the losses for this lone parent increase the more hours they work above 30 hours per week.[12]

Figure 1.4 shows the budget constraint for an adult in a couple with two children. For any positive number of working hours, the family will be better off under Universal Credit than under the current system. These gains are attributable to the lower withdrawal rate of Universal Credit compared with the combined withdrawal rate of WTC and Housing Benefit in the current system. The Universal Credit system will create a marginal effective tax rate that is either 65% or 76.2% for most working hours; the current system, though, involves a 100% rate as Income Support is withdrawn at low hours, and an approximately 90% rate due to the combination of WTC and HB withdrawal at higher levels of hours worked. The gap between the two budget constraints translates to significant differences in incentives to engage in paid work.

Figure 1.5 shows the budget constraint for the second earner in a couple. If the second earner works no more than about 10 hours a week, the family will be unambiguously better off under Universal Credit than under the current system: such a family's entitlement to Universal Credit will be higher than its entitlement to Working Tax Credit under the current system. As the second earner's working hours rise, the higher maximum entitlement to Universal Credit will be outweighed by its higher withdrawal rate (for jobs of between 10 and 24 hours a week, the marginal effective tax rate is 65% under Universal Credit, and 41% under the current system). Overall, the second earner's financial incentive to work is generally weaker under Universal Credit: this is as single earner couples are treated more favourably by Universal Credit than the current system, but also because the withdrawal rate in Universal Credit affecting second earners is higher than its equivalent in the current system.

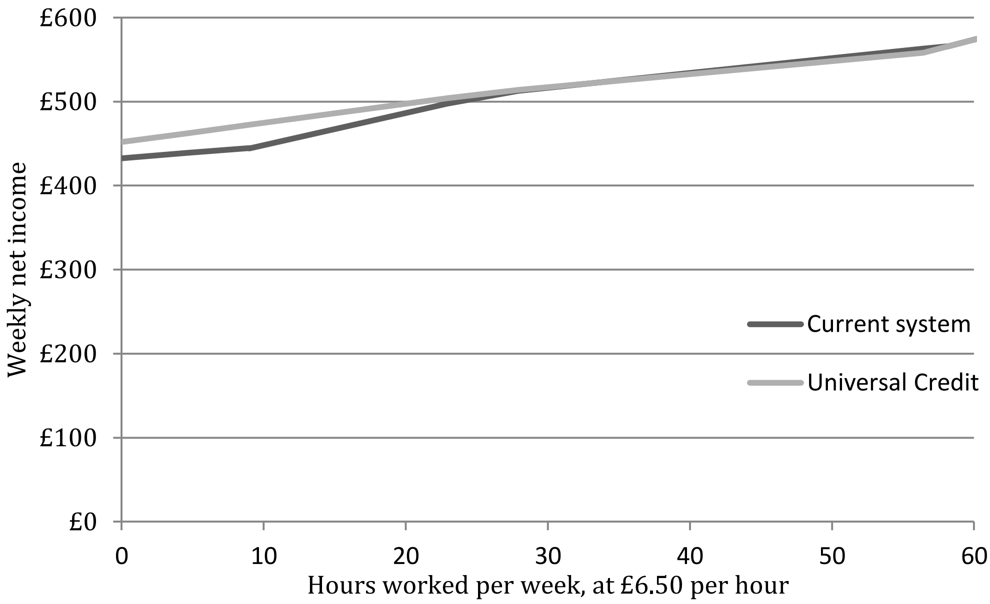
[12] We have assumed that the lone parent is not using formal childcare, but this does not affect the analysis materially as the effective subsidy for childcare under Universal Credit UC will be unchanged from the one under tax credits, but slightly less generous than that which applied to families receiving HB or CTB (Department for Work and Pensions 2011b).

Figure 1.4. Budget constraint under Universal Credit for an example single-earner couple with two children



Notes: based on an assumed couple with two children: one partner can choose how many hours to work at a given wage rate, £8 per hour; the other is out of work; their LHA is £100 per week; and they have no disability and no unearned income.

Figure 1.5. Budget constraint under Universal Credit for second earner in an example couple with two children



Notes: based on an assumed couple with two children: one partner can choose how many hours to work at a given wage rate, £6.50 per hour; the other earns £245 per week; their LHA is £80 per week; and they have no disability and no unearned income.

CHAPTER 2
Distributional impact of Universal Credit reform in Northern Ireland

This chapter presents the results of a microsimulation of the impact of Universal Credit in Northern Ireland, assuming that parity is maintained with Great Britain.[13] The analysis looks at which families gain and lose from the full introduction of Universal Credit in 2014–15, compared with the continuation of the existing benefit. We consider the reforms both with and without transitional protection: the UK Government has promised that no existing benefit recipient will be worse off in cash terms under Universal Credit than the existing system, though this transitional protection operates on a cash basis and will therefore will be eroded in real terms by inflation over time, and expires when families experience a change in circumstances.[14] Our analysis therefore examines two extreme cases: one in which no transitional protection applies, and can therefore be thought of as showing the long-run impact of the reform, and one in which all claimants of existing benefits are moved across to Universal Credit at the same time and transitional protection applies to all of them. At any given point in time, the true impact will be somewhere in between these two cases. Throughout this chapter, we assume full take-up of both the existing set of means-tested benefits and tax credits and Universal Credit, and no behavioural response to Universal Credit's introduction. This is different to analysis published by HM Treasury and the Department of Work and Pensions for the UK as a whole, and that by the Department of Social Development for Northern Ireland, which takes into account the expected higher take-up resulting from the introduction of Universal Credit – as it will no longer be possible for a family to claim one part of its means-tested benefit entitlement but not others, this seems reasonable.[15] One might also expect take-up to be higher under Universal Credit because of the greater simplicity of the system. The analysis in this chapter and in Chapter 3, which looks at the impact of the reforms on work incentives, excludes rates rebates because some decisions will need to be made around the design of rates rebates in Northern Ireland following the introduction of Universal Credit. In Chapter 4 we discuss potential options for the design of a rates rebate replacement scheme, and present the results from a simulation of the effect of these options on the rate rebates families receive and on measures of work incentives.

2.1 Aggregate entitlements

In the long run, entitlements to means-tested benefits under Universal Credit will be around £325 million per year lower than under the current system for the UK as a whole, and £13 million per year lower for Northern Ireland in 2013–14 prices. However, in the case where all claimants are subject to transitional protection if they would otherwise receive less in benefits under Universal Credit, entitlements rise by around £155 million in Northern Ireland and £4.6 billion in the UK as a whole. This demonstrates that, although aggregate entitlements are roughly the same under Universal Credit, there are significant winners and losers.

[13] As previously noted, although social security is a devolved matter in Northern Ireland, retaining parity with Great Britain has always been an attractive option as the UK Treasury has only agreed to meet the cost of social security benefits in full if parity is maintained.

[14] The changes in circumstances that would lead to transitional protection being ended are outlined in a DWP Universal Credit Briefing Note, http://www.dwp.gov.uk/docs/ucpbn-transitional-protection.pdf.

[15] HM Treasury's costing of Universal Credit is in Appendix A of HM Treasury (2012a). Analysis of the distributional impact of Universal Credit, including the impact of higher take-up is available in HM Treasury (2012b), and in the DWP impact assessment (http://www.dwp.gov.uk/docs/universal-credit-wr2011-ia.pdf). Analysis specific to Northern Ireland produced by the Department for Social Development is available at http://www.dsdni.gov.uk/uc-impact-booklet-transitional-protection.pdf.

These figures may seem surprising given that the UK Government expects the introduction of Universal Credit to cost £2.2 billion in 2017–18.[16] This difference is likely to be due to the fact that, as stated above, we are assuming full take-up of means-tested benefits and tax credits both before and after Universal Credit is introduced, whereas in reality it is likely that there will be higher take-up under Universal Credit. Comparison of the two figures does show though that the cost of Universal Credit is largely driven by higher take-up rather than more generous benefit entitlements.

2.2 Total winners and losers

As shown in Figure 2.1, the introduction of Universal Credit will benefit 11.4% (103,000) of the approximately 900,000 families in Northern Ireland,[17] and, in the absence of transitional protection, leave almost the same number of families (10.9%, or 99,000) worse off. 56% of families (504,000) are not eligible for any means-tested benefit or tax credit under the current system, and will not be entitled to Universal Credit, and a further 22% (197,000) are not affected because their entitlement to Universal Credit will equal their current entitlement to means-tested benefits and tax credits.[18] Of these, 93,000 are working-age families who receive the same amount in Universal Credit as they would have under the existing system and 104,000 where all members are above the female State Pension Age and thus continue to claim Pension Credit and other existing means-tested benefits.

Northern Ireland has a relatively high proportion of both winners and losers. In the UK as a whole, 8.8% of families will win from the reforms, 8.7% lose, 67% are not entitled to means-tested benefits before or after the reform, and 18.2% will be unaffected. This is because the population of Northern Ireland is relatively poor compared to the UK as a whole, and hence more people are entitled to, and affected by, reforms to means-tested benefits. Under our full take-up assumption, the introduction of Universal Credit will lead to a negligible reduction, of 0.07%, in average disposable incomes in Northern Ireland. The loss is even smaller as a percentage of net income in the rest of the UK, at 0.04%. This can at least in part be attributed to the relatively high proportion of individuals claiming Disability Living Allowance (DLA) in Northern Ireland compared with the UK as a whole. Administrative data shows that Northern Ireland has nearly double the UK average of people claiming DLA per thousand of the population.[19] Universal Credit will reform disability premiums in means-tested benefits. Although the overall impact is intended to be revenue neutral, the reforms will create winners and losers amongst those currently claiming disability benefits. In particular, single individuals claiming at the higher and middle rates of the care component of DLA will lose out, as the severe disability premium element of Income Support will lose this under Universal Credit. However, others who are in the Employment and Support Allowance (ESA) support group and are not entitled to the severe disability premium because they either have a partner to care for them or are not entitled to either the middle or higher rate of the care component of DLA will gain because the premium given to those in the support group will increase.

Those families who gain will do so by an average of 9% of their disposable income, equivalent to £30.13 per week in 2013 prices. The corresponding average percentage decline in disposable income for those who lose in the absence of transitional protection is 8%, or £31.42 per week. There is significant variation between working and non-working families; 14.5% of families containing an individual in work will gain from the reforms compared to 6.8% of families without an individual in work. Around 13% of working and 9% of non-working families will lose from the reforms, but where working families lose, they will lose by an average of 5.3% of disposable weekly income, compared to 13.9% for non-working

[16] See Appendix A of HM Treasury (2012a).

[17] Note that this includes all families, including those where all members are aged above the female State Pension Age and hence will be unaffected by Universal Credit's introduction.

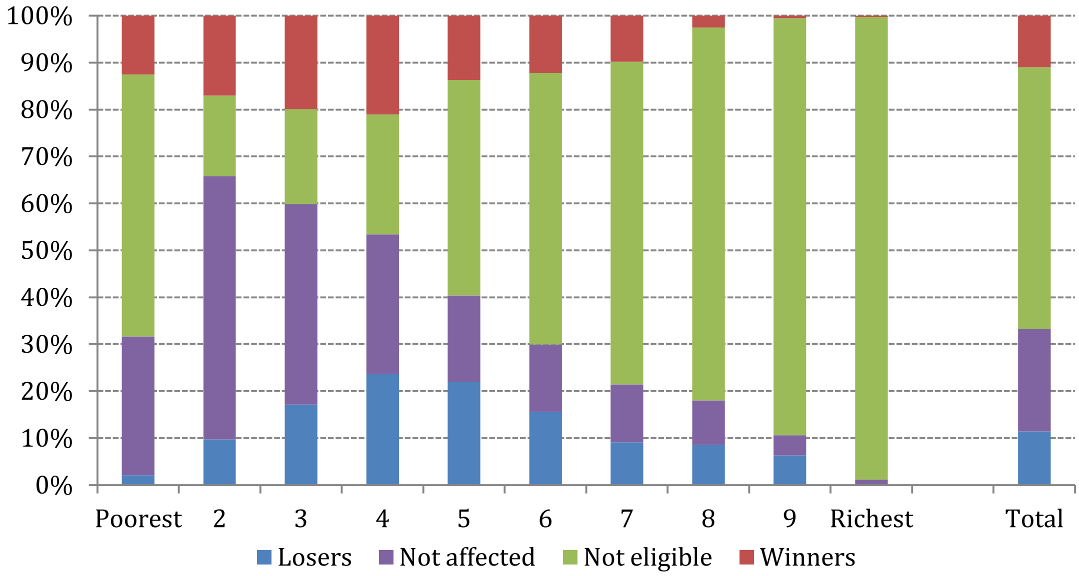
[18] All those who lose in the case without transitional protection maintain the same entitlement in the case with transitional protection, meaning the number of unaffected families rises to 270,000.

[19] Data from Office for National Statistics, General Register Office for Scotland and Northern Ireland Statistics and Research Agency http://www.dsdni.gov.uk/dla.

families. Although out-of-work benefit rates will not be affected by the introduction of Universal Credit, the harsher treatment of capital and certain types of unearned income (see Chapter 1) will lead to families with significant savings or income from these sources losing significantly.

The overall impact of the reforms disguises substantial variation in the impact on different types of families. Figure 2.1 shows the proportions of families that will gain and lose from the reform in the long run by decile group of the income distribution in Northern Ireland. Few families in the upper three decile groups are affected by the reform, as few are entitled to means-tested support either before or after the reform. Winners and losers are concentrated in the lower-middle of the income distribution, with the 4th decile group seeing the largest share of both winners (21.1%) and losers (23.7%). With the exception of the richest tenth of families, the share of losers is smallest in the poorest decile: this is largely as only 16% of such families contain an individual in work, and as noted earlier, out-of-work entitlements will be the same under Universal Credit as the current system of means-tested benefits.

Figure 2.1: Winners and losers by income decile group, without transitional protection

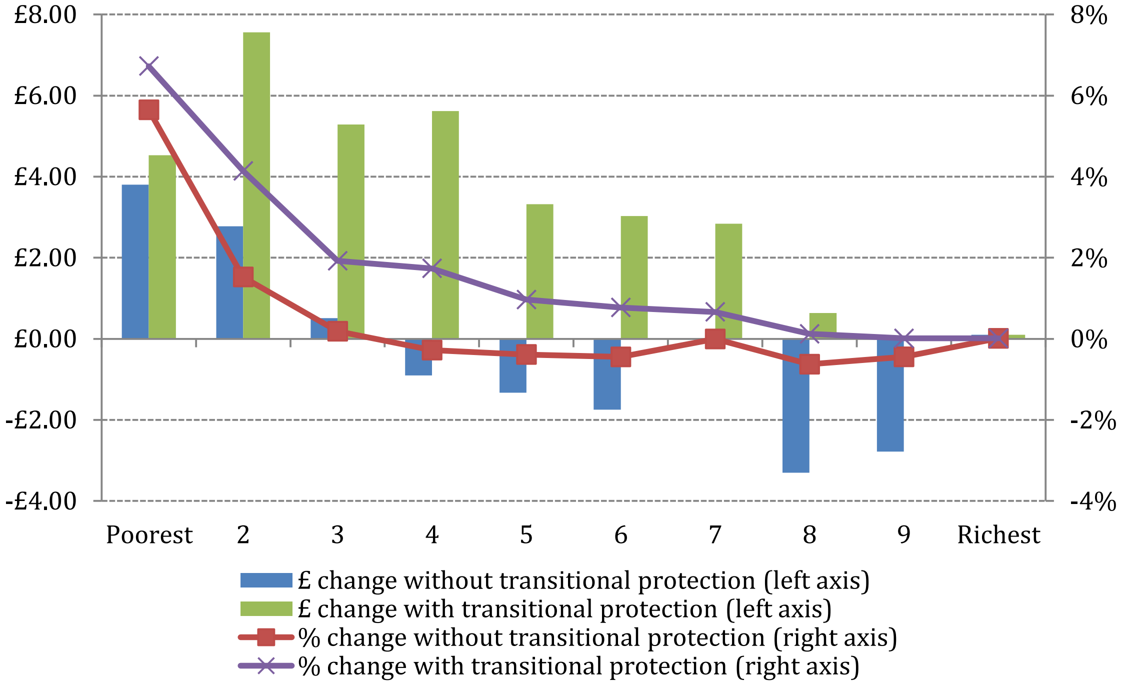


Notes: Assumes full take-up and ignores behavioural response. Income decile groups are based on equivalised family income using the McClements equivalence scale.

Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated data from the 2009–10 and 2010–11 Family Resources Survey.

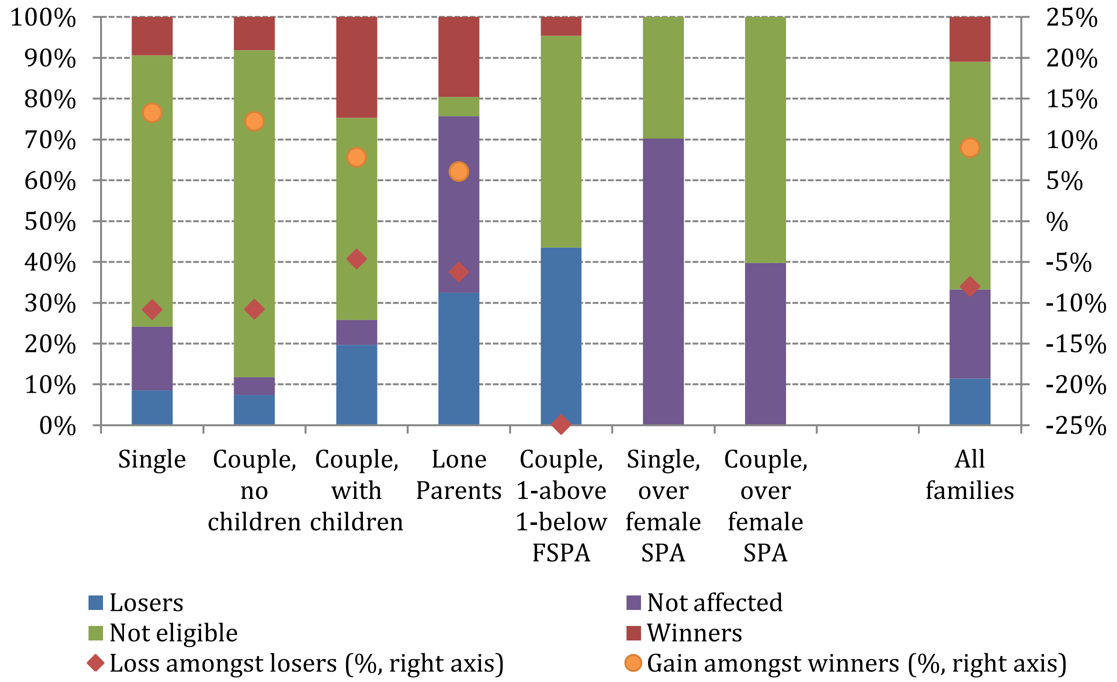
The average change in disposable income by income decile group is shown in Figure 2.2, both in cash terms and as a percentage of income. On average, only those in the lowest two deciles of the income distribution will gain in the long run (i.e. without transitional protection) as a result of the reforms, with families in other income deciles seeing no change or a slight (less than 1%) fall, though as we have seen there are winners and losers right across the income distribution. The poorest tenth of families will see their disposable incomes rise by an average of 5.7% (£3.80 per week), while families in the second decile group will see a smaller increase, of 1.5% (£2.78 per week). Transitional protection is most important for those in the middle of the income distribution; in the absence of transitional protection, these families would lose by an average of £1–2 per week. However, this obscures the significant losses for a small number of families that would occur in the absence of transitional protection, a factor which drives the large (temporary) cost of this measure. While the general distributional impact of the reforms is similar to the UK as whole, the second decile are on average unaffected in the UK as a whole without transitional protection, as opposed to a gain of 1.5% in Northern Ireland.

Figure 2.2: Change in current disposable income by decile group



Notes: As for Figure 2.1.
Source: As for Figure 2.1.

Figure 2.3: Winners and losers by family type, without transitional protection

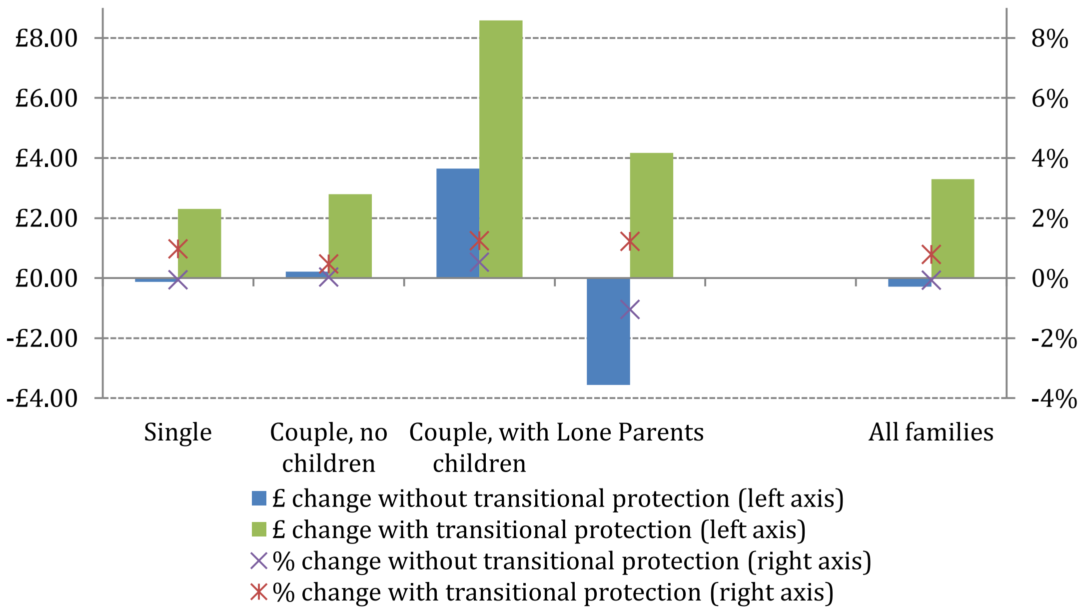


Notes: Assumes full take-up and ignores behavioural response.
Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated data from the 2009–10 and 2010–11 Family Resources Survey.

Turning to the number of winners and losers by family types, Figure 2.3 shows that pensioners are unaffected by the reforms, with the notable exception of couples where one partner is above and one below the female state pension age. Although this group represents only 2.4% of all families, about 45% of them lose substantially from the reforms; the average loss amongst those who lose is £76.61 per week, equivalent to 25% of disposable income. This is because they will be forced to claim Universal Credit rather than the more generous Pension Credit, and there will be pensioner premiums in Universal Credit for such families, as there are in Jobseeker's Allowance at present.

Among working-age families (the first four columns), couples with children are most likely to gain from the reform, and lone parents are most likely to lose. Around a third of lone parents lose from the reform and a fifth gain, whereas a quarter of couples with children gain and a fifth lose from the reforms. Fewer families without children are affected by the reform. The average loss among losers varies between 6.2% for couples with children to 10.9% for single adults. Single adults also see the biggest gain amongst winners, at 13.2%, equivalent to almost £25 per week, compared to 6%, or £21 per week for lone parents who win.

Figure 2.4: Average impact on disposable income by family type



Notes: As for Figure 2.3.
Source: As for Figure 2.3.

