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Tax Credit changes from April 2016

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Inside:

Contents

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Summary

Summer Budget 2015 announced a package of welfare measures expected to yield savings of £13 billion a year by 2020-21. Changes to tax credits and to Universal Credit (UC) (which is replacing tax credits and means-tested social security benefits) taken together are expected to save £4.6 billion in 2016-17, rising to £5.8 billion a year by 2020-21.

The *Welfare Reform and Work Bill* introduced following the Budget provides for the child element in tax credits and in UC to be limited to two children for new claims and births after April 2017, and abolishes the family elements in tax credits and UC for new claims from 2017.

The draft *Tax Credits (Income Thresholds and Determination of Rates) (Amendment) Regulations 2015*, published on 7 September, introduce two other important elements in the Budget tax credits package: the increase in the taper rate from 41% to 48%, and reductions in the income thresholds. These changes take effect from April 2016, and will deliver savings of around £4.4 billion in 2016-17. There is no transitional protection for existing families on tax credits.

The Social Security Advisory Committee (SSAC) expressed concern at the lack of available evidence to support the policy changes, and urged the Treasury to make available more detailed information on the changes and their potential impacts, to ensure effective Parliamentary scrutiny. The Government said initially that it would not be publishing an Impact Assessment for the regulations, but in response to a request from the Lords Secondary Legislation Scrutiny Committee released a document which gives some further information.

These changes from April 2016 will affect almost all in-work recipients of tax credits. At April 2015, 3.3 million in-work families received tax credits, of whom 2.7 million had children. The average impact across all affected families can be roughly estimated as a reduction in the tax credit award of around £1,300 in 2016-17. The actual impact will vary from family to family however; some will lose more than this amount, others less. Some families will lose entitlement to tax credits completely.

The Government has drawn attention to the overall impact on families of the measures announced in the Summer Budget including the new National Living Wage (NLW), the ambition to increase the income tax Personal Allowance to £12,500 by 2020, and free childcare for 3-4 year olds. It states that a "typical" working family – and the vast majority of working households – will be better off as result of the wider package of measures. Analysis by the Institute for Fiscal Studies (IFS) suggests however that among the 8.4 million working households currently eligible for benefits or tax credits, the biggest element of the Government's wider package – the National Living Wage – would on average only compensate for 26% of the losses due to cuts to benefits and tax credits.

In response to a request from the Chair of the Work and Pensions Committee, Frank Field, the Government brought forward the Commons vote on the regulations introducing the tax credit changes. The debate was held on the floor of the House on 15 September, and the motion to approve the regulations was agreed by 325 votes to 290. Mr Field subsequently wrote to the Chancellor asking him to consider alternative proposals to mitigate the tax credit cuts by maintaining the current threshold and taper for the poorest households.

A date has not yet been announced for the Lords debate on the draft regulations.

This note outlines what tax credits are, the changes announced in the Summer Budget 2015 and how these changes will be implemented. It also looks at the impact these changes will have for families in combination with other measures announced in the Summer Budget 2015, including the introduction of the National Living Wage, the increase to the Personal Allowance and freeze in Child Benefit.

1. What are tax credits?

Tax credits – the Child Tax Credit and the Working Tax Credit – were introduced in April 2003. They replaced Working Families Tax Credit and Disabled Persons Tax Credit, which had been introduced in 1999.

At April 2015, **4.6 million families containing 7.6 million children were receiving tax credits**. 3.3 million tax credit recipients (72% of the total) were in-work families, of whom 2.7 million had children.[1]

Total expenditure on tax credits in the UK is forecast to be **£29.5 billion in 2015-16**. Expenditure on tax credits increased significantly in real terms during Labour's term in office.

Tax credits comprise:

- **Child Tax Credit (CTC)**, payable to people with children. Along with Child Benefit, it provides a single system of financial support for families with children, whether in or out of work. It also replaced the additions for children that were payable with benefits such as Income Support and income-based Jobseeker's Allowance.
- **Working Tax Credit (WTC)**, payable to people in low-paid work, including those without children. Those with children may be able to get help with childcare costs via the childcare element of the Working Tax Credit.

People may receive the CTC, or the WTC, or both. **Tax credits are claimed on a family rather than an individual basis**, so that for couples the incomes and circumstances of both partners will be taken into account.

How much a family receives from tax credits will depend on a number of factors including:

- The **number of dependent children**, and whether any are disabled
- The **number of hours worked** by the adults, and whether they are disabled
- Whether the family is incurring **childcare costs** for eligible childcare
- The family's **income from earnings** and other sources

Tax credits are **means-tested**; i.e. the amount received depends on income, so that in general the amount received tapers away as income increases. For families eligible for Working Tax Credit, the maximum tax credit award is withdrawn at the rate of 41p for every Pound gross income in excess of the income threshold (currently £6,420 a year). For

[1] HMRC, Tax Credits Provisional Statistics: April 2015

families eligible for Child Tax Credit only[2], the income threshold is currently £16,105.[3]

Tax credits – along with means-tested benefits – are to be replaced by **Universal Credit**, but even under the most optimistic scenario for the introduction of UC, some people will still be in receipt of "legacy benefits" in 2020.

2 Many families in receipt of tax credits who are eligible for both WTC and CTC will only be paid CTC, because the WTC part of their award will have tapered to zero because of their earnings. WTC will however have been taken into account in the calculation of their overall tax credit award. The reference here to "families eligible for Child Tax Credit only" refers to families not eligible for WTC.

