Finance Bill Report Stage:
Meeting with Harriett Baldwin, Chair of Treasury Committee

Tax Thresholds freeze

Income tax thresholds are frozen until April 2028**.** The Office of Budget Responsibility said in March that the effect of the freeze will be to increase receipts by a combined £29.3 billion a year (1.0 per cent of GDP) in 2027-28, this would be equivalent to a 4p increase in the basic rate of income tax. The figure for 2023/24 is £12 billion and for 2024/25 it is £25 billion[1]

Families with average or below average household incomes are disproportionately affected since income tax liabilities take no account of families. The Treasury say that in 2020/21 a single earner couple with two children would need a gross income of £52,000 to be in the fifth decile of the income distribution. By contrast, a single taxpayer with earnings of £52,000 would be in the ninth decile.[2] Using the same methodology as the Treasury and the very latest income figures *'Tax and the Family'* have found that with three children a couple would now need £68,000 to be in the fifth decile.
The problem is made worse because of the freeze in the income level (£50,000) at which child benefit is withdrawn. The Resolution Foundation has said if £50,000 was right in 2013 the correct figure today would be £64,000. Moreover even today some of these families will be on universal credit with the result that with two children they have a marginal tax rate of 83%. The number will increase significantly if nothing is done.[3]

The IFS said a few days ago that one in five taxpayers, and one in four teachers, will be paying higher-rate tax by 2027 as the threshold freezes bite .[4]

High Income Child Benefit Charge (HICBC).

The two main problems are

- The treatment of single-earner and two-earner households
- The operation of the £50,000 threshold

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1 The impact of frozen or reduced personal tax thresholds OBR March 2023

2 Impact on households: Distributional analysis accompanying Spring Statement 2022 HM Treasury
3 System collision Gavin Kelly Resolution Foundation January 2023
4 Delestre and Walters IFS May 2023

Tax and the Family have drafted two New Clauses (copies attached): one to deal with the single earner household problem and the other the £50,000 threshold. It is possible to have one without the other.

History

In October 2010 the then Chancellor George Osborne proposed capping child benefit on higher incomes and in his 2012 Budget he announced the HICBC which came into effect in January 2013.

The HICBC claws back Child Benefit from families where the higher earner has an income in excess of £50,000 and withdraws it completely at £60,000. The charge is collected through the income tax self-assessment scheme. Individuals who are liable to it are required to file an annual tax return.

For every £100 an individual earns in excess of £50,000, the tax charge increases by 1%, however many children they have. If the Child Benefit recipient is affected by the charge because either they or their partner earns in excess of £50,000, they can choose to opt out of receiving payments. The number of opt outs has increased each year. In August 2022 (latest figure) 683,000 families had opted out. 85% of claimants are female.[5]

In the tax year 20/21 355.000 self-assessed taxpayers paid the HICBC. Revenue raised was £405 million. 624,000 people opted out of receiving child benefit. The Office of Tax Simplification thinks that the HICBC raises over £1 billion each year taking account of opt outs[6].

When the HICBC was originally announced in 2010, George Osborne said that it would only apply to the to the top 15%. Income for this purpose is however measured on a household basis; individual income is a very poor guide. Even in 2013 a single parent with two children and a single earner married couple with two children and earnings of £50,000 would both have been in the better off half of the population but certainly not in the top 15%. A single earner married couple with three children would have been in least well off half of the population.[7]

Clearly the frozen £50,000 HICBC threshold has changed the position very considerably and now results in child benefit being withdrawn from families who are not well off, in particular those with large families. It now applies to low income households and may even apply to some larger households that are officially in poverty i.e. with incomes of less than 60% median and some families entitled to universal credit are caught by the HICBC (see below).

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5 Child Benefit Statistics August 2022.

6 OBF Evaluation note March 2022.

7 Table 6.1 Independent Taxation 25 years on Draper and Beighton CARE

Treatment of single-earner and two earner households.

From the very first it was pointed out the Charge was unfair. A single earner family (a single parent or a single earner couple) earning over £50,000 would be losing some of their child benefit. By contrast a dual earner couple each earning just under £50,000 – with a much larger household income - retained their child benefit.

The Treasury defence has been that, if it is accepted that child benefit payments should be taken away from "better off" families, because of independent taxation there is no alternative unless every family is put into the benefit system. [8] To introduce a new means test for family income "would be complicated costly and confusing". They say they would need to assess all of the 8 million households receiving child benefit each year".[9]

In a more recent Westminster Hall debate the Financial Secretary simply said "the charge, sitting as it does within the income tax system, must adhere to the principle of independent taxation".[10]

Can the problem be solved without breaching the principle of independent?

The New Clause dealing with the single earner problem solution proposed does NOT breach any of the principles" of independent taxation. It does NOT require 8 million families to make a return of their household income.

The proposal is that, if the person subject to the charge (the person called P in Section 681 of the Income Tax (Earnings and Pensions) Act 2003) does not have a partner or has a partner earning less than the income tax personal allowance, only half of the income shall be taken into account. As a result the actual income would have to reach £100,000 before the Charge came into effect. [This figure could be reduced, eg to £80,000, if it were thought to be too generous.] This will reduce the number of families affected and will go a long way to solving the problem for single parents and couples with only one income.

Treasury Ministers have never challenged the claim that the present system is unfair. They have resisted it on the grounds that it would not be practicable to deal with because of independent taxation. Hence a solution which is drawn on the principles in the Charge itself and which would not affect independent taxation answers the only defence which they have hitherto put forward.

The HICBC in any event breaches the principle of independent taxation to some extent. If the Treasury really believed that the tax liabilities of couples should be determined wholly on the basis of an individual's income, they would only have taken into account the income of the person who gets the child benefit. 85% of child benefit claimants are female.

