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## Personal tax and benefit changes

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# 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



# 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
- 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



# 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

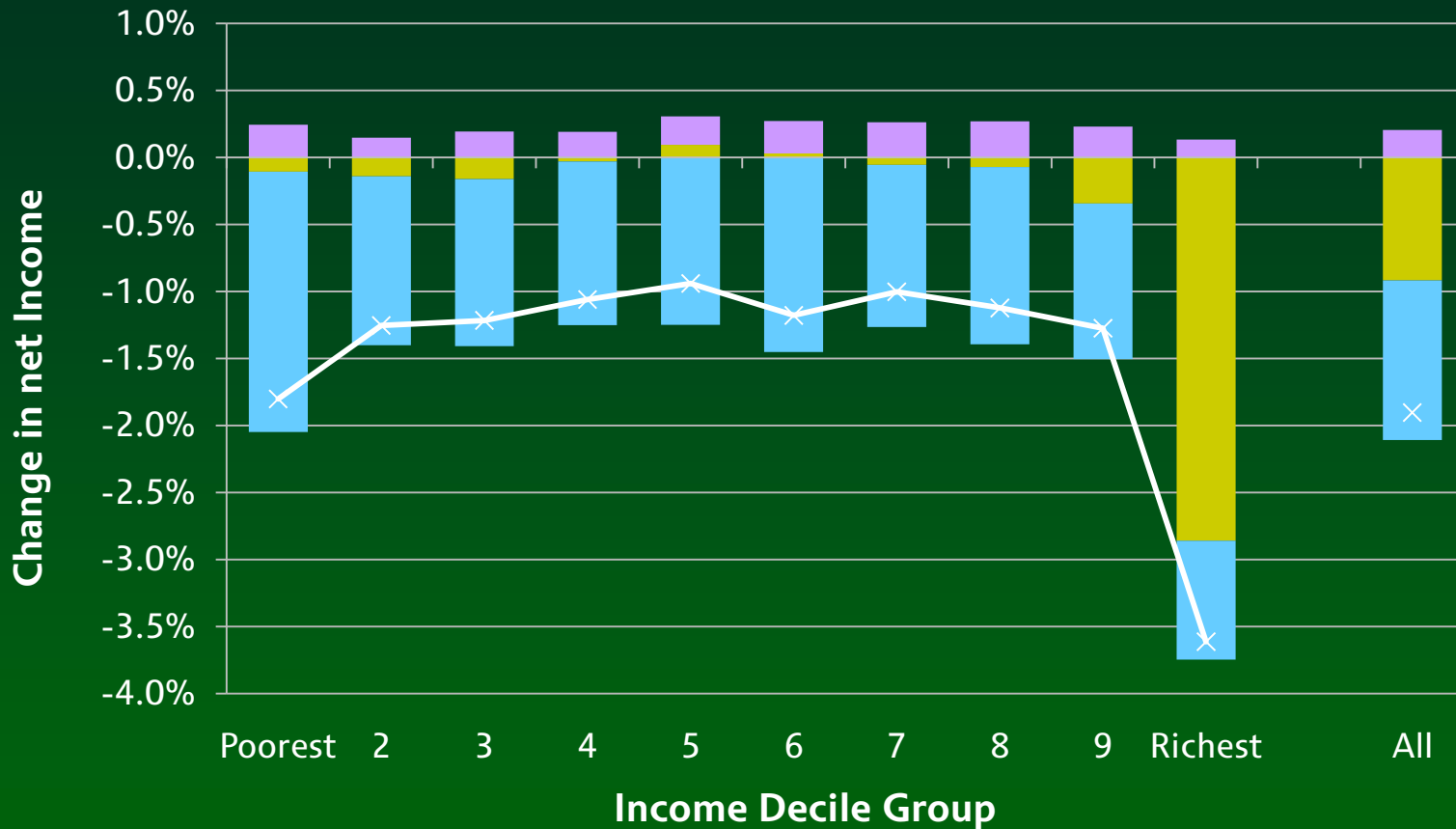
# Pensions consultations

- 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