3 For further information on how awards are calculated see "What are tax credits?" in HMRC's Child and Working Tax Credit Statistics - Finalised annual awards 2013-14

2. What was announced in the Summer Budget?

Changes announced

Summer Budget 2015 announced a package of measures aimed at "making Tax Credits and Universal Credit fairer." In presenting the measures, the Red Book emphasised the growth in spending on tax credits, and the need to focus on the "root causes of low pay":

> **1.141** Tax credit expenditure more than trebled in real terms between 1999-00 and 2010-11, with total expenditure in 2014-15 estimated to be around £30 billion – an increase of almost £10 billion in real terms over the last 10 years. UK expenditure on family cash benefits is the highest in the OECD, and was double the OECD average in 2011. 9 out of 10 families with children were eligible for tax credits in 2010. As a result of the reforms undertaken in the last Parliament, 6 out of 10 are eligible currently.
>
> **1.142** The government believes that now is the best time to address this growing expenditure if the welfare system is to be put on a sustainable footing. Tackling tax credit spending is part of properly addressing the root causes of low pay, with the new NLW [National Living Wage] and a more generous tax system to help people earn more and keep more of what they earn, rather than addressing only the symptoms of the problem by subsidising low pay through the benefit system.
>
> **1.143** The Budget will therefore reform the tax credits system (and its successor, Universal Credit) to protect existing families on the lowest incomes while favouring support to working families through the tax system and earnings growth, rather than the benefit system.[4]

The welfare measures announced in the Summer Budget are expected to **yield savings of £12 billion a year in 2019-20, rising to £13 billion in 2020-21**. The changes to tax credits and to Universal Credit taken together are expected to save £4.6 billion in 2016-17, rising to £5.8 billion in 2020-21. The **changes will see expenditure on tax credits return to 2007-08 levels in real terms**. The main savings arise from:[5]

- **Reducing the income thresholds** in tax credits and UC work allowances, so that maximum awards start to be withdrawn at a

[4] Summer Budget 2015, HC 264 2015-16

[5] The Budget also announced a reduction in the in-year income disregard – which allows income increases below a certain amount to be disregarded when calculating entitlement to tax credits – from £5,000 to £2,500 from April 2016, saving £170 million in 2016-17. The previous Government had already reduced the disregard from £25,000 to £10,000 in April 2011, and to £5,000 in April 2013. The further reduction will increase the number of tax credit overpayments. The draft *Tax Credits (Income Thresholds and Determination of Rates) (Amendment) Regulations 2015* provides for the reduction in this threshold, but it is not considered further in this note.

lower income level (saving £2.9 billion a year in 2016-17, rising to £3.4 billion a year by 2020-21);

- **Increasing the tax credits withdrawal rate** (taper) from 41% to 48%, so that tax credits reduce more sharply as income increases (saving £1.5 billion in 2016-17, declining to £245 million by 2020-21);
- **Limiting the child element** of tax credits and UC to two children for new claims and births after April 2017 (saving £1.4 billion a year by 2020-21); and
- **Removing the family element** in tax credits and UC (and the family premium in Housing Benefit) for new claims from 2016 or 2017 (saving £675 million a year by 2020-21)

The **Institute for Fiscal Studies** estimates that the long-run savings from some of the measures will be even greater (as transitional protection for existing families declines). It estimates the long-run savings from the abolition of the family element at around £2 billion a year, and from removing tax credit/UC support for third and subsequent children at around £3 billion a year.[6] At April 2015, just under 900,000 families (of whom 590,000 were in work) were receiving tax credits for three or more children.[7]

Implementation

The ***Welfare Reform and Work Bill*** introduced following the Budget provides for the child element in tax credits and in UC to be limited to two children for new claims and births after April 2017, and abolishes the family elements in tax credits and UC for new claims from 2017.

The changes to the tax credits taper and income threshold from April 2016 do not require primary legislation and can be made via regulations. The draft ***Tax Credits (Income Thresholds and Determination of Rates) (Amendment) Regulations 2015***, published on 7 September, makes the necessary amendments to the taper and to thresholds. The regulations are subject to the affirmative procedure.

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6 Andrew Hood, Benefit changes and distributional analysis, IFS presentation, 9 July 2015

7 HMRC, Child and Working Tax Credits Statistics: April 2015, Table 3.2

3. How will tax credit awards change from April 2016?

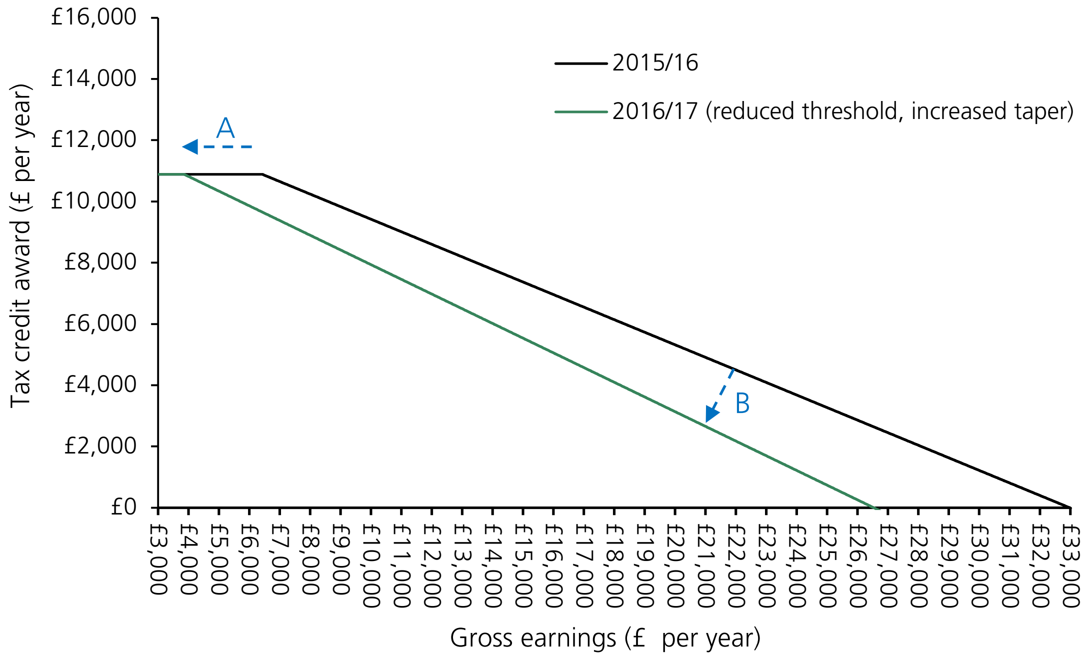
For most working families receiving tax credits, the lower threshold and increased taper rate have the combined effect of reducing a working family's tax credit award in 2016-17 by:

