Written evidence submitted by CARE (Christian Action Research and Education)

About CARE

1. CARE (Christian Action Research and Education) is a well-established mainstream Christian charity providing resources and helping to bring Christian insight and experience to matters of public policy and practical caring initiatives across the UK.

Introduction

2. Since 2008 CARE has published an annual report, the Taxation of Families, which explores the way in which different OECD countries share out the tax burden between those with and without family responsibilities. The message over the years has been remarkably consistent, demonstrating that the UK gives one-earner families a particularly rough ride compared with other developed OECD countries. We have always been clear about the reason: the radical individualism of the British tax system.

3. The advent of independent taxation in 1990 was an important step in the modernisation of our fiscal arrangements. We have no desire to return to the pre-1990 world of the 'married man's allowance' but we have consistently pointed out that while the decision to embrace independent taxation was right, the UK adopted an unusually individualistic form of independent taxation that is almost entirely blind to family responsibility.

4. This pressure dates back to the year 2000, when all recognition of family responsibility was finally removed from the tax system by Gordon Brown (the process had been underway since the mid-1970s). In its place a generous welfare system was called into being to offset the rugged individualism favoured by the Treasury.

5. In effect this meant that the Department for Work and Pensions ended up filling in the holes that the Treasury had made, creating perversely high effective marginal tax rates (EMTRs) that stifle ambition and aspiration. In other words, the failure to recognise family responsibility in the tax system does not result in the state escaping its obligations to poorer members of society. It just means that those obligations are met through inflated benefits but with the huge cost that this particular approach traps working families in poverty with some of the highest effective marginal tax rates in the world.

6. The pressures brought by COVID-19 related debt on the tax burden have taken us to a tipping point. In the context of an increased tax burden the current failure of taxation to have regard for family responsibility will become unsustainable. Its unfairness will become more pronounced, generating greater political grievance and it will nurture greater dependence of low-income families on the state, trapping them in poverty rather than empowering them to earn their way to a better standard of living.

7. CARE considers that this unprecedented time of change presents an opportunity to ensure that the tax and benefits system work together, not against each other. We are calling for the income tax system to be reviewed and reformed so that it takes account of the make-up of a family rather than just looking at the individual being taxed. Taking the family into account will ensure that as we begin to pay off the debts created in this time of national crisis, this is done fairly and equitably and in a way that does not trap low-income families in poverty.

Long term pressures on the tax system

8. Our research has consistently shown that the UK tax system exerts particular pressure on the one-earner family.

9. The IFS has noted that UK income taxes and SSCs yield less, as a share of national income, than in the mid 1970s (around 15% today compared with 19% in 1975). Moreover, the yield is low compared with 2016 averages of 20% of national income for G7 countries and 25% for Scandinavia.[1]

10. However, the evidence is compelling that one-earner families bear a heavier share of the tax burden in the UK than in other countries, particularly when income tax is looked at on its own. This is true both for single parents and for one-earner couples.

11. The latest figures from our report[2] released in March this year show that at the OECD average wage a married couple with two children pays 39% more income tax than a comparable French family, more than three times that of a US family, and more than ten times as much as a German family. Two-earner families also bear a heavy income tax burden, although their overall tax rates are less than the international averages.

12. The amount of tax that families pay bears little relationship to how well off they are. Some pay more tax than other households that are much better off. Some low income families even pay higher rate tax and in 2018 were liable for the High-Income Child Benefit Charge. This problem, which has been ignored by successive Chancellors, is a serious one, and needs to be tackled. Tax liabilities should be brought closer into line with household incomes.

13. The problem arises because UK income tax is based on individuals and, unlike in most other developed countries, takes little account of family responsibility. By contrast, benefits, including tax credits and the universal credit, are based on households, reflecting how people actually live.

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[1] IFS Green Budget 2019, Institute for Fiscal Studies, Chapter 8

[2] CARE, The Taxation of Families: International Comparisons 2018. https://care.org.uk/uploads/pages/taxation-report.pdf

14. The Government's annual analysis of household income takes account of family size and composition as well as of incomes. In the table below we have used the figures for 2017-18 (the latest tax year for which they available) to show how much money various households must earn in order to remain above the poverty line, that is defined as 60% of median household income. The table looks at this from the perspective of: a) the net income (after income tax, NICs and benefits, and housing costs[3]) needed to be above the poverty line (i.e. at 60% of median household income), b) the corresponding gross earned income required. It also looks in each case at how much income tax would be paid.

