

Reform of the tax-benefit system to
support low-middle earners:
Tax Credits and
Personal Tax Allowances

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Discussion

1. Raising revenue
2. Introduction to Tax Credits and Personal Allowances
3. CentreForum and Landman Economics proposals
4. Analysis of modelling
5. Arguments in favour of Tax Credits and Personal Allowances

Revenue

Remove higher rate pension tax relief	£7 bn
End pension tax free lump sums above higher rate threshold of income tax	£0.5bn
Introduce a mansion tax	£1.7bn
Increase CGT to align it with income tax	£1 bn
Remove of winter fuel allowance, TV licences and bus passes for those eligible for basic rate tax	£1.7bn
Total	£11.9 bn

Child and Working Tax Credits

(2011-12)

CTC

- Child element (per child) £2,555
- Disabled child element £2,800
- Severe disabled child element £1,130
- Withdrawn from £15,860

WTC

- Basic element £1,920- minimum 16 hours work
- Couple and lone parent element £1,950
- 30 hour element £790
- Childcare element 70% of £175/week for 1 child or £300/week for >1 child
- Withdrawn from £6,420

Strengths of credits and allowances

PTAs

- Simplicity
- Incentives for second earners
- Workers keep more of extra income, which is determined by own effort

Tax Credits

- Less 'leakage' to high earners
- Strong incentive effect for households with young children
- Greater reduction of child poverty

CentreForum Tax Allowance Proposals

Policy	Higher rate threshold	Cost
PTA to £10,000	£42,475	£9.7 billion
PTA & NI threshold to £10,000	£35,795	£11.15 billion
PTA to £12,500 and basic rate to 23%	£42,475	£11.8 billion

Reforms considered

- Increasing basic element of WTC (currently £1,920 per year)
- Increasing per child element of CTC (currently £2,690 per year)
- Increasing generosity of support for childcare in WTC (currently 70% of childcare costs up to £175 (for 1 child) and £300 (for 2 or more children))

