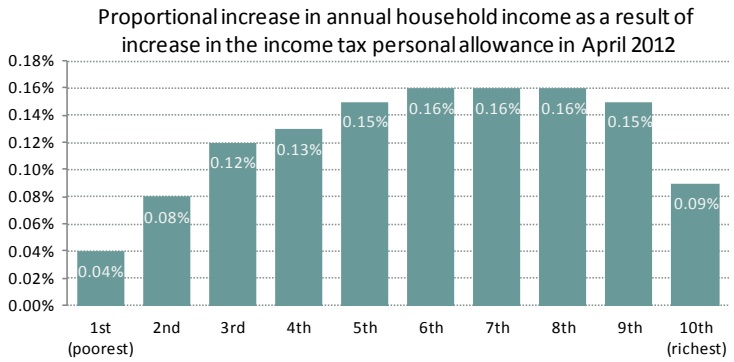

Chart 1: Source *RF analysis using the IPPR tax-benefit model*

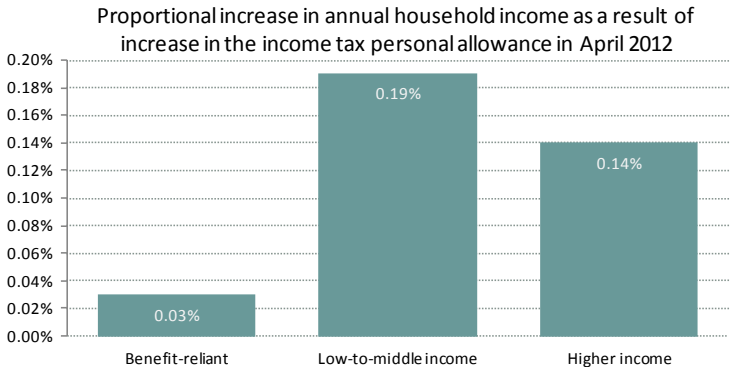

Chart 2: Source *RF analysis using the IPPR tax-benefit model*

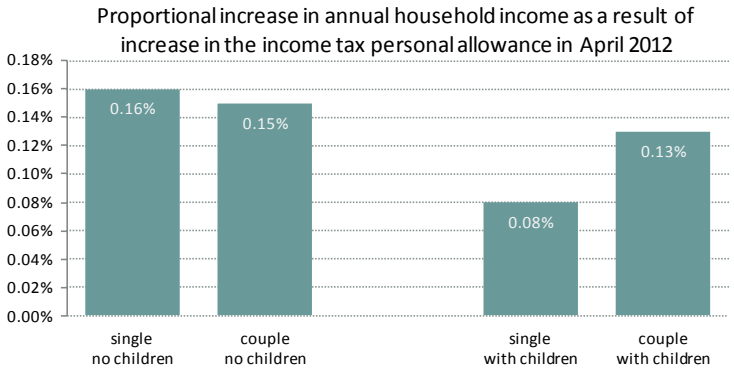

Chart 3: Source *RF analysis using the IPPR tax-benefit model*

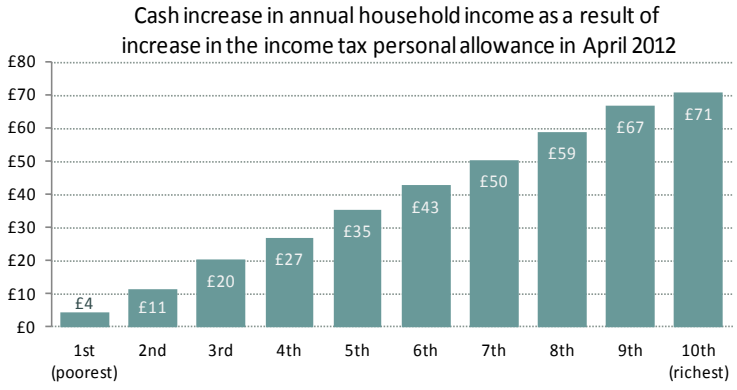

Chart 4: Source *RF analysis using the IPPR tax-benefit model*

2012 personal allowance change

The income tax personal allowance is set to increase to £8,105 in April 2012, rather than the £7,900 it would have been if increased in line with September's RPI. The increase in the allowance, along with a reduction in the basic rate limit from £34,610 to £34,370 (designed to maintain the higher rate threshold at its existing level of £42,475), **is set to benefit all basic rate taxpayers by £41 a year**. Most higher rate taxpayers will also gain by this amount, but those with earnings above £100,000 stand to lose by up to £41 a year because of the gradual withdrawal of the allowance (and therefore any gain associated with its increase) above this threshold.

