

## **Revised projected numbers of higher rate taxpayers**

Projections for the public finances are based on the assumption that tax allowances and thresholds are indexed in line with retail price inflation. But earnings typically rise by more than inflation, which means that over time a higher proportion of people's earnings fall into the higher tax brackets. This helps explain why in the Pre-Budget Report we see the share of GDP taken in income tax rising from 11.3 percent in 2006-07 to 11.6 percent in 2008-09, at a time when the output gap is constant.

Thanks to fiscal drag and the freezing of the personal allowance this year, the effective higher rate threshold (i.e. the basic rate limit plus the personal allowance) has fallen from 161 percent of average earnings in 1996-97 to 143 percent in 2003-04, which has seen the number of higher rate taxpayers rise from 2.1 million to 3.3 million. The Treasury does not publish its assumptions for earnings growth. But if we were to assume that earnings rose by 2 percent a year on top of inflation (slightly less than the trend rate of increase in productivity), the effective higher rate threshold would drop to 129 percent of average earnings over the next five years.

On our current estimates, fiscal drag alone would increase the number of people paying higher rate income tax to more than 4 million by 2008-09. The number of higher rate taxpayers would be higher still if the dispersion of pre-tax incomes in the population continues to increase as it has in the past. We hope to have a more precise estimate at the time of our Green Budget on 28 January.

**Note to editors:** This replaces the estimate we gave in our post PBR briefing and at the Treasury Select Committee on 16 December that 2 percent real earnings growth per year would increase the number of higher rate taxpayers to 6 million by 2008-09. Apologies for any confusion.