Table 1

Households at 60% of Median Household Income after Housing Costs

	Net income	Gross income	Income tax
Single person, no children	14,200	15,900	800
One-earner couple, no children	21,700	26,600	2,700
Single parent, two children under 13	22,300	6,500	0
One-earner couple, two children under 13	28,700	32,900	4,000
Two-earner couple, two children under 13 (income split 50:50)	28,700	29,400	1,000

Note: all figures rounded to nearest hundred pounds

15. As the table above shows, in 2018, a one-earner couple with two children would have needed more than twice the gross income of a single person to enjoy the same standard of living and would have paid more than three times the amount of income tax.

16. The IFS has drawn attention to the fact that the majority of children in poverty are in working families, and that one third of children living in poverty are children of one-earner couples. But, as the figures above show, it is not only families with poverty level incomes or one earner couples who bear a disproportionately large tax burden.

17. Although income tax liabilities have fallen generally since the 1990s, those of families have come down less than those of other households. The increases in the personal allowance since 2010 have mainly benefitted single people or couples without children, households which are more likely than families to be in the top half of the income distribution.

Work incentives and effective marginal tax rates

3 Housing costs vary widely across the UK. For illustrative purposes, we use weekly housing allowances applicable in Leeds: £100 per week for a single person household, £122 for a couple with no children, £150 for all other households

18. The very high marginal tax rates placed on lower income working families are the inevitable result of the failure of the tax system to recognise family responsibility. It is a supreme irony that rather that fostering independence and self-reliance, the failure to recognise family responsibility actually has the polar opposite effect of calling into being offsetting benefits, the withdrawal of which traps working families in a dependent relationship with the state and poverty.

    18.1. This is a huge issue. The tax paid on the next pound of income matters because it affects the ability and willingness of people to increase their incomes. If they cannot increase their income significantly by working harder or longer, many will be stuck in poverty, some crippled by unrepayable debts.

    18.2. For most high earners (with taxable income of over £150,000) the top EMTR is 47%, but for many low-income families on legacy benefits it is likely to be at least 80%. Where a family is in rented accommodation, the EMTR may well be over 90% – almost twice as high as that of the highest earners.[4]

19. Marginal rates will be somewhat lower for most low-income households under Universal Credit than under legacy benefits, but still much higher than those faced by most high earners or those faced by comparable low income working families across the OECD. The EMTR will still be 76% for those on Universal Credit and 80% if council tax support is involved.[5]