The charts on the left describe the distributional impact of these changes. Chart 1 shows the gains as a proportion of average household income in each decile. On this basis, **the biggest winners are those around the middle to upper end of the distribution,** with households in deciles 5-9 all gaining to a similar degree. Overall, however, the measure remains regressive in the lower half of the distribution.

This is not surprising, given the concentration of pensioner and workless households at the lower end of the income distribution who will not benefit, and the presence of large numbers of dual earning households at the top end. Chart 2 considers the proportional gains accrued within the three household income groups that the Resolution Foundation defines. It shows that the measure does target gains on low-to-middle income households, although a significant proportion of the giveaway is still accounted for by higher income families.

Chart 3 focuses on the impacts on different family types (across all income groups). It shows that, in proportional terms, couples and singles without children are equally likely to benefit, couples with children do slightly less well, but single parents are significantly less likely to gain. Chart 4 details the average annual cash gains received by households within each income decile and shows that the benefit increases steadily with income, but in real terms the cash amounts are very small.

Prospects for personal allowance change in 2013

The coalition government has committed to increasing the income tax personal allowance to £10,000 over time. Although it is not yet clear how it intends to meet this goal, the OBR's projections for RPI inflation in the coming years mean that such an outcome will require further above-inflation increases. One option would be to increase to £9,000 in 2013-14, and revert to inflation increases thereafter. Here we model the distributional impact of such a path.

When the personal allowance was increased above-inflation in April 2011, the basic rate limit was reduced sufficiently to remove any gains from higher rate taxpayers (by increasing the amount of income they paid 40 per cent tax on to offset the reduced amount they paid 20 per cent tax on). By contrast, the April 2012 personal allowance amendment did not include any such offset. In relation to any possible change in 2013, we consider both options, starting with a repeat of the 2012 approach.

Measured against a counterfactual in which the personal allowance is increased in line with RPI; namely £8,360 and a basic rate limit of £33,730. All basic rate taxpayers would stand to gain by £128 a year, as would those higher rate taxpayers earning less than £100,000. Those above this threshold would have their gain steadily reduced to zero.

Charts 5 & 6 consider the impact across household income deciles. They show that the pattern looks very much like the one for 2012, but at a larger magnitude. That is, those in the top decile would benefit most in cash terms, while those in deciles 4-9 would gain most in proportional terms.

Similarly, Charts 7 & 8 paint a familiar picture for different household types. Chart 7 shows that it is low-to-middle income households that would again be the biggest winners, while Chart 8 highlights that those families without children would once more gain significantly more than those with them.