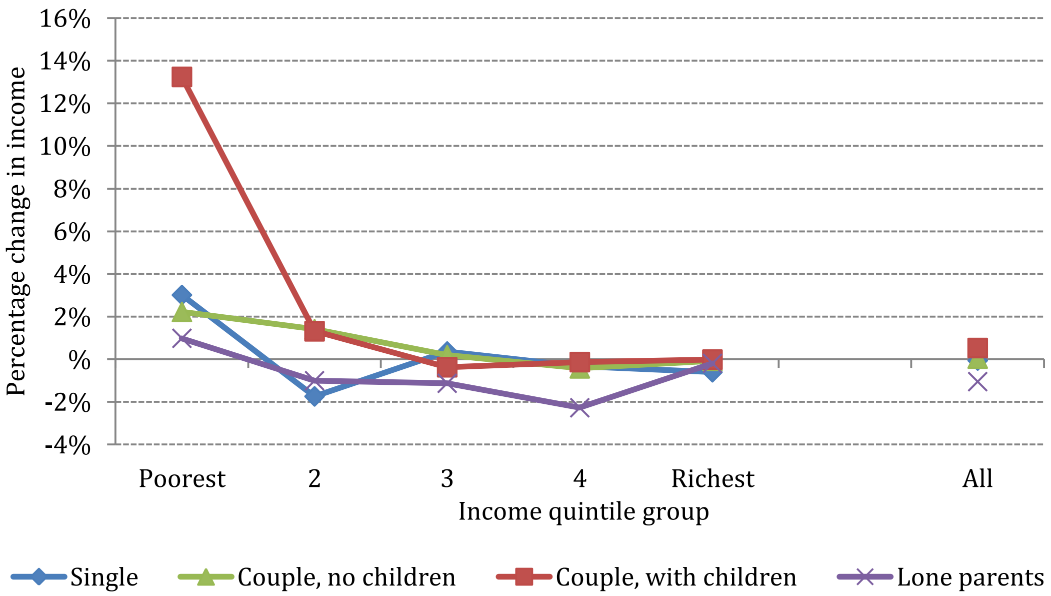
Figure 2.4 shows the average change in disposable income for different working-age family types in both cash and percentage terms. The only group who will gain on average from the reforms once transitional protection expires are couples with children, who will see their disposable incomes increase by 1.3% on average or £8.58 per week. On average, those without children see little change in their entitlements once transitional protection expires, though as we have seen there are both winners and losers among this group, meaning that there is an average gain in the case where all families are entitled to transitional protection. Transitional protection does the most for lone parents who, on average, gain by 1.2% (£4.17 per week) with but lose by 1% (£3.56 per week) without. Losses for lone parents on average are driven by those for a small number of non-working lone parents who either have significant amounts of unearned income or are entitled to the severe disability premium, which will be abolished under Universal Credit.[20] The higher claimant rate for disability benefits in Northern Ireland also helps to

[20] As we discussed in Section 1, unearned income will be treated much more harshly under Universal Credit than the current system of tax credits; such income will not be subject to a disregard and will result in a pound-for-pound reduction in an individual's entitlement to Universal Credit.

explain why single adults lose slightly rather than gain slightly on average, as in the UK as a whole (see Figure C.4 in Appendix C).

Just as considering only the average impact of the reforms disguises variation by family type, aggregating across family types masks substantial within-group variation. Figure 2.5 shows the average impact of the reforms without transitional protection for the family types considered above by quintile of the income distribution. We saw in Figure 2.4 that couples with children are the only group who gains once transitional protection expires, and we can now see that gains are concentrated in the bottom fifth of the income distribution. On average, lone parents will see their disposable income unchanged or fall slightly across the income distribution. As noted above, however, a fifth of lone parents do lose from the reform, including a small number who lose out significantly due to the harsher treatment of maintenance payments from former partners under Universal Credit than the current system.

Figure 2.5: Impact on disposable income by family type and income quintile, without transitional protection



Notes: Assumes full take-up and ignores behavioural response. Income quintile groups are based on equivalised family income using the McClements equivalence scale.
Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated data from the 2009–10 and 2010–11 Family Resources Survey.

Table 2.1 shows the average percentage and absolute change in income for family types by the number of adults in work. The largest winners from the reform are couples with one person in work; such couples with children will, on average, gain by 3% of disposable income, while those without children will on average gain by 1%. This is a result of the UK Government's choice of earned income disregard for this group. The biggest losers from the reform are couples without an individual in work: such couples without children will see an average 2% (£7 per week) reduction in disposable incomes, while those with children will on average see a smaller decline of 1.2% (£4.80 per week). Lone parents, either in work or out of work, will also lose on average. However, unlike for other family groups, in-work lone parents will on average see larger losses than out-of-work lone parents, at 1.3% of disposable income versus 0.8%. These losses among lone parents are largely attributable to the harsher treatment of unearned income, in particular maintenance payments, under Universal Credit than the current system. As with the previous results though, this figure disguises some substantial losses among those who lose; for example, just under a quarter of the 21,000 lone parents who lose from the reform do so by at least £30 per week, and around a tenth will lose by at least £60.

Table 2.1: Average change in disposable income by family type and number of adults in work

Family type	*Share of family type (%)*	*Number of adults in work*	*Change in income (£)*	*Change in income (%)*
Single adult aged under female SPA	57	1	0.72	0.2
Single adult aged under female SPA	43	0	–1.26	–0.9
Couples without kids, both aged under female SPA	62	2	–0.18	0.0
Couples without kids, both aged under female SPA	26	1	4.47	1.0
Couples without kids, both aged under female SPA	12	0	–7.03	–2.0
Couples with kids, both aged under female SPA	58	2	–2.43	–0.3
Couples with kids, both aged under female SPA	32	1	16.96	3.0
Couples with kids, both aged under female SPA	10	0	–4.80	–1.2
Lone parents, aged under female SPA	43	1	–5.10	–-1.3
Lone parents, aged under female SPA	57	0	–2.39	–-0.8

Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated data from the 2009–10 and 2010–11 Family Resources Survey.

Differences in the composition of the Northern Irish population and that of the rest of the UK go some way to explaining the difference in the overall impact of Universal Credit. In particular, lone parents and couples with children constitute a much larger share of total working-age families in Northern Ireland (27.1%) than the rest of the UK (23.6%). Therefore, Northern Irish families are more likely to be affected by the introduction of Universal Credit both because the type of families whose entitlements are disproportionately affected by Universal Credit, namely lone parents and couples with children, constitute a larger share of overall families in Northern Ireland, and because lower private incomes in Northern Ireland mean that a greater proportion of each family type is entitled to Universal Credit.

2.3 Summary

The main winners from the introduction of Universal Credit in Northern Ireland, as in the rest of the UK, will be single earner couples and the biggest losers will be families with large amounts of capital or unearned income, those currently claiming the severe disability premium in out-of-work benefits, and couples where one person is above the female State Pension Age and one person is below it. Northern Ireland loses slightly more on average from the introduction of Universal Credit than the UK as a whole. This is partly because of the composition of the Northern Irish population, and partly because Northern Ireland has a much higher proportion of people claiming DLA who lose out from the abolition of the severe disability premium. However, single-earner couples with children in Northern Ireland gain more on average from the introduction of Universal Credit than in the UK as a whole: the lower levels of earnings in Northern Ireland mean that more of these families are entitled to means-tested benefits in Northern Ireland than in the UK as a whole and hence more benefit from the additional support Universal Credit gives such families on low incomes.

An important caveat to these findings is that our analysis assumes full take-up of means-tested benefits and tax credits both before and after the introduction of Universal Credit, in other words we are looking at the impact of Universal Credit on benefit entitlements rather than family incomes. It is likely that take-up of means-tested support will increase as a result of the introduction of Universal Credit as it is an integrated and simpler system and that therefore benefit receipt will increase following Universal Credit's introduction. Assumptions have been made by HM Treasury and the Department of Work and Pensions around the impact of higher take-up in Great Britain, and similar analysis published by the Department of Social Development in Northern Ireland also accounts for this.

CHAPTER 3
The impact of Universal Credit on work incentives

As we discussed in Chapter 1, a central motivation underlying the Universal Credit reforms was to strengthen the incentives facing individuals to be in paid work and for those in work to increase earnings.[21] This section examines the effect of Universal Credit on those incentives, as measured by the participation tax rate (PTR) and the effective marginal tax rate (EMTR) respectively. Domestic rates and rates rebate are again excluded from this analysis; as we discuss in Chapter 4, some reforms will need to be made to rate rebates when Universal Credit is introduced. A consequence of excluding a means-tested benefit from our analysis is that the PTRs and EMTRs are underestimated in what follows. As in the previous section, we assume that Universal Credit is introduced in Northern Ireland on a parity basis.

3.1 Methodology

Our methodology is the same as that used in Adam and Browne (2010). We use the IFS tax and benefit microsimulation model, TAXBEN, to calculate how much income workers would receive were they not to work. For non-workers, however, an assumption is required about how much they would earn, and how many hours they would work, if they did move into work. Our approach to this is the same as that used in Section 2 of Adam and Browne (2010). We use the observed characteristics of non-workers (age, sex, years of education, marriage and cohabitation status, number of dependent children, age of youngest child, ethnicity, and housing tenure) to predict their earnings conditional on being in each of four different hours bands (1–15, 16–23, 24–29 and 30+) using an ordinary least squares (OLS) regression. We then use the same characteristics to estimate (using a multinomial logit model) the likelihood of each individual being in each of these hours bands were they to work, and we weight the participation tax rate associated with each earnings/hours band combination accordingly.

In what follows, we examine work incentives for all those in Northern Ireland aged between 18 and 59, excluding full-time students.

3.2 Effect of Universal Credit on the incentive to be in paid work

A key measure of the incentive to be in paid work is the participation tax rate (PTR), defined as the percentage of earnings lost in tax or withdrawn benefits when an individual moves into work.[22] We calculate each individual's in-work and out-of-work incomes under the pre- and post-Universal Credit systems using the methodology described above.

Table 3.1 shows the distribution of PTRs before and after the full introduction of Universal Credit for all working-age adults. The reforms reduce the number of individuals facing a PTR of over 70% from around 45,000 to less than 10,000. This is due to the combination of a higher level of disregarded earnings and the fact that Universal Credit combines a series of overlapping means tests into a single one, lowering the maximum withdrawal rate: as discussed in Section 1, the overlapping tapers of multiple means-tested benefits lead to extremely high effective tax rates for some individuals. However, Universal Credit will also leave more individuals facing a PTR above 50% – a result of the fact that some individuals will have a lower entitlement to Universal Credit when in work than they currently receive in tax credits, and that (as we shall see later in this section) work incentives for those whose partner works are weakened by the introduction of Universal Credit.

[21] See Department for Work and Pensions (2010b).

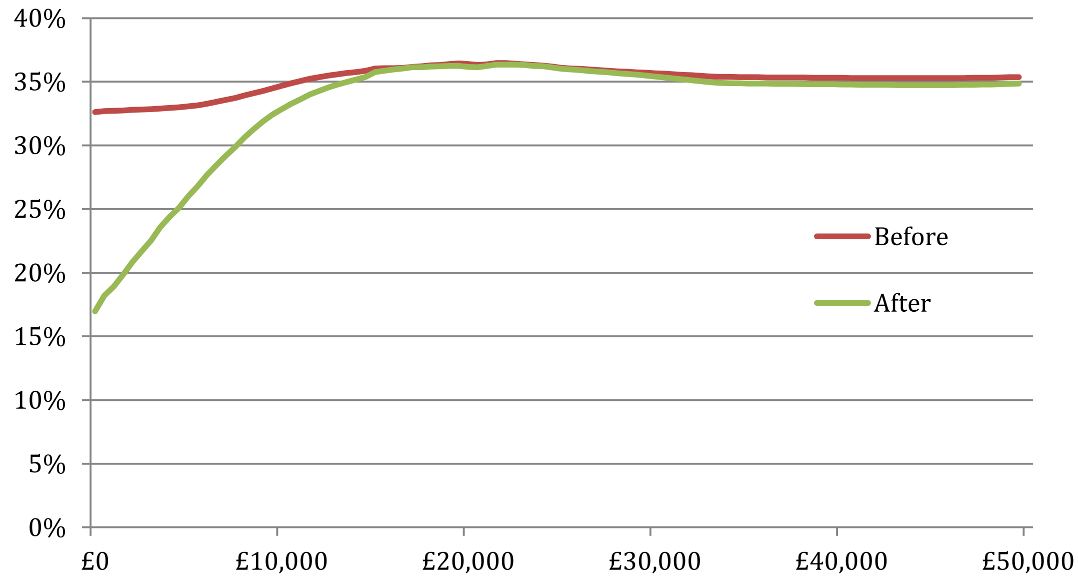
[22] A more precise definition is given in Appendix A.

Table 3.1: PTRs amongst working-age adults before and after introduction of Universal Credit

Participation tax rate	*Number of individuals*			
	Before		*After*	
<10%	83,000	8%	92,000	9%
10–19.9%	132,000	13%	135,000	14%
20–29.9%	174,000	18%	166,000	17%
30–39.9%	258,000	26%	242,000	24%
40–49.9%	143,000	14%	142,000	14%
50–59.9%	102,000	10%	121,000	12%
60–69.9%	57,000	6%	87,000	9%
70–79.9%	29,000	3%	7,000	1%
80–89.9%	7,000	1%	—	0%
90%+	10,000	1%	0	0%

Notes: — indicates negligible number. In-work incomes for non-workers are estimated as described in the text. Full-time students and those aged over the female State Pension Age are excluded from this analysis.
Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated data from the 2009–10 and 2010–11 Family Resources Survey.

Figure 3.1: Average PTRs by earnings for both workers and non-workers



Notes: In-work incomes for non-workers are estimated as described in the text. Non-parametric regression (lowess) estimates for PTRs. Full-time students and those aged over the female State Pension Age are excluded from this analysis.
Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated data from the 2009–10 and 2010–11 releases of the Family Resources Survey.

Figure 3.1 shows the profile of average PTRs by earnings before and after the reform, for individuals of working age. Universal Credit will reduce the average PTR at the lower end of the earnings distribution, below £15,000. As with the distributional impact of Universal Credit however, there is substantial variation between different types of individual.

Table 3.2: Participation tax rates by person type

		Participation Tax Rate			
		Without Children		With Children	
		Before	*After*	*Before*	*After*
In a couple and partner does not work	p25	26%	25%	48%	34%
	Median	41%	39%	55%	48%
	p75	53%	49%	64%	56%
	Mean	41%	37%	56%	43%
In a couple and partner works	p25	15%	14%	21%	22%
	Median	20%	20%	34%	38%
	p75	26%	26%	44%	58%
	Mean	21%	22%	33%	39%
Single adult	p25	33%	32%	22%	22%
	Median	37%	37%	36%	35%
	p75	52%	48%	47%	45%
	Mean	41%	38%	34%	33%

Notes and sources: As for Table 3.1.

Table 3.2 shows some summary statistics for individuals in a variety of family types. The median PTR is the level at which half of the population is has a higher PTR and half the population has a lower PTR. Likewise, the rows labelled p25 and p75 show the level where a quarter of the population have a lower and higher PTR, respectively. This shows that in general, those in a couple whose partner does not work will see a fall in their PTR, particularly those who have the highest PTRs (i.e. the weakest incentives to work) to start with, whereas those in a couple where one partner works will see their PTR increase. Before the reforms, the mean (average) PTR facing an individual with children whose partner is in paid work was 33%, rising to 39% after the reforms, compared to a fall from 56% to 43% for those whose partner is not in paid work. These are both explained by the fact that, as we saw in Chapter 1, Universal Credit provides more support for single-earner couples than the current tax and benefit system, but this additional support is withdrawn quicker when the second member of the couple enters work. An actual or potential second earner in a couple who is initially entitled to Universal Credit will lose 65p of each pound earned when they move into work, compared to 41p as is the case for tax credits currently.

We now examine how the impact of Universal Credit on work incentives varies by (actual or potential) earnings for each person type.

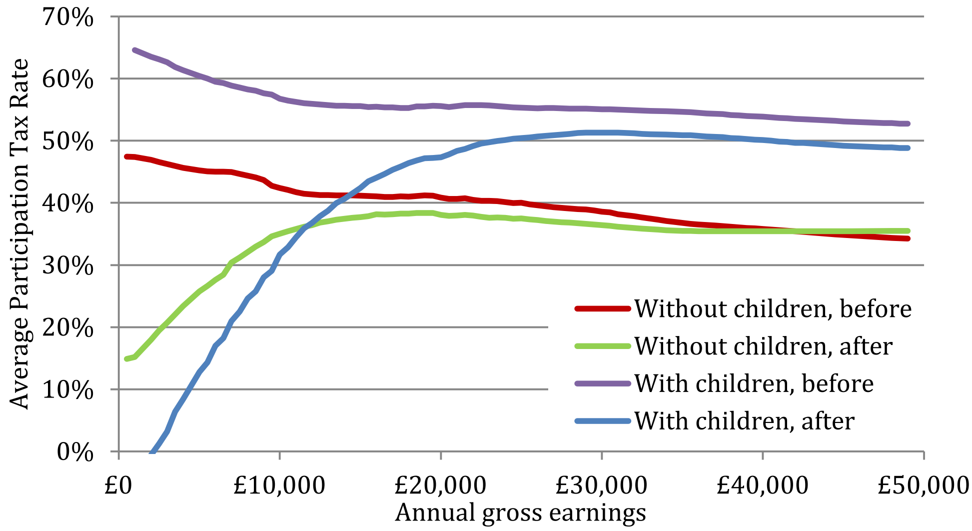
Actual and potential first earners in couples

Figure 3.2 shows the estimated PTRs for those in couples where the partner does not work; this includes both members of couples where neither partner works and workers in one-earner couples, i.e. potential and actual first earners in couples.[23] There is a substantial strengthening of the incentive to be in work for the first or potential first earner in a couple, particularly for those with children at very low levels of earnings; a result of the working allowance built into Universal Credit and discussed in Chapter 1. This is shown by the decline in average PTRs, a decline that ranges between 10 and 30 percentage

[23] Earnings are truncated below £5,000 and above £50,000 due to concerns about the reliability of estimates derived from small sample sizes at lower and higher levels of earnings.

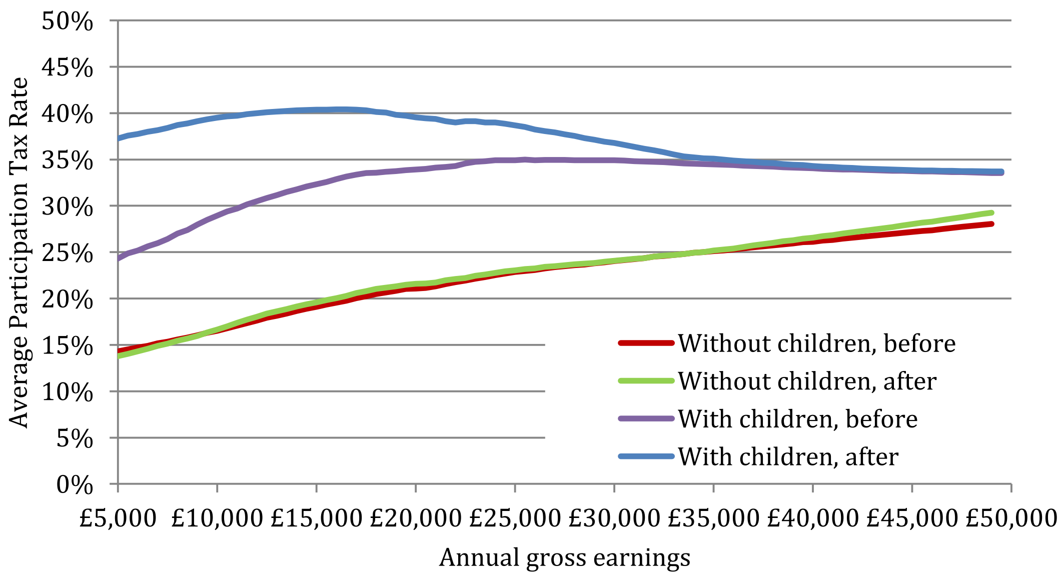
points for those with children and earnings of less than £10,000. The strengthening of work incentives is less pronounced for first or potential first earners without children, and is again greatest for those with low earnings or potential earnings.

Figure 3.2: Average PTRs for those in couples whose partner does not work



Notes: As for Figure 3.1. Non-parametric regression (lowess) estimates for PTRs.
Source: As for Figure 3.1.

Figure 3.3: Average PTRs for those in couples where partner works



Notes: As for Figure 3.1. Non-parametric regression (lowess) estimates for PTRs.
Source: As for Figure 3.1.

Actual and potential second earners in couples

Figure 3.3 shows the same analysis for those in couples whose partner works. This includes both members of two-earner couples and non-workers in single-earner couples. While those without children will on average see no change to their incentive to be in work across all income ranges, second or potential second earners with children will on average see a large increase in their PTR at low earning levels. The weakening of the incentive such couples face to have more than one adult in work is greatest at earnings of less than £20,000, and results from the higher withdrawal rate faced under Universal Credit, as outlined in Chapter 1. To recap, currently a potential second earner who moves into work loses 41p in tax credits for every additional pound of earnings, in addition to NICs and income tax. Universal Credit will be withdrawn at a rate of 65p for every additional pound of net income (i.e. after income tax and National Insurance have been deducted).

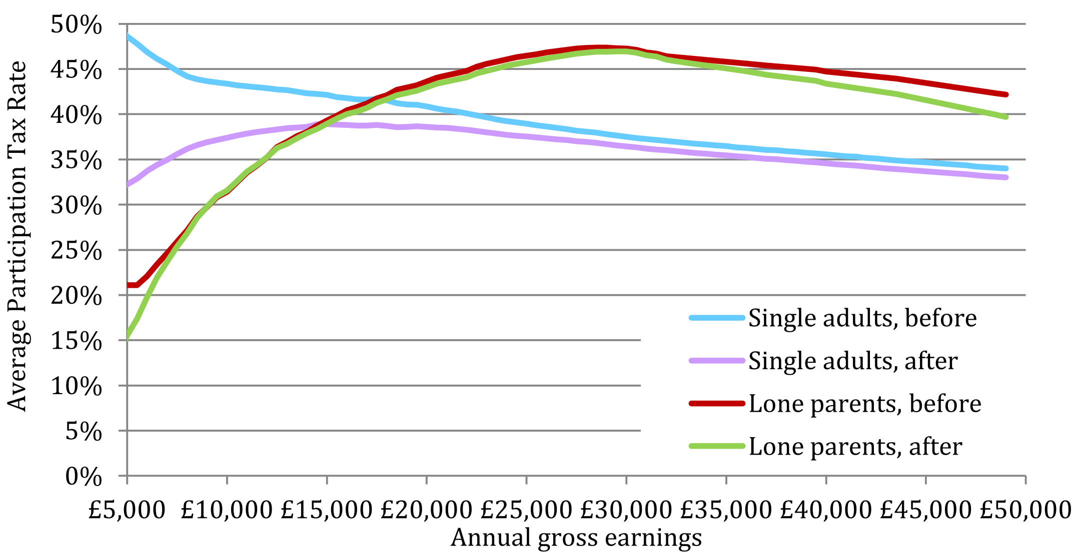
This weakening of the work incentives for second earners with children is greater in Northern Ireland than elsewhere in the UK.[24] This is most likely because earnings levels are lower in Northern Ireland, increasing the likelihood an individual's partners' earnings are sufficiently low to entitle them to Universal Credit if they do not work and hence face withdrawal of Universal Credit if they enter paid work.

Single adults with and without children

Finally, Figure 3.4 shows that the introduction of Universal Credit will strengthen work incentives for single adults, particularly at lower earnings levels. These individuals will see a decline in their average PTR due to the increased earnings disregard under Universal Credit, which allows individuals to earn a larger amount of income before benefits begin to be withdrawn, compared to the current system.

At higher earnings levels, lone parents on average see a slight reduction in PTRs, and so a strengthening of the incentive to be in work; this is because some lone parents with high levels of savings who currently receive CTC when not working (but not any other means-tested benefits) will not receive any Universal Credit because of the stricter treatment of assets than in tax credits.[25]

Figure 3.4: Average PTR for single adults and lone parents



Notes: As for Figure 3.1. Non-parametric regression (lowess) estimates for PTRs.
Source: As for Figure 3.1.

Summary

Overall, we can summarise that the introduction of Universal Credit will strengthen work incentives for both potential and actual first earners in couples and single-adult families, particularly those with children, but weaken the incentive for both members of a couple to work rather than just one. This pattern is quite similar to the rest of the UK, although the increase in PTRs for actual and potential second earners with children is far larger in Northern Ireland than in Great Britain across the earnings

[24] See Brewer, Browne and Jin (2012).

[25] Single adults without children do not receive any tax credits when out of work and already face a stringent asset test for the out-of-work means-tested benefits to which they might be entitled; as a result, this aspect of Universal Credit will not affect them.

distribution.[26] This is likely, because earnings levels are lower in Northern Ireland, meaning that these individual's partners' earnings are likely to be relatively low and increase the likelihood that they will face withdrawal of Universal Credit if they enter paid work.

