Tax and benefit changes, excluding those affecting mainly the very rich

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Outline

• Pre-announced reforms to be implemented this April

• Specific measures announced yesterday
  – Changes to income tax personal allowances
  – Change to income-related withdrawal of Child Benefit

• Estimated distributional impacts of reforms under coalition
  – By April 2012; by April 2014
  – By income; by household type

• DISTRIBUTIONAL ANALYSIS IGNORES MEASURES LARGELY AFFECTING THE VERY RICH (MANY OF WHICH CAN NOT BE MODELLLED ROBUSTLY)
Big changes already announced for April 2012

- Income tax allowance up by £210 above indexation; higher rate threshold frozen

- (Funds for) council tax freeze in England

- CPI indexation for benefits/tax credits; now also use CPI for some direct tax thresholds. Implies 5.2% increase for those parameters.
  - Would have been 6.8% for most means-tested benefits
  - Would have been 5.6% for most other benefits and direct tax thresholds

- Other real cuts to tax credits and Child Benefit

- These, plus other changes, bring average net takeaway from tax and benefit reforms under coalition to date to £790 per household in 2012-13
Income tax allowance: more progress to £10,000

• In April 2013, would increase by £250 to £8,355 under default indexation (for those aged under 65)

• Will instead increase by additional £850, to £9,205
  – Costs £3.3 billion in 2013-14
  – Basic rate taxpayers gain £170 per year

• Higher rate threshold lowered so higher rate taxpayers gain only £42.50
  – Creates another 325,000 higher rate taxpayers
  – 15% of taxpayers will face the higher (or additional) marginal rate in 2013-14 (was 3% in 1978-79)

• Additional cost of reaching £10k in 2015-16 is now £1.5 billion in that year (if higher rate threshold unaffected)
What does this achieve?

• Another 840,000 individuals taken out of income tax

• Biggest beneficiaries: families in upper-middle of income distribution
  – Many individuals in lowest-income families pay no income tax anyway
  – Two-earner families gain twice

• Strengthens work incentives for low-earners

• But why fixate on taking people out of income tax and ignore National Insurance (NI)?
  – Raising employee NI threshold (will be £7,592 per year in 2012-13) would reduce tax for even lower earners
The end of age-related income tax allowances

• Currently, those aged 65 and over have larger income tax allowances (£10,500 if aged 65-74; £10,660 if aged 75+)
  – Tapered away as income rises above £25,400

• From April 2013: available only to existing recipients; frozen until no higher than the allowance for others (then abolished)
  – HMRC: 4.4 million losers in 2013-14; average loss among losers of £83
  – Raises £1.2 billion per year by 2016-17

• Less impact than otherwise due to substantial increases in allowance for those aged under 65
  – But worst case: someone turning 65 in 2013-14 with income between £10,820 and £26,200 would lose £323 in that year

• A simplification
Withdrawing Child Benefit (CB)

- Government planned to withdraw all CB from any family containing higher rate income taxpayer from January 2013

- Two major issues with this:
  1. ‘Cliff-edge’: CB removed entirely when income crosses particular threshold
  2. CB entitlement would depend only on the income of higher-income person in family

- Government has chosen to tackle the first issue (the cliff-edge)
  - Those who were worried about issue 2 - the relative treatment of 1-earner/2-earner families – will still be worried
Walking away from the cliff-edge

• CB will now be withdrawn from families containing an individual with income > £50,000 (rather than £42,475)

• Crucially, will be withdrawn *gradually* as income rises
  
  – Will lose 1% of CB for every £100 by which income exceeds £50k
  
  – In cash terms, you lose CB at a faster rate as income rises if you have more children (receive more CB)
  
  – Adds about 11/18/24 percentage points to your effective marginal tax rate between 50k and 60k if you have 1/2/3 children
  
  – All CB exhausted when income reaches £60k
Child Benefit: consequences of policy change

• Treasury expects new policy to raise £1.5 billion in first full year, compared to £2.2 billion under original policy

• Of 1.6 million families losing CB under original plan, we estimate:
  – 700k still lose all CB; 400k lose only some CB; 500,000 retain all CB

• Gradual withdrawal means people cannot have lower net income after pay rise (unless they have 8 or more children!)
  – Improvement over very undesirable feature of previous policy
Impact of changes taking effect by April 2012

Change in net income

Income Decile Group

Poorest 2 3 4 5 6 7 8 9 Richest All

Announced in Budget 2012
All changes in April 2012
All changes implemented by coalition

Note: ignores measures affecting mainly the very rich
Impact of changes taking effect by April 2012

<table>
<thead>
<tr>
<th>Category</th>
<th>Change in Annual Net Income</th>
<th>Announcement</th>
<th>April Changes</th>
<th>Coalition Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Households with children</td>
<td>-3.5% (-£1,335)</td>
<td>Announced in Budget 2012</td>
<td>-1.3% (-£511)</td>
<td>-3% (-£1,335)</td>
</tr>
<tr>
<td>Pensioner households</td>
<td>+0.5% (+£119)</td>
<td>Announced in Budget 2012</td>
<td>-1.0% (-£209)</td>
<td>+0.5% (+£119)</td>
</tr>
<tr>
<td>Working-age households without children</td>
<td>-2.1% (-£675)</td>
<td>All changes in April 2012</td>
<td>-0.5% (-£156)</td>
<td>-2.1% (-£675)</td>
</tr>
</tbody>
</table>

Note: ignores measures affecting mainly the very rich
Impact of changes taking effect by April 2014

Change in net income by income decile group, compared to 2012 levels:
- Announced in Budget 2012
- All changes implemented by coalition, ignoring Universal Credit...
- ...or assuming Universal Credit fully in place

Note: ignores measures affecting mainly the very rich
Impact of changes taking effect by April 2014

Change in annual net income

- **Households with children**: -4.7% (-£1,781)
  - Announced in Budget 2012
  - All changes implemented by coalition, ignoring Universal Credit...
  - …or assuming Universal Credit fully in place
- **Pensioner households**: -1.4% (-£316) / -1.4% (-£315)
- **Working-age households without children**: -2.3% (-£646) / -2.0% (-£751)

Note: ignores measures affecting mainly the very rich