Personal tax and benefit changes

James Browne
What’s coming up

• Pre-announced changes
• Budget measures
  – Income tax allowances
  – Shift to CPI indexation
  – Consultation on integration of income tax and National Insurance
• Distributional effects
Big changes already announced for April 2011

• 1 ppt increase in all National Insurance rates
• Increases in income tax allowance and NICs thresholds
• Reduction in higher rate threshold
  – Means lower combined bill for those on low incomes, higher for those on high incomes and 750,000 more higher-rate taxpayers
April’s income tax and employee NI changes

Combined income tax and employee NI rate

Change in income tax and employee NI payments (right-hand axis)

Gross income

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Big changes already announced for April 2011

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- Increases in income tax allowance and NICs thresholds
- Reduction in higher rate threshold
  - Means lower combined bill for those on low incomes, higher for those on high incomes and 750,000 more higher-rate taxpayers
- Cuts to tax credits and local housing allowance
  - Families with gross income above £41,300 lose their tax credits
- Use of CPI rather than RPI/Rossi to uprate benefits
  - Most means-tested benefits will go up by 3.1% rather than 4.8%
  - Most contributory and universal benefits will go up by 3.1% rather than 4.6%
- All these were confirmed yesterday
Income tax personal allowance – progress to £10k

- Increase to £8,105 in April 2012 announced yesterday
  - Would have been £7,865 if increased in line with RPI in usual way
  - No change in higher rate threshold this time, so everyone on £8k-£116k benefits by £48 a year
Income tax and employee NICs changes

Combined income tax and employee NI rate

Gross income

Change in income tax and employee NI payment

2010–11 rate

2012–13 rate

Change in payments, 2010-11 to 2012-13
Income tax personal allowance – progress to £10k

• Increase to £8,105 in April 2012 announced yesterday
  – Would have been £7,865 if increased in line with RPI in usual way
  – No change in higher rate threshold this time, so everyone on £8k-£115k benefits by £48 a year
  – But pre-announced freeze in higher rate threshold in 2012 offsets this gain for higher rate taxpayers, and increases number of higher rate taxpayers by 500,000
  – Further freeze planned for 2013 increases number by another 300k

• Increasing allowance to £10,000 in 2015–16 would cost £4.1 billion a year if done in this way (i.e. with higher rate taxpayers benefiting)
  – If it was done without higher-rate taxpayers benefiting, would only cost £3.1 billion
  – Though 500,000 more higher-rate taxpayers that way
  – Some of the lower cost comes about because more families would lose child benefit (saving of £200 million on child benefit)
RPI vs. CPI (1)

• From April 2012, the following will be indexed with CPI each year
  – Employee and self-employed NICs threshold
  – Class 2 and 3 NICs flat rates
  – Capital gains tax threshold
  – ISA limit
• But other thresholds will still be increased in line with RPI until the end of this Parliament
  – Employer NICs threshold
  – Age-related allowances and married couples allowance for pensioners
  – Amount of savings income taxed at the 10p income tax rate
• Other changes during this Parliament still going ahead
  – Personal allowance going up at least in line with RPI
  – Freezes in higher rate threshold and inheritance tax threshold
RPI vs. CPI (2)

• Using CPI rather than RPI will mean these thresholds will increase less quickly than they otherwise would have done
• Loss from CPI indexation of employee NI threshold partly offsets gain from higher income tax allowance
  – Will be £240/year lower than would otherwise have been by 2014–15
  – Increases employee NICs payments by £28/year
• Change will raise £1 billion a year by the end of the Parliament
• Increases over time, and increases pace of fiscal drag
• Ambition to increase duty rates in line with CPI too when fiscal position allows
Integrating the operation of income tax and NICs

- Full integration would be a major simplification
- Committed to maintaining the ‘contributory principle’
  - Hard to justify in its current form
- Ruled out extending NICs to pensions & pensioners
- Ruled out extending NICs to savings and dividends
  - Maintains incentives to save
  - But also keeps incentives to convert labour income to capital income
- Consulting on reform
  - Not clear what integrating “the operation” of tax & NICs means
  - So what might they look at...?
Differences between income tax and NICs

• Administration and rules re payment, appeals, legislation, etc
• Availability of reliefs (eg for charitable donations)
• Definition of earnings (eg gratuities, benefits in kind, expenses,...)
• Period of assessment (annual vs weekly/monthly)
• Unit of assessment (per-person vs per-job)
• Treatment of the self-employed
NICs contracted-out rebates