A- 48% of the difference between the old and new thresholds (48% of £6,420-£3,850 = £1,233.60)

B- 7% of gross earnings above £6,420 (this income is currently tapered at 41%, from 2016 at 48%)

Figure 1 illustrates the combined impact of the **increase in the taper rate** and the **reduction in the income threshold** for a working family (lone parent or couple, working 30 hours or more) with two children. It is assumed no additional amounts are payable for disability or for childcare costs.

Figure 1: Impact of threshold reduction and increased taper rate on a couple/lone parent with two children, 1 full time earner, no childcare costs



The combined impact of these changes is to reduce tax credit awards for working families and to take some families out of tax credits altogether – in this example, **the tax credit award is extinguished for earnings above approximately £26,520 instead of £32,960**.

Families who do not satisfy the conditions for Working Tax Credit – Child Tax Credit only claimants – will not be affected by the changes as outlined above. However, the separate, higher income threshold for CTC only claimants is also to reduce in April 2016, from £16,105 a year to £12,125. These changes will impact upon families eligible for CTC only with incomes (for tax credit purposes) in excess of £12,125.

4. How many families will be affected?

The main group affected by the tax credit changes in April 2016 will be **in-work families eligible for Working Tax Credit**.[8] All such families with incomes in excess of the new, lower threshold of £3,850 will be affected.

In 2016-17, the increase in the tax credit taper rate to 48% and the reductions in the income thresholds are expected to result in **savings totalling £4.355 billion**.[9] Assuming savings accrue only from in-work families (ie ignoring the impact of the reduction in the threshold for CTC only families) gives a rough estimate of the **average loss across all in-work families in the region of £1,300 in 2016-17**. This is an average figure however – for some families, the loss will be greater, for others less. See Sections 5 and 6 for further details.

Quick statistics

At 3 April 2015, 4.57 million families were in receipt of tax credits of which 3.28 million (72%) were in-work. These statistics are from HMRC's Child and Working Tax Credit provisional statistics, April 2015. Of these 3.28 million in-work families:

- 2.72 million in-work families (83%) had children
- 2.28 million in-work families received the 30hr element of WTC
- 0.12 million in-work families received the Disabled Worker element of WTC
- 0.16 million in-work families received the Disabled Child element of CTC

HMRC's Provisional Child and Working Tax Geographic Statistics show that, as of April 2015:

- 2.73 million (83%) in-work families in receipt of tax credits were in England, including 0.42 million (13% of the UK total) in the North West, 0.41 million (12% of the UK total) in London and 0.35 million (11% of the UK total) in the South East.
- 0.17 million (5% of the UK total) in-work families in receipt of tax credits were in Wales
- 0.25 million (8% of the UK total) in-work families in receipt of tax credits were in Scotland
- 0.11 million (3% of the UK total) in-work families in receipt of tax-credits were in Northern Ireland

8 While Child Tax Credit only claimants may be affected by the reduction in the income threshold for that group from £16,105 to £12,125, only 35,000 of the 1,290,000 families receiving CTC only at April 2015 were receiving less than the maximum CTC because they had income in excess of the £16,105. This suggests the impact of the lower threshold for CTC only families will have less of an impact (in terms of the numbers affected) than the lower threshold for those eligible for WTC.

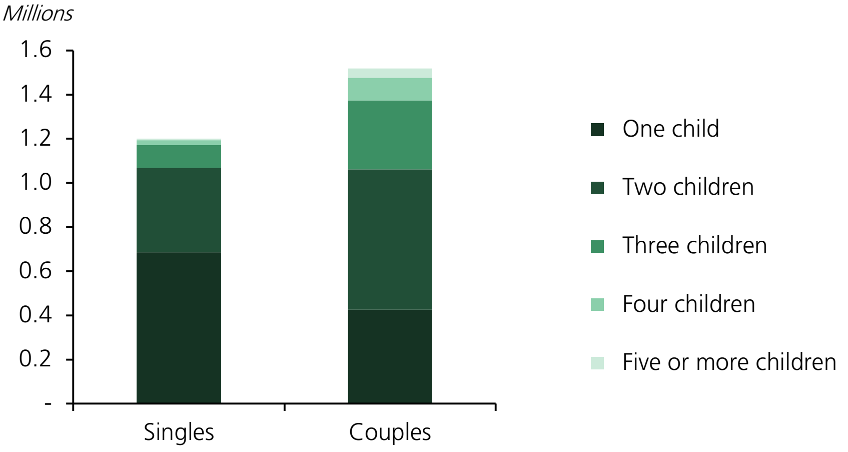
9 Summer Budget 2015, HC 264 2015-16, Table 2.1

In-work families in receipt of tax credits with children

As of April 2015, there were 5.16 million children in 2.72 million in-work families in receipt of tax credits.

Figure 2 shows the number of in-work families in receipt of tax credits with children by number of children.