3.2 Effect of Universal Credit on the incentive to increase earnings

A key measure of the incentive for those in work to increase earnings is the effective marginal tax rate (EMTR). It measures how much of a small increase in gross wage is lost to tax payments and forgone state benefits and tax credit entitlements.[27] This tells us about the strength of the incentive an individual has to increase earnings in work, whether that is by increasing hours, gaining promotion, qualifying for bonus payments or moving to a better paid job. An EMTR of zero means that an individual will keep any increase in their gross wage, while an EMTR of 100% means the individual keeps none. Previous IFS research has emphasised the fact that employer National Insurance contributions and indirect taxes also affect work incentives,[28] though we do not do so here for two reasons. First, the introduction of Universal Credit does not affect employer NICs or indirect taxes, so excluding these will not alter our view of the change in work incentives caused by the introduction of Universal Credit. Second, this approach makes our results more understandable for the reader – most basic-rate taxpayers think that their EMTR is 32% at the moment (20% income tax plus 12% employee NICs) rather than 40.6%, which is what it would be if we were also to include employer NICs. However, it does mean that our results will show work incentives to be stronger than they actually are in terms of the value of goods and services individuals are able to purchase with their wages relative to the cost to their employers of employing them in both the pre- and post-Universal Credit systems.

Table 3.2: Distribution of EMTRs amongst those in paid work aged under the female SPA

Effective Marginal Tax Rate	*Number of individuals*			
	Before		After	
<10%	50,000	(7%)	44,000	(6%)
10–19.9%	13,000	(2%)	14,000	(2%)
20–29.9%	43,000	(6%)	45,000	(7%)
30–39.9%	380,000	(55%)	391,000	(57%)
40–49.9%	69,000	(10%)	54,000	(8%)
50–59.9%	15,000	(2%)	8,000	(1%)
60–69.9%	23,000	(3%)	50,000	(7%)
70–79.9%	72,000	(10%)	80,000	(12%)
80–89.9%	2,000	(0%)	—	(0%)
90%+	20,000	(3%)	0	(0%)
Total	686,000	(100%)	686,000	(100%)

Note: Only includes those aged between 18 and 59 who are in paid work. — indicates that the number of individuals is negligible.
Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated data from the 2009–10 and 2010–11 Family Resources Survey.

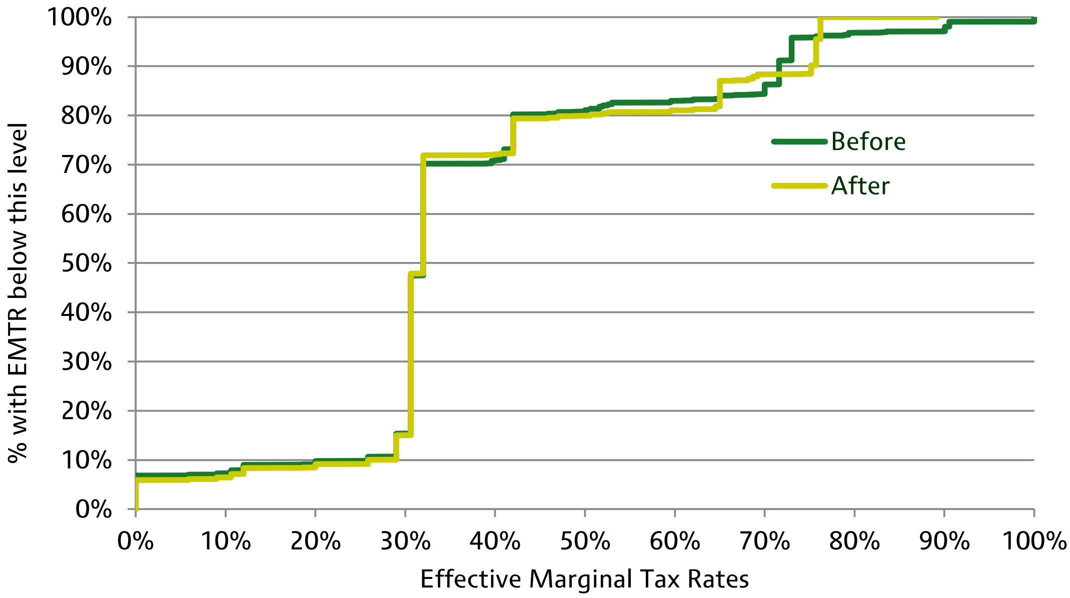
[26] See Brewer, Browne and Jin (2012).

[27] For more details, see Appendix A.

[28] To see why this is the case, consider that paying an employee an additional pound will cost the employer £1.128 because of the existence of employer NICs. Presumably, in the absence of employer NICs, the employer would have been prepared to increase the employee's wages by £1.128 in this case, which would strengthen the incentive for the employee to do this additional work. Also, since employees' willingness to work presumably depends on the quantity of goods and services they can purchase with whatever money they earn, indirect taxes also weaken the incentive to work.

Table 3.2 gives an estimate for the number of individuals in each ten percentage point band of EMTRs. The reforms ensure no individual faces an EMTR of more than 76.2%, but increases the numbers facing an EMTR of more than 60%. Universal Credit also increases the number of workers with EMTRs less than 40%. This is because some families currently entitled to tax credits will not be entitled to Universal Credit, meaning that they will no longer face the steep withdrawal of means-tested support if they increased their earnings slightly. It is important to note that the reforms do not affect most workers. Of the almost 700,000 in-work individuals in our simulation, Universal Credit will reduce the EMTR facing 64,000 individuals while increasing it for 96,000. That leaves 525,000 unaffected by the reform, as they are entitled to neither tax credits nor means-tested benefits currently, and will not be entitled to Universal Credit.

Figure 3.5: Cumulative distribution EMTRs before and after Universal Credit UC reforms



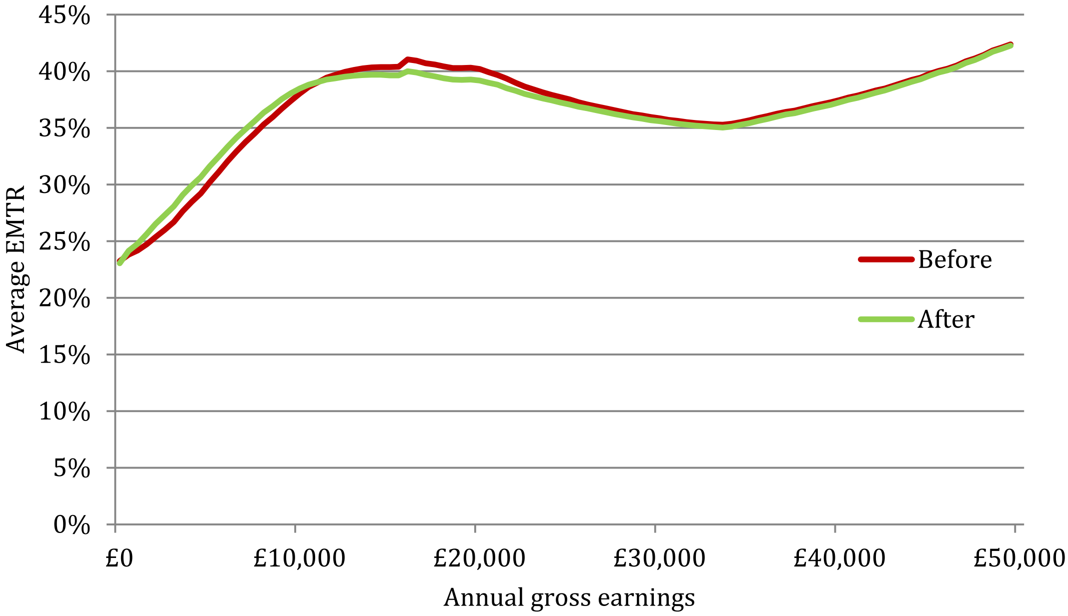
Note: Only includes those aged between 18 and 59 who are in paid work.
Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated data from the 2009–10 and 2010–11 releases of the Family Resources Survey.

Figure 3.5 shows the cumulative distribution of EMTRs before and after the introduction of Universal Credit. Again, we see that both before and after the reforms, around 70% of workers have an EMTR of 32% or less. The largest change takes place among those with high pre-reform EMTRs: those with EMTRs above 76.2% see their EMTRs reduced to 76.2%, but those only entitled to tax credits at the moment (whose EMTR is around 73%) see their EMTRs increased to around 76.2%.

Figure 3.6 shows average EMTRs by earnings before and after the reform. Those towards the lower end of the earnings distribution will on average see a slight increase in the EMTR they face, those earning more than around £10,000 will see a slight decline. Again, there is some variation in this pattern between different types of individual. Figures 3.8–3.10 show the estimated average EMTRs by earnings for six different family types, before and after the reform: two-earner couples with and without children, single-earner couples with and without children, single adults, and lone parents.[29]

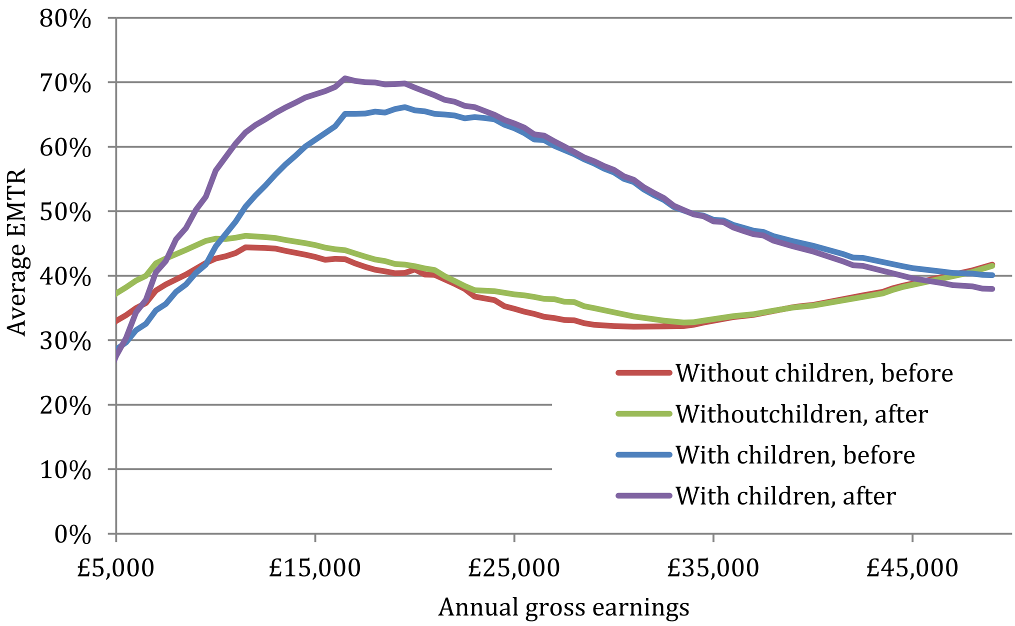
[29] Again, earnings are truncated at £5,000 and £50,000 due to concerns about the reliability of estimates derived from small sample sizes.

Figure 3.6: Average EMTRs by earnings



Notes: As for Figure 3.5. Non-parametric regression (lowess) estimates for EMTRs.
Source: As for Figure 3.5.

Figure 3.7: Average EMTRs by earnings for single-earner couples



Notes: As for Figure 3.5. Non-parametric regression (lowess) estimates for EMTRs.
Source: As for Figure 3.5.

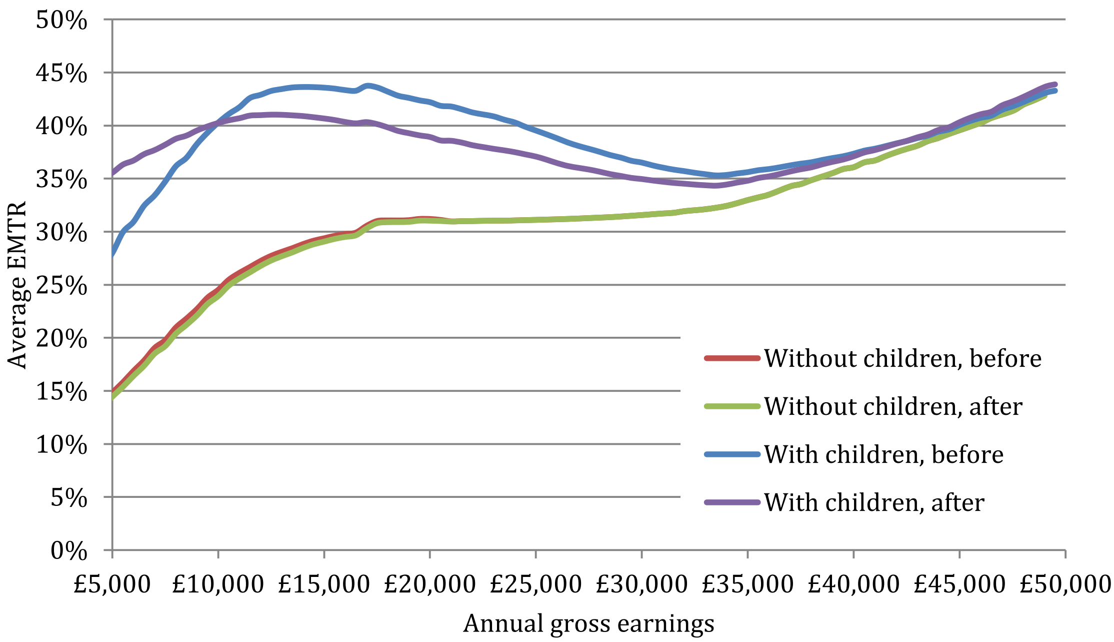
Single-earner couples

As Figure 3.7 shows, the introduction of Universal Credit will increase the EMTR facing single-earner couples, especially for those with children, at low earning levels, and hence weaken the incentives for such individuals to increase their earnings. This is because, as we saw in Chapter 2, the choice of the earnings disregard for couples with children causes single-earner couples with children benefiting from the introduction of Universal Credit, but it also increases the number of such families with an entitlement to in-work benefits: 42% of families in Northern Ireland will have some entitlement to Universal Credit, whereas only 29% have an entitlement to means-tested benefits or tax credits under the current system. Although these new recipients will be better off in financial terms, they face the withdrawal of Universal Credit in addition to paying income tax and National Insurance if they increase their earnings slightly. Similarly, the EMTR for basic-rate taxpayers facing withdrawal of Universal Credit will be higher than under the current system, at 76.2% rather than 73%.

Two-earner couples

The impact of Universal Credit on work incentives is very different for those with a working partner than for those without (Figure 3.8). Two-earner couples will see a weakening in their incentives to earn more (i.e. an increase in their EMTR) at earnings levels below £10,000 if they have children, but are on average unaffected if they do not. The weakening of work incentives for second-earners in a couple with children are caused by the fact that those who are non-taxpayers will face an EMTR of 65% if they are entitled to Universal Credit (rather than the 41% they would face if they were entitled to tax credits at the moment), and an EMTR of 76.2% rather than 73% if they are basic-rate taxpayers. However, for the same reason, entitlement to means-tested support is exhausted at a lower earnings level under Universal Credit, meaning that average ETMRs fall at higher levels of earnings.

Figure 3.8: EMTRs for those in two-earner couples

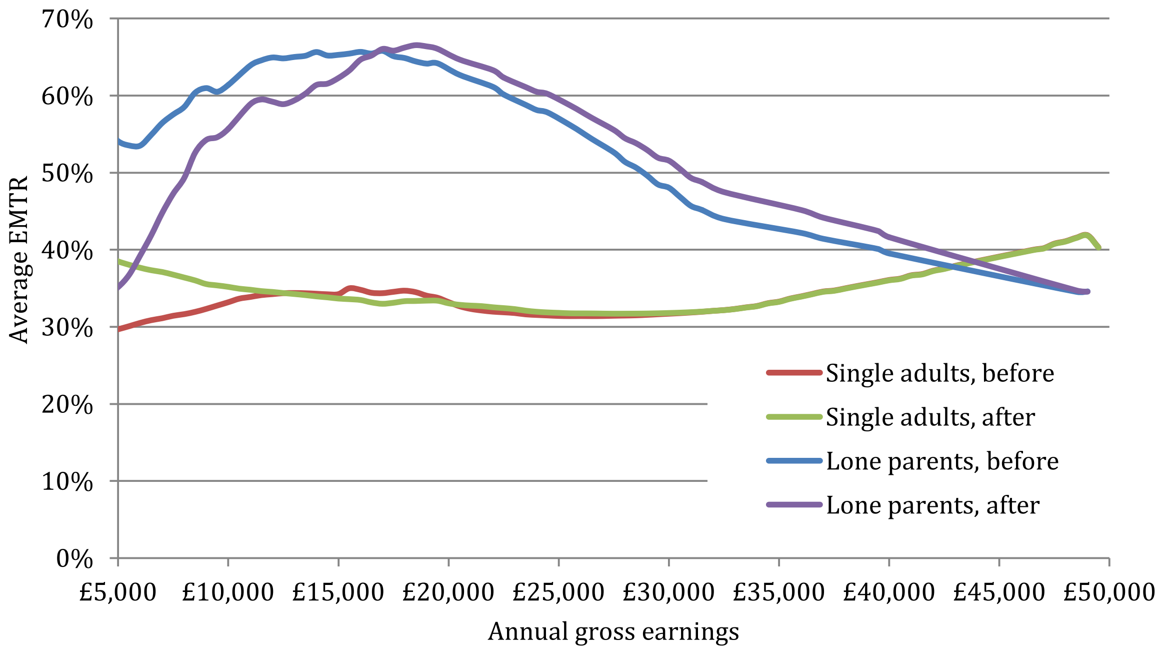


Notes: As for Figure 3.5. Non-parametric regression (lowess) estimates for PTRs.
Source: As for Figure 3.5.

Single adults with and without children

Lone parents on low levels of earnings see a strengthening of their incentive to work, with EMTRs falling on average at earnings below £17,000 (see Figure 3.9). This is again due to the more generous earnings disregard and because of the removal of the extremely high EMTRs that are caused by overlapping tapers under the current system. At higher levels of earnings though, where lone parents are only entitled to tax credits and not Housing Benefit under the current system, average EMTRs increase as this group sees their EMTR increased from 73% to 76.2%. However, single adults without children find their EMTRs slightly increased at low earnings levels. This is because some of this group become entitled to Universal Credit and hence face its withdrawal if they slightly increase their earnings, meaning that they have a weaker incentive to increase their earnings, though are better off in financial terms.

Figure 3.9: EMTRs for single adults and lone parents



Notes: As for Figure 3.5. Non-parametric regression (lowess) estimates for PTRs.
Source: As for Figure 3.5.

Summary

The vast majority of workers do not have their EMTRs affected by the introduction of Universal Credit since they are not entitled to means-tested benefits or tax credits under the current system, and will not be entitled to Universal Credit. Around 96,000 will see their incentive to increase in-work earnings weaken and 64,000 will see their incentives strengthened.

Universal Credit will ensure that the maximum EMTR is 76.2%, and so those currently facing a higher EMTR than that – because they face several means-tested benefits or tax credits withdrawn simultaneously, or 100% withdrawal of an out-of-work means-tested benefit – will see their EMTR reduced. These tend to be lone parents or low earners with children who do not have a partner in paid work. However, low earners who do have a working partner will tend to see their EMTR increase: this is because Universal Credit will have a higher withdrawal rate than tax credits do in the current system, whether combined with income tax and National Insurance or not. Many low earners without a partner in work become entitled to Universal Credit due to the generous earnings disregard which the UK Government has set: although these individuals benefit financially from this decision, they will face the withdrawal of an entitlement where previously they did not, weakening their incentive to increase earnings.

CHAPTER 4
Designing a rate rebate replacement scheme for Northern Ireland in a Universal Credit world

If Universal Credit were introduced in Northern Ireland on a parity basis, it would replace six of the seven main means-tested benefits for those of working age in Northern Ireland. The seventh is rate rebates. The Northern Ireland Executive would then need to carefully consider how to reform the current system of rate rebates to work alongside Universal Credit.

This section gives a brief overview of rate rebates in Northern Ireland and reforms affecting them that will be introduced in the near future[30] before discussing the issues surrounding designing a new system of rate rebates to work alongside Universal Credit and setting out some options for the Northern Ireland Executive to consider.

4.1. Introduction

Domestic rates are a property tax levied in Northern Ireland, filling the role that Council Tax plays in England, Scotland and Wales. Domestic rates are levied as a percentage of the estimated capital value of the property on 1 January 2005 (up to a £400,000 cap), with the Northern Ireland Executive setting a 'regional rate' (0.378% in 2012–13) across the whole province and local authorities setting a 'district rate' (ranging from 0.2136% to 0.4092% in 2012–13). Certain empty properties are exempt (in particular those with a rateable value of less than £20,000 and new properties that have never been occupied, as well as some smaller exemptions). The average domestic rates bill in Northern Ireland at £789 per year in 2011–12 is significantly lower than the average Council Tax bill in England and Wales of £1,185 in the same year.[31] Rate rebates exist to provide support for families with a low income relative to their needs with their rates bill. There are two components to rate rebates in Northern Ireland, the system of support provided through Housing Benefit, which is very similar to the system of Council Tax Benefit in Great Britain, and which is paid for by the UK Treasury through the principle of 'parity', and other rate rebates and discounts designed by the Northern Ireland Executive itself. In this section we discuss both of these before studying the reforms being introduced in 2013–14.

4.1.1. Support provided through Housing Benefit

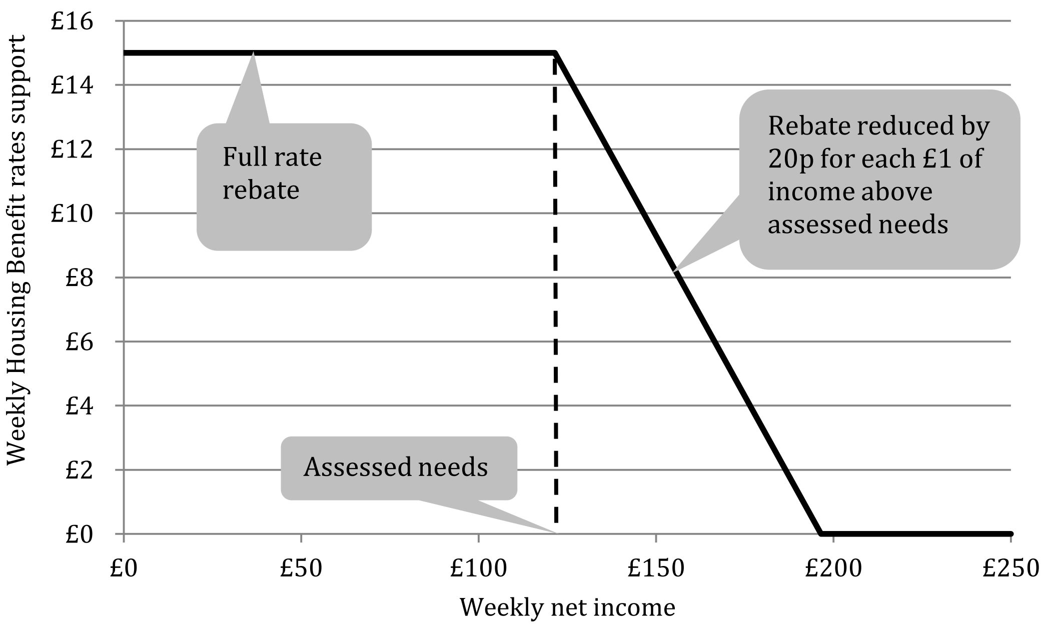
In Northern Ireland, there are two components of Housing Benefit; one of which provides support for rental costs and the other of which provides support for domestic rates. Entitlement to the two components is calculated separately; the rent component is identical to Housing Benefit in Great Britain and the rates component is very similar to the system of Council Tax Benefit in Great Britain. Housing Benefit is administered by the Northern Ireland Housing Executive (NIHE) for those in rented accommodation, and by the Land and Property Services agency for owner-occupiers. Claimants receive their rebate in the form of a reduced (or zero) rates liability, rather than paying rates in full and receiving the benefit in cash separately. Although domestic rates (and hence rate rebates) do not exist elsewhere in the UK, because the rates component of Housing Benefit is the same in all important respects to the system of Council Tax Benefit (CTB) in Great Britain, the costs of the scheme are met by the UK Government in full under the principle of 'parity'.