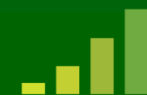
# Distributional effects

- 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



■ Pre-announced April 
 ■ Implemented in January 
 ■ Budget 2011 
 ✕ Total





# Distributional impact of measures to be in place by 2014 – 15

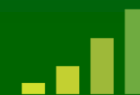


Pre-announced

Budget 2011

Total

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



# Incorporating impact of Universal Credit (hypothetical, assuming fully in place in 2014–15)



■ Pre-announced

■ Budget 2011

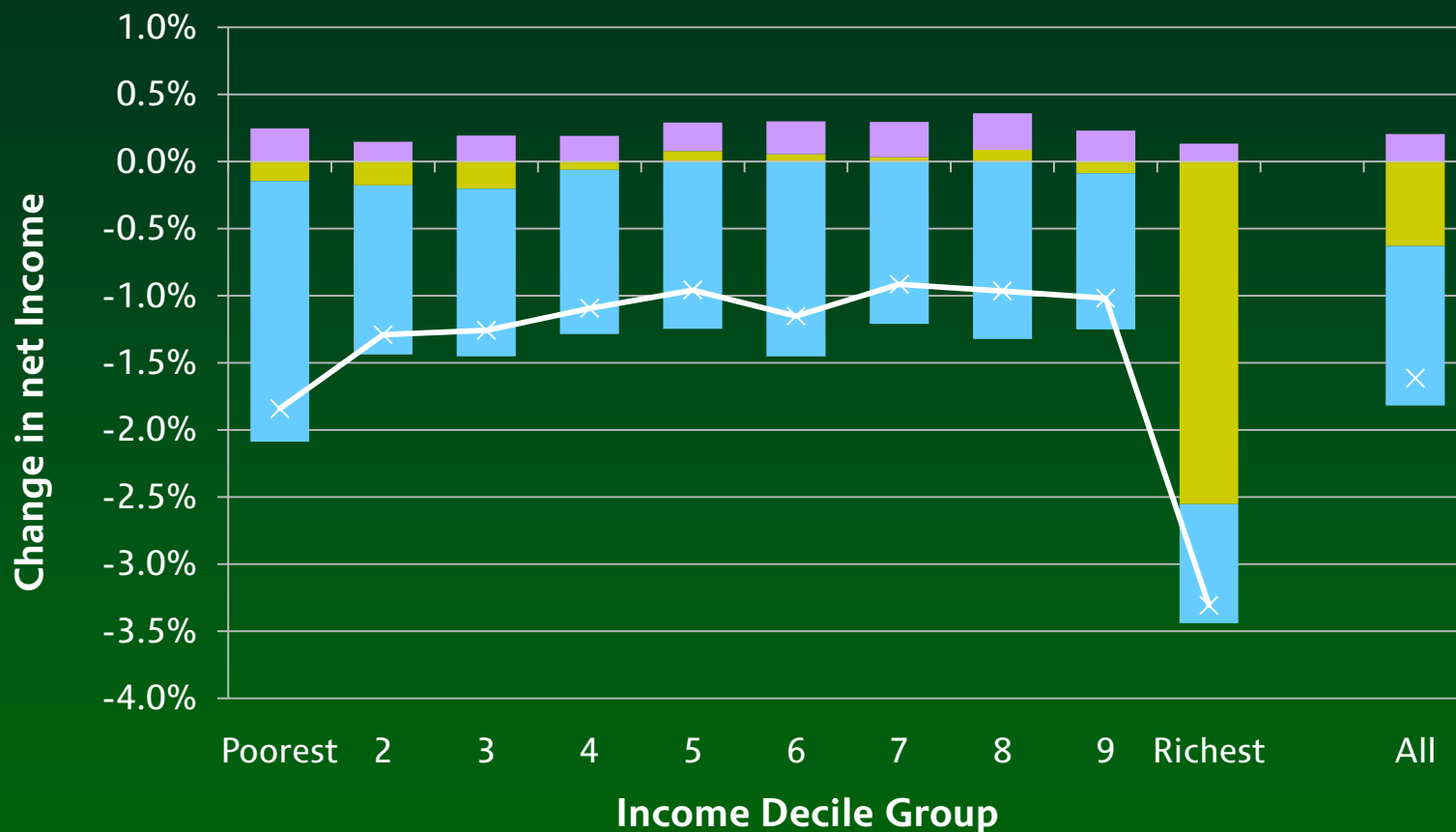
✕ Total

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

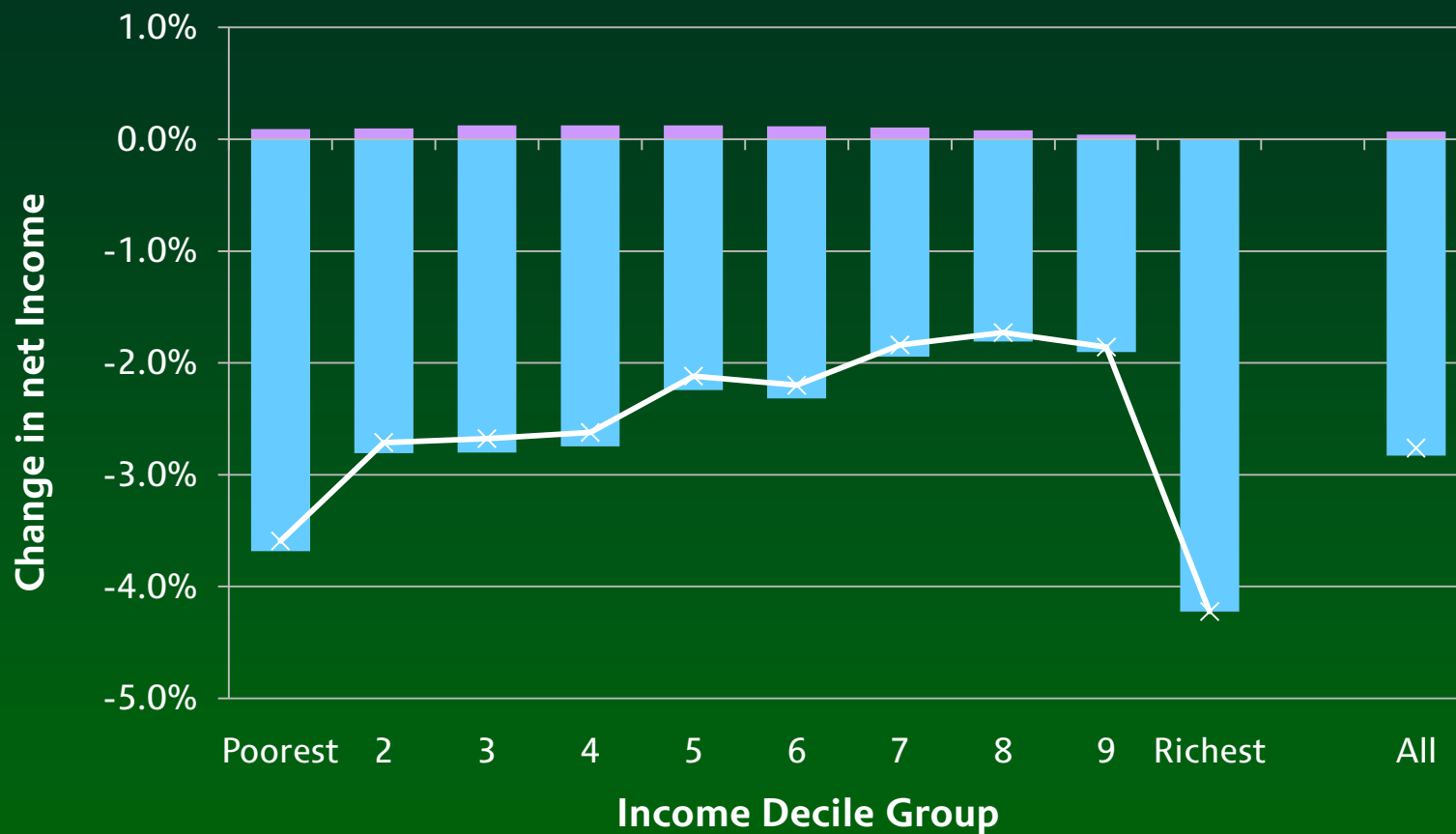


■ Pre-announced April 
 ■ Implemented in January 
 ■ Budget 2011 
 ✕ Total



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# Distributional impact of measures to be in place by 2012 – 13