Figure 2 In-work families in receipt of tax credits with children, by number of children, April 2015



Source

HMRC Child and Working Tax Credits Provisional Statistics, April 2015

Of all 2.72 million in-work families in receipt of tax credits with children:

- 1,200,300 (44%) contained a single adult and 1,518,600 (56%) a couple
- 686,000 single adult families contained 1 child, 57% of all in-work single adult families in receipt of tax credits with children
- 426,500 couples in receipt of working tax credits had one child (28% of all in-work couples with children in receipt of tax credits)
- 634,500 couples had two children (42% of all in-work couples with children in receipt of tax credits)

In-work families in reciept of tax credits by income bands

HMRC also publish data on the income of in-work tax credit recipients by income bands. **Figure 3** shows latest available data for April 2015. Of all in-work families, 43% had gross earnings of below £10,000 per annum and 77% had gross earnings below £20,000 per annum.

Figure 3 In-work tax credit claimants by income band used to taper awards, April 2015

Source

HMRC Child and Working Tax Credits Provisional Statistics, April 2015

The impact in constituencies – constituency level data

Constituency data on the impact of welfare measures announced in the Summer Budget 2015 is available from the Library's Summer Budget 2015: a summary briefing paper. The attached spreadsheet shows the number of families receiving Child and Working Tax Credits by constituency, including a breakdown for in- and out- of work families and families with children. The spreadsheet also shows the number of children in these families.

Almost all in-work families will be affected by the changes to tax credits discussed above. Therefore, the number of in-work families in a constituency is a reasonable guide to the number of families in a constituency that will be impacted by these changes.

Impact on individual families

The Low Incomes Tax Reform Group (LITRG) has produced a quick reference table to help gauge the impact of the changes from April 2016 on individual families – see How will the tax credits cuts in April 2016 affect you?

5. What will the impact of these and other Budget measures be?

Multiple, seemingly contradictory assessments of the impact of changes to tax credits on working families have appeared in the media in recent weeks. When assessing these statements it is useful to distinguish between those that relate to the impact on *specimen* or *example* families – that is, hypothetical families under a combination of circumstances selected for purposes of the analysis – and the impact across all families *on average* – that is, macro modelling that takes all families in the UK, or a subset of them, into account.

This section analyses three different approaches to calculating the impact of changes to tax credits on working families in combination with other measures in the Summer Budget. Calculations from the House of Commons Library and Summer Budget 2015, below, show the impact of these changes on *example* families (sometimes referred to as 'typical'). Alternatively, analysis from the Institute of Fiscal Studies shows the impact of changes across all households *on average.*

Calculating a family's tax credit entitlement
The maximum tax credit award to which a family is entitled depends on a range of issues. See Section 1 for further details.

The Summer Budget 2015 included other measures that will impact upon the income of individuals and families. These included:

National Minimum Wage & National Living Wage
An increase in the National Minimum Wage for people aged 25 and over. From April 2016 the "National Living Wage" (NLW) is to be set at £7.20 an hour. The intention is to increase the NLW so that it reaches 60% of median hourly wages by 2020. Based on Office for Budget Responsibility estimates, the NLW would rise to £9.35 an hour by April 2020.

Personal Allowance increase
An increase in the income tax Personal Allowance to £11,000 in 2016-17. It is the Government's "ambition" to increase the Personal Allowance further to £12,500 by 2020.[10]

Child Benefit frozen
A freeze in Child Benefit for the duration of the Parliament.

House of Commons Library calculations: impact of combined Budget measures on a single-earner couple with two children

Figure 4 shows the combined impact of these measures – together with changes to tax credits - on **a single-earner couple with two children, neither of whom is in childcare, working 35 hours a week on the National Minimum/Living Wage**. It compares the impact of these measures ("Scenario 1a") to a "no policy change" scenario ("1b") in which the Summer Budget 2015 did not occur and

[10] HM Treasury, Summer Budget 2015: key announcements, 8 July 2015

policy inherited from the Coalition government is extrapolated to the end of this Parliament unchanged.

Figure 4: Final tax credit award, child benefit and net income of a single-earner couple or lone parent (with two children) working 35 hrs a week

All figures in nominal (cash) terms

	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Scenario 1a - Transfer from the NMW to the NLW in 2016-17, Summer Budget 2015 changes applied						
Gross Earnings p.a.	£12,227	£13,139	£14,052	£14,964	£15,968	£17,063
Net earnings p.a.	£11,402	£12,102	£12,769	£13,441	£14,179	£15,120
Final tax credit award	£8,504	£6,426	£5,988	£5,550	£5,068	£4,753
Child benefit receipt	£1,794	£1,794	£1,794	£1,794	£1,794	£1,828
Net Income p.a.	***£21,699***	***£20,322***	***£20,551***	***£20,785***	***£21,041***	***£21,700***
Scenario 1b – No policy change – working on the NMW, ignoring changes announced in the Summer Budget 2015						
Net earnings p.a.	£11,401	£11,774	£12,116	£12,539	£13,026	£13,693
Final tax credit award	£8,504	£8,280	£8,223	£8,183	£8,131	£8,132
Child benefit receipt	£1,794	£1,794	£1,815	£1,846	£1,880	£1,914
Net Income p.a.	***£21,699***	***£21,847***	***£22,153***	***£22,568***	***£23,037***	***£23,738***
Comparison of scenarios 1a and 1b						
Gross Earnings p.a.	+£0	+£365	+£821	+£1,186	+£1,551	+£2,099
Net earnings p.a.	+£0	+£328	+£653	+£902	+£1,153	+£1,427
Final tax credit award	-£0	-£1,853	-£2,235	-£2,633	-£3,063	-£3,379
Child benefit receipt	£0	£0	-£21	-£52	-£86	-£86
Net Income p.a.	+£0	-£1,525	-£1,603	-£1,783	-£1,996	-£2,038