[30] In particular, the decision to localise responsibility for Council Tax support in Great Britain has implications for Northern Ireland as the costs of the rates component of Housing Benefit will no longer be refunded in full by the UK Treasury and instead the Northern Ireland Executive will be given a grant equal to 90% of what would have been spent on the existing system.

[31] Source: Northern Ireland Neighbourhood Information Service and CIPFA Council Tax Demands and Precepts Statistics.

The maximum rebate that a family can receive is their rate liability.[32] Families receiving a means-tested out-of-work benefit – that is, Income Support, income-based JSA, income-based ESA or Pension Credit Guarantee Credit[33] – automatically qualify for a full rate rebate through Housing Benefit. In practice this accounts for more than 70% of claimants in Northern Ireland, significantly reducing the administrative burden for NIHE and LPS, as these claimants do not have to undergo a full means test.[34] Those who are not 'passported' onto a full rebate in this way must undergo a separate means test, which compares the family's income with a centrally determined measure of minimum needs. If the family's income is below their assessed needs, they qualify for a full rebate; otherwise, their rebate is reduced by 20p for each £1 of income in excess of their assessed needs until their entitlement is exhausted. This basic structure is illustrated in Figure 4.1.

Figure 4.1. An example of Housing Benefit support for domestic rates by income



When measuring 'income' for the purposes of the means test for Housing Benefit:

- Income is measured after deducting income tax and National Insurance contributions.
- Some other social security benefits and tax credits (such as the State Pension, contributory JSA and ESA, Carer's Allowance and tax credits) count as income for the means test, while others (including Child Benefit, Housing Benefit and Disability Living Allowance) do not. The out-of-work benefits listed above do not count as income, though this does not matter under current rules as receipt of those is a passport to maximum rebate entitlement.
- A small amount of earnings is disregarded – £25 per week for lone parents, £20 for those who qualify for certain of the disability premiums listed in Table 2.2, £10 for couples not entitled to one of these disability premiums and £5 for single people without children who are not entitled to one of these disability premiums – in all cases increased by £17.10 if the family qualifies for Working Tax Credit.

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[32] The weekly cost of domestic rates is worked out as the annual bill divided by the number of days in the year and multiplied by seven. If there is more than one person in the house eligible to pay domestic rates, the maximum benefit is the *share* of the total bill that each benefit unit is eligible for. So, for example, if there were a married couple and a third person all eligible to pay domestic rates in a given property, one member of the couple would be entitled to claim up to a two-thirds share of the weekly tax, and the third person could claim a one-third share.

[33] For brief descriptions of these benefits, see Browne and Hood (2012); for full details, see Child Poverty Action Group (2012b).

[34] Thanks to Brian McClure of the Department of Finance and Personnel for providing us with statistics on rate rebate claims.

- Childcare costs of up to £175 per week for one child or £300 for two or more children can be deducted from income if the adults in the family all work 16 or more hours per week.
- Child maintenance received, and the first £15 of spousal maintenance, do not count as income.
- Pension income is included (and half of any pension contributions are deducted); income from other savings is not, but non-pension savings (other than in housing or other physical assets) above £6,000 (£10,000 for pensioners) are assumed to generate income of £1 a week for each £250 of savings (£500 for pensioners), and savings above £16,000 eliminate entitlement altogether.

Table 4.2. Housing Benefit applicable amounts in 2012–13, £ per week

Personal allowance – single person:	Aged 18–24	56.25[a]
	Aged 25–PC age[b]	71.00
	PC age[b]–64	142.70
	Aged 65 or over	161.25
Personal allowance – couple:	Aged 18–PC age[b]	111.45
	Elder one between PC age[b] and 65	217.90
	One or both aged 65+	241.65
Dependent child allowance:[c]	(Per child)	64.99
Family premium:	(Per family with dependent children)	17.40[d]
Disability-related premiums:	Disabled child (each)	56.63
	Disability: single	30.35
	Couple	43.25
	Enhanced disability:[e] child (each)	22.89
	Single	14.80
	Couple	21.30
	Severe disability	58.20[f]
	Carer	32.60[f]
	ESA support component	34.05
	ESA work-related activity component	28.15

[a] This rate does not apply to lone parents or those on main phase ESA. They receive £71.00, the same rate as single people aged 25–59, even if they are aged under 25.
[b] The qualifying age for Pension Credit, which is in the process of increasing in line with the female State Pension age and will be between 61 and 61½ during 2012–13.
[c] An individual is classed as a child until the September following their 16th birthday (or until their 20th birthday if they are in full-time, non-advanced education).
[d] An additional £4.80 premium is payable to lone parents who have been lone parents and claiming the addition since April 1998.
[e] The enhanced disability premium is payable where the claimant or a family member receives the highest rate of Disability Living Allowance (care component) and is below the qualifying age for Pension Credit, or if an adult qualifies for the support component of Employment and Support Allowance.
[f] This amount is doubled if both partners qualify.

'Needs' are expressed as an 'applicable amount', the sum of various allowances and premiums, which depend on age, whether single or in a couple, number of children and any disability, as set out in Table 4.2. In most cases this is identical to the level to which out-of-work benefits top up families' income, so claimants start having their rates rebate withdrawn at the same point that their income is high enough to disqualify them from out-of-work benefits. For families with children, rates rebates start to be withdrawn at a higher level of income than out-of-work benefits run out, because the applicable amount includes an element equivalent to Child Benefit rates despite Child Benefit not being counted as income in the means test. Since recipients of out-of-work benefits would have low enough income to receive a full rates rebate anyway, 'passporting' them onto a full rebate largely serves to save the administration of a separate assessment, rather than changing the amount to which people are entitled.

In 2012–13, it is projected that around £120 million will be spent on the rates component of Housing Benefit in Northern Ireland.[35] Over 220,000 households receive support with their rates through Housing Benefit, and the average annual award is £500, or less than £10 per week. This is significantly less than the average award for Council Tax Benefit in Great Britain of £15.72 per week, reflecting the lower average level of local taxation in Northern Ireland.[36] Around a third of claimants of the rates element of Housing Benefit are pensioners, as shown in Table 4.3.

Table 4.3: Numbers of claimants of the rates element of Housing Benefit in NI, 2012–13

	Owner-occupiers		*Renters*		*Total*	
Pensioners	39,433	64%	30,933	29%	70,366	34%
Working age	21,837	36%	116,527	71%	138,364	66%
Total	61,270	100%	147,460	100%	208,730	100%

Source: Northern Ireland Executive (2013).

More detail on the composition of rate rebate claimants using administrative data is given in Appendix B.

4.1.2. Supplementary rate relief schemes in Northern Ireland

As well as the Housing Benefit scheme outlined above, the Northern Ireland Executive has introduced additional rate relief schemes. These are paid for out of its own (Departmental Expenditure Limit) budget as there is no equivalent to these schemes in Great Britain.

Supplementary low income rate relief scheme

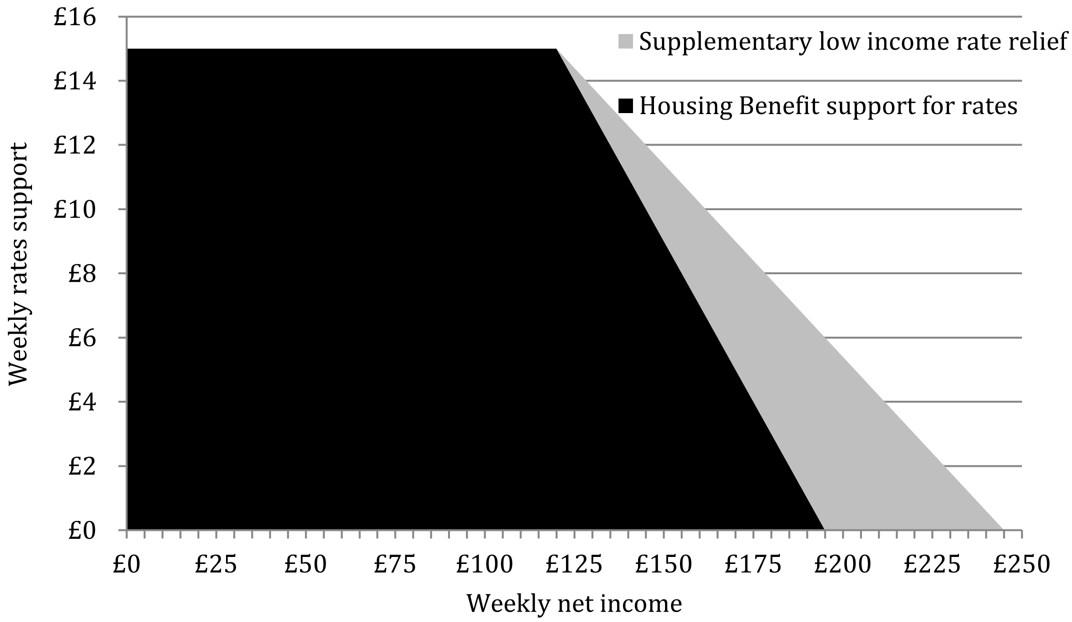
The supplementary low income rate relief scheme offers additional support to low income households who do not receive a full rates rebate through the main scheme or whose income is just above the level for eligibility for the main scheme. The impact of the scheme is to effectively reduce the rate at which rebates are withdrawn as income rises from 20% to 12%. Applicants make claims using the same form as for making a Housing Benefit application: the reason that there are two schemes rather than one is that the UK Government refunds the cost of Housing Benefit in full because it is equivalent to the system of HB and CTB that exists in Great Britain, whereas the additional rebates given by the Northern Ireland Executive using the supplementary scheme have to be funded out of its own Departmental Expenditure Limit budget.

Figure 4.2 below shows how the low income rate relief scheme affects the total amount of rate rebate received.

[35] See Northern Ireland Executive (2013).

[36] Source: DWP Housing Benefit and Council Tax Benefit Statistics, August 2012, http://statistics.dwp.gov.uk/asd/index.php?page=hbctb.

Figure 4.2. An example of rate rebate entitlement by income



Lone pensioner allowance

The lone pensioner allowance is a flat-rate 20% discount on rates bills for those aged 70 and over who live alone. The discount is non-means tested. Like the other rebate schemes, it is paid as a reduction in a household's rate bill rather than in cash. Therefore, it is similar to the single person discount that exists in Council Tax in Great Britain, except that it is a 20% discount rather than 25% and only applies to those aged 70 and over. Property taxation is an issue that is devolved to Northern Ireland, meaning that the Executive and Assembly have flexibility over the type of domestic property taxation they can introduce, and that the revenue raised from domestic rates remains in Northern Ireland rather than being shared with the UK Treasury. Thus, discounts such as this must be paid for by increasing domestic rates for other households or reducing expenditure in Northern Ireland: the Northern Ireland Executive could not introduce a 25% single person discount in domestic rates and then use the principle of parity to claim the money back from the UK Treasury.

Early payment discount

Households typically pay rates in monthly instalments. The early payment discount entitles households who pay their whole rates bill for the financial year before 4 May to a 4% discount. At current levels of take-up, this discount costs £4 million a year.

Disabled person's allowance

The disabled person's allowance exists to ensure that those who have had special adaptations made to their property (namely, the addition of a room, kitchen or bathroom or additional floor space to allow the use of a wheelchair indoors) to meet the needs of a disabled person do not have to pay higher rates as a result of any increase in the value of the property associated with these modifications. Those who are entitled to the allowance see a reduction of 25% in their rates bill. Around 11,000 ratepayers receive this allowance at a cost of £3 million a year.

Clergy residence discount

Properties owned by religious bodies attract a 50% discount to their rates liability if the property is occupied by someone who holds a full-time office of a religious denomination and performs the duties of that office from the property. Around 1,600 properties benefit from this discount at a cost of £1.1 million a year.

4.1.3. Future reforms

As of April 2013, the UK Government will abolish CTB as a nationwide scheme and devolve responsibility for delivering support for Council Tax to local authorities in England and the Scottish and Welsh Governments. These bodies will each receive a grant equal to 90% of what would have been spent on CTB in their area and will have to design their own systems. This means that there will no longer be a parallel system in Great Britain for the rates component of Housing Benefit in Northern Ireland to have parity with. The Northern Ireland Executive will receive a fixed grant equal to 90% of what would have been spent on the rates component of Housing Benefit. This leaves the Executive with the decision of whether to pass this cut on to claimants or make up the difference by finding savings elsewhere. For 2013–14, the Executive has decided to retain the current system of rate rebates and make savings elsewhere.

The shift from a situation where the UK Government refunds all expenditure on the rates component of Housing Benefit to one where the Northern Ireland Executive has to make payments out of its block grant will add risk to the Executive's finances: since spending on rate rebates is partly down to factors outside the Executive's control, such as the level of unemployment and growth in Northern Ireland, actual spending will differ from what was budgeted for. But unlike for local authorities in England, for whom Council Tax rebates will make up a substantial proportion of their budget, this is only a minor concern for the Northern Ireland Executive, as spending on the rates component of Housing Benefit at £120 million per year is only 1% of its total budget.

The shift in the way rate rebates are funded will also have an impact on the incentives faced by the Northern Ireland Executive and local authorities in Northern Ireland, in particular regarding:

- **Setting domestic rates levels.** Currently, Northern Ireland does not face the full cost of domestic rates, as part of any increase in bills is paid for by the UK Treasury refunding the costs of the rates component of Housing Benefit in full. A fixed grant will correct this distortion to the Northern Ireland Executive's incentives, improving local accountability for rate setting decisions.
- **Encouraging employment and growth in Northern Ireland.** Again, because the cost of the rates component of Housing Benefit is refunded in full by the UK Treasury, the Northern Ireland Executive does not face the cost of rate rebates, and so does not currently benefit financially from reductions in the cost of rate rebates brought about by higher levels of employment and growth in Northern Ireland. A fixed grant will mean that the Northern Ireland Executive does get to keep these savings. The strength of this incentive will depend on how the UK Government alters the grants given to the devolved administrations over time: if grants are fixed for long periods, there will be a strong incentive for the Northern Ireland Executive to minimise costs, whereas if lower expenditure one year simply leads to a lower grant the following year, the incentive will be correspondingly weakened.
- **Encouraging take-up of rate rebates.** On the other hand, for similar reasons, the Northern Ireland Executive will have a weaker incentive to encourage households to take up their entitlement than at present. This is because any additional expenditure resulting from the higher take-up will be refunded from where any increase in take-up is paid for by additional funding from the UK Treasury. Again, the strength of this incentive will depend on how, and how often, the UK Government will adjust the grants to the devolved administrations.

Of course, just because these incentives exist, it does not necessarily imply that the Northern Ireland Executive will act on them. The Northern Ireland Executive presumably wishes to encourage employment and growth in the province at the moment, and will continue to encourage take-up of benefits in the future, because of a concern for the welfare of the people of Northern Ireland. Nevertheless, it will still get additional financial benefit from encouraging employment and growth, and a financial penalty for encouraging take-up, relative to the current system.

Whatever the advantages or otherwise of localisation, designing a Northern Ireland-specific rates rebate scheme will be more attractive to the Northern Ireland Executive than it has done until now, as the UK Government has said it will only refund the cost of rebates in full if parity is maintained. Localisation of rate rebates provides an opportunity for Northern Ireland to consolidate existing forms of rate support and to consider whether the existing schemes meet its priorities. For example, there will be little point in maintaining the separation between the main rate relief scheme and the supplementary low income rate relief scheme: as both will now be paid for by the Northern Ireland Executive out of its block grant, there is no need to account for spending on each of them separately. For this reason, we include the supplementary low-income rate relief scheme in our baseline in our analysis in Section 4.3. Describing the system as a single rate rebate scheme with a 12% taper would reduce confusion among claimants without changing anyone's entitlement. There will be no changes to the current system of rebates in 2013–14, though the Northern Ireland Executive has recently published a consultation on a rate rebate replacement scheme that may be introduced in 2014–15 or later.[37] Irrespective of any changes to the system of rate rebates resulting from the changes in funding arrangements though, as we discuss in the next section, some changes will have to be made in the near future in order for rate rebates to work alongside Universal Credit as it starts to be introduced in Northern Ireland from April 2014.

4.2 Rate rebates and Universal Credit

As we argued in Section 2, the main advantages of the introduction of Universal Credit lie in its more integrated structure and the removal of the weakest work incentives that exist under the current system. Leaving support for domestic rates outside of Universal Credit has the potential to undermine both of these advantages. Having support for domestic rates provided outside Universal Credit clearly undermines the simplification that it offers. Whether it also undermines the strengthening of work incentives will depend on the decisions made by the Northern Ireland Executive in designing its rate rebate system. As we showed in Section 3, by removing the jumble of overlapping means tests with a single taper, Universal Credit will ensure that overall effective tax rates cannot rise too high. But having a separate means test for rate rebates could undermine this, potentially reintroducing the extremely weak work incentives that Universal Credit was supposed to eliminate.

Universal Credit opens up possibilities for a rate rebate replacement scheme that would not be practical or sensible at the moment. With Universal Credit in place, it would be possible to withdraw rate rebates from a lower level of earnings than under the current system. This is because, as discussed in Chapter 2, out-of-work benefits are withdrawn on a pound-for-pound basis when income rises above a small disregard. Rate rebates cannot therefore be withdrawn over this range of income without creating EMTRs of greater than 100%: the benefit system is designed such that rate rebates only start to be withdrawn after entitlement to out-of-work benefits is exhausted. Under Universal Credit, the removal of 100% benefit withdrawal rates means that there is scope to withdraw rate rebates from lower income levels. This may help to prevent the situation where rate rebates are withdrawn over the same range of income as Universal Credit, creating the very high EMTRs described above (though by reducing support at low levels of income it would of course weaken the incentive for families to have someone in paid work at all). It would also reduce the cost of rate rebates. We return to this idea later in the section.

As well as opening up new possibilities for the design of rebates, Universal Credit also necessitates some decisions where sticking with the status quo – that is, broadly replicating the existing system – will no longer be an option.

[37] Northern Ireland Executive (2013).

One key issue that arises is whether Universal Credit is counted as income for the purposes of the means test for rate rebates. Which option the Northern Ireland Executive chooses has consequences for other issues that arise, as we discuss in Section 4.2.1 below.

The move to Universal Credit also raises issues around the administration of rate rebates. The administrative cost of rate rebates has the potential to increase significantly for two reasons. First, both components of Housing Benefit are administered using the same system for those in rented accommodation. As the rent component of Housing Benefit will be subsumed into Universal Credit once it is fully in place, the existing infrastructure will be used solely for rate rebates. Second, the out-of-work benefits used to passport families to a full rate rebate through Housing Benefit will be abolished when Universal Credit is fully in place. If these claimants had to go through a full means test, the administrative cost could increase substantially. In Section 4.2.2 we discuss these issues further and possible solutions.

4.2.1. Treatment of Universal Credit in the means test

When Universal Credit is introduced, the Northern Ireland Executive will need to decide whether or not to include it in income in its rate rebate replacement scheme.

Some change will be required whichever option is chosen because some of the benefits that Universal Credit is replacing do count as income for the Housing Benefit means test (notably tax credits), while others do not (Income Support, income-based JSA, income-based ESA, and Housing Benefit). So either option – counting Universal Credit as income or ignoring it – would involve a change from the status quo.

Whether to count Universal Credit as income is not just a technical question. Measuring someone's income as, say, £200 per week higher (not an untypical Universal Credit entitlement) could potentially wipe out any entitlement to rate rebates. It could be impossible even for those with no private income at all to be entitled to a full rate rebate. But importantly, it need not necessarily mean that. If Universal Credit were counted as income, the income threshold at which rebates started to be withdrawn (the 'applicable amount') could be increased to mirror the family's maximum Universal Credit entitlement, so that only income above that reduced the family's entitlement to rebates. That is, for example, the way in which Child Tax Credit is currently treated in Housing Benefit currently: allowances in Housing Benefit mean that families that have no private income still receive a full rebate even if they also claim the Child Tax Credit to which they are entitled. [38]

This option – counting Universal Credit as income but introducing a corresponding allowance in the means test – may appear to be a rather roundabout way of ensuring that Universal Credit does not reduce entitlement to rate rebates for those with no private income. It is certainly more complicated than simply ignoring Universal Credit for the means test. But it has an important advantage. Making two income assessments sequential rather than simultaneous, or in other words calculating one of them on income measured after the other, rather than using the same income measure for both, moderates the combined EMTR.[39] This is why the 'default' scheme for Council Tax rebates in England by the Department for Communities and Local Government includes Universal Credit in the income measure used in the means test.[40]

Table 4.2 illustrates how this would work for someone earning an extra £100 assuming a tax rate of 32% (the current basic rate of income tax plus employee NICs), a withdrawal rate of 65% for Universal

[38] In particular, Child Tax Credit is counted as income, but the child allowance in rate rebates is set equal to the child element of Child Tax Credit plus the rate of Child Benefit received by the second and subsequent children and the family premium is set equal to the family element of Child Tax Credit plus the additional amount received for the first child in child benefit. This means that there are allowances in rate rebates that are set equal to the amount of Child Benefit a family receives, even though Child Benefit is not counted as income for the rate rebate means test. This is a relatively recent innovation introduced in April 2009, when Child Benefit ceased to be counted as income for the purposes of the rate rebate and Housing Benefit means tests. The effect of this reform was to give families an allowance that could be used against earned income equal to the amount of Child Benefit they receive.

[39] See Section 5.3.2 of Mirrlees *et al.* (2011) for a discussion of this.

[40] If local authorities in England do not adopt their own scheme of council tax support by 31 January 2013, the 'default scheme' will apply in that area. The Council Tax Reduction Scheme regulations for England are available at http://www.legislation.gov.uk/2012/3085.

Credit (as is currently proposed) and a withdrawal rate of 12% for rate rebates (as exists at the moment, once the impact of the supplementary low income rate relief scheme is taken into account). Universal Credit will be assessed on income after income tax and employee NICs, so someone earning an extra £100 loses £32 of that in tax and a further £44.20 (65% of the remaining £68) in withdrawn Universal Credit, leaving her with £28.30. Withdrawal of rate rebates at a rate of 12% based on the same measure of income as Universal Credit would mean losing a further £8.16 (12% of £68), leaving her with only £15.64 of her original £100: an overall EMTR of 84.36%. But if rate rebates were assessed on income including Universal Credit, she would lose only a further £2.86 (12% of £23.80), leaving her with £20.94: an EMTR of 79.06%.

In other words, counting Universal Credit as income means that when someone increases their earnings, the fact that their Universal Credit entitlement falls is taken into account and moderates how much rate rebate is withdrawn by the means test.

Table 4.2: Sequential versus simultaneous income assessment

	Rebates assessed on income after tax	*Rebates assessed on income after tax and Universal Credit*
Extra earnings	£100	
Tax due	32% of £100 = £32	
Universal Credit withdrawn	65% of (£100 – £32) = £44.20	
Rate rebate withdrawn	12% of (£100 – £32) = £8.16	12% of (£100 – £32 – £44.20) = £2.86
Extra net income	£100–£32–£44.20 – £8.16 = £15.64	£100 – £32 – £44.20 – £2.86 = £20.94
EMTR	(£100 – £15.64) / £100 = 84.36%	(£100 – £20.94) / £100 = 79.06%

This effect of moderating the highest EMTRs is not a free lunch. There is a trade-off between the level of the maximum EMTR and the number of people subject to high EMTRs: effectively lowering the withdrawal rate for rate rebates in this way brings more people onto the rate rebate taper, increasing their EMTRs. But, on the whole, this is a positive: it is generally preferable to have two people on EMTRs of 80% rather than one at 70% and one at 90%, because the distortion caused by taxes rises more than proportionally to the tax rate.