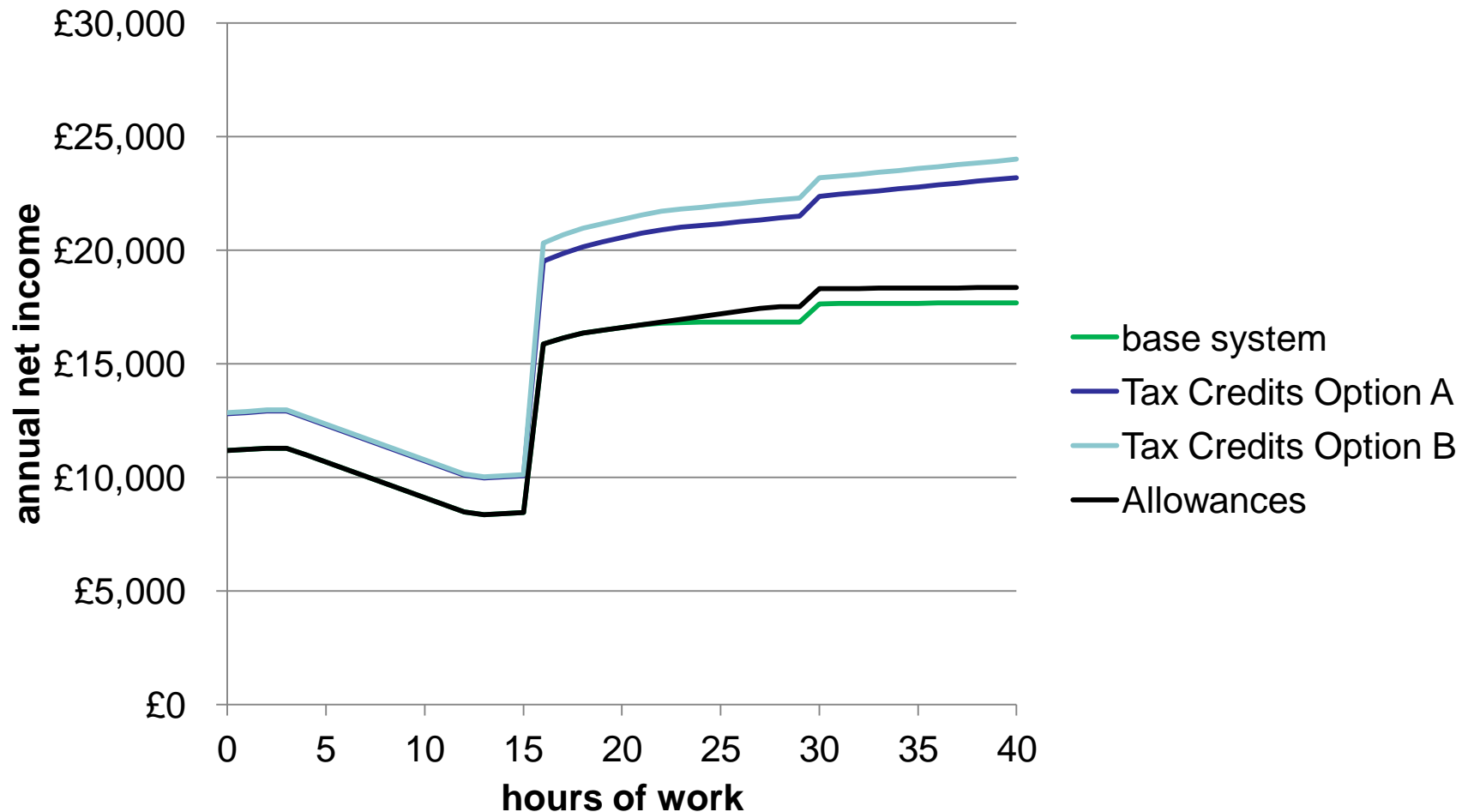
Reform options

Tax credit parameter	Value of parameter in:		
	April 2012 system	Reform option A	Reform option B
Working Tax Credit			
Basic credit	£1,920	£2,690	£3,450
Minimum hours for eligibility (couples)	at least one partner working 16 hours, partners' total hours 24 or more	At least one partner earning 16 hours	At least one partner earning 16 hours
Childcare: maximum eligible cost (one child)	£175	£175	£175
Childcare: maximum eligible cost (two or more children)	£300	£300	£300
Childcare: percentage of expenditure eligible	70%	95%	95%
Child Tax Credit			
per child element	£2,690	£3,500	£4,400
Child Benefit			
First child	£20.30	£20.30	Abolished
Second and subsequent children	£13.40	£13.40	Abolished
Overall modelled net cost (relative to April 2012 system)		£10.8bn	£11.3bn