Source
House of Commons Library calculations
Notes
National Minimum/Living Wage
Scenarios 1a and 1b - projections based on Chart 1.12, page 33 of Summer Budget 2015
Personal Allowance
Scenario 1a - Government pledge to raise the Personal Allowance to £12,500 by 2020-21 Summer Budget 2015
Scenario 1b - Personal Allowance uprated to £12,500 by 2020-21. In his Autumn Statement 2014 the Chancellor referred to the "new goal that we have set of raising the personal allowance to £12,500 so that people working full time on the minimum wage pay no tax at all". The Liberal Democrat Party announced this as a 'red line' in any coalition negotiations prior to the May 2015 General Election.
Tax Credit awards
Scenarios 1a and 1b – both scenarios assume this family is not in receipt of any award from the Childcare element of Child Tax Credits
Scenario 1a – Four year freeze of all components from 2016-17 to 2019-20 as announced in the Summer Budget
Scenario 1b – Basic, Additional Couples/Lone Parent and 30 hr elements of Working Tax Credits and Child element of Child Tax Credits uprated by CPI 2016-17 to 2020-21
Tax Credit thresholds and tapers
Scenario 1a – 2015-16 Income threshold of £6,420 and taper rate of 41%; 2016-17 to 2020-21 Income threshold of £3,850 and taper rate of 48%
Scenario 1b – All years, income threshold of £6,420 and taper rate of 41%
Child Benefit
Scenario 1a – Four year benefit freeze 2016-17 to 2019-20 as announced in the Summer Budget 2015
Scenario 1b – Uprated in line with CPI

Scenario 1a shows that in 2015-16 the annual gross earnings of someone working 35 hours a week on the **National Minimum Wage** (£6.70 an hour from October 2015) would be **£12,227**.

In 2016-17 the **National Living Wage** will be £7.20 per hour, equivalent to an **annual gross earnings of £13,139** for someone aged 25 or over working 35 hours a week. This would increase to approximately £9.35 per hour in 2020-21 according to forecasts in the Summer Budget 2015, equivalent to an **annual gross earnings of £17,063** for someone (aged 25 or over) working 35 hours a week.

Given these assumed changes in earnings a single-earner family with 2 children and 1 adult (aged 25 or over) working 35 hours a week would **receive £8,504 in tax credits in 2015-16**, falling to £6,426 in 2016-17 and to **£4,753 in 2020-21**. Note that, together with the reduced threshold and increased taper rate, these calculations take into account the four year freeze of all working age benefits (including tax credit elements) at 2015-16 rates.

Child Benefit will be frozen for the duration of the Parliament. Therefore, the family would receive **£1,794 in Child Benefit each year 2015-16 to 2019-20** and £1,828 in Child Benefit in 2020-21.

Net income of this family, accounting for changes to tax credits, the Minimum Wage, Child Benefit and the Personal Allowance announced in the Summer Budget, would **fall from £21,699 in 2015-16 to £20,322 in 2016-17**. In 2020-21 the family's net income would be £21,700, meaning this family's net income will not return to its current level, in cash terms, until the end of this Parliament.

Comparison of these projections to a "no policy change" scenario shows that **in 2016-17 the family's net income would be £1,525 below what it would otherwise have been** had changes announced in the Summer Budget 2015 not been applied.

Summer Budget 2015: impact of combined measures on households in receipt of Housing Benefit and Universal Credit

Two statements in the Summer Budget 2015 concerning the impact of these combined measures on working families have received media attention.

First, that 8 in 10 working households will be better off as a result of changes in the Summer Budget 2015.

Paragraph 1.66, page 25, of Summer Budget 2015 states that:

> *"By 2017-18, 8 out of 10 working households will be better off as a result of the income tax Personal Allowance, living wage and welfare (including tax credits) changes in this Budget. On average, these households will be £130 per year better off."*

Note that this figure is for *all working households*, not just those in receipt of tax credits. This estimate is from HM Treasury micro-simulation modelling, as stated on page 25 of the Summer Budget 2015 data sources guide.

According to latest available data, in the UK there are:

- **17,413,000 working-age households containing someone is in work** (source: Working and Workless Households, Apr-June 2015 table A)
- **3,277,300 in-work families on tax credits** (equivalent to 19% of the above) (source: HMRC April 2015 stats)

Second, that a typical single earner couple working 35 hrs a week on the NLW will be around £2,400 better off. The Prime Minister cited this figure in a BBC interview on the 5 October 2015, for example.

Figure 5 Table 1.8 from the Summer Budget 2015, page 40

Table 1.8: Illustrative impact on households of personal tax, welfare and National Minimum Wage/National Living Wage changes 2010-11 to 2020-21

	net income (cash)			Change since 2015-16 (cash terms)	% change since 2015-16 (cash terms)	% change since 2015-16 (real terms)
	2010-11	2015-16	2020-21			
Dual earner family: Couple, 2 children, 2x35hrs on NLW	£24,850	£28,160	£33,730	£5,570	20%	12%
Part-time second earner: Couple, 2 children, 1st earner earns median salary, 2nd earner 16hrs on NLW	£27,020	£29,130	£35,480	£6,350	22%	14%
Single earner family: Couple, 2 children, 1x35hrs on NLW	£23,060	£26,040	£28,510	£2,480	10%	3%
Working lone parent: 1 child, 35hrs on NLW	£18,850	£21,110	£22,650	£1,550	7%	1%
Single person: no children, 35hrs on NLW	£11,560	£13,060	£15,170	£2,110	16%	9%
Out of work couple, 1 child	£15,600	£17,690	£18,030	£350	2%	-4%
Out of work couple with children, living outside London, subject to benefit cap	£28,300	£26,000	£20,000	-£6,000	-23%	-28%

Households are assumed to be renting at the average LHA rate. Benefit cap example is based on a higher rent and 3 children. Legacy benefits system is used for 2010-11 and 2015-16; UC system for 2020-21. Excludes council tax and Council Tax Benefit/Council Tax Support.

2020-21 includes the Government's ambition to raise Personal Allowance to £12,500

All working households earn the NMW (NLW in 2020-21) unless stated otherwise. Minimum wage rates used are those in effect at the beginning of the fiscal year. Individuals' earnings above the NMW/NLW are assumed to rise with average earnings.