The fact that some of the benefits that Universal Credit is replacing count as income for rate rebates at the moment and some do not means that some changes will have to be made whether or not Universal Credit is counted as income:

- If Universal Credit is not counted as income, this will mean that the components of Universal Credit that replace Child Tax Credit will no longer be counted as income for the rate rebate means test. In other words, the allowances that exist to cover Child Tax Credit will no longer be needed under Universal Credit, and would merely serve to increase the level of private income families with children could have before their rate rebate started to be withdrawn. These allowances could therefore be reduced by the maximum amount of Child Tax Credit a family could receive, because families would no longer be receiving the Child Tax Credit that previously offset these allowances. However, in the short run, there would need to be provisions for those who had not been transferred to Universal Credit and were still claiming Child Tax Credit. One obvious option would be to have different rate rebate means tests for those on Universal Credit and those on the current system of means-tested benefits and tax credits.[41]

[41] Alternatively, Child Tax Credit could cease to be counted as income in the means test for rate rebates. However, this would lead to EMTRs in excess of 100% for those on the tax credit, Housing Benefit and rate rebate tapers because of the problems of simultaneous income assessment discussed above.

- If Universal Credit is counted as income, there are already allowances that are set equal to the components that replace Child Tax Credit and out-of-work benefits in Housing Benefit.[42] There is not, however, an allowance to cover families' entitlements to Housing Benefit. Therefore, any family claiming the rent component of Universal Credit who had no private income would no longer receive a full rate rebate, as the amount of Universal Credit they received would be greater than their applicable amounts. This could be overcome by introducing an allowance equal to a household's eligible rent in rate rebates to offset the rent component of Universal Credit. For those still claiming the existing set of benefits and tax credits, Housing Benefit could also be counted as income for the purposes of the means test for rate rebates. This would reduce the EMTR of those claiming both the rent and rates components of Housing Benefit because these benefits would be means-tested sequentially rather than simultaneously (see above).

Box 4.1: Unearned income

As discussed in Chapter 2, Universal Credit treats certain forms of unearned income (namely, income from private pensions, contributory benefits and spousal maintenance) very harshly compared to the way HB and tax credits do at the moment: income from these sources reduces entitlement to Universal Credit on a pound-for-pound basis, with no disregard. The means test for rate rebates currently counts income from these sources and applies the same 20% withdrawal rate (or 12% once the supplementary low income rate relief is accounted for) to this income as to income from other sources. Therefore, if the same rules were applied after the introduction of Universal Credit, and Universal Credit was not counted as income in the means test, £1 of income from these sources would reduce total entitlement to means-tested support by £1.12: in other words, people would in some cases be better off without this income if they were entitled to both Universal Credit and rate rebates.

In the case where Universal Credit was not counted as income in the rate rebate means test, a solution would be to ignore this income in the means test for rate rebates. Universal Credit would continue to apply a 100% taper rate to this income, but it would not affect the amount of rate rebate received. This would be an expensive solution, however.

If Universal Credit were counted as income for the purposes of the rate rebate means test, this problem would not arise. In this case, if unearned income increased by £1, Universal Credit would fall by £1, leaving total income for the purposes of the means test for rate rebates (and hence the amount of rate rebate received) unchanged. For claimants of rate rebates not entitled to Universal Credit, it would simply mean that each additional pound of income reduced the rebate received by 12p in the same way as at present.

The problem of Universal Credit and rate rebates being withdrawn over the same income range could be minimised by ensuring that, wherever possible, entitlement to rate rebates is already exhausted by the point that Universal Credit starts to be withdrawn. This can be achieved by withdrawing rate rebates from the first pound of income and significantly increasing the taper rate so that eligibility is on the whole exhausted before Universal Credit starts to be withdrawn. We explore an option that achieves this in Section 4.3.

If Universal Credit is not counted as income in the rate rebate replacement scheme, questions arise around the treatment of unearned income and childcare. This is because:

- As we discussed in Chapter 2, unearned income from private pensions, contributory benefits and spousal maintenance is treated very harshly in the Universal Credit means test – we saw

[42] As previously discussed, the allowances to cover Child Tax Credit exist because Child Tax Credit is counted as income for the rate rebates means test. The allowances that are set equal to a family's entitlement to out-of-work benefits exist to ensure that rate rebates do not start to be withdrawn until entitlement to out-of-work benefits is exhausted. (Out-of-work benefits are withdrawn on a pound-for-pound basis so allowances set equal to these benefits achieve this objective.)

that families with income from these sources tend to lose out from the introduction of Universal Credit. Using the current definition of income for the rate rebates means test and not counting Universal Credit as income would lead to a situation where additional income from these sources made some people worse off, though this issue does not arise if Universal Credit is counted as income (see Box 4.1).

Box 4.2: Childcare

Currently, childcare costs up to a maximum of £175 per week for one child and £300 per week for two or more children are deductable from income for the Housing Benefit means test. This deduction exists because without the disregard families claiming Housing Benefit would not receive the full benefit of the childcare element of the Working Tax Credit (WTC): WTC is counted as income in the means test for Housing Benefit, so additional income from the childcare element of WTC would reduce the amount of rate rebate received. At the moment, the childcare disregard means that those on the rate rebate taper see their income for the Housing Benefit means test fall by 30p when they spend an additional pound on childcare: this is because the childcare disregard means that their income for the purposes of the rate rebate means test falls by £1, but it is then increased by 70p by the additional WTC they receive. This in turn leads to their rate rebate increasing by 3.6p (12% of 30p), including the supplementary low income rate relief. Thus, a family on both the rate rebate and tax credit tapers can receive an effective childcare subsidy of 73.6%, and a family who is also on the HB taper can receive an effective subsidy for their childcare of 93.1%.

Universal Credit also has a 70% subsidy for childcare costs up to the same limits. Therefore, if Universal Credit were counted as income for the purposes of the means test for rate rebates, the situation would remain much the same as at present with the WTC subsidy: those on both the Universal Credit and rate rebate tapers would continue to receive an effective subsidy of 73.6% towards their childcare costs. This would represent no change for those not entitled to the rent component of HB, but would represent a reduction in generosity for those who were previously entitled to the rent component of HB: as the rent component of HB will be integrated within Universal Credit, the effective subsidy for this group will fall from 93.1% to 73.6%.

However, if Universal Credit were not counted as income in the rate rebate means test, leaving the childcare disregard in place in rate rebates would lead to an increase in the generosity of the childcare subsidy for most groups. In this case, a £1 increase in childcare spending would lead to a £1 fall in the measure of income used to determine entitlement to rate rebates and hence a 12p increase in the amount of rebate received, including the supplementary low income rate relief. Thus, a family on both the Universal Credit and rate rebate tapers would receive an effective subsidy of 82% towards their childcare costs. This is more than a family on the tax credit and rate rebate tapers currently receives, but still slightly less than is received by a family that is also on the taper for the rent component of HB. Alternatively, it would also be possible to abolish the childcare disregard in this case: if Universal Credit were not counted as income for the purposes of the means test for rate rebates, the childcare component of Universal Credit would not affect families' entitlements to rate rebates at all and the overall childcare subsidy would be 70%. This is the same amount received by those on tax credits at the moment, but less than is received by those also on other means-tested benefits (in particular, those who receive both components of HB).

- If Universal Credit is not counted as income in the means test for rate rebates, the Northern Ireland Executive will have to choose between making support for childcare significantly more generous or significantly less generous than it is at the moment for some groups: it is impossible to replicate the current system of support for childcare closely for all groups. If Universal Credit is counted as income, the position is simpler, with little change from the current situation except for some reduction in the generosity of childcare subsidies to those currently receiving Housing Benefit (see Box 4.2).

4.2.2. Administrative issues

Currently, different parts of the benefit system are administered by different government departments in Northern Ireland: out-of-work benefits are administered by the Department of Social Development (DSD) (though some training and welfare-to-work schemes for those claiming these benefits are run by the Department of Employment and Learning (DEL)), Housing Benefit is administered by the Northern Ireland Housing Executive (NIHE) for renters and by Land and Property Services (LPS) for owner-occupiers, who also collect domestic rates, and tax credits are administered by HM Revenue and Customs, as in Great Britain. Universal Credit will be administered by the DSD.

The costs of administering rate rebates could potentially increase significantly after Universal Credit is introduced for two reasons. First, the same computer system is currently used to administer both components of Housing Benefit for those in rented accommodation, and the same application form is used to claim both benefits. When support for rent is subsumed within Universal Credit, the current administrative systems at the NIHE will only support rate rebates, as those at LPS do at the moment, increasing the administrative cost of rate rebates. Second, the benefits that are currently used to 'passport' people to a full rate rebate will no longer exist once Universal Credit is introduced. Currently, anyone receiving means-tested out-of-work benefits is automatically passported to a full rate rebate without having to go through another means test, significantly reducing the cost of processing these claims. Under Universal Credit, these out-of-work benefits will no longer exist as a way of identifying those who would be entitled to a full rate rebate. At present more than 70% of rate rebate recipients are passported in this way. If all these people needed to go through a full means test in order to qualify for rate rebates, the burden on claimants and administrators would increase substantially.

A tempting solution would be to seek an equivalent kind of passport that could be operated under Universal Credit: a simple yes/no indicator that could be used to grant maximum entitlement to rebate without the rigmarole of a full means test. There are many candidates for such an indicator that could serve as a passport: being out of work; receiving maximum Universal Credit; having a Universal Credit award that includes certain elements (a disability element or a child element, for example); being subject to benefit conditionality (work search requirements, etc.); and so on. Any of these could indeed be used as a passport. But unlike the existing rate rebate passport, none of these identifies *exclusively* people who would qualify for a full rebate anyway, assuming the underlying means test operates like the current one. (To see this, consider someone in any of the groups listed and suppose they have large amounts of unearned income or financial assets.) Using a passport like this would therefore extend entitlement to some who do not currently have it, and also create an undesirable 'cliff-edge' whereby a small change that disqualifies someone from the passport leads to a large reduction in support as their entitlement falls to its underlying level. A relatively tightly defined passport would minimise these problems, but it would also likely passport only a relatively small number of people to full rebate entitlement, and so do correspondingly little to ease the burden on claimants and administrators. Under Universal Credit there will be no straightforward indicator that accurately identifies only (and ideally the majority of) those people who would be entitled to maximum support under the current means test. This suggests that another solution would have to be sought.

One way of reducing the burden of means testing for claimants and administrators would be to use information collected from Universal Credit claims for the purposes of administering rate rebates. Almost all working-age claimants of rate rebates will be entitled to Universal Credit, and the information that will need to be collected for the administration of Universal Credit would contain almost all the information required to implement rate rebates. Furthermore, as it is intended to use real-time information on earned income collected through the PAYE income tax system as part of the Universal Credit income assessment, such information would be likely to be more up-to-date and accurate than that provided by claimants themselves. There are several ways in which this could be implemented. As both Universal Credit and rate rebates will be administered at a Northern Ireland level, both benefits could be administered by DSD using the same claim form and computer system. Or, information from Universal Credit claims could be transferred from DSD to the NIHE or LPS to avoid claimants having to submit the same information twice to different agencies. A variant on this would be for the rate rebate replacement scheme to make use of the Universal Credit award notices, which will contain information on a family's maximum Universal Credit entitlement, Universal Credit award and income from different sources. When deciding which option to go for, the Northern Ireland Executive will also need to consider what will happen to rate rebates for pensioners after the introduction of Universal Credit. The UK Government intends to introduce a housing costs component into Pension Credit once Housing Benefit is abolished in Great Britain, but will keep CTB as a separate scheme administered by local authorities. If the same pattern was implemented in Northern Ireland, the systems for calculating rate rebate entitlements would need to remain in place, negating some of the advantages of using the same administrative systems for Universal Credit and rate rebates for those of working age. Alternatively, Northern Ireland could choose to go in a separate direction, designing a new scheme of rate rebates for pensioners that could use the same administrative systems as Pension Credit, allowing the current Housing Benefit administration to close down.

The technical difficulties in getting such systems set up to work effectively should not be underestimated – one need only look back to the introduction of the current system of tax credits in 2003–04 to see the potential for problems. Indeed, it has been reported that the IT system for the administration of Universal Credit was placed at the top of HM Treasury's Risk Register of government projects.[43] Requiring this system to either administer rate rebates as well as Universal Credit, or to transfer data to the NIHE or LPS would only add to the complexity of an already difficult IT project. And as Northern Ireland would require a different IT system to administer Universal Credit compared to that in Great Britain, this would involve significant additional costs for the Northern Ireland Executive.

Whatever else is chosen, however, there will be even less argument for retaining separate rate rebate administration for renters and owner-occupiers once Universal Credit is introduced. Once Housing Benefit is abolished, both the NIHE and LPS will be doing identical jobs administering rate rebates for different groups. There would be some cost saving in combining these operations.

4.2.3. Summary

There is no simple way that making only minimal changes to the current system of rate rebates will allow a replacement scheme to interact with Universal Credit in a coherent way. The abolition of out-of-work benefits will mean that it will no longer be possible to give claimants of these benefits a full rate rebate automatically. More than 70% of claimants in Northern Ireland are currently passported to a full rebate through receipt of another benefit: if these all had to be put through a full means test in order to receive support, this would increase the burden on both claimants and administrators. One way to alleviate this burden would be for data from Universal Credit claims (either through a direct data transfer from DSD to NIHE or LPS or by using Universal Credit award notices) to be used for the purposes of administering rate rebate claims, so that claimants would not need to be asked for the same information again. Any of these options could potentially deliver significant administrative savings if the IT systems can be set up to in a timely and efficient way.

There are many other questions that will have to be answered, particularly around the treatment of unearned income and childcare expenditure in the means test. But the decision made about each of these issues will have to be made in tandem with the bigger decision of whether to count Universal Credit as income in the means test for rate rebates. Counting Universal Credit as income would be preferable in moderating the highest EMTRs and requiring fewer changes to the treatment of unearned income and

[43] 'George Osborne is warned of disaster over welfare reforms', *Daily Telegraph*, 25 September 2011 (http://www.telegraph.co.uk/news/politics/labour/8788299/George-Osborne-is-warned-of-disaster-over-welfare-reforms.html).

childcare. However, not counting Universal Credit as income would allow those with low levels of earnings to continue to receive the high rates of childcare subsidy they do at the moment (and which would otherwise fall to 70% when Universal Credit was introduced). It would also have the advantage of simplicity from an administrative point of view, as it would not be necessary to check with DSD how much Universal Credit each family was receiving.

In the next section we examine three specific ways in which rate rebates could be designed in a coherent way with Universal Credit.

4.3 Some specific options

This section examines three ways in which rate rebates could be designed to interact with Universal Credit in a coherent way. In each case, we examine the cost of that particular option, its distributional impacts, and its effect on work incentives.

We begin by analysing the 'default scheme' being proposed for England: this is the scheme that will take effect in April 2013 in English local authorities that failed to agree a new scheme for Council Tax support by 31 January 2013. This involves counting Universal Credit as income in the means test and having allowances equal to a family's maximum entitlement to Universal Credit to ensure that those with no private income could still receive a full rate rebate. This means that an allowance equal to the rent component of Universal Credit would need to be introduced into the rate rebate replacement scheme.

We also consider an option where Universal Credit is ignored for the purposes of the means test for rate rebates and abolish the allowances in rate rebates that are set equal to a family's maximum entitlement to out-of-work benefits and CTC.

Our third option attempts to ensure that the tapers for Universal Credit and rate rebates do not overlap, wherever possible. We do this by increasing the withdrawal rate for rate rebates to 65% (the same rate as for Universal Credit) and withdrawing rate rebates from the first pound of private income. In this option we do count Universal Credit as income, and again introduce allowances that are set equal to a family's maximum Universal Credit entitlement.

As in most of the analysis in Chapter 3, we ignore families where all members are aged over the female State Pension Age: these families will not be affected by Universal Credit anyway, so the existing system of rate rebates can remain in place for them. Unlike in our analysis in Sections 2 and 3, we allow for some non-take-up of rate rebates in our analysis: we attempt to calibrate our model so that it matches the number of claimants of different types in recent years, though our model estimates that the number of working-age renters entitled to a full rate rebate is lower than the numbers actually claiming. We suspect that this is because of higher unemployment in Northern Ireland in the years for which we have administrative data available than there was in the years our data was collected. More detail is available in Appendix B.

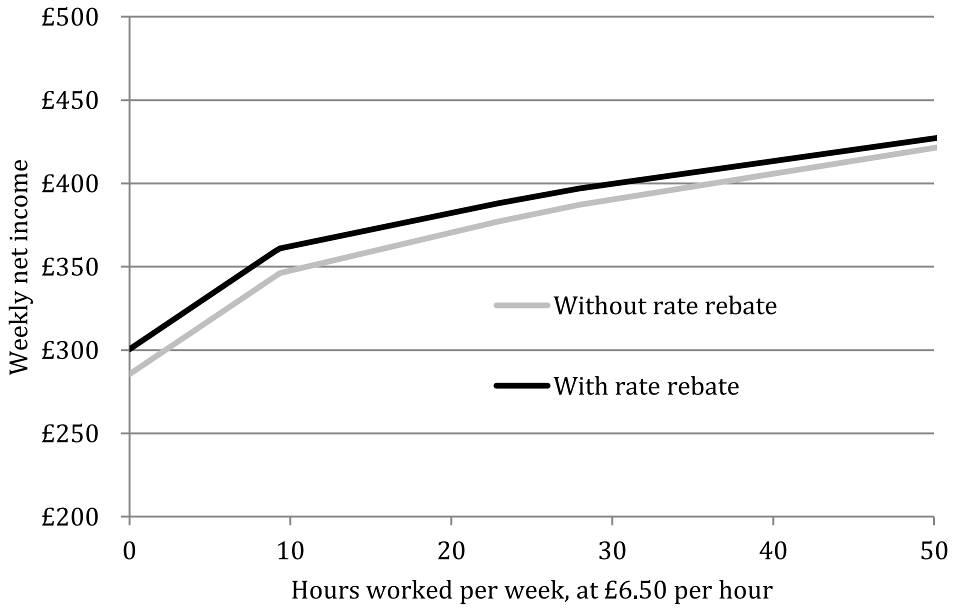
Option 1: Default scheme for England

The draft Council Tax support regulations for England provide for a 'default scheme' to come into effect in local authorities who failed to agree their own scheme of Council Tax support before 31 January 2013. This is identical to the current system of CTB, though incorporates rules around how Universal Credit will be treated once families start receiving it. Although most local authorities in England have decided not to adopt this scheme,[44] it is likely that local authorities in England and the Scottish and Welsh Governments will take a lead from the Department for Communities and Local Government (DCLG) over how Universal Credit will be treated in their new Council Tax Support Schemes given their lack of experience in designing means-tested benefit schemes.

[44] Details of the options that have been chosen by local authorities in England are available at http://counciltaxsupport.org/.

The option that DCLG has chosen is to count Universal Credit as income and then have allowances set equal to a family's maximum Universal Credit entitlement in the default Council Tax support scheme. In practice this means that an allowance equal to a family's eligible rent would be introduced into the Council Tax support scheme to offset the rent component of Universal Credit.[45] It also means that there would be no need to reconsider the treatment of unearned income in rate rebates and there would be an effective childcare subsidy of 73.6% for all those on both the Universal Credit and rate rebate tapers, a reduction in the subsidy given to those currently entitled to Housing Benefit as well. Figure 4.3 shows how this system of rate rebates would affect the budget constraint of an example lone parent. As we discussed in the previous section, this option has the advantage of moderating the highest EMTRs – the highest EMTR is around 79%, though over a fairly wide range of income above around 28 hours per week. Note that we assume that an equivalent to the supplementary low-income rate relief scheme would remain in place, and that the withdrawal rate for rate rebates would remain 12% rather than 20%.

Figure 4.3: Budget constraint for a lone parent with two children with Universal Credit and rate rebate replacement scheme of the form described in the text



Notes: Assumes lone parent with two children who can choose how many hours to work at a given wage rate, £6.50 per hour, and who has rent of £80 and domestic rates of £15 per week, no disability and no other income.

How much does this option cost, and who gains and loses?

The differences between this rate rebate system and the current one create a complex pattern of winners and losers. The following factors determine whether a family would receive more or less rate rebate as a result of this change:

- Because Universal Credit is counted as income in this rate rebate system and tax credits count as income for the purposes of the rate rebates means test, those who receive more in Universal Credit than they received in tax credits tend to get less rate rebate than previously, and vice versa for those who receive less Universal Credit. This option would therefore moderate the gains and losses resulting from the introduction of Universal Credit that we saw in Chapter 2.

[45] For full details of how Universal Credit will be treated in the default Council Tax Support scheme, see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/36781/121212_Universal_Credit_Worked_Example.pdf.

- Counting Universal Credit as income effectively reduces the withdrawal rate of rate rebates for those entitled to Universal Credit, as shown in Table 4.2. This tends to increase the amount of rate rebate received by those with higher incomes.
- On the other hand, rate rebates would be withdrawn from a lower level of earnings than under the current system. This tends to reduce the rate rebate received by those with some private income.

This system would cost around the same as the current system of rate rebates, and there would be a roughly equal number of winners and losers. Many of those who receive a larger rate rebate are those who lose out from the introduction of Universal Credit (around 22,000 out of 36,000). Similarly, almost all of those who receive a lower rate rebate under this scheme are winners from the introduction of Universal Credit (around 23,000 out of 24,000). However, there are around 13,000 families who would gain from both this system of rate rebates and the introduction of Universal Credit: these tend to be those in rented accommodation who benefit from the introduction of the rent disregard in this rate rebate replacement scheme.

How would this system work while some claimants are still claiming the existing means-tested benefits and tax credits?

This system could be amended to allow for some families who are still on the existing set of means-tested benefits and tax credits. If the rent component of HB were counted as income for means test for rate rebates to offset the allowance set equal to a family's rent, the system would be very similar for those on Universal Credit and those on the existing set of means-tested benefits and tax credits. This would, however, increase the cost of rate rebates, as it would involve moving to sequential income assessment for HB and rate rebates, lowering the effective withdrawal rate for rate rebates. Under the default Council Tax support scheme in England, it is proposed that the 'applicable amount' is calculated differently for those on Universal Credit and those on the existing set of benefits and tax credits: in this case, there would be no need to make changes for those on one of the existing benefits and tax credits.

Option 2: Not counting Universal Credit as income in the rate rebate means test

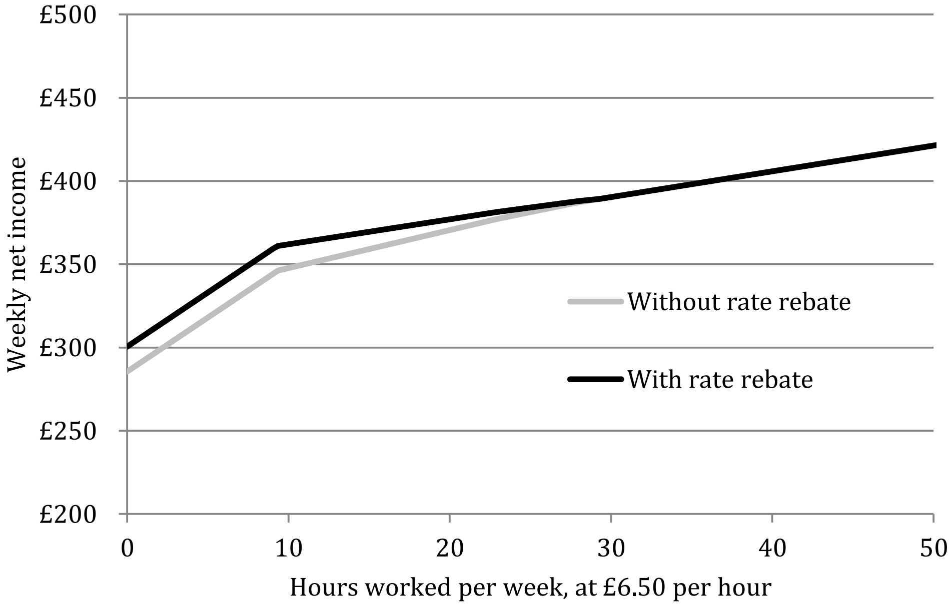
An alternative to the default scheme for England that might be administratively easier to implement, as it would not require information on how much Universal Credit a family is receiving to be transferred from DSD to the NIHE or LPS, would be to ignore Universal Credit income for the purposes of the rate rebate means test. Since there would cease to be a need for allowances set equal to a family's maximum entitlements to out-of-work benefits and CTC (see previous discussion), these allowances could be abolished. In this option we assume that:

- Unearned income would cease to be counted in the means test for rate rebates to prevent the situation where an additional pound of income from contributory benefits, private pensions or spousal maintenance led to total social security payments falling by more than £1.
- Childcare costs up to £175 per week for one child and £300 per week for two or more children would continue to be deducted from income for the purposes of the means test for rate rebates.