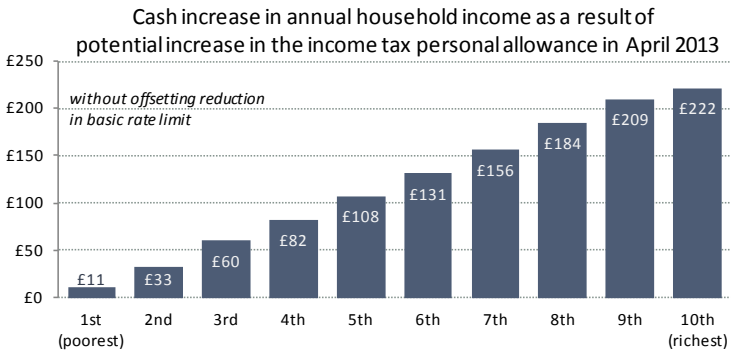

Chart 5: Source *RF analysis using the IPPR tax-benefit model*

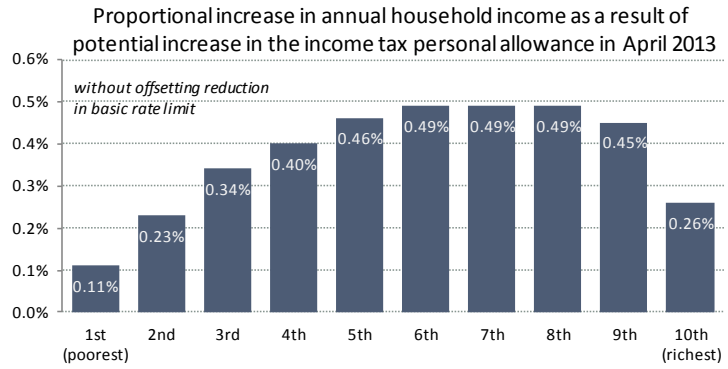

Chart 6: Source *RF analysis using the IPPR tax-benefit model*

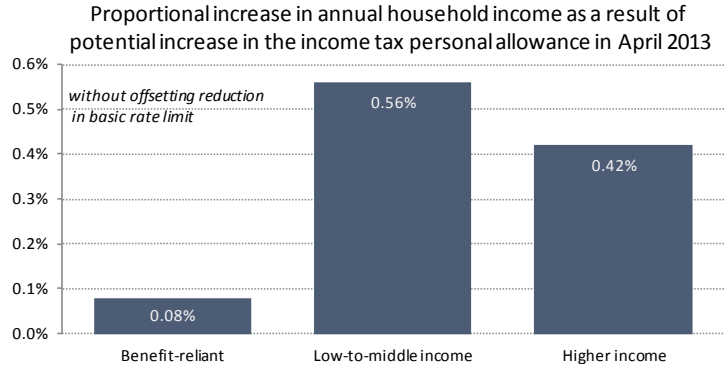

Chart 7: Source *RF analysis using the IPPR tax-benefit model*

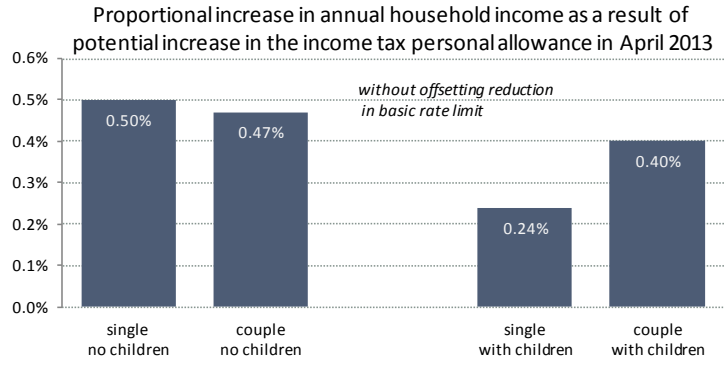

Chart 8: Source *RF analysis using the IPPR tax-benefit model*

Distribution of total giveaway associated with potential increase in the income tax personal allowance in April 2013