Figures may not sum due to rounding.

Source: HM Treasury calculations, ONS earnings data, OBR earnings and inflation forecasts.

This figure is based on table 1.8, page 40 of the Summer Budget 2015 (**figure 5**). The table shows the illustrative impact on households of personal tax, welfare and National Minimum Wage/ National Living Wage changes 2010-11 to 2020-21. It shows that the net income of a single earner family with 2 children, working 35 hrs a week on the NLW would, on the basis of the assumptions made, receive a cash terms boost of around £2,480 from 2015-16 to 2020-21.

Note that these figures are for *specimen* families under a selected combination of circumstances; neither these nor the Library calculations in figure X represent the average impact of combined Summer Budget measures across *all* families. See below and Section 6 for the Institute of Fiscal Studies' analysis of the average impact on Summer Budget measures across all families.

Specifically, table 1.8 shows data for families:

- Renting private accommodation for which they receive Housing Benefit based on the average LHA rate (note net income is shown before rent has been paid)
- Receiving Universal Credit in 2020-21 and equivalent legacy benefits in 2010-11 and 2015-16
- Earn the National Minimum/Living Wage, assumed to rise with average earnings
- That have, in the case of the example family subject to the Benefit Cap, 3 children and pay a higher rent than other families shown in the table

Institute of Fiscal Studies analysis: average impact of combined Budget measures across all households

The **Institute of Fiscal Studies** has analysed the combined impact of changed announced in the Summer Budget 2015. **Figure 6**, based on the IFS's 10 September 2015 briefing note, shows the impact of forthcoming tax and benefit changes and gains from the new National Living Wage by household working status and whether or not the household contains children. Figures are for 2019-20.

Average gains from the NLW are based on a "better case" calculated by the IFS. This assumes the overall increase in gross wages due to the NLW to be £5.6 billion, compared to £4 billion suggested by the Office for Budget Responsibility (see page 10 of the IFS briefing note for further details).

Figure 6 Estimated impact of forthcoming tax and benefit changes and "better case" gains from the new NLW, by household working status and whether or not the household contains children (2019-20)

	Number of households (millions)	Av. Annual impact of tax & benefit changes (£ per year)	Av. "better case" annual gain from the new NLW (£ per year)	**Av. "better case" net change (£ per year)**	*"Offset" (impact of NLW as % of impact of benefit & TC changes)*
All households	27.1	-£478	£129	**-£348**	*27%*
All working age HH eligible for benefits/tax credits	11.3	-£1,089	£147	**-£942**	*13%*
Of which:					
with somone in paid work	8.4	-£754	£198	**-£556**	*26%*
w/o someone in paid work	2.9	-£2,069	£0	**-£2,069**	*0%*
All working age HH eligible for benefits/tax credits with children	7.0	-£1,272	£144	**-£1,127**	*11%*
Of which:					
with somone in paid work	5.9	-£909	£172	**-£737**	*19%*
w/o someone in paid work	1.1	-£3,159	£0	**-£3,159**	*0%*
All working age HH eligible for benefits/tax credits w/o children	4.3	-£796	£153	**-£643**	*19%*
Of which:					
with somone in paid work	2.6	-£400	£257	**-£142**	*64%*
w/o someone in paid work	1.8	-£1,374	£0	**-£1,374**	*0%*

Source
Based on table 2 page 13, IFS Briefing Note BN175 (10 September 2015)

Figure 6 shows that in 2019-20:

- Among the **2.9 million working age households eligible for benefits or tax credits and not containing anyone in work** the average loss from the cuts to benefits and tax credits is estimated at **£2,070 per year**, with no offsetting compensation from the NLW.
- Among the **8.4 million working age households who are currently eligible for benefits or tax credits who contain someone in paid work** the average loss from the cuts to

benefits and tax credits is **£750 per year**. Gain from the NLW among this group, according to the IFS' "better case" scenario, is estimated at **£200 per year** – offsetting **26%** of losses.

- Among the **4.3 million working age families who are eligible for benefits or tax credits but do not have children** the average loss from cuts to benefits and tax credits is **£800 per year** and the average gain from the NLW (under the "better case" scenario) **£150 per year** – offsetting **19%** of losses.
- Among the **7 million working age families who are eligible for benefits or tax credits and who have children** the average loss from cuts to benefits and tax credits is **£1,270 per year** and the average gain from the NLW (under the "better case" scenario) is **£140 per year** – offsetting **11%** of losses.[11]

Note that the IFS analysed the average impact of tax and benefit changes, together with the National Living Wage, across all 8.4 million working households – a much larger group than the 3.3 million working households receiving tax credits.

[11] These findings are summarised from pages 12 to 14 of the IFS briefing note BN175 (10 September 2015)

6. What about the National Living Wage?

Almost all in-work families in receipt of tax credits will be affected by the reduction in threshold and increase in taper rate. Reductions in tax credits will not, on average, be fully offset by gains from the new National Living Wage.

Tax credits and minimum wages are not, as explained in the Institute for Fiscal Studies' post-Budget briefing, substitutes. Tax credits support those with low annual family incomes, whereas minimum wages support those with low hourly wages, many of whom will be in families with higher incomes. Not all those affected by changes to the National Minimum/Living Wage will be affected by changes to tax credits, nor vice versa.

Many working people will benefit from the introduction of the National Living Wage. However, studies by the IFS and the Resolution Foundation show that average annual gains from the National Living Wage are concentrated in the middle of the household income spectrum. In addition, the OBR's analysis of families who gain from the NLW shows financial gains are evenly spread across the household income distribution.