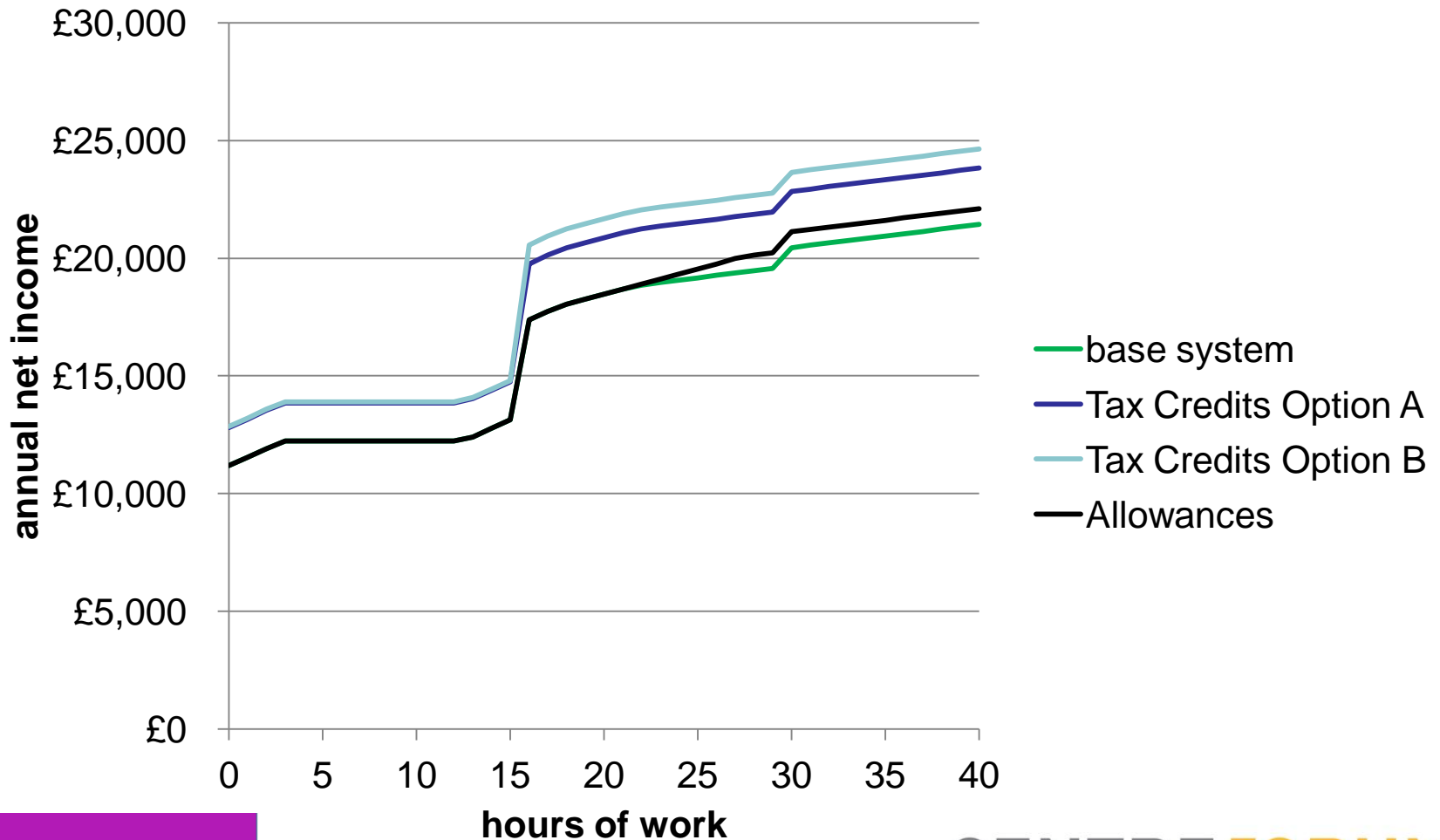
Work incentives: examples

- Lone parent
- Gross wage: £7 per hour
- Two children
- With childcare at £6/hour
- Net income = gross earnings + WTC/CTC/IS – (income tax + NICs + gross childcare costs)

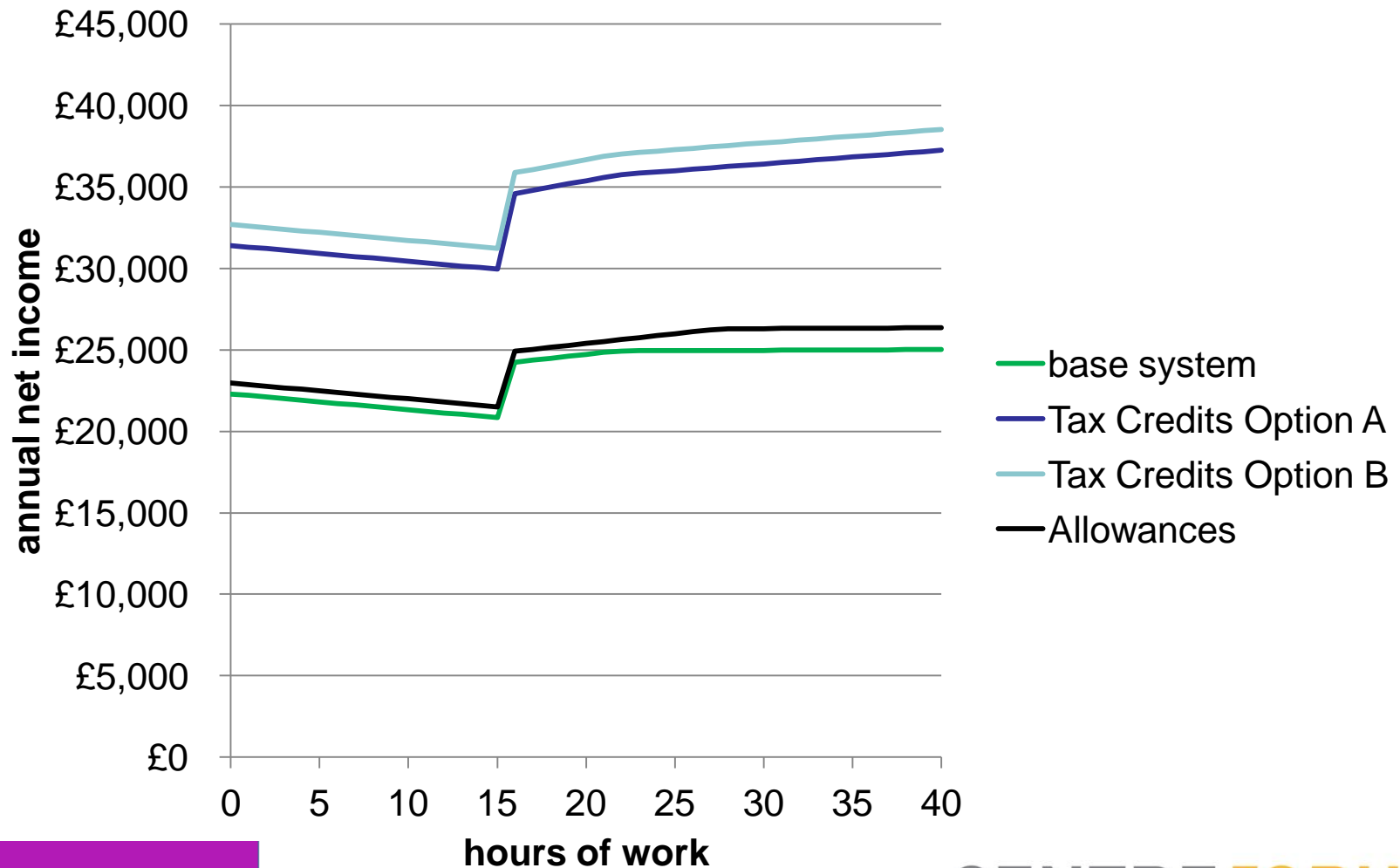
Work incentives: lone parent with childcare