- NICs rates are reduced for people who ‘contract out’ of S2P into a private pension scheme
  - From April 2012, available for defined benefit (DB) pensions only
  - Two thirds of DB scheme members are public sector
- Size of the rebate is reviewed every 5 years to reflect relative value of S2P
- Government Actuary suggested 3 options in February
- Government chose the biggest revenue-raiser
- So rebate will fall in April 2012
  - From 1.6% to 1.4% for employees
  - From 3.7% to 3.4% for employers
- Raising £0.6bn
  - £250m from employees, £350m from employers
Pensions consultations

• Single-tier pension system
  – Bringing together basic state pension and S2P into a single payment
  – Currently estimated at £140 – more than pension credit guarantee
  – Ends contracting out for DB pensions
  – But only for future accruals
  – And keeping contributory system
  – No new details on when and how
  – No increase in cost

• Linking state pension age to longevity more automatically
  – Seems sensible
Distributional effects

- Look at both pre-announced and Budget reforms
  - See http://www.ifs.org.uk/publications/5369 for more details of pre-announced changes
  - Include changes to income tax, NICs and duties announced in Budget

- Key assumptions
  - No behavioural response
  - Pre-tax prices in the economy unaffected
  - Full take-up of means-tested benefits

- All the same as HM Treasury’s analysis
Distributional impact of changes taking effect in 2011

<table>
<thead>
<tr>
<th>Income Decile Group</th>
<th>Pre-announced April</th>
<th>Implemented in January</th>
<th>Budget 2011</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poorest</td>
<td>-2.0%</td>
<td>-1.5%</td>
<td>-1.0%</td>
<td>-0.5%</td>
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<tr>
<td>2</td>
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<td>0.0%</td>
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<tr>
<td>3</td>
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<tr>
<td>4</td>
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<tr>
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<td>2.5%</td>
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<tr>
<td>9</td>
<td>2.0%</td>
<td>2.5%</td>
<td>3.0%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Richest</td>
<td>2.5%</td>
<td>3.0%</td>
<td>3.5%</td>
<td>4.0%</td>
</tr>
<tr>
<td>All</td>
<td>3.0%</td>
<td>3.5%</td>
<td>4.0%</td>
<td></td>
</tr>
</tbody>
</table>

Note: assumes employers increase or reduce wages in response to changes in employer NICs.
Distributional impact of measures to be in place by 2014 – 15

Note: assumes employers increase or reduce wages in response to changes in employer NICs, councils means-test CTB more aggressively.
Incorporating impact of Universal Credit (hypothetical, assuming fully in place in 2014–15)

Note: assumes employers increase or reduce wages in response to changes in employer NICs, councils means-test CTB more aggressively. For Universal Credit assumptions, see IFS Briefing Note 116.
Conclusions

• Changes announced in yesterday’s Budget very minor
  – Increase in personal allowance partly offset by CPI uprating of employee National Insurance threshold

• Welcome consultations on income tax and NI and state pension age

• Our assessment of distributional impact of tax and benefit changes to be in place by 2014–15
  – Within bottom 90% of households, loss as a percentage of income falls as income rises
  – But much less pronounced once full effect of Universal Credit taken into account
  – Very richest households lose the most
Distributional impact of changes taking effect in 2011, overnight effect
Distributional impact of measures to be in place by 2012 – 13

Change in net Income

Income Decile Group

Pre-announced
Budget 2011
Total

Note: assumes employers increase or reduce wages in response to changes in employer NICs
Distributional impact of tax and benefit measures to be in place by 2014–15: by family type
Distributional impact of measures to be in place 2014–15 by region (ranked richest to poorest)

<table>
<thead>
<tr>
<th>Region</th>
<th>Average loss as a percentage of net income</th>
</tr>
</thead>
<tbody>
<tr>
<td>London</td>
<td>-4%</td>
</tr>
<tr>
<td>South East</td>
<td>-3%</td>
</tr>
<tr>
<td>South West</td>
<td>-2%</td>
</tr>
<tr>
<td>Overall</td>
<td>-1%</td>
</tr>
<tr>
<td>East Anglia</td>
<td>0%</td>
</tr>
<tr>
<td>Scotland</td>
<td>1%</td>
</tr>
<tr>
<td>West Midlands</td>
<td>2%</td>
</tr>
<tr>
<td>Yorkshire</td>
<td>3%</td>
</tr>
<tr>
<td>Wales</td>
<td>4%</td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>-4%</td>
</tr>
<tr>
<td>North West</td>
<td>-3%</td>
</tr>
<tr>
<td>East Midlands</td>
<td>-2%</td>
</tr>
<tr>
<td>North East</td>
<td>-1%</td>
</tr>
</tbody>
</table>

Note: assumes councils means-test CTB more aggressively when localised.
Distributional impact of measures to be in place by 2014 – 15

- Change in net Income
- Expenditure Decile Group
- Pre-announced
- Budget 2011
- Total

Note: assumes employers increase or reduce wages in response to changes in employer NICs, councils means-test CTB more aggressively