As summarised by Paul Johnson, Director of the IFS:

> *"…the key fact is that the increase in the minimum wage simply cannot provide full compensation for the majority of losses that will be experienced by tax credit recipients. That is just arithmetically impossible. The gross increase in employment income from the higher minimum wage is about £4 billion. Welfare spending as a whole is due to fall by £12 billion and, even excluding the effects of the four year freeze tax credit spending is due to be cut by getting on for £6 billion. And of course many of the recipients of the higher minimum wage will not be tax credit recipients. Unequivocally, tax credit recipients in work will be made worse off by the measures in the Budget on average."*

Who will gain from the National Living Wage?

Among households that gain from the NLW in 2020 around half of cash gains may accrue to the top half of the household income distribution, according to the Office for Budget Responsibility. Tax credits are conditioned on household income, whereas the NLW affects the income of individuals *within* households. Since many workers on the NLW will be a households' second earner, gains from the NLW are spread across the income distribution – as opposed to concentrated at its bottom. See Chart B.3, page 208, of the OBR's Economic and Fiscal Outlook July 2015 for further details.

Across **all households** (as opposed to just those which gain), gains from the NLW in 2020 are concentrated in the middle of the income distribution, according to analysis by the Resolution Foundation.

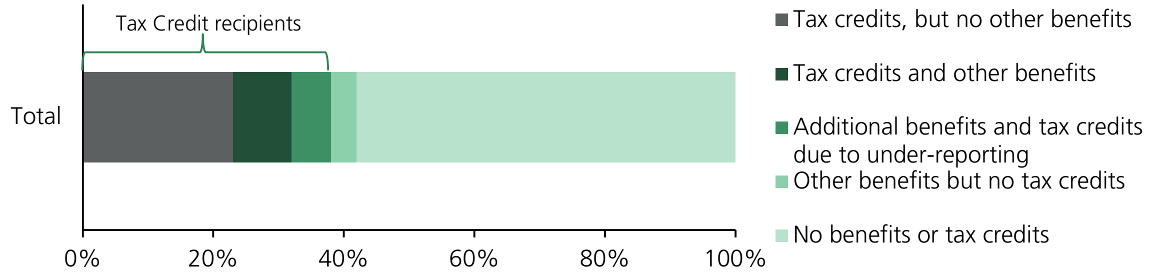
Households in the bottom and top deciles of the income distribution will experience the smallest average annual gains, in terms of both gross and net income. Households in the fourth decile will, on average, experience the largest percentage increase in net income – followed by those in the third and sixth income deciles. See Figure 6, page 26, of the Resolution Foundation's Higher ground: who gains from the National Living Wage? September 2015 publication for further details.

How does this relate to families on tax credits?

Earning at the minimum wage is not necessarily synonymous with receiving tax credits (or any other form of benefit).

Between 58% and 64% of adults earning near the minimum wage do not receive tax credits or benefits, according to the New Policy Institute's February 2015 paper *How the minimum wage interacts with the tax and benefit system* (published by the Low Pay Commission). Around 23% of adults earning near the minimum wage are receiving tax credits but no other benefits; 9% tax credits and other low income benefits; and 4% benefits but no tax credits.

Figure 7 Proportion of adults earning near the NMW in receipt of tax credits and/or benefits, 2010-11 to 2011-12



Source
From page 46 of the New Policy Institute's How the minimum wage interacts with the tax and benefit system (February 2015), published by the Low Pay Commission
Based on 2010-11 to 2011-12 data from the Family Resources Survey

Note these figures are based on 2010-11 to 2011-12 data and, therefore, do not fully reflect the reductions in tax credit recipients as a result of measures introduced by the 2010-15 Government. Alternatively, analysis by the Resolution Foundation shows that in 2020 26% of households gaining from the NLW will be entitled to in-work support.[12]

Average losses as a result of combined measures in the Summer Budget 2015 are greater towards the bottom of the income distribution, according to separate studies by the IFS and the Resolution Foundation.

The average annual losses in 2019-20 from tax and benefit changes in deciles 2, 3 and 4 of the household income distribution are £1,340, £980 and £690 per year respectively, according to analysis by the IFS.[13] These same groups are estimated to gain £90, £120 and £160 from the new NLW in 2019-20 (a "better case" scenario – see Section 5.2 for further detail).

[12] Resolution Foundation; Higher Ground; page 29
[13] See page 2 http://www.ifs.org.uk/publications/7975

The National Living Wage reduces total income losses due to welfare changes for households in the bottom half of the income distribution by 13%, according to the Resolution Foundation.[14] Figure 7, page 30 of the Foundation's Higher Ground report shows the impact of Summer Budget 2015 measures on households by income decile with and without the NLW. Taking the NLW into account, greatest average losses are for households in the bottom three deciles of the income distribution.

[14] See page 29

7. What has the Social Security Advisory Committee said about the draft Regulations?

The **Social Security Advisory Committee** (SSAC) is an independent statutory body that provides impartial advice to the Government on social security and related matters. Comprised of Chair Paul Gray, Vice Chair Les Allamby and up to 13 other members, it scrutinises most of the secondary legislation that underpins the social security system.

In a letter of 9 September to the Financial Secretary to the Treasury, the SSAC Chair Paul Gray said that the Committee was concerned at the lack of available evidence to support the policy changes in the draft *Tax Credits (Income Thresholds and Determination of Rates) (Amendment) Regulations 2015*. While recognising the fiscal challenge faced by the Government and its manifesto pledge to reduce welfare spending; and the challenging timescales officials had been working within, Mr Gray said that the Committee "would be concerned if the changes being proposed had not been informed by evidence, at least in some rudimentary form." SSAC was particularly disappointed that HMRC officials were not in a position to share their observations on key issues, including-

- the potential impact the introduction of the national living wage might have on the proposals;
- whether there were likely to be any behavioural impacts brought about by the proposals;
- the degree to which the proposals are likely to impact upon the successful transition of Tax Credits to Universal Credit;
- the likely or actual effects of the policy on people of 'protected characteristics' and the evidence considered in reaching that view; and
- the evidence that had resulted in a view that the proposals will have no impact on charities or the voluntary sector.