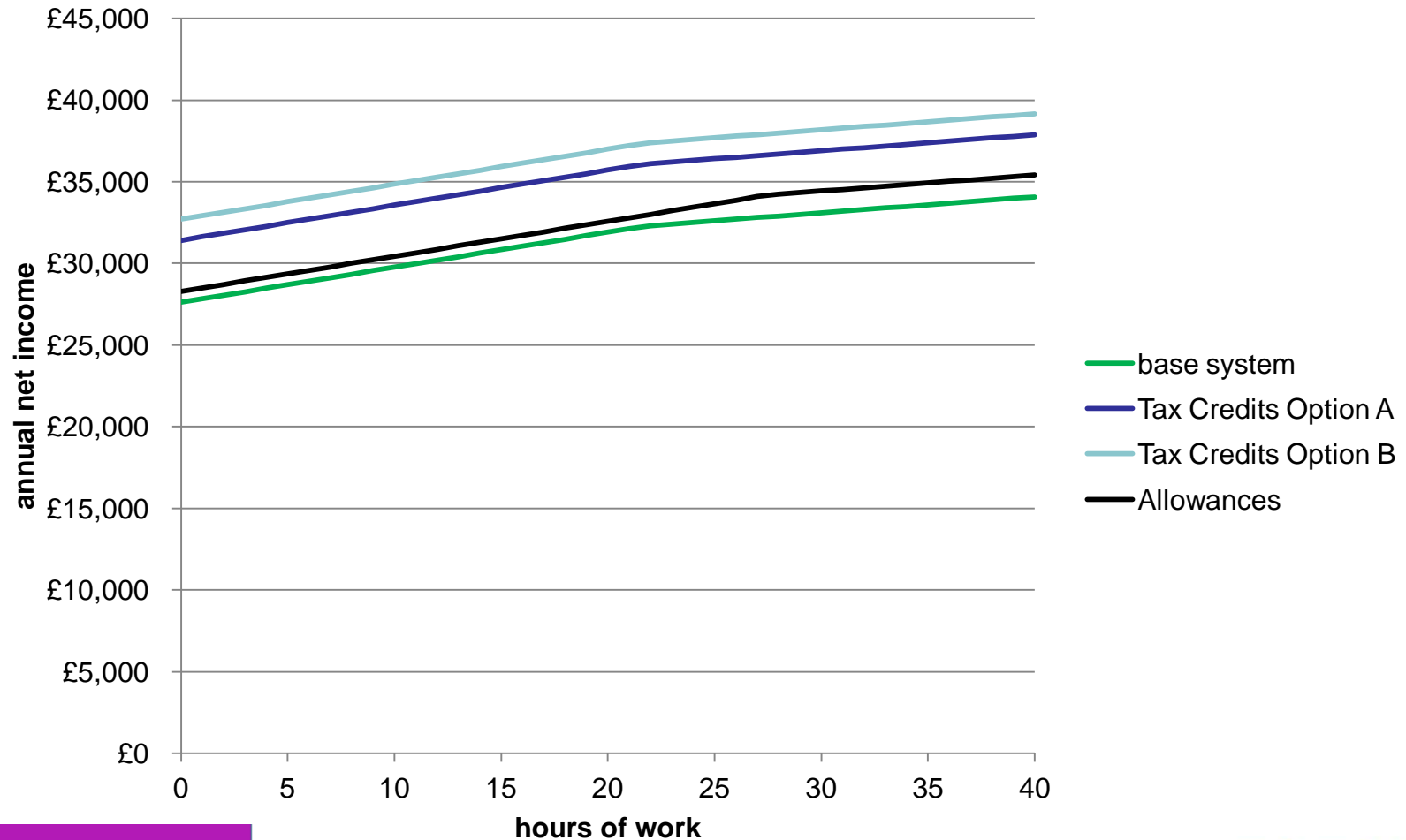
Work incentives: lone parent, no childcare