Pre-announced

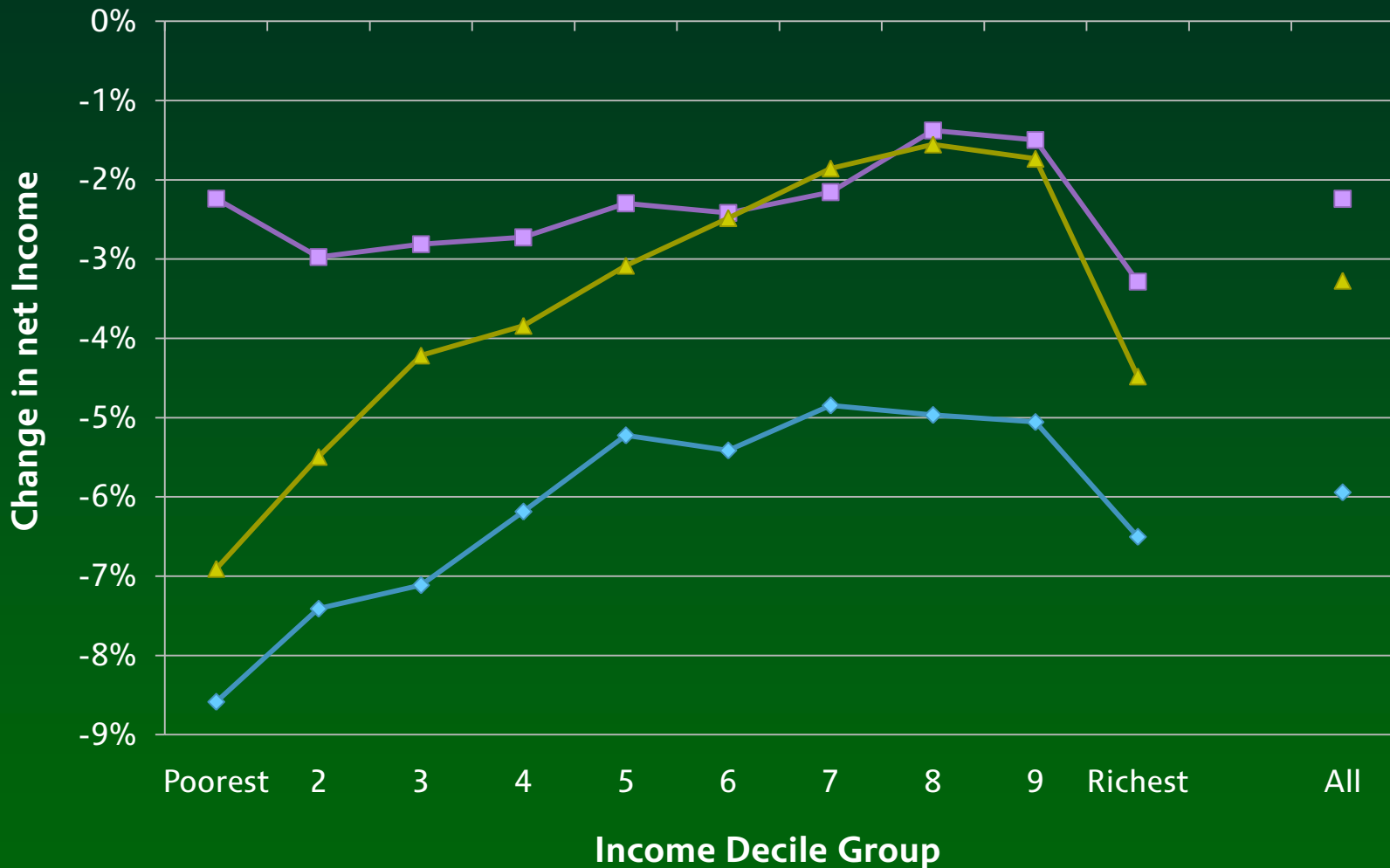
Budget 2011

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



◆ Families with children