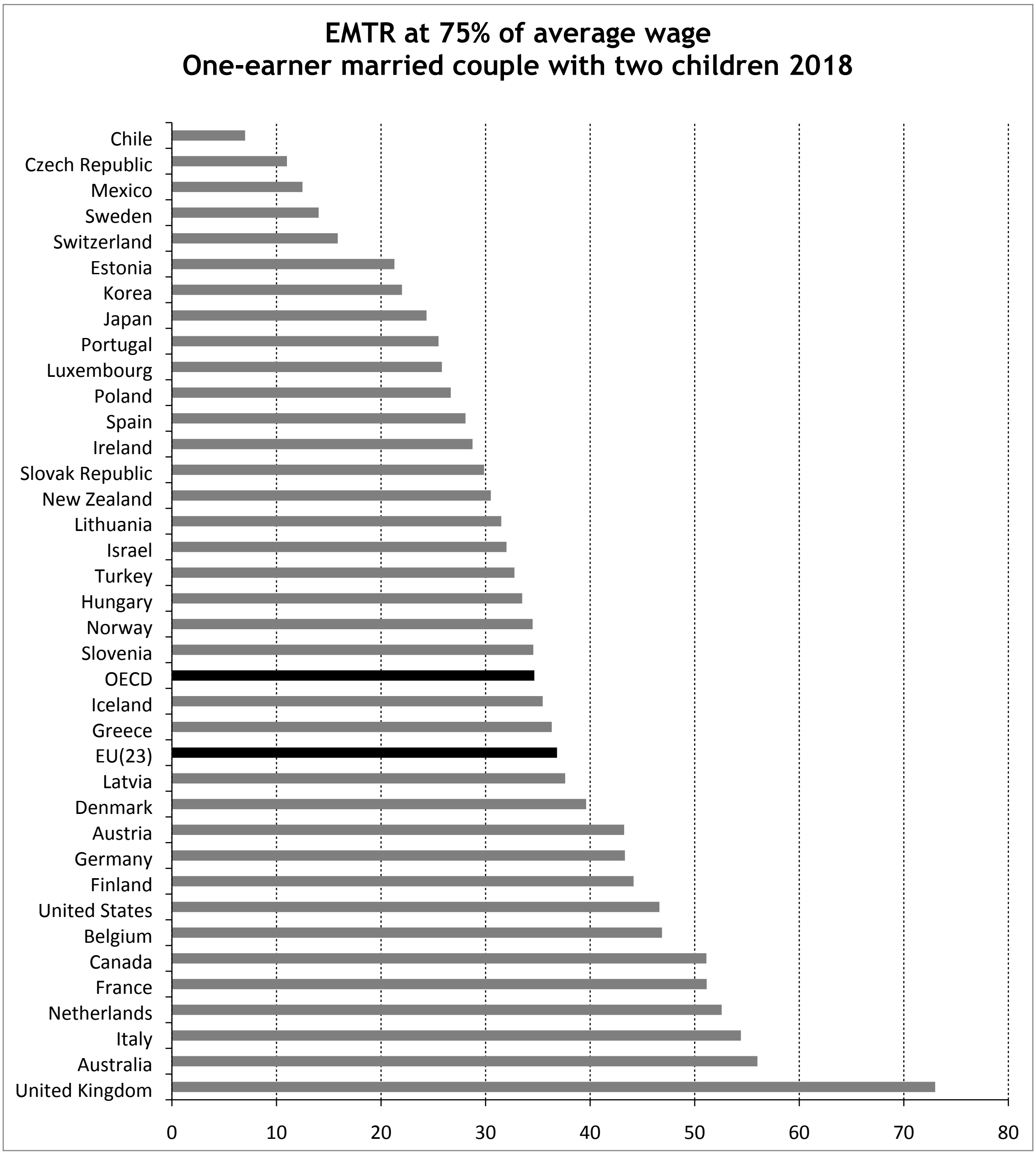
    19.1. In 2018 the average EMTR for OECD countries at 75% of average wage (£29,496) was 34%. In other words, far from being trapped in poverty, such families knew that from the equivalent of an additional pound they would get to keep 66 pence.[6]

    19.2. In the UK, meanwhile, they only get to keep between 24 pence and 20 pence in the pound. If housing benefit is also involved, then one could be looking at less than 10 pence in the pound. This is completely unsustainable.

20. The chart below shows EMTRs in OECD countries at 75% of average wage for a one-earner married couple with two children. The UK EMTR is the highest of all OECD countries, more than twice as high as the OECD and EU(23) averages.[7]

Chart 1

[4] CARE, The Taxation of Families: International Comparisons 2018. Page 38.
[5] Ibid. Page 38.
[6] Ibid. Page 38.
[7] Ibid. Page 35.



21. Families with an EMTR of 70% or higher will find it very difficult to work themselves out of poverty. The EMTR will become more apparent as families move onto Universal Credit. An increase in income (resulting, for example, from overtime or an income tax cut) will reduce next month's credit, whereas under tax credits it affects next year's. Family budgeting will become more difficult, and employers will find it harder and more costly to get employees to work overtime or do additional shifts.

Where things went wrong

22. When independent taxation was introduced in the UK (in 1990), recognition of family responsibility was retained within the income tax system through provision of the Married Couples Allowance and the Additional Persons Allowance, and the EMTR for a one-earner family on 75% average wage was only 34%, close to the OECD average in 2018.

23. In 1999-2000 these provisions were removed, and tax credits introduced. It is the withdrawal of these benefits as incomes rise that has caused the UK EMTR to rise to 73% in 2018 (the level it has been for at least 10 years) and higher if account is taken of the withdrawal of housing benefit and council tax support.

24. High EMTRs have their origins in decisions made in the 1980s and 1990s. Consideration was given to ways of integrating the income tax and benefit systems, involving negative income tax, but the difficulties were perceived to be too great. The conclusion reached at that time was that income tax should be based on individual income whereas benefits should be based on household income. This was thought to be the cost-effective way to support the poorest households. The introduction of independent taxation with no recognition of family responsibility from 1999-2000 and the introduction of tax credits from 1999-2000 to compensate were an outcome of this decision.