Work incentives: second earner in couple with childcare



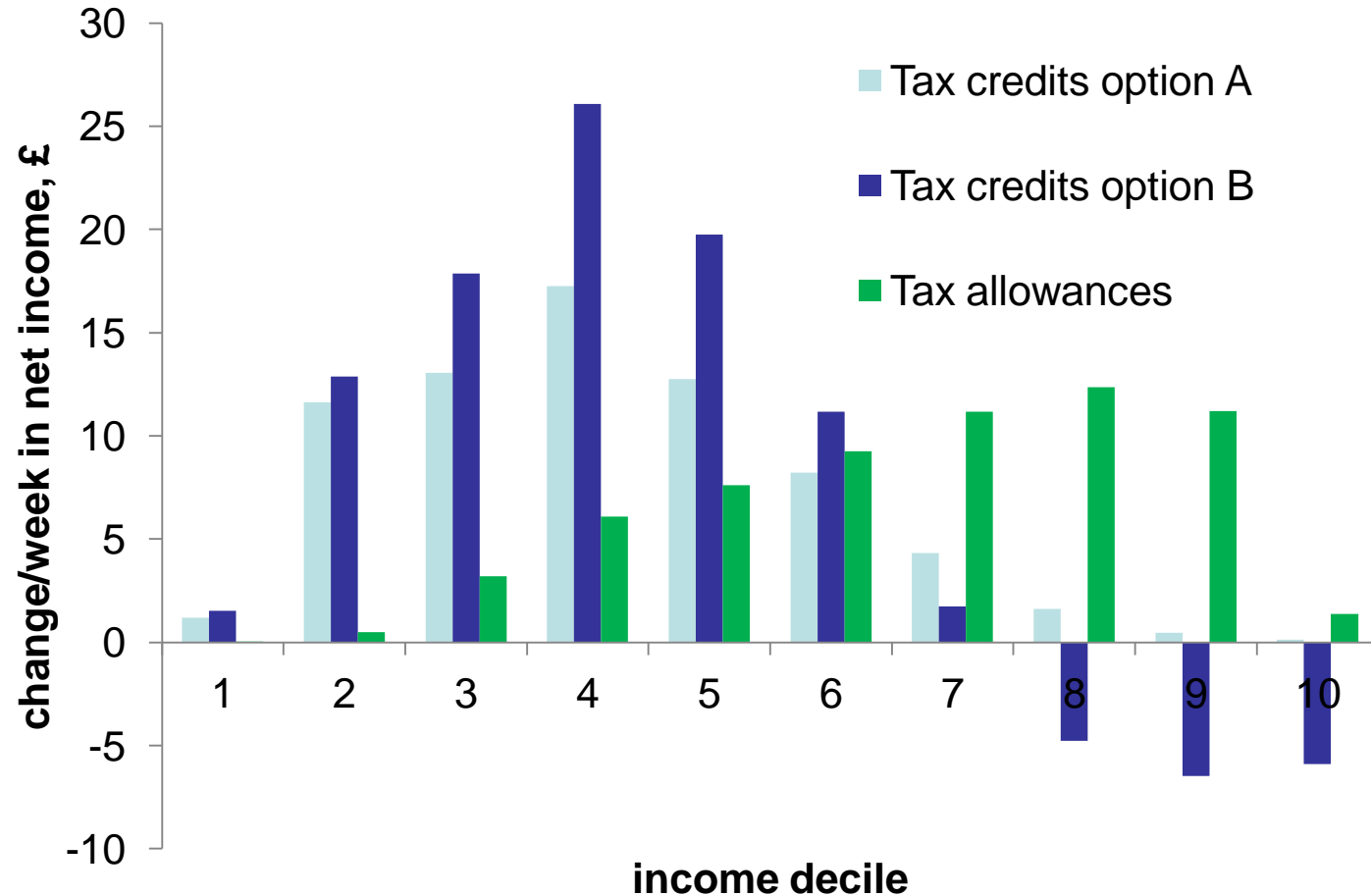
Work incentives: second earner in couple, no childcare