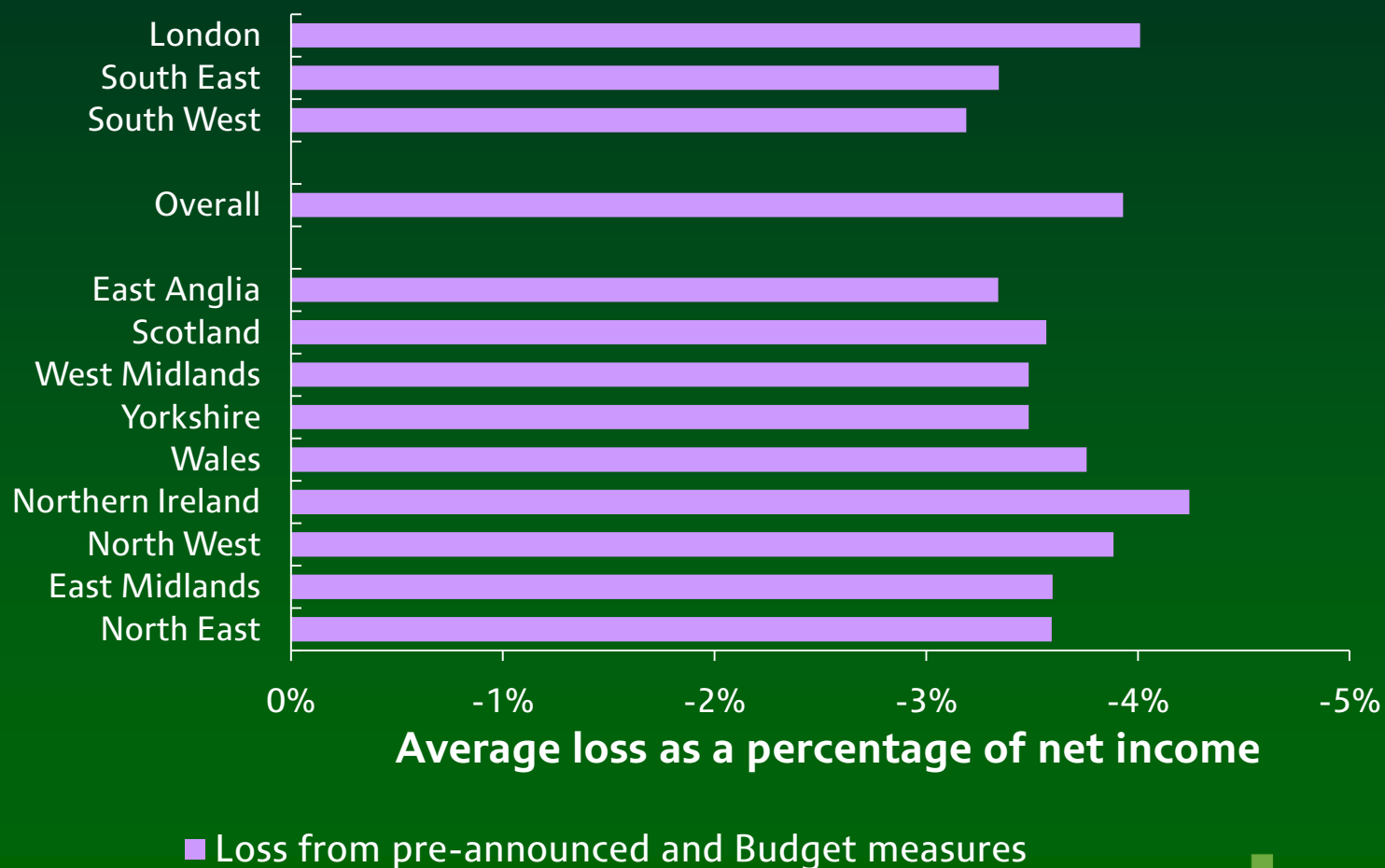
■ Pensioners

▲ Others

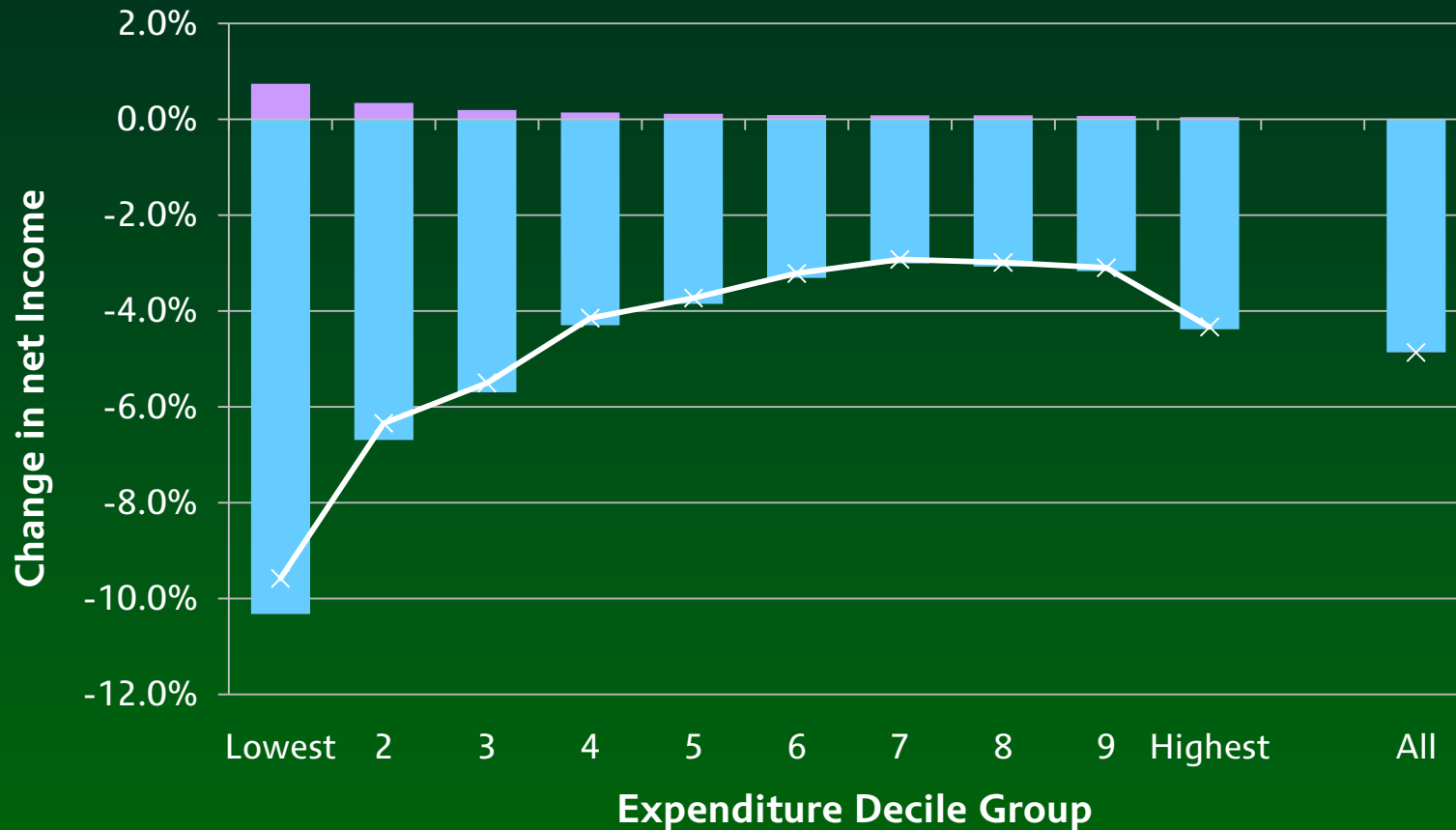


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# Distributional impact of measures to be in place 2014–15 by region (ranked richest to poorest)



# Distributional impact of measures to be in place by 2014 – 15



Pre-announced

Budget 2011

Total