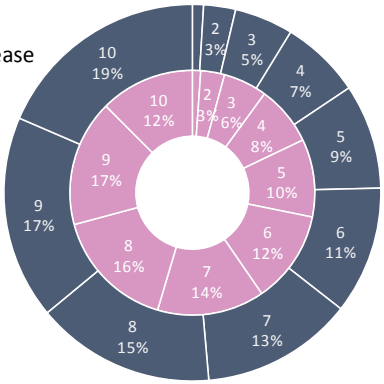

Chart 9: Source *RF analysis using the IPPR tax-benefit model*

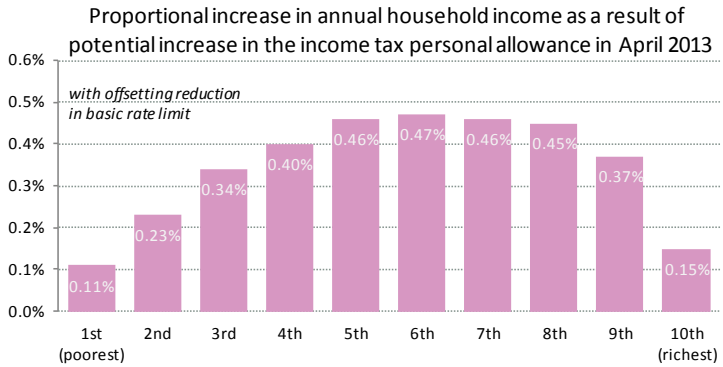

Chart 10: Source *RF analysis using the IPPR tax-benefit model*

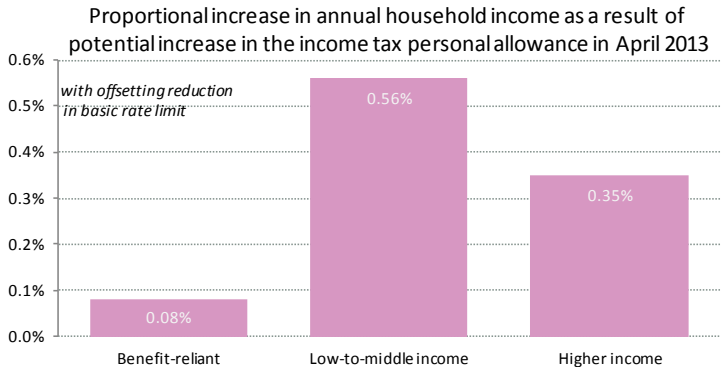

Chart 11: Source *RF analysis using the IPPR tax-benefit model*

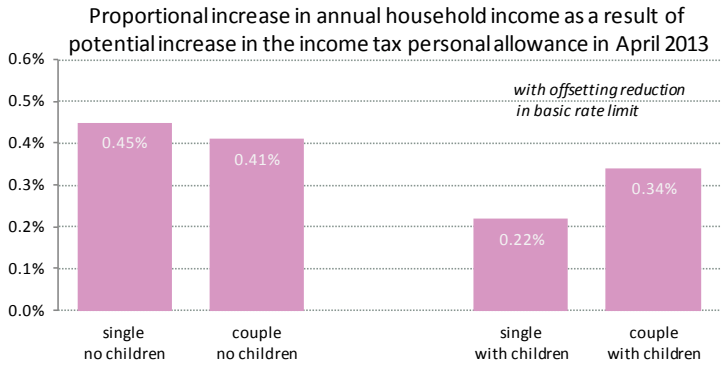

Chart 12: Source *RF analysis using the IPPR tax-benefit model*

The implications of offsetting the increase in April 2013

Clearly, a key consideration in any such move is the cost to the Exchequer. Our modelling suggests that the path set out above would cost around £3.3 billion in 2013-14. Here we consider the cost and distributional implications of offsetting the personal allowance increase with a reduction in the basic rate limit to £33,090, thereby focusing the giveaway on basic rate taxpayers. Under this option, the cost falls to £2.9 billion.

Chart 9 compares the distribution of the gains associated with these two approaches across the income deciles. It shows that the second approach reduces the share of the gain accounted for by those at the very top of the distribution, with the 9th and 10th deciles counting for 29 per cent of the total in this instance rather than 36 per cent as in the first model.

Clearly the measure is still somewhat regressive in cash terms, however. Chart 10 sets out the distribution of proportional gains under this approach. Once again it is deciles around the middle to top that benefit most, but the distribution is much flatter than the one described in Chart 6.

The implication of focusing the benefit on basic rate taxpayers is that a larger portion of the gain is accounted for by low-to-middle income households. Chart 11 shows that the difference in the proportional gain between this group and the higher income one is bigger under this approach than under the one set out above.

Looking across all income groups, Chart 12 shows that the difference between the gains achieved by families with and without children is somewhat smaller than in Chart 8, though the trend remains obvious.

While more focused however, this second approach is potentially more difficult to sell politically because of its impact on the number of higher rate taxpayers. While the first option would increase the number of higher rate taxpayers by around 200,000, the second path would add take a total of 350,000 workers above this threshold (with implications for Child Benefit receipts).

Tax credits

At the same time as the increase in personal allowances, huge additional cuts to tax credits from April 2012 will save over £2.5bn in 12/13, compared to cuts of only £320m that came into effect this year (11/12).

Planned savings to tax credits

£m	11/12	12/13	13/14	14/15
Cumulative	320	2,850	3,615	4,215
Additional	320	2,530	765	600

Low to middle income households receive 56% of all tax credits in cash terms – so will be hit disproportionally by this - compared to 11% received by households on higher incomes and the remaining third for benefit reliant households. Not only is the change huge overall, but it is not widely understood or known about – being made up of a number of smaller changes to both the child tax credit and working tax credits. See below list for specifics.

The changes coming into force from April 2012 include:

- The removal of the £545 family element of the Child Tax Credit from middle income families, saving £475m in 2012-13
- The reversal of the coalition's previous plan to increase the child element of the Child Tax Credit by £110, saving £1.0 billion in 2012-13
- An increase in the number of hours that couples with children are required to work in order to receive the Working Tax Credit from 16 to 24 hours, saving £515m in 2012-13
- The abolition of the 50 plus element of the Working Tax Credit (a payment of up to £2,030 for those over 50 restarting work after a period of unemployment), saving £45m in 2012-13
- The reversal of the previous government's plans to introduce a supplement in the Child Tax Credit for children aged one and two, saving £180m in 2012-13
- A freeze in the value of the £1,950 couple and lone parent elements of the Working Tax Credit, saving £265m in 2012-13

The changes that already came into force in April 2011 include:

- A reduction in support for childcare costs through the Working Tax Credit, reducing the amount of help that parents receive from 80% to 70%
- A £180 above inflation increase in the child element of the Child Tax Credit
- An ongoing three year freeze in the basic and 30 hour elements of the Working Tax Credit
- The faster withdrawal of tax credits as income rises, from 39 pence being withdrawn for ever additional pound earned to 41 pence being withdrawn
- The removal of the £545 baby element of the Child Tax Credit