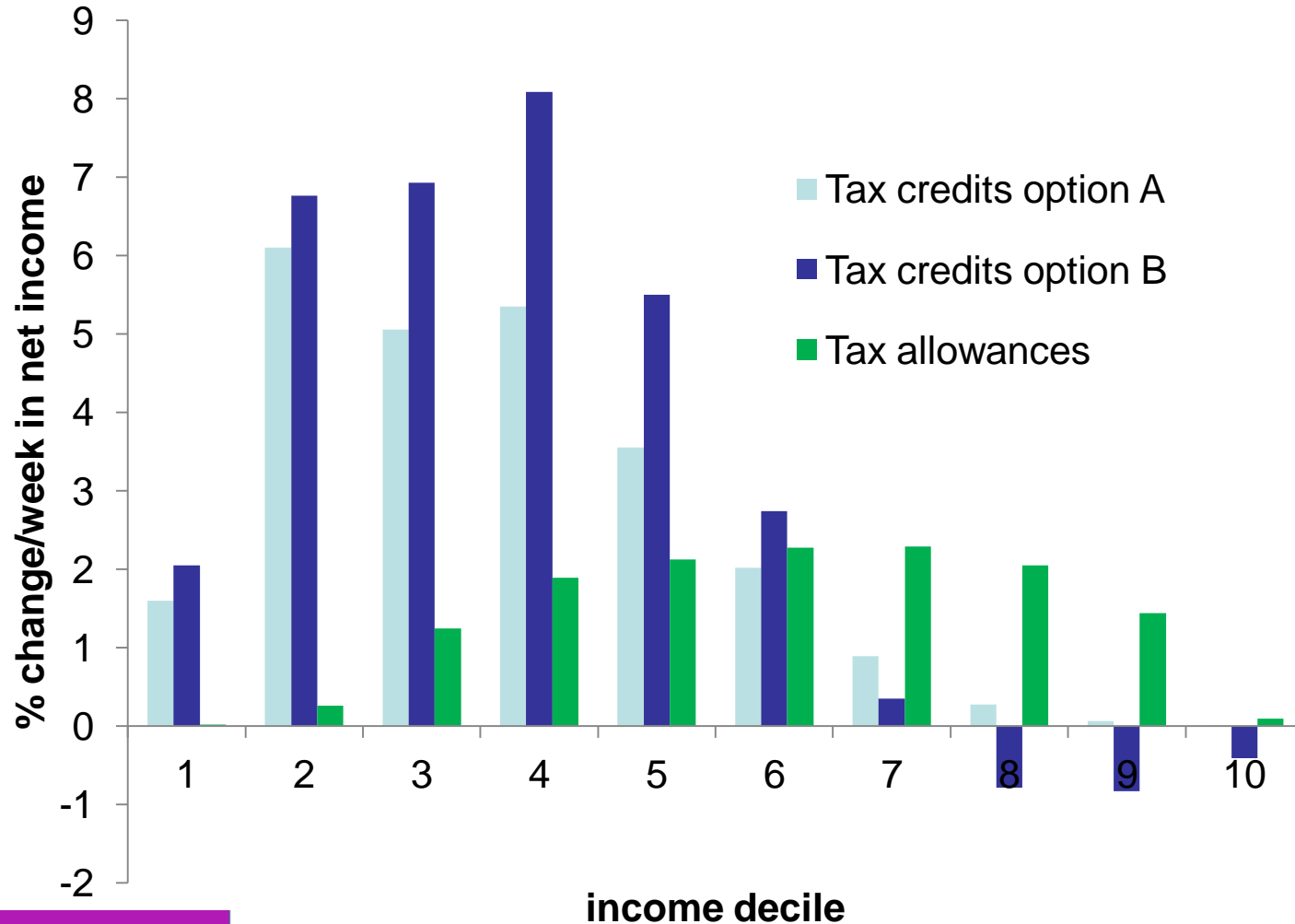
Summary: work incentives

- For single parents and first earners in couples, tax credit reforms better than allowances for increasing work incentives at 16 hrs vs not working
- For second earners in couples, allowances perform better because:
 - WTC & CTC payments when first earner is in work act as disincentive for second earner to enter work
 - Double benefit from personal allowance increase