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8 House of Commons debate 19 aril 2010 cc 602-629.

9 HC Deb 22 May 2012 c2WH

10 Debate 3rd February 2023

Operation of the £50,000 and £60,000 thresholds

The threshold New Clause increases the £50,000 threshold to £70.000 in 2024/25 and indexes the threshold by reference to the CPI for subsequent years. [This figure could be reduced if it were thought to be too generous.]

The £50,000 threshold has remained unchanged since it was introduced in 2013. Even if it is accepted that the £50,000 and £60,000 thresholds were right in 2013, they would need to be £64,000 and £77,000 today and rise to something like £77,000 and £87,000 by the end of the decade.[11]

If the aim is to withdrawal child benefit only from high income households the £50,000 and £60,000 figures were not right in 2013 and are certainly not right 10 years later.

Effect of freezing the £50,000 HICBC threshold

The freezing of the £50,000 threshold at which child benefit begins to be withdrawn has led to 26% of families with children (2 million) now losing some or all of their child benefit – double the proportion when the policy was introduced a decade ago. [12] Higher rate income tax applies now at £50,570 and this is also the point at which the marriage allowance is withdrawn at a cliff edge. So for some families this level of income can bring considerable difficulties.

Overlap with universal credit

As a result of the freeze an increasing number of families entitled to universal credit are caught by the HICBC and as a result have an extremely high effective marginal tax rate. Universal credit does not only apply to households with low earnings. Where there is a housing element and a child element universal credit can apply to incomes well in excess of £50,000.

Universal credit claimants with children earnings between £50,000 and £60,000 will have an effective marginal tax rate of at least 80%. For a family with three children the marginal rate is 87%. If student loan repayments are also involved the marginal rate for a family with three children is 97% and 98% in Scotland. By contrast, the top marginal rate is only 47% for those with incomes over £125,000. The Resolution Foundation table below shows the effective marginal rates that apply in the current tax year to families affected by the gradual withdrawal of the HICBC

11 Collision Resolution Foundation January 2023

12 IFS Green Budget August 2022.

Examples of marginal deduction rates faced by adults receiving UC and affected by a partial withdrawal of Child Benefit, by family circumstances: 2023-24

Resolution Foundation

	Family with one child	Family with two children	Family with three children
Subject to partial HICBC and receives UC	80%	83%	87%
Partial HICBC, UC and repaying student loan	89%	92%	96%
Partial HICBC, UC and pension contributions	81%	84%	88%
Partial HICBC, UC, student loan and pension contributions	89%	93%	96%
Pays basic rate Income Tax and receives UC	69%	69%	69%
Subject to partial HICBC and does not receive UC	55%	63%	71%

Notes: Marginal deduction rates shown for individuals with adjusted net incomes (gross income after pension contributions) between £50,270 and £60,000 and not living in Scotland. MDRs in Scotland are approximately 1 percentage higher for the examples set out in this table. MDRs calculated as take-home pay as a proportion of gross earnings. Pension contributions assumed to be 5 per cent of gross pay and paid as salary sacrifice. Pension contributions affect student loan repayments and Universal Credit award, and therefore have a small additional impact on marginal deduction rates. Assumes High Income Child Benefit Charge is repaid through additional Income Tax.
Source: RF case study model.

The Resolution Foundation think there are around 50,000 families currently affected, but that this number will arise to 90,000 by the end of the decade, with steadily more thereafter unless the thresholds change. There are another 250,000 families on universal credit and receiving child benefit with someone on £40,000-£50,000 who could easily find themselves in this 'no-gain' income zone if the main earner gets a pay rise.

The sole earner in a family would need to reach earnings of £60k before their marginal effective tax rate *falls* down to 42 per cent (51 per cent for graduates with student loan repayments; 54 per cent pension contributions are included). This is unrealistic for most people.

Policies which may appear sensible when viewed in isolation make no sense at all when viewed from a family/household perspective. Finding a solution will not be easy. The status quo cannot however be left as it is. The economic effects of a large number of working families gaining no advantage from increased earnings will become ever more apparent. The injustice seems indefensible. The New Clauses will not solve the underlying mismatch of the tax and benefit systems, but they will reduce some of these problems and are the minimum necessary.

May 2023

Proposed New Clauses:

HICBC new clauses

A new clause on the single earner/two earner issue

High Income Child Benefit Charge

(1) In Section 681 of the Income Tax (Earnings and Pensions) Act 2003 (High income child benefit charge) in Section 681C after subsection (2) insert

(2A) In any year in which P does not have a partner or any partner P has does not have an income exceeding the personal allowance, P's adjusted net income shall be halved.

(2) The amendment made by this section shall come into effect for the tax year 2024/25 and subsequent tax years.

A new clause on the threshold and marginal rate providing also for indexation

High Income Child Benefit Charge

(1) In Section 681B of the Income Tax (Earnings and Pensions) Act 2003 (High income child benefit charge) in subsection (1)(a) delete ‘£50,000’ and insert ‘£70,000’.

(2) In Section 681C of that Act in the formula the figure L shall be £70,000 and the figure X shall be £200.

(3) If in any tax year the consumer price index for the September before that year is higher than it was for the previous September, the figure in subsection (1)(a) of Section 681B and the figures L and X in the formula in Section 681C shall be increased by the same percentage increase as the percentage increase in that index, if need be rounding the figures up to the nearest £100, £100 and £1 respectively.

(4) The amendments made by subsections (1) and (2) above shall come into effect for the tax year 2024/25 and subsequent tax years and the amendment made by subsection (3) above shall come into effect for the tax year 2025/26 and subsequent tax years.