These decisions are both expensive as they lead to higher levels of rate rebate being received by those with large amounts of unearned income, and a more generous system of support for childcare costs.

Figure 4.4 shows how this form of rate rebate would affect the budget constraint for a lone parent with two children.

Figure 4.4: Budget constraint for a lone parent with two children with Universal Credit and rate rebate replacement scheme of the form described in the text



Notes: Assumes lone parent with two children who can choose how many hours to work at a given wage rate, £6.50 per hour, and has rent of £80 and domestic rates of £15 per week, no disability and no other income.

How much would this option cost, and who gains and loses?

We can see that in this case, the simultaneous withdrawal of Universal Credit and rate rebates lead higher EMTRs across the income range from 10 to 30 hours per week, reaching a peak of 84.4%. Rate rebates would still not start to be withdrawn until income reached this level because lone parents would have significant allowances to offset their private income against in the means test for rate rebates: lone parents have a £25 *de minimis* disregard plus allowances set equal to the amount of child benefit they receive.

This system would not significantly affect the cost of rate rebates. There are several offsetting effects that mean some claimants receive a higher rate rebate under this replacement scheme than at present, and other effects that mean that others receive less:

- The abolition of CTC and WTC (which are counted as income for the purposes of the rates rebate means test at the moment) increase spending on rate rebates. This means that those currently receiving these benefits receive a larger rate rebate as a result.
- Ceasing to count unearned income in the means test for rate rebates further increases the cost of rate rebates as this means those who have income from contributory benefits, spousal maintenance or private pensions receive a larger rate rebate.
- Removing the allowances we discuss, however, reduces the cost of rate rebates. This tends to reduce the rebate received by low earners.

Thus, although this option is roughly revenue-neutral, there would be winners and losers: we estimate that around 20,000 families would receive a larger rate rebate and 34,000 a lower one under this rate rebate replacement scheme. Those who would receive a higher rebate tend to be those who have significant amounts of unearned income (and who, as we discussed in Chapter 3, tend to lose out from the introduction of Universal Credit: the higher rate rebate would only slightly offset this effect). By contrast, those who receive less are those who are in paid work. This is because they lose out from the reduced allowances that cause rate rebates to start to be withdrawn from a lower level of income.

How would this option work while some claimants are still in the current system of benefits and tax credits?

Reducing or abolishing the allowances we discuss here would not be sensible while there are still families claiming the existing set of benefits and tax credits as it would lead a situation where some people would be worse off after a pay rise. Therefore, if this system were to be considered before the transition to Universal Credit were complete, there would need to be separate systems for those on the existing set of means-tested benefit and tax credits and for those on Universal Credit. Of course, a similar system could be introduced that did not involve reducing allowances to avoid this problem, but this would be expensive: this option is only revenue neutral because the cost of not counting unearned income in the means test is offset by savings from reducing allowances.

Option 3: Ensuring that, wherever possible, entitlement to rate rebates is exhausted at the point where Universal Credit starts to be withdrawn

We saw in Chapter 3 that one of the main advantages of the introduction of Universal Credit was that it would remove the very high EMTRs that exist in the current tax and benefit system. Both of the options we have considered so far would undermine this achievement, as these systems of rate rebates involve the tapers for rate rebates and Universal Credit overlapping, creating a higher maximum EMTR than would be created by Universal Credit alone. A system of rate rebates that ensured that the tapers for rate rebates and Universal Credit did not overlap wherever possible would be desirable, as it would avoid very high EMTRs. This could be achieved in almost all cases by increasing the rate rebate withdrawal rate to 65% (the same rate as for Universal Credit) and starting to withdraw rate rebates from the first pound of private income. The option we model here involves the following changes to rate rebates:

- Counting Universal Credit as income in the means test;
- Introducing allowances set equal to a family's maximum Universal Credit entitlement (as in Option 1; in practice this would involve adding an allowance set equal to a family's rent or maximum LHA entitlement);
- Abolishing all other allowances, namely the *de minimis* disregards and allowances set equal to a family's child benefit entitlement (as we previously noted, because child benefit is not counted as income in the means test for rate rebates, these allowances are not necessary to prevent a family from being entitled to a full rate rebate if they are receiving child benefit and do not have any private income); and
- Increasing the withdrawal rate for rate rebates to 65%.

Figure 4.5 shows the impact of this system of rate rebates on the budget constraint faced by the example lone parent we examined earlier in this section. We can see that in this case, the tapers for rate rebates and Universal Credit do not overlap: entitlement to rate rebates ends before Universal Credit starts to be withdrawn. The lone parent now has an EMTR of 65% in the income range where rate rebates are withdrawn, then a 0% EMTR in the income range after entitlement to rate rebates is exhausted but before Universal Credit starts to be withdrawn, at which point it increases to 65% again. This system of rate rebates is much more aggressively means-tested than both the current system and the other systems we have considered so far: support is withdrawn very quickly when income rises and is exhausted entirely after the lone parent works for just a few hours per week. We can see that this system would dramatically reduce the number of in-work claimants of rate rebates.

Figure 4.5: Budget constraint for a single person without children with Universal Credit and rate rebate of the form described in the text

Notes: Assumes single person without children who can choose how many hours to work at a given wage rate, £6.50 per hour, and who has rent of £80 and domestic rates of £20 per week, no disability and no other income.

It is theoretically possible for the Universal Credit and rate rebate tapers to overlap in this replacement scheme. However, this requires a family to have a domestic rate liability that is significantly larger than the average for Northern Ireland, have a low disregard under Universal Credit (all those without children will have a disregard of £1,330 per year in 2013–14) and a very low income. In the example below of a single person without children who has a domestic rates liability of £20 per week, we see that there is a very small range of income where the individual's EMTR is nearly 89%, but even in this case it is only over a very small range of hours at low numbers of hours worked per week. Because very few people with high domestic rates liabilities have such low incomes, there are negligible numbers of individuals with this very high EMTR in our empirical analysis in Section 4.4.

How much would this system cost, and who gains and loses?

As the figures above make clear, the number of in-work families entitled to rate rebates would fall dramatically under this system, and it would therefore be cheaper overall than the current system. We estimate that this scheme would cost around £18 million per year less than the combined cost of the current system of rate rebates and the supplementary low-income rate relief. A small number of families (around 7,000) receive a larger rate rebate under this system: as with Option 1, these are those who receive less in Universal Credit than they received in tax credits under the previous system and hence see their income for the purposes of the rate rebate means test fall. However, far more families (around 43,000) would receive less as a result of the more aggressive means testing introduced by this option.

How would this system work while some claimants are still claiming the existing means-tested benefits and tax credits?

It would not be sensible to introduce a system like this within the current framework of means-tested benefits and tax credits. The abolition of all disregards would not be sensible as the EMTR at very low levels of income is already 100% because of the pound-for-pound withdrawal of out-of-work benefits. If this option were to be introduced, the Northern Ireland Executive would have to wait until all working age people in Northern Ireland had been transferred to Universal Credit or had separate systems for those on Universal Credit and the existing system of means-tested benefits and tax credits.

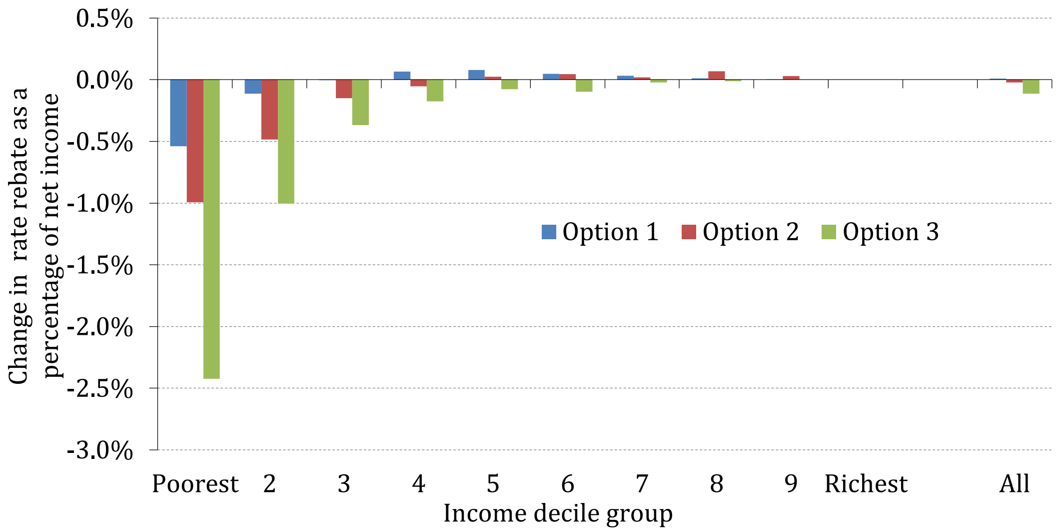
4.4 Comparing the reforms

This subsection compares the distributional and work incentive impacts of the three reforms outlined in the previous subsection.

Distributional impact of the reforms

Figures 4.6 and 4.7 show the distributional impact of the three reforms considered in Section 4.3 by income decile group and family type.

Figure 4.6: Change in average rate rebate as a percentage of net income by income decile under the three options for rate rebate replacement schemes discussed in the text

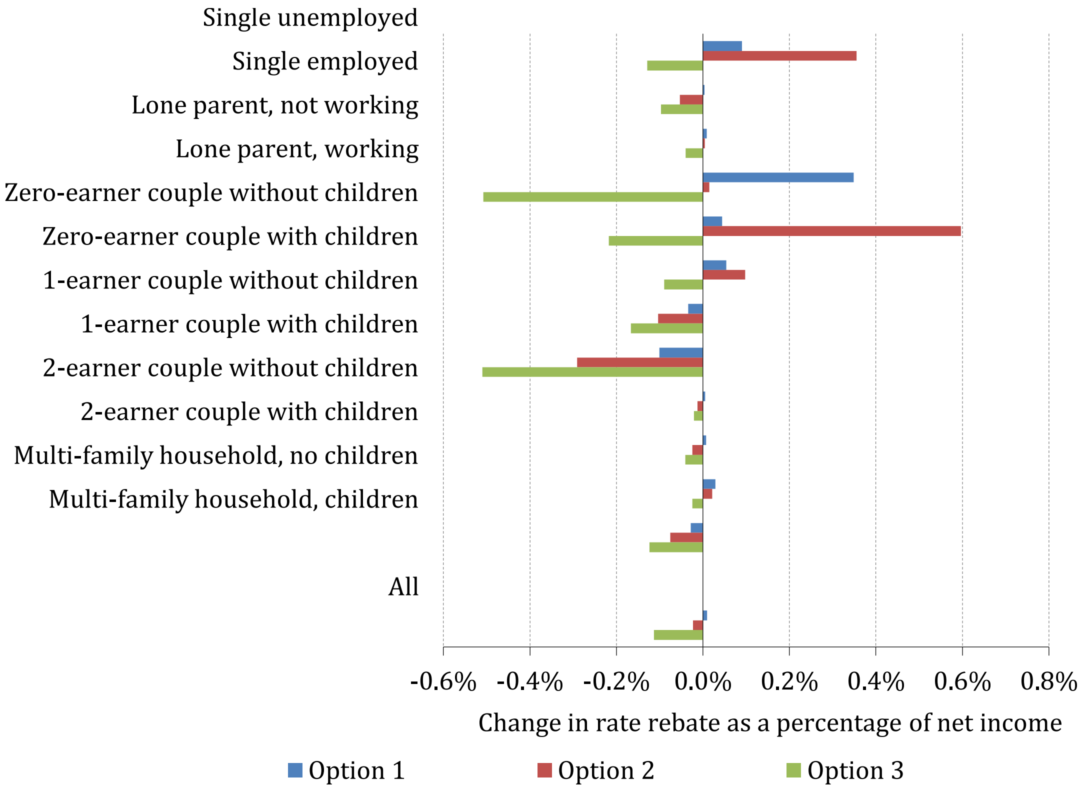


Notes: Income decile groups are derived by dividing all families in Northern Ireland into 10 equal-sized groups according to income adjusted for household size using the McClements equivalence scale. Decile group 1 contains the poorest tenth of the population, decile group 2 the second poorest, and so on up to decile group 10, which contains the richest tenth.
Source: Authors' calculations using TAXBEN run on 2009–10 and 2010–11 Family Resources Survey.

As we saw in the previous Section, options 1 and 2 are roughly revenue-neutral, but have winners and losers from the reforms. Option 1 is the most distributionally neutral overall, whereas option 2 has a larger number of losers but fewer winners (though the average gain among winners is larger). Those who receive a smaller rate rebate under these options are low earners who lose out as rate rebates start to be withdrawn at lower levels of earnings. Those who receive a larger rate rebate are those with substantial amounts of unearned income (who are either not in paid work or lone parents in paid work receiving spousal maintenance from a former partner), but it is worth noting that this group loses out from the introduction of Universal Credit. These options would simply moderate the loss these groups would receive from the introduction of Universal Credit that we saw in Chapter 3.

By contrast, option 3 represents a significant reduction in the cost of rate rebates. We can see that most of the saving results from lower rebates for those in paid work: working lone parents and single-earner couples with children are the most affected. This is because of the much more aggressive means test under this option, which removes entitlement to rate rebates for almost all of these types of family.

Figure 4.7: Change in average rate rebate as a percentage of net income by household type under the three options for rate rebates discussed in Section 4.3



Source: Authors' calculations using TAXBEN run on 2009–10 and 2010–11 Family Resources Survey.

Impact on work incentives

As we saw in Chapter 3, Universal Credit strengthens the incentive to do paid work for those who have the weakest incentives to do so under the current system of benefits and tax credits. When we also consider the impact of the rate rebate schemes we consider here, PTRs are slightly higher, though much of the benefit of Universal Credit is maintained: as Table 4.3 shows, very few people face PTRs of more than 80% under any of the options for integrating rate rebates with Universal Credit we have considered in this chapter. Thus, because domestic rates in Northern Ireland are lower on average than Council Tax in Great Britain, the design of the rates rebate replacement scheme has less potential to weaken work incentives in Northern Ireland than new Council Tax Support schemes do in Great Britain. Nevertheless, there are differences between the three options. Option 1, which is similar to the default scheme in England for Council Tax support, has the fewest number of people with PTRs above 60%. This is because this is the most generous of the three systems towards those in paid work: because those with low earnings lose less of their rate rebate when they move into paid work, they face lower PTRs under this option. Option 2, in which Universal Credit is not counted as income for the rate rebate means test, has slightly more people with a PTR above 60% as rebates are withdrawn more quickly on moving into paid work than in Option 1. Option 3 involves the fewest number of people with PTRs above 70%, though the most with PTRs between 50% and 70%. The very aggressive means test in this option, with the rates rebate taper being 65% and rates rebates starting to be withdrawn from the first pound of private income means that many more people have PTRs in this range. Fewer though have a PTR above 70%. This is because, although means testing rates rebates more aggressively weakens work incentives for the first earner in a couple, it strengthens work incentives for those who have a partner in paid work as it reduces the income they would receive if they did not work.

Table 4.3: Participation tax rates under different options for rate rebates after the introduction of Universal Credit

	Without rate rebates	*Option 1*	*Option 2*	*Option 3*
<10%	92,000	88,000	89,000	81,000
10.01–20%	135,000	132,000	130,000	135,000
20.01–30%	166,000	164,000	160,000	159,000
30.01–40%	242,000	228,000	227,000	224,000
40.01–50%	142,000	141,000	140,000	142,000
50.01–60%	121,000	122,000	120,000	124,000
60.01–70%	87,000	103,000	114,000	120,000
70.01–80%	7,000	16,000	14,000	10,000
80.01–90%	0	—	—	—
90.01%+	—	—	—	—

Notes: Figures rounded to nearest 1,000. — indicates negligible number. Excludes employer NICs and indirect taxes and most 'business taxes' (notably corporation tax and business rates) and capital taxes (notably inheritance tax, stamp duties and capital gains tax). Only includes those non-pensioner families. Earnings for those not in paid work calculated as specified in Chapter 3.
Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated Family Resources Survey data from 2008–09 and 2009–10.

Table 4.4: Effective marginal tax rates under different options for rate rebates under Universal Credit

	Without rate rebates	*Option 1*	*Option 2*	*Option 3*
<10%	44,000	36,000	37,000	44,000
10.01–20%	14,000	21,000	20,000	14,000
20.01–30%	45,000	44,000	45,000	45,000
30.01–40%	391,000	391,000	391,000	391,000
40.01–50%	54,000	56,000	54,000	54,000
50.01–60%	8,000	8,000	8,000	8,000
60.01–70%	50,000	46,000	39,000	50,000
70.01–80%	80,000	83,000	87,000	80,000
80.01–90%	—	—	3,000	1,000
90.01%+	0	0	0	0

Notes: Figures rounded to nearest 1,000. — indicates negligible number. Excludes employer NICs and indirect taxes and most 'business taxes' (notably corporation tax and business rates) and capital taxes (notably inheritance tax, stamp duties and capital gains tax). Only includes those in paid work in non-pensioner families.
Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated data from the 2009–10 and 2010–11 Family Resources Survey.

4.4 Summary

The reforms to CTB in Great Britain being introduced in April 2013 have consequences for the funding of rate rebates in Northern Ireland. Instead of the costs of the rates component of Housing Benefit being funded in full by the UK Treasury, the Northern Ireland Executive will be given a grant equal to 90% of what would have been spent. This means that it will no longer be the case that mirroring the systems of support for local taxes in Great Britain will be such an attractive option (the UK Government only promised to refund the costs of the rates element of Housing Benefit in full if parity was maintained). The Northern Ireland Executive will therefore have the chance to reconsider how it provides support for low income families with their domestic rates and redesign the system to focus on its own priorities. An obvious change that could be made straight away would be to formally merge the rates component of

Housing Benefit with the supplementary low-income rate relief, which would reduce confusion for claimants.

The introduction of Universal Credit will also require some changes to be made to the existing system of rate rebates. One key question will be whether to count Universal Credit as income in the means test. It would be simpler not to from an administrative perspective, but counting Universal Credit as income does moderate the maximum EMTR faced by workers in contrast with the option that we examine that does not count Universal Credit as income, which reintroduces some of the very high EMTRs, above 80%, that Universal Credit was supposed to eliminate. The UK Government's default scheme for the design of Council Tax rebates in England does count Universal Credit as income in the means test, and therefore involves a lower maximum EMTR, though this applies to more people. This would be an obvious model for the Northern Ireland Executive to consider. But there are other options: in this section we have examined an option where Universal Credit is not counted as income in the rate rebate means test, and a more aggressively means-tested option that attempts to avoid the high EMTRs caused by overlapping tapers wherever possible. The latter option minimises the number of people with EMTRs and PTRs above 70%, but involves increasing the number of people with PTRs between 50% and 70% and significantly reduces rate rebates for working families.

The introduction of Universal Credit also has implications for the administration of rate rebates in Northern Ireland. The introduction of Universal Credit will mean that the means-tested out-of-work benefits that are currently used to 'passport' families to a full rebate will cease to exist, and there is no obvious equivalent passport in Universal Credit that would identify which families are entitled to a full rebate. More than 70% of recipients are passported in this way, and if they had to go through a full means test, the burden on both claimants and administrators would increase substantially. Ways around this problem include merging the administration of Universal Credit and rate rebates, allowing claimants to claim both with the same form and transferring the administration of rate rebates for those of working age to DSD, or transferring information on Universal Credit claims from DSD to LPS or the NIHE so that claimants would not have to submit the same information twice.

As IFS researchers have pointed out elsewhere,[46] keeping local tax support schemes separate from Universal Credit has the potential to undermine two of the key advantages of Universal Credit we observed in Chapter 3, namely the simplification offered and the stronger work incentives provided. As domestic rates in Northern Ireland are lower on average than Council Tax in Great Britain, support for local taxation is a correspondingly smaller component of the overall benefit system in Northern Ireland, and so this issue is less important in Northern Ireland than in the rest of the UK. Nevertheless, keeping support for domestic rates will definitely make the overall benefits system more complicated, and could lead to the reintroduction of the very high overall withdrawal rates that Universal Credit was supposed to eliminate. How much this happens in practice will depend on decisions made by the Northern Ireland Executive surrounding the design and administration of rate rebates.

[46] See in particular Adam and Browne (2012).

CHAPTER 5
Other non-Social Security benefits and Universal Credit

In Chapter 4, we mentioned how the introduction of Universal Credit would cause problems for the administration of rate rebates because the out-of-work benefits that are used to passport families to a full rebate will be abolished. The rates component of Housing Benefit is not the only scheme run by the Northern Ireland Executive that uses this passport to identify low-income families, however. Many of the same issues we discuss in Chapter 4 also arise in the administration of other non-social security benefits that will remain separate from Universal Credit. The Northern Ireland Executive has formed a working group to consider options post introduction of Universal Credit. In this section, we discuss these schemes and consider the options and opportunities available to the Northern Ireland Executive.

5.1. Non-Social Security benefits in Northern Ireland

The Northern Ireland Executive provides means-tested in-kind support to low income families in a number of areas. In a number of cases, these means tests are linked to those for out-of-work social security benefits and the 'passports' that are currently used will no longer exist once Universal Credit is introduced. The particular schemes that use such passports are as follows:

- The Department for Health, Social Services and Public Safety provides a number of forms of means-tested support that are based on receipt of an out-of-work benefit. In particular, families in receipt of an out-of-work benefit can receive free dental treatment, free optical treatment, assistance with travel to hospital, and free Healthy Start vouchers and vitamins for pregnant women and young children. Together these measures cost around £30 million a year in Northern Ireland.
- Private-sector tenants and owner-occupiers claiming one of these benefits are also eligible for the Warm Homes Scheme, which enables them to help with the costs of insulation measures and new heating systems for their homes. This costs around £15 million a year.
- The Department for Employment and Learning provides support to low-income families claiming one of these benefits in a number of ways. In particular, children can receive free school meals and help with the cost of school clothing if their parents receive one of these benefits. Together these cost £29 million a year.
- The Special Support Grant for higher education (HE) students is only available to those who are claiming other means-tested benefits. The cost of this and other means-tested grants for HE students is £69 million a year.
- The Legal Aid means test uses a similar 'passport' to full entitlement for those who are entitled to one of these out-of-work benefits, and there are also exemptions from some court fees and assistance with the cost of visiting family members in prison for those entitled to these benefits. Means-tested support for other claimants is also available. The cost of these schemes in Northern Ireland is around £100 million a year.
- The Department for Social Security offers various grants, including the Disabled Facilities Grant, Home Repairs Assistance Grant, Replacement Grant, Renovation Grant and Group Repair Grant to those on out-of-work benefits.
- The Northern Ireland Memorial Fund, which offers grants to those who have suffered as a result of the conflict in Northern Ireland.
- Those claiming one of these out-of-work benefits can receive discounts for entry to Ulster American Folk Park, at golf clubs and leisure centres, arts classes, assistance with dog licence fees and with the costs of non-public health pest control treatments. These schemes are all operated by the Department of the Environment.

As well as these benefits that rely on passports from social security benefits to identify those eligible for support, there are other forms of means-tested support in Northern Ireland. These are around support for students attending schools and Further and Higher Education Colleges and based on parental income. Furthermore, receipt of Free School Meals is used as a proxy deprivation indicator for schools to determine how much funding schools receive.

All of these means-tested forms of support weaken work incentives, just as means-tested cash benefits do. In particular, the 'cliff edge' created by families losing entitlement to all of these non-social security benefits as soon as their entitlement to an out-of-work benefit runs out leads to a situation where families are effectively worse off after a pay rise. The introduction of Universal Credit offers the Northern Ireland Executive an opportunity to consider these benefits and to ensure that resources are efficiently focused on its own priorities.