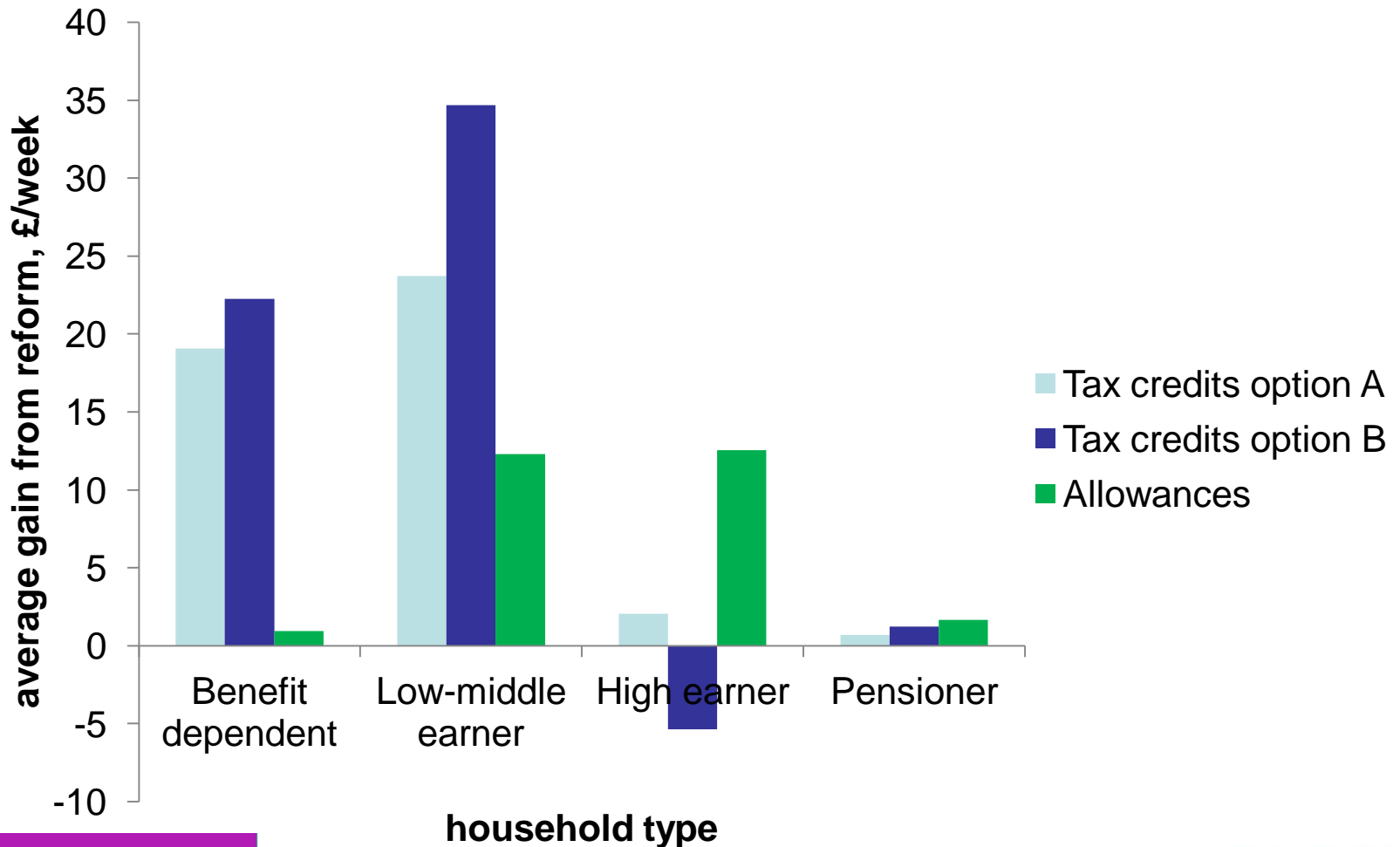
Distributional impacts: rich/poor



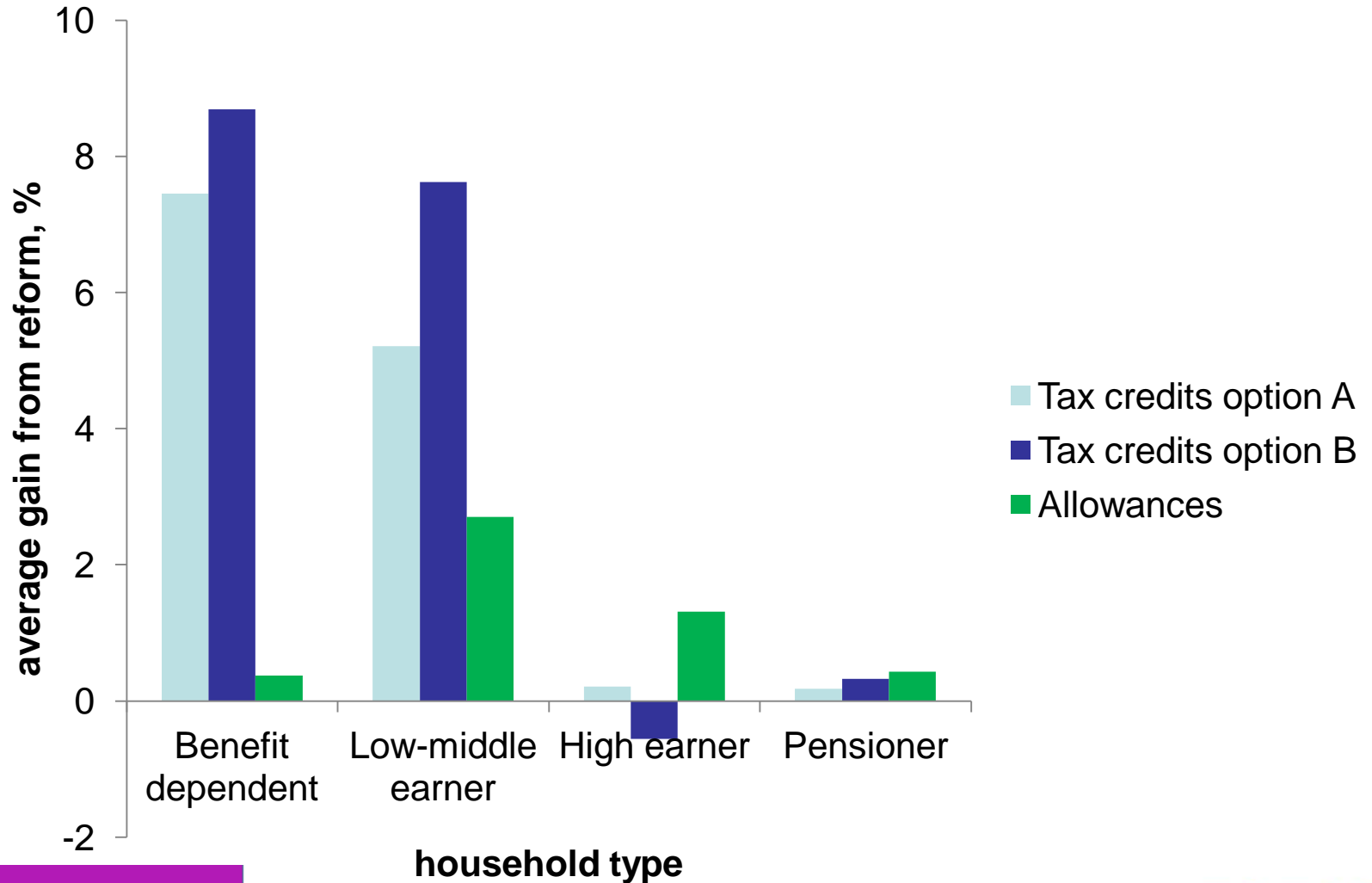
Distributional impacts: rich/poor



Distributional impacts: household type



Distributional impacts: household type



Tax credit increases are more progressive than personal allowance increases

Because:

- 1 in 6 workers already pay no income tax
- Most of the people who do earn enough to benefit from a £10,000 PTA are not low-paid
 - 37% of the gain from PTA/NI PT increase goes to LMEs, 54% to high earners
 - 61% of tax credit reform A goes to LMEs, 7% to high earners

Personal Tax Allowance and Tax Credit Proposals

(After Housing Costs)

RF type	PTA and NI £10,000		Tax credits option A	
	Change in weekly income (£)	Change in weekly income (%)	Change in weekly income (£)	Change in weekly income (%)
Benefit dependent	0.91	0.44	19.08	7.45
Low-middle earner	12.2	3.26	23.73	5.21
High earner	12.5	1.47	2.04	0.21
Pensioner	1.67	0.46	0.68	0.18
Cost	£11.15 billion		£10.8 billion	

Why focus on increasing personal tax allowances?

Principle: Individuals' effort should, where possible, determine their income rather than the state.

- Cost to government
- Simplicity
- Incentives to work

Cost to government

- Cost of getting an individual into work often exceeds their earned income.
- E.g. a single parent with 2 children, using Landman Economics' Proposal A (ignoring housing benefit and JSA):

Hours	Gross wage	WTC	Childcare @ 95%	Tax and NI	Total govt cost: Landman Proposal A	Net wage
16	£5,824	£4,640	£9,984	£0	£14,624	£5,824
30	£10,920	£3,585	£14,820	£962	£17,443	£9,958
40	£14,560	£2,093	£14,820	£2,127	£14,786	£12,433

Simplicity

- Adam Smith's canons of taxation
- Illogical overlap of tax and tax credit system
- Take-up

Incentives

- Second earners
- More hours for some low earners