25. The situation today is different from that in the 1980s and 1990s. Then the main concern was out-of-work poverty; now it is in-work poverty. High marginal rates were not a problem then. In 1990 a one-earner family in the UK on 75% average wage faced an EMTR of 34% and thus knew that they would take home 66 pence from every additional pound earned. They were not trapped in poverty.

Review and reform of the income tax system

26. The UK system of independent taxation linked with means tested benefits does not meet the needs of families as we move into the third decade of the 21st century. The result is that families in the poorer half of the population, including those whose household income is below the unofficial but widely accepted poverty line[8], pay significant amounts of income tax when they would be paying little if any in France, Germany or the US. Of course, the benefit system does take account of household income and family circumstances, but this support comes at an unacceptable price, trapping low income working families in poverty.

[8] Net household income after housing costs of less than 60% of median equivalised household income

27. The cost of working-age benefits has doubled since the 1980s. The IFS has noted that the annual cost has reached £96 billion, exceeding expenditure on education or national defence and policing.[9] Approximately 1.8 million households get 80% or more of their income from working-age benefits. The Resolution Foundation expects Universal Credit to be rolled out to one in four working-age families in the UK, and nearly one in three in the Liverpool area.[10] These families will all have an EMTR of 76% or more. This is an issue that requires urgent attention.

28. The priority for the Government at this moment should be to ensure that the inevitable tax burden that will be required after COVID-19 does not fall disproportionately on families in the ways that income tax currently does. This is imperative both because of the need for the larger post-COVID-19 tax burden to be allocated fairly and also because of the need to create an environment within which one can seek to significantly lower the EMTR on low income working families.

29. The Government should find ways of rebalancing the distribution of income tax, ensuring that the income tax burden on low income households with children is reduced, and in particular their marginal rates. It makes no sense to be levying income tax on these families which is then handed back to them through means tested benefits, especially when these involve steep tapers.

30. Focusing on an individual's pay rather than household income will not deliver enough help to low income families. For example, the proposal to increase to £9,500 the income point at which employee NICs start to be paid (set to rise to £8,788 in 2020-21) would result in approximately 430,000 fewer people paying them, and those still liable paying £85 per year less. But the failure of this allowance to have cognisance of family responsibility means that only 8% of this 'giveaway' will benefit the poorest 20% of working households.[11] Moreover those receiving Universal Credit gain only £53 per year.

31. The Treasury needs to recognise that low pay does not necessarily equate with low income, and that tax cuts that apply to everyone cannot reduce income inequality. The raising of the personal allowance threshold should be rolled back and tax cuts that can be afforded should be focused on households with low incomes, which in practice means those with children.

32. The Government needs to rethink the way in which the income tax system works for families and the overlap with the benefit system. Marginal rates of 80% or 90% don't just weaken incentives; they all but destroy them. Families facing these rates cannot lift themselves out of poverty or prevent themselves sliding into poverty.

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[9] Robert Joyce, Benefits spending, Institute for Fiscal Studies, 22 March 2019

[10] L Gardiner & D Finch, The long and winding road: The introduction and impact of Universal Credit in Liverpool City Region and the UK, Resolution Foundation, January 2020. It is expected that 31% of working-age families in the Liverpool area (205,000) will receive Universal Credit once it has been fully rolled out, compared with 24% in the UK as a whole (6.2 million).

[11] Luke Sibieta, Institute for Fiscal Studies, November 2019

33. A major step to reduce inequality would be, as this submission has made clear, to base income tax liabilities on household rather than individual income. The household is the basis for the award of benefits (and for the statistics on the distribution of income), so why should taxation be different? Looking at individuals means that one-earner couples pay considerably more income tax than do two-earner couples with the same joint income. This is a major cause of poverty in the UK today.

34. Independent taxation was introduced for very good reasons to give married women privacy and control in their tax affairs, and we are certainly not saying that it should be abolished. But the High-Income Child Benefit Charge and the Marriage Allowance show, in different ways, how it is possible to look across from one of the couple to the other without departing from the principle of independent taxation.

35. Some might argue that the aiming for a simple tax system should be our goal and that recognising family responsibility would make things more complicated. In principle making our tax system simple is certainly highly desirable. To the extent, however, that the cost of doing so is a failure to properly recognise family responsibility in the tax system, this comes at too high a price.

36. It would be much better to have a tax system that is fair and which does not trap people in poverty even if this came at the cost of more complexity. Given what is actually at stake, it would be a small price to pay. Moreover, if other independent taxation jurisdictions can have proper regard for family responsibility, such an arrangement should not be beyond us.

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