5.2 Options for the reform of non-social security benefits

The introduction of Universal Credit gives the Northern Ireland Executive the opportunity to consider the rationale behind the existence of these non-social security benefits. There are several reasons why governments might wish to provide support to low-income families in forms other than cash benefits. For example, they might wish to provide insurance against the possibility of having to pay large one-off costs. Or it may be the case that low-income households are subject to credit constraints that mean they are unable to purchase goods or services that have a large upfront cost but yield benefits over a period of time. Providing additional support enables poorer families to overcome these constraints. Alternatively, governments might want to encourage consumption of particular goods or services. When examining the non- social security benefits that are provided in Northern Ireland, one can see where such arguments might apply. For example, the Northern Ireland Executive might want to provide insurance for low-income families against large dental and legal costs. Low-income families may face credit constraints that would render them unable to purchase home insulation or participate in Further or Higher Education in the absence of additional support, despite the ongoing benefits of doing so. And it may be the case that families do not value healthy school meals as much as the Northern Ireland Executive would wish.

The question remains though as to why the Northern Ireland Executive would wish to provide these benefits only to lower-income households. This is easier to justify in some cases than in others: it is certainly true that lower-income households are more likely to face credit constraints, and it may be more reasonable to expect higher-income households to self-insure against the costs of dental care and optical treatment than low income households who might otherwise find such treatment completely unaffordable, particularly if they faced credit constraints. For others of these benefits, it is less clear cut. The Northern Ireland Executive might wish to consider whether some of these benefits should be given to everyone, or abolished completely. For example, until 2010 free prescriptions were only given to those on one of the 'passport' benefits, before prescription charges were abolished altogether. In a similar vein, the Northern Ireland Executive could decide that no one should have to pay for dental charges, or that everyone should.

Assuming that it was considered desirable to keep some of these benefits means-tested, there are few attractive options available. The most obvious option would be to withdraw these benefits when income crossed a particular income threshold. This would, however, create a 'cliff edge' whereby some people would be worse off if they increased their earnings slightly, which is not a sensible feature of any tax and benefit system.[47] The current benefit system avoids this in most cases because people become entitled to Working Tax Credit at the same point that they lose entitlement to an out-of-work benefit because of the hours rules that exist under the current system. Although benefit run-ons or fixing awards for a particular length of time might partly alleviate these concerns by preventing an individual entering work from

[47] Optimal tax theory shows that it is always possible to improve on a tax system with EMTRs above 100%. See Mirrlees (1971).

losing all their benefits in kind immediately, this would still be a concern for them in the longer run. The alternative of withdrawing benefits more gradually (through an income taper) would not seem sensible in this case: it would be administratively complicated, and it is not clear how one could receive only a portion of any of these benefits. What might be possible, though, is for claimants to choose which benefits in kind they wish to receive, and agree to pay for these benefits out of their Universal Credit award, which would increase with income. This would effectively amount to benefits in kind being offered to all Universal Credit recipients and the taper rate for the cash amount received for those who do opt to receive them being increased above 65%. Presumably this would lead to those who were out of work opting to receive all of these benefits (as they would not have to pay for them), whereas those in work would only take up a minority of them (depending on which they considered to be worth the cash they would be giving up), leading to the same outcome as the current system and avoiding any 'cliff edges'. Acknowledging the attractiveness, but also the administrative complexity, of such an approach, the UK Government has agreed to consider introducing such a system for England in the next Spending Review.[48]

Assuming that an income threshold is the only option that would be available in the short term, the abolition of the 'passport' benefits that are currently used to identify families with particularly low incomes will mean that a new threshold will have to be found once Universal Credit is introduced. There is no obvious equivalent 'yes/no' indicator in Universal Credit to identify the exact same group of families who would currently be entitled. Although there are many candidates for such an indicator that could serve as a passport (e.g. having zero earnings; receiving maximum Universal Credit; having a Universal Credit award that includes a disability or a child element, being subject to benefit conditionality; etc.), none of these would give entitlement to exactly the same group of families as the current system. Some families who no longer received these benefits, and others who became eligible. There would be cost implications also depending on the total number of families who would be eligible.

5.3. Summary

The introduction of Universal Credit will mean that the conditions for receiving a range of non-social security benefits will have to be reconsidered. The abolition of the out-of-work benefits that are currently used to identify families entitled to these benefits will mean that, at the very least, new means of identifying those families who are entitled to these benefits will have to be found.

More fundamentally though, the introduction of Universal Credit also offers an opportunity for the Northern Ireland Executive to consider the rationale for providing benefits in kind rather than in cash, and whether these benefits should be means tested or offered universally. For those benefits it is decided to retain as means-tested benefits in kind, the most obvious solution would be to give these benefits only to families with incomes below a certain threshold. This would, however, create 'cliff edges' that would make some people worse off after a pay rise. A longer-term solution would be to allow claimants to choose which benefits in kind they wish to receive, and agree to pay amount for these benefits out of their Universal Credit award which would increase according to their income. This would be more administratively complex, but would avoid the 'cliff edges' inherent in alternative approaches.

[48] See http://www.dwp.gov.uk/docs/ssac-rev-of-pass-bens.pdf for further details.

CHAPTER 6

Conclusions

Universal Credit represents a significant simplification of the benefit system in the UK, making it less confusing and easier to navigate for claimants. By rationalising a jumble of overlapping means tests into a single one, it rationalises work incentives and removes some of the extremely high effective tax rates that can exist under the current system. Assuming that Universal Credit is introduced in Northern Ireland on a parity basis, the main beneficiaries will be single-earner couples, and the main losers will be those with large amounts of unearned income or capital and some single claimants of disability benefits.

As incomes are relatively low in Northern Ireland, any reform to means-tested benefits will have greater effects there than in the UK as a whole. There are therefore both more winners, and more losers from the introduction of Universal Credit in Northern Ireland than when we examine the UK as a whole. The overall average reduction in benefit entitlements resulting from Universal Credit's introduction however is larger in Northern Ireland than in the UK as a whole. This is for two reasons. First, the higher prevalence of worklessness in Northern Ireland increases the number of losers as workless families lose out slightly on average from Universal Credit's introduction. Second, Northern Ireland has an unusually large number of claimants of Disability Living Allowance compared with the UK as a whole, and single claimants of the middle and higher rates of the care component of DLA will significantly lose out from reforms to support for those with disabilities being introduced alongside Universal Credit. However, single-earner couples with children in Northern Ireland gain more from the introduction of Universal Credit than their counterparts in the UK as a whole. This is because average earnings are relatively low in Northern Ireland and the additional support for this group is focused on those with low earnings. An important caveat to bear in mind is that our analysis does not account for non take-up of means-tested benefits, and that as take-up of means-tested support is likely to increase as a result of Universal Credit's introduction, increasing the incomes of those who do not currently take up all of their benefit entitlements.

As in the rest of the UK, Universal Credit will strengthen the work incentives of those in Northern Ireland who have the weakest work incentives at the moment. However, it will weaken work incentives for those who have a working partner, and particularly do so in Northern Ireland, as lower earnings levels mean that there will be greater entitlement to Universal Credit for two-earner couples (and potential two-earner couples) in Northern Ireland than in the rest of the UK.

However, both of the key advantages of Universal Credit's introduction could be undermined by the fact that rate rebates and other forms of in-kind means-tested support will continue to exist outside of Universal Credit. As domestic rates in Northern Ireland are lower on average than Council Tax in Great Britain, support for local taxation is a correspondingly smaller component of the overall benefit system in Northern Ireland, and so this issue is less important in Northern Ireland than in the rest of the UK. Nevertheless, keeping support for domestic rates will definitely make the overall benefits system more complicated than it need be, and could lead to the reintroduction of the very high overall withdrawal rates that Universal Credit was supposed to eliminate. One key question where a decision will have to be made will be whether to count Universal Credit as income in the means test. It would be simpler not to from an administrative perspective, but counting Universal Credit as income does moderate the maximum EMTR faced by workers: the option that we examine here that does this reintroduces some of the very high EMTRs, above 80%, that Universal Credit was supposed to eliminate. The UK Government's default scheme for the design of Council Tax rebates in England does count Universal Credit as income in the means test, and would be an obvious model for the Northern Ireland Executive to consider.

The introduction of Universal Credit also has implications for the administration of rate rebates and other non-social security benefits in Northern Ireland. The introduction of Universal Credit will mean that the means-tested out-of-work benefits that are currently used to 'passport' families to a full rebate will cease to exist, and there is no obvious equivalent passport in Universal Credit that would identify which families are entitled to a full rebate. More than 70% of recipients are passported in this way, and if they had to go through a full means test, the burden on both claimants and administrators would increase substantially. Ways around this problem include merging the administration of Universal Credit and rate rebates, allowing claimants to claim both with the same form and transferring the administration of rate rebates for those of working age to DSD, or transferring information on Universal Credit claims from DSD to LPS or the NIHE so that claimants would not have to submit the same information twice.

Universal Credit also offers an opportunity for the Northern Ireland Executive to consider the rationale for providing benefits in kind rather than in cash, and if certain benefits in kind are to continue being provided whether they should be means tested or offered universally. For those benefits that it is decided to retain as means-tested benefits in kind, the most obvious solution would be to give these benefits only to families with incomes below a certain threshold. This would, however, create 'cliff edges' that would make some people worse off after a pay rise. A longer-term solution would be to allow claimants to choose which benefits in kind they wish to receive, and agree to pay for these benefits out of their Universal Credit award, with the cost increasing according to their income. This would be more administratively complex, but would avoid the 'cliff edges' inherent in alternative approaches.

The UK Government and Northern Ireland Executive have taken a welcome big and radical step forward by proposing the introduction of Universal Credit. But many of the advantages it will bring could be undermined by the decision to keep support for local taxes separate from Universal Credit. Decisions to be made by the Northern Ireland Executive around the design of a rate rebate replacement scheme and other non-social security benefits will therefore determine the extent to which this will happen.

Appendix A. Measuring work incentives

In this analysis, we distinguish between the incentive for individuals to undertake paid work at all, and the incentive for those in paid work to slightly increase their earnings.

The incentive to work at all

We measure the incentive to work at all by examining the participation tax rate (PTR). PTRs give the proportion of earnings that are not taken away in tax or lower benefit entitlements when an individual starts work, i.e.

$$PTR = 1 - \frac{in\ work\ income - out\ of\ work\ incomegross\ earnings}{}$$

Therefore, someone whose income after taxes and benefits was £50 if they did not work and £200 if they did work, earning £250, would have a PTR of 40%.

Note that:

- Net income means income after benefits have been added and taxes deducted.
- Low numbers indicate that the incentive to work is strong and vice versa. A PTR of 0% would indicate that an individual did not have to pay any tax on their earnings and did not lose any benefit entitlement when they started work. A PTR of 100% would indicate that all of an individual's earnings would be taken from them in tax or lower benefit entitlements if they worked, so they would be no better off in paid work than not working. High PTRs are sometimes referred to as the 'unemployment trap'.
- For individuals in couples, it is possible to calculate the PTR using individual or family income, and this choice will affect our impression of the strength of the financial reward to work. In this report, we use family income.

The incentive to earn more

The incentive for those in work to increase their earnings can be measured by the effective marginal tax rate (EMTR). The EMTR measures how much of a small change in employer cost is lost to tax payments and forgone state benefit and tax credit entitlements, and it tells us about the strength of the incentive for individuals to increase their earnings slightly, whether through working more hours, or through promotion, qualifying for bonus payments or getting a better-paid job. Throughout this report, we use the term 'incentive to earn more' for all these possibilities.

As with the incentive to work at all, low numbers mean stronger financial incentives. An EMTR of zero means that the individual keeps all of any small change in what their employer pays, and a rate of 100% means that the individual keeps none. High EMTRs amongst workers in low-income families are often referred to as 'the poverty trap'.

Appendix B.
Comparing entitlement and receipt of the rates component of Housing Benefit in our data with administrative data

The IFS tax and benefit microsimulation model, TAXBEN, calculates families' entitlements to the rates component of Housing Benefit. However, not all families take up the benefits to which they are entitled. In Chapter 4, to model this non take-up of rate rebates, we assume those families in our Family Resources Survey (FRS) data who report receipt of CTB take it up, and some other families, in order that we match the numbers claiming in administrative data. In this appendix, we give details of the numbers claiming and entitled in our FRS data and the administrative data provided by the Department of Finance and Personnel in Northern Ireland (DFPNI).[49]

Table B.1 shows the number of families in owner-occupied housing entitled to and claiming rate rebates in our FRS data, and the administrative data provided by DFPNI from Land and Property Services (LPS).

Table B.1: Numbers entitled to and claiming the rates component of Housing Benefit in our FRS data and numbers of claimants: owner-occupiers, 2012–13

	Number claiming in FRS	*Number entitled in FRS*	*Actually claiming, 2012–13*
Pensioners:			
–Passported	20,970	42,010	30,810
–Non-passported	9,297	30,138	13,256
Working age:			
–Passported	7,843	23,551	16,604
–Non-passported	4,719	13,423	10,375
Total	42,829	109,122	71,045

Sources: Numbers claiming from 2008–09 and 2009–10 Family Resources Survey, numbers entitled using TAXBEN run on 2008–09 and 2009–10 Family Resources Survey, numbers actually claiming from LPS data provided by DFPNI.

Table B.2: Numbers entitled to and claiming the rates component of Universal Credit in our FRS data and numbers of claimants: renters, 2011–12

	Number claiming in FRS	*Number entitled in FRS*	*Actually claiming, 2011–12*
Pensioners:	32,296	39,111	31,614
Working age:			
–Passported	52,682	57,845	97,883
–Non-passported	10,658	14,058	22,717
Total	108,478	111,759	152,214

Sources: Numbers claiming from 2008–09 and 2009–10 Family Resources Survey, numbers entitled using TAXBEN run on 2008–09 and 2009–10 Family Resources Survey, numbers actually claiming from LPS data provided by DFPNI.

We can see that there is substantial non take-up of the rates component of Universal Credit among owner-occupiers in Northern Ireland (the overall take-up rate is 65% among this group), and that this is most prevalent among pensioners who are not passported to full entitlement through receipt of Pension

[49] The authors would like to note their grateful thanks to Brian McClure of DFPNI for providing this data.

Credit. Furthermore, many people who do in fact receive the rates component of Universal Credit do not report this when surveyed by the FRS.[50] (Another partial explanation might be that take-up increased between the time our survey data was collected in 2008–09 and 2009–10, and 2012–13, the year for which we have administrative data. Administrative data from earlier years was unavailable.)

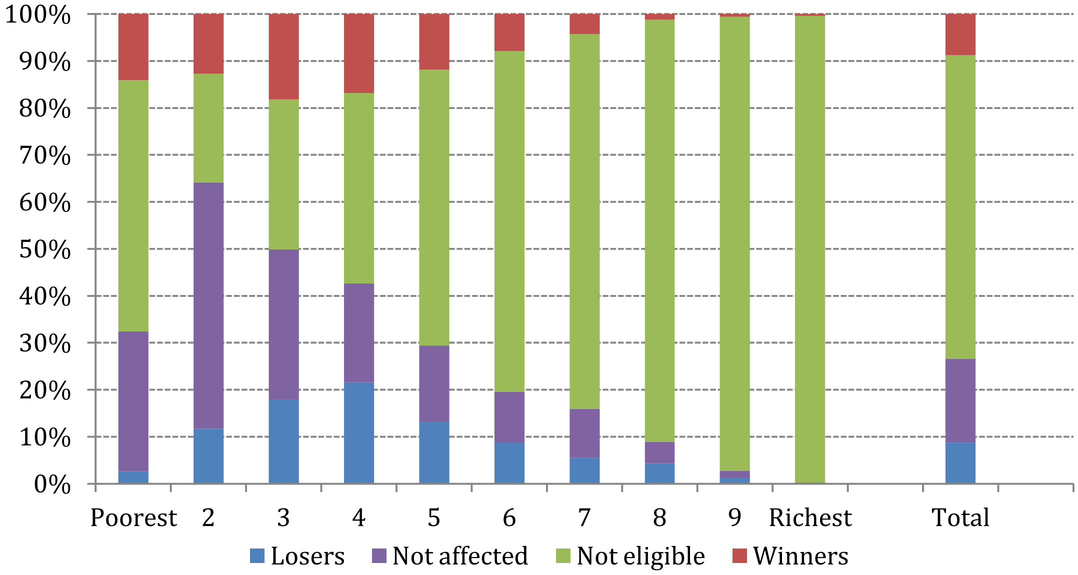
Table B.2 repeats this analysis for renters. In this case, administrative data is from 2011–12. We can see that TAXBEN substantially underestimates the number of working-age people entitled to the rates component of Universal Credit in the rented sector (though slightly underestimates the number of pensioners claiming the rates component of Universal Credit). In our analysis, we therefore assume full take-up of the rates component of Universal Credit among working-age renters in order to get as close as possible to these estimates. A partial explanation for this difference might be that entitlement to the rates component of Universal Credit increased between the time our data was collected in 2008–09 and 2009–10, and 2011–12 (the year for which we have administrative data), perhaps as a result of higher unemployment and lower real earnings resulting from ongoing weakness in the economy.[51] Our costings of the savings resulting from the reforms to rate rebates we consider in Chapter 4 are therefore likely to be underestimates.

[50] This is a widely known problem with survey data; see Appendix D of Cribb, Joyce and Phillips (2012) for more information.

[51] Unemployment in Northern Ireland rose substantially between the end of 2008 and the start of 2011 and has remained persistently high since then.

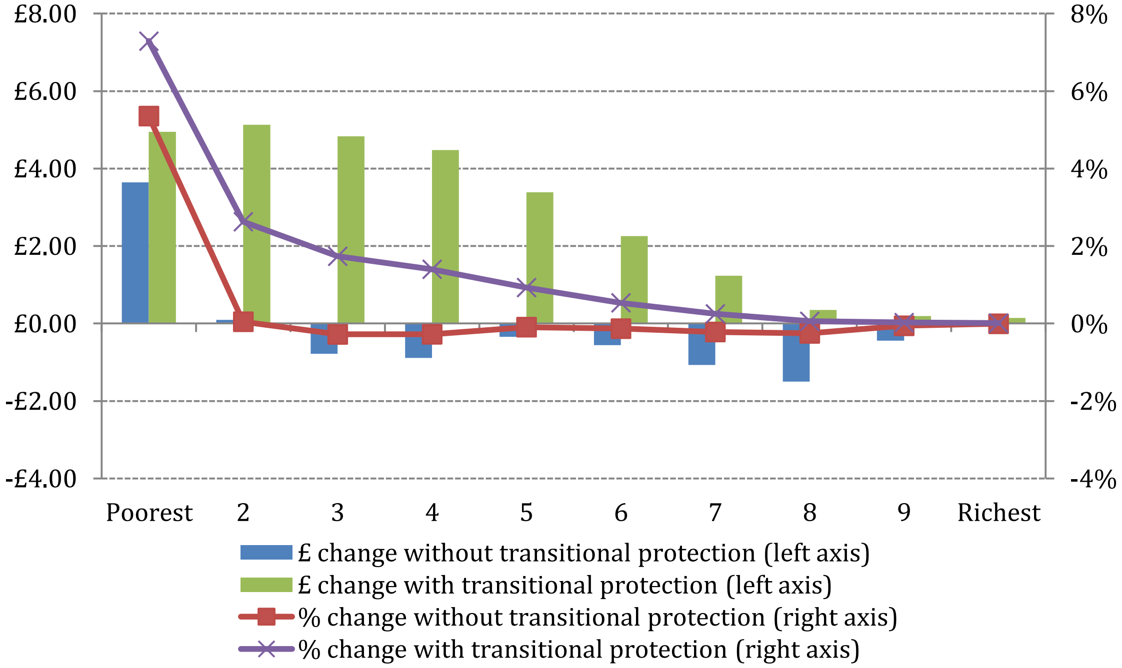
Appendix C:
Figures for the UK as a whole

Figure C.1: Winners and losers by income decile group, without transitional protection, UK as a whole



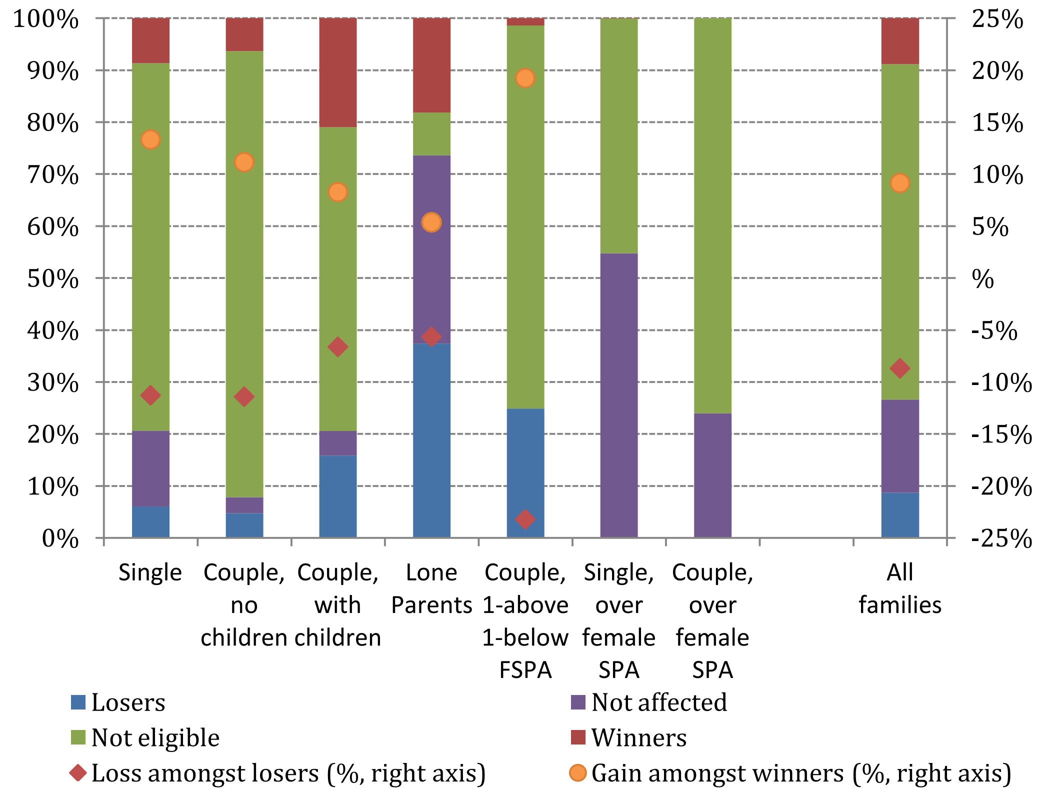
Notes: As for Figure 2.1.
Source: As for Figure 2.1.

Figure C.2: Change in current disposable income by decile group, UK as a whole



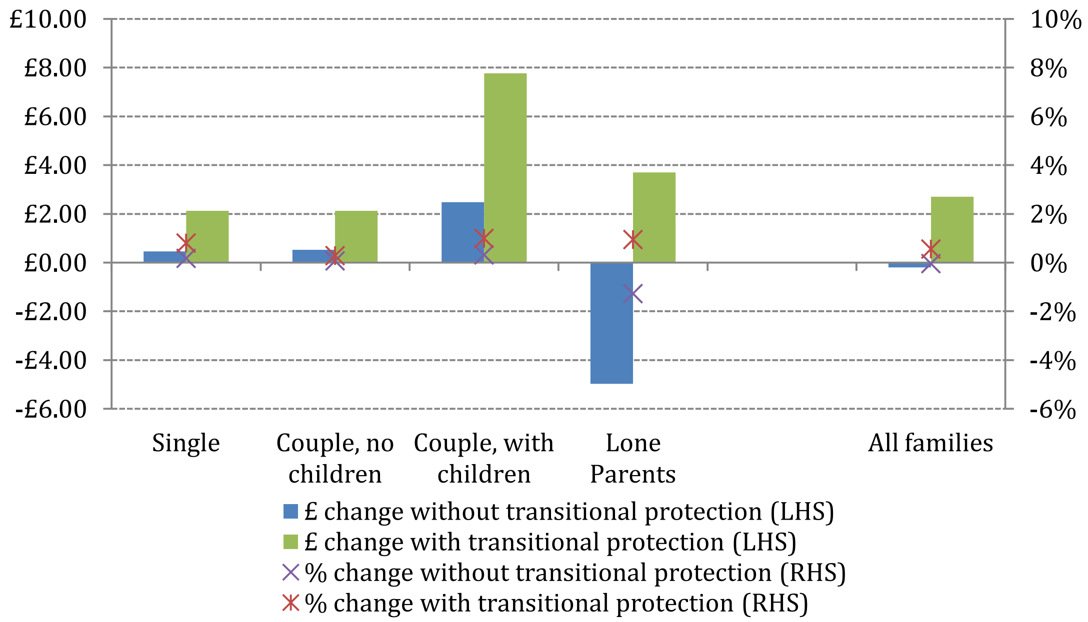
Notes: As for Figure 2.1.
Source: As for Figure 2.1.

