Options for withdrawing Child Benefit from better-off families

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Introduction

• Child Benefit (CB) is currently universal
  – £1,056 per year for first child; £697 for each subsequent one
  – Costs about £12 billion per year (6% of benefit/tax credit spending)

• From January 2013, Government plans effectively to remove all CB from families containing higher rate taxpayer
  – HMT estimated saving of about £2.4 billion in 2013-14
  – Will affect about 1.5 million families (average annual loss of £1,570)
Key concerns about Government’s proposal

1. The ‘cliff-edge’
   - CB removed entirely when income exceeds certain threshold

2. CB withdrawal effectively depends on income of higher-income person in family, rather than family income

PM also appears concerned about (one or both of?) these issues:

“Some people say that’s the unfairness of it, that you lose the child benefit if you have a higher rate taxpayer in the family. Two people below the level keep the benefit. So, there’s a threshold, a cliff-edge issue.”

(http://www.politicshome.com/uk/article/43591/david_cameron_interview.html, published on 13 January 2012)
Issue 1: the cliff-edge, illustrated
Budget constraint for example one-earner family with two children, 2013-14

Notes and sources: see Figure 11.1 of *The IFS Green Budget: February 2012*
The cliff-edge and behavioural incentives

- Cliff-edge results in extremely high effective tax rates on additional income, sometimes exceeding 100%:
  - 170,000 families could increase net income by reducing taxable income
  - 200,000 families could have lower net income after rise in taxable income

- Treasury anticipates revenue loss of £280 million per year due to “tax planning”, of which legitimate forms could include:
  - Working less (reduction in economic activity)
  - Arranging salary cut with employer
  - Increasing pension contributions, deductible from taxable income
  - Re-allocating income between members of a couple
What about a gentler slope?

• Government could introduce a *gradual* CB withdrawal
  
  – Still weakens incentive to increase private income
  
  – But avoids sharpest distortions caused by cliff-edge
  
• Relative to current proposal, we estimate the direct costs of 10%/20% withdrawal rates (starting at higher rate threshold) are about £600/£300 million per year
  
  – Could be partly offset by reductions in “tax planning”
Issue 2: withdrawal based on individual income

• A family’s CB will depend on income of higher-income person

• One-earner couple or lone parent with annual income of £43,000 would lose CB

• Two-earner couple could each earn up to almost £43,000 per year and keep CB

• Seems likely that family income would be better indicator of families’ ability to cope without CB
Killing two birds with one stone

• There is already system of income-related support for families with children, with no cliff-edge and based on family income
  – Child Tax Credit (and its planned replacement, Universal Credit)

• Could abolish CB and compensate some families by increasing Child Tax Credit (and/or Universal Credit) amounts
Merging Child Benefit with tax credits and/or Universal Credit: who would lose out?

- Mostly depends on income threshold above which new element of CTC/UC withdrawn (and the withdrawal rate)
  - Would need to weigh up usual tradeoffs between distributional goals, work incentives and revenue requirements

- Some below chosen threshold may still lose out, if they do not claim what they are entitled to or have financial capital
Distributional impacts by income decile group, 2013-14

Average % change in net income among families with children

Income decile group

Poorest 2 3 4 5 6 7 8 9 Richest

Government proposal
CB withdrawn at 10%: raises £600 million p/a less
CB merged with CTC, withdrawn using separate taper (starting at £50k): raises £600 million p/a more

Notes and sources: see Figure 11.3 of *The IFS Green Budget: February 2012*
Does Government’s proposal have administrative advantages over traditional means tests?

- Will continue CB payments, but increase tax liability for higher rate taxpayers who live with CB recipient

- Relies on people identifying themselves as liable
  - Treasury expects £150 million lost revenue per year from difficulties in identifying the affected families and “non-compliance”

- Government will also need to deal with cases such as:
  - Both parents are higher rate taxpayers
  - Families change mid-year (income tax is assessed annually; CB weekly)
Conclusions

• Leaving aside question of whether Child Benefit should be universal, current proposal looks poorly thought out
  
  – Unfair for people to have lower net income after pay rise
  
  – Will create inefficiencies by seriously distorting economic incentives
  
  – Appropriateness of basing withdrawal on income of higher-income family member also questionable (and has been questioned)

• Could easily tweak current proposal to get rid of cliff-edge

• Most coherent solution may be to merge CB with tax credits (and/or, later, Universal Credit)