Figure C.3: Winners and losers by income decile group, without transitional protection, UK as a whole



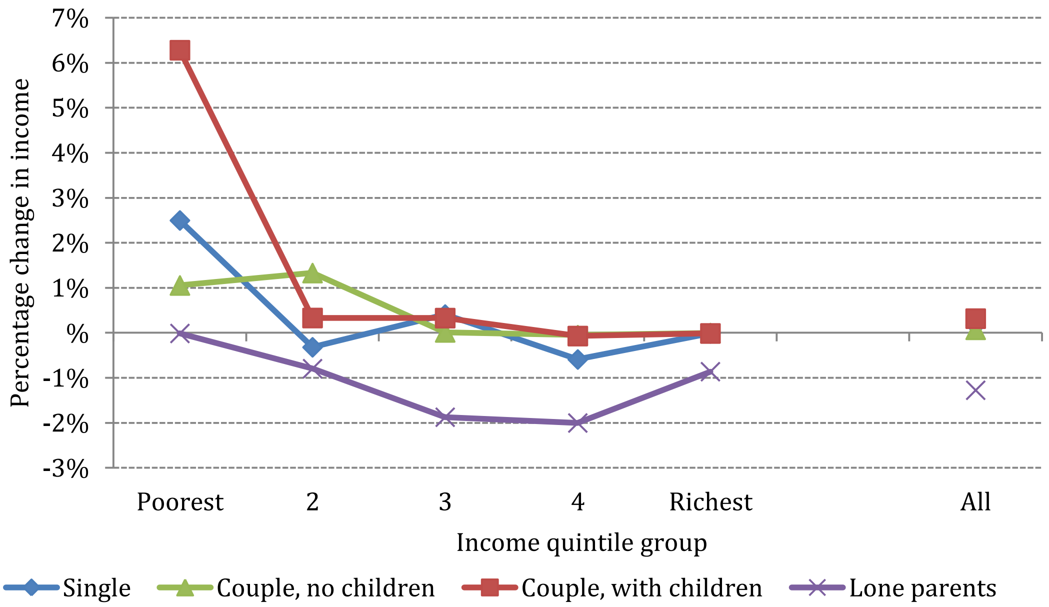
Notes: As for Figure 2.3.
Source: As for Figure 2.3.

Figure C.4: Average impact on disposable income by family type, UK as a whole



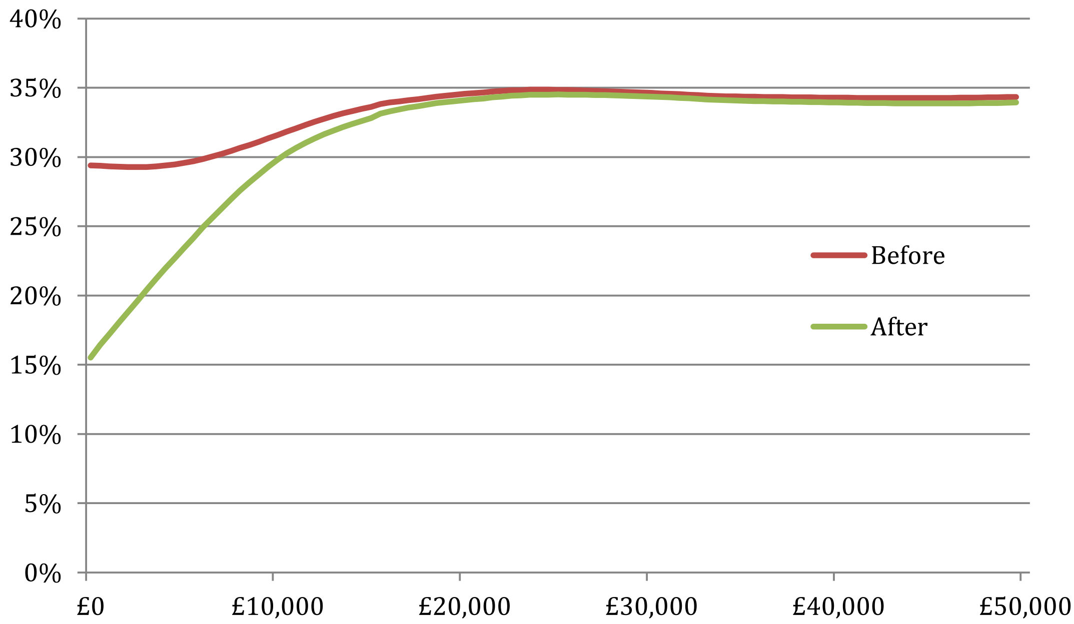
Notes: As for Figure 2.3.
Source: As for Figure 2.3.

Figure C.5: Impact on disposable income by family type and income quintile, without transitional protection, all UK



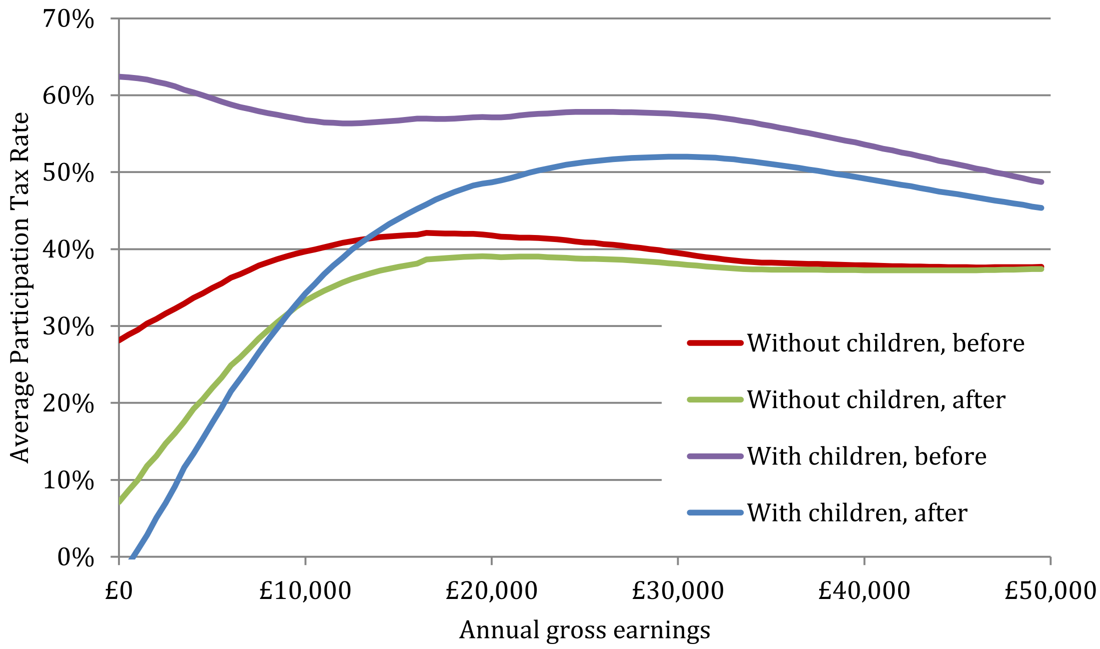
Notes: As for Figure 2.5.
Source: As for Figure 2.5.

Figure C.6: Average PTRs by earnings for both workers and non-workers, all UK



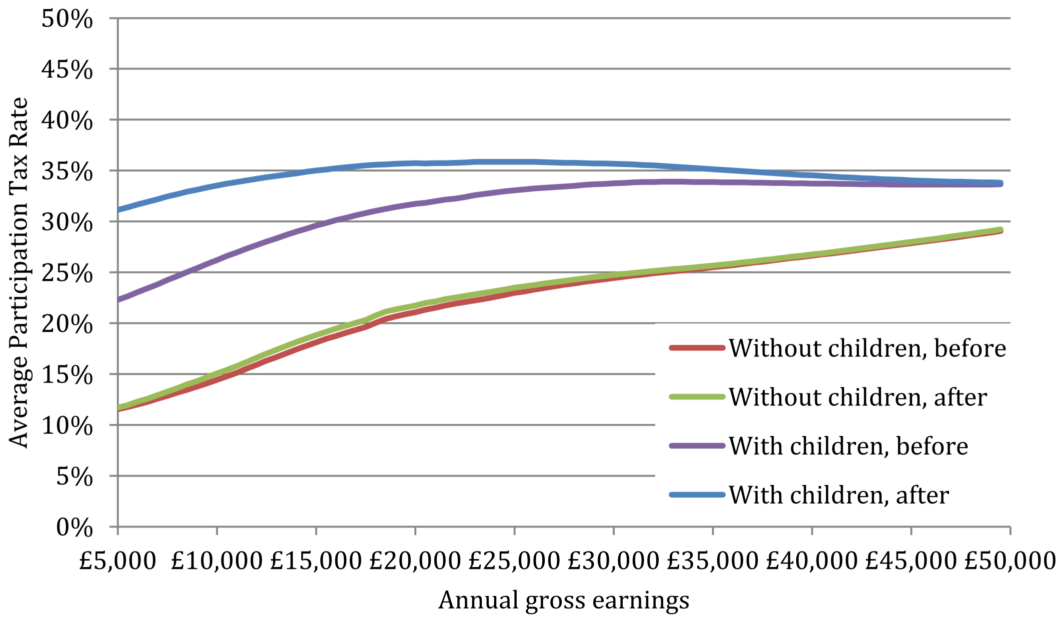
Notes: As for Figure 3.1.
Source: As for Figure 3.1.

Figure C.7: Average PTRs for those in couples where partner does not work, all UK



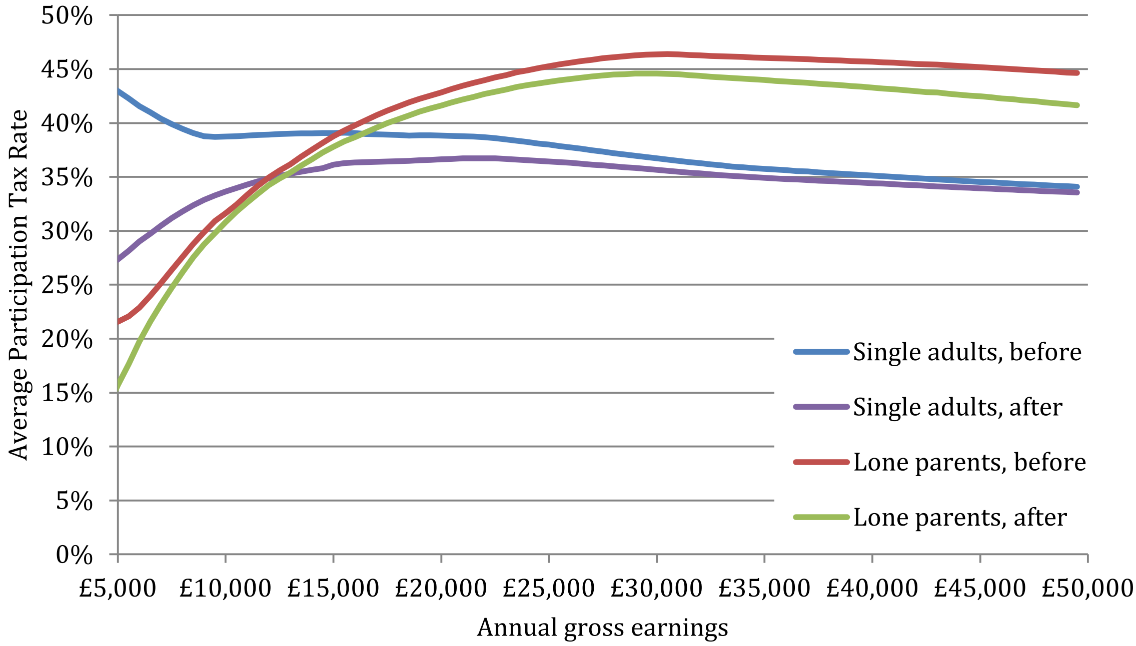
Notes: As for Figure 3.1. Non-parametric regression (lowess) estimates for PTRs.
Source: As for Figure 3.1.

Figure C.8: Average PTRs for those in couples where partner works, all UK



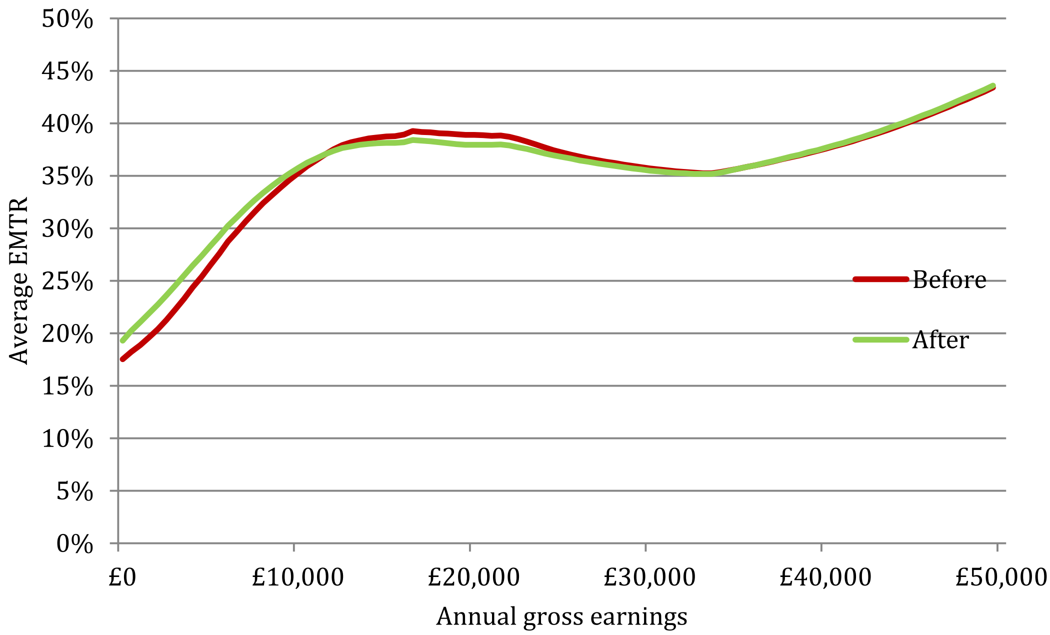
Notes: As for Figure 3.1. Non-parametric regression (lowess) estimates for PTRs.
Source: As for Figure 3.1.

Figure C.9: Average PTR for single adults and lone parents



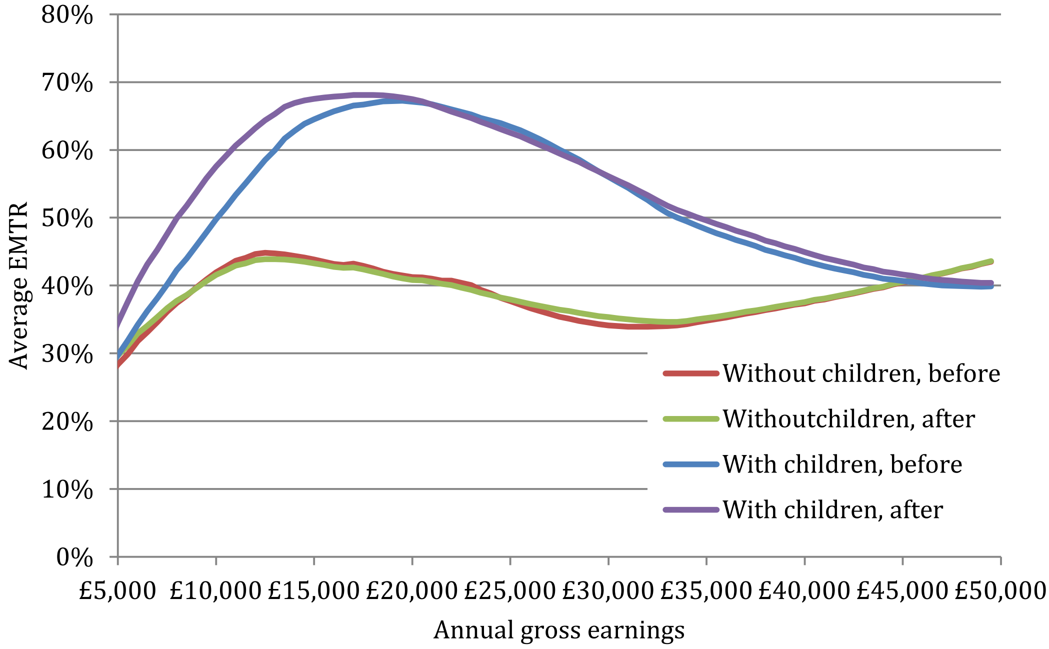
Notes: As for Figure 3.1. Non-parametric regression (lowess) estimates for PTRs.
Source: As for Figure 3.1.

Figure C.10: Average EMTRs by earnings, all UK



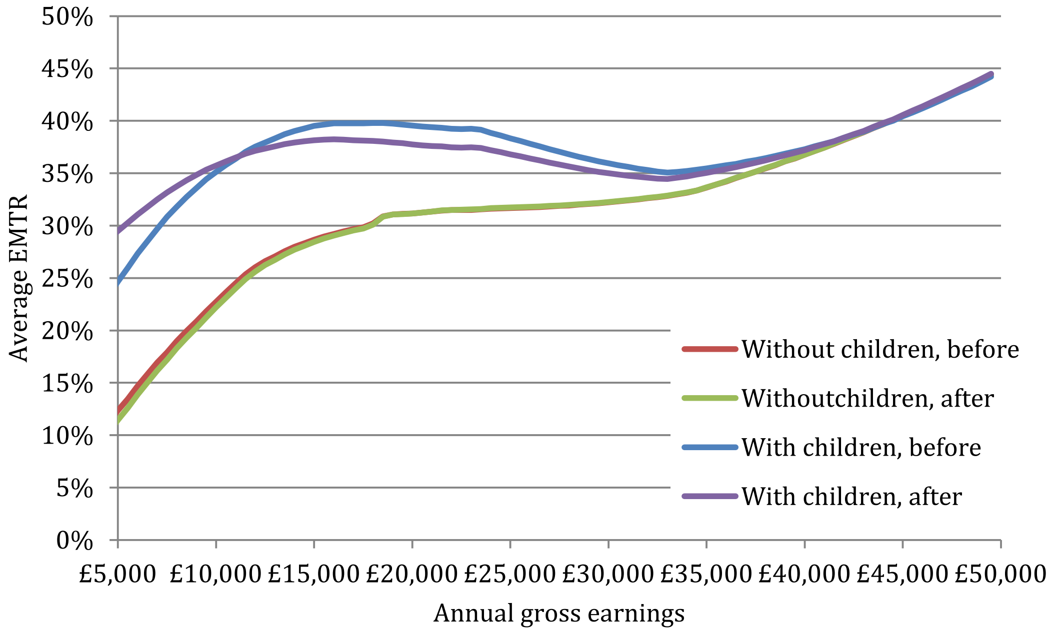
Notes: As for Figure 3.6. Non-parametric regression (lowess) estimates for EMTRs.
Source: As for Figure 3.6.

Figure C.11: Average EMTRs by earnings for single-earner couples, all UK



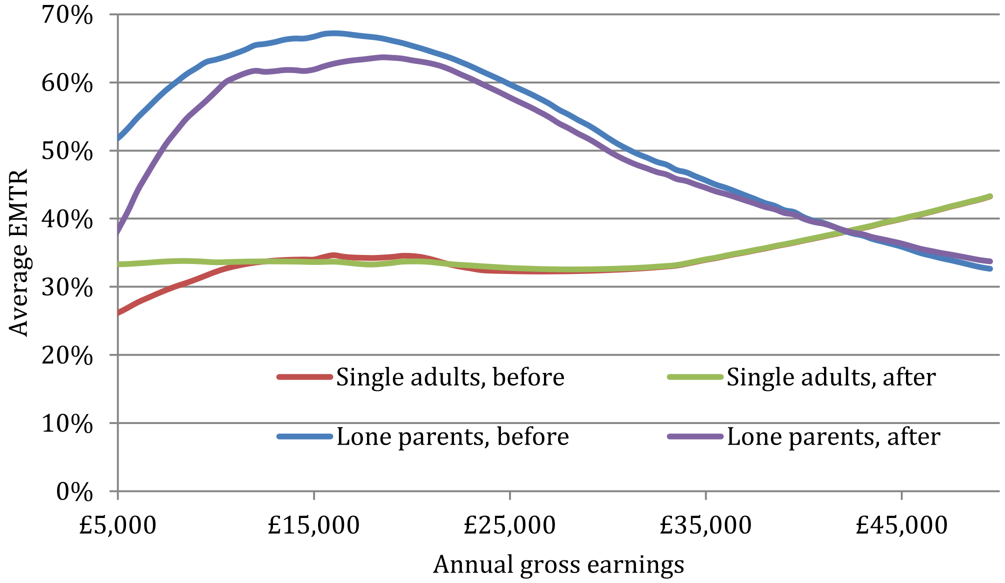
Notes: As for Figure 3.6. Non-parametric regression (lowess) estimates for EMTRs.
Source: As for Figure 3.6.

Figure C.12: EMTRs for those in two-earner couples



Notes: As for Figure 3.6. Non-parametric regression (lowess) estimates for PTRs.
Source: As for Figure 3.6.

Figure C.13: EMTRs for single adults and lone parents



Notes: As for Figure 3.6. Non-parametric regression (lowess) estimates for PTRs.
Source: As for Figure 3.6.

Table C.1: Average change in disposable income by family type and number of adults in work

Family type	*Share of family type*	*Number of adults in work*	*Change in income (£)*	*Change in income (%)*
Single adult aged under female SPA	61%	1	0.72	0.2
Single adult aged under female SPA	39%	0	–1.26	–0.9
Couples without kids, both aged under female SPA	68%	2	–0.18	0.0
Couples without kids, both aged under female SPA	23%	1	4.47	1.0
Couples without kids, both aged under female SPA	9%	0	–7.03	–2.0
Couples with kids, both aged under female SPA	60%	2	2.43	–0.3
Couples with kids, both aged under female SPA	32%	1	16.96	3.0
Couples with kids, both aged under female SPA	7%	0	–4.80	–1.2
Lone parents, aged under female SPA	54%	1	–£5.10	–1.3
Lone parents, aged under female SPA	46%	0	–£2.39	–0.8

Source: As for Table 2.1.
Note: Figures may not sum due to rounding.

Table C.2: PTRs amongst working-age adults before and after introduction of Universal Credit

Participation tax rate	*Number of individuals*			
	Before		*After*	
<10%	3,300,000	10%	3,500,000	10%
10–19.9%	4,600,000	13%	4,800,000	14%
20–29.9%	7,200,000	21%	7,100,000	21%
30–39.9%	8,500,000	25%	8,100,000	24%
40–49.9%	4,500,000	13%	4,400,000	13%
50–59.9%	2,800,000	8%	3,500,000	10%
60–69.9%	1,800,000	5%	2,700,000	8%
70–79.9%	1,200,000	4%	200,000	1%
80–89.9%	300,000	1%	—	0%
90% +	300,000	1%	—	0%

Notes: As for Table 3.1.
Source: As for Figure 3.1.

Table C.1: Participation tax rates by person type

		Participation Tax Rate			
		Without Children		With Children	
		Before	*After*	*Before*	*After*
In a couple and partner does not work	p25	25%	24%	46%	35%
	Median	40%	39%	55%	48%
	p75	53%	49%	68%	57%
	Mean	40%	37%	56%	44%
In a couple and partner works	p25	16%	15%	19%	19%
	Median	22%	21%	32%	33%
	p75	27%	28%	42%	53%
	Mean	22%	22%	31%	35%
Single adult	p25	30%	28%	21%	22%
	Median	36%	35%	37%	36%
	p75	48%	44%	48%	46%
	Mean	39%	35%	35%	33%

Notes and sources: As for Table 3.1.

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