The letter stated "There can be no question that this Committee is hampered in its role of scrutinising proposed changes in cases where the supporting explanatory material and evidence is scant." It also added:

> In the case of The Tax Credits (Income Thresholds and Determination of rates) (Amendment) Regulations, which are affirmative, we would expect Parliament to want more detailed information that clearly explains the changes and potential impacts to ensure that they can be subject to effective scrutiny. We would encourage you to take steps to make that material available for that purpose.

8. Debate on the regulations

The draft *Tax Credits (Income Thresholds and Determination of Rates) (Amendment) Regulations 2015* were debated on the floor of the House of Commons on 15 September 2015.[15] Introducing the debate, the Exchequer Secretary to the Treasury, Damian Hinds, said the timing of the debate had been brought forward in response to a request from Frank Field (Chair of the Work and Pensions Committee). In presenting the changes, Mr Hinds explained:

> For too long, low pay has been addressed in this country not by genuine reform and driving productivity, but by subsidising it through the tax credit system. In the decade to 2010, tax credit expenditure more than trebled in real terms. The changes introduced in this order will build on the last Parliament's reforms and return real-terms tax credit spending to its 2007-08 levels—a decade into the Labour party's tenure in government. It is not a stand-alone measure, but part of what my right hon. Friend the Chancellor called a "new contract" with working Britain. It says to businesses, "You will have to pay higher wages, but you will get lower business taxes and a stable economy"; it says to people, "You can get higher pay and lower tax, but with less benefit top-up"; and it says to the country, "We are going to spend less and live within our means". These regulations are an important part of that, and I commend them to the House.[16]

For Labour, the Shadow Chief Secretary to the Treasury, Seema Malhotra, said that the measures would "attack families in which people are working hard to do the right thing and to achieve what we all want to see: a higher-wage economy in which people are less reliant on tax credits to make ends meet."[17]

She added:

> The Government have sought to argue that working people will be compensated for the cuts by the increases in the minimum or living wage. That is contested by the Institute for Fiscal Studies, which says that it is "arithmetically impossible". Although we welcome the increase to the personal allowance and the introduction of the so-called national living wage, as the Low Incomes Tax Reform Group has stated, any gains from those measures will not negate the impact of these tax credit cuts from April 2016. The IFS recently concluded that families will lose over £1,000 a year on average from cuts to tax credits, while they will gain between £100 and £200 a year at most from the proposed national living wage, and even that is seen as optimistic.[18]

Ms Malhotra said that the proposed changes "arguably represent the largest single cut to family incomes ever implemented by a Government" and urged Conservative Members to join Labour in voting against the regulations.[19]

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15 HC Deb 15 September 2015 cc964-994
16 Ibid. c967
17 Ibid. c969
18 Ibid. cc970-1
19 Ibid. 973

Frank Field said that the tax credit measures were not only "the most significant fiscal change a Conservative Government have made, but it affects disproportionately the poor" and that many Members, including Conservative Members, would "want to put on the record their disquiet with the Government."[20]

Mr Field continued:

> I am surprised that the Chancellor is not present—this was my main reason for calling for this debate—because he was clearly the architect of the Budget. He is the most political Chancellor I have known in my whole period in the House of Commons. In the lead-up to the last election, and during it and since, he managed to push Labour into a very unpleasant corner where we were the welfare party and the Conservatives were the party of the strivers. In one single move, he has destroyed his 2020 election strategy. We heard the Chancellor's very powerful speeches saying that the Conservative party was in favour of individuals who, when they got up in the morning to do grotty jobs for very low pay, passed the windows with the curtains still drawn of their neighbours on benefits. Individuals in this country who still get up with the work motive, which is so important for both economic and human advance, will know as they pass the windows with the curtains drawn that they do so with, on average, £1,300 a year less in their pocket.[21]

The regulations were agreed by 325 votes to 290.

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[20] Ibid. cc980-1
[21] Ibid. c981

9. Frank Field's proposal

On 29 September Frank Field wrote to the Chancellor of the Exchequer urging him, in advance of the Autumn Statement, to consider a proposal to mitigate the impact of the tax credit changes from April 2016 on the poorest working households. Mr Field highlighted estimates that 3.2 million low income working families would lose an average of £1,350 a year, "despite striving to make ends meet." He continued:

> As you will know I welcome wholeheartedly the introduction of the National Living Wage. But its potentially revolutionary impact will be extinguished next year by these cuts to tax credits. Might I therefore ask please whether you would consider introducing a mitigation policy, as nil cost to the Treasury, to protect the lowest paid while the National Living Wage is phased in?
>
> There is one cost neutral policy in particular which could protect National Living Wage-earners: a secondary earnings threshold paid for by a steeper withdrawal rate for those earning above this new minimum rate.
>
> This option would retain the existing £6,420 income threshold but introduce a second gross income threshold of £13,100, the equivalent of working 35 hours a week on the National Living Wage. For gross earnings between £6,420 and £13,100, the taper rate would be kept at 41%. The lowest paid working families, therefore, would experience no reduction in tax credit income compared with the current system. To keep the policy cost neutral, gross earnings above £13,100 would need to be tapered at 65%.[22]

Of the 3.3 million in-work families in receipt of tax credits at April 2015, around 1.8 million (54%) had earnings below the proposed second threshold of £13,100, and 1.5 million (46%) above.[23]

Mr Field's proposal would protect in-work tax households earning less than £13,100 – who would see no change to their tax credit award from April 2016 – but at the expense of families receiving tax credits earning more than this amount.

Figure 8 shows the tax credit award received by a full-time single earner family with two children at selected earnings levels. It shows the award a family in these circumstances might expect to receive under current arrangements, those announced by the Summer Budget and those proposed by Mr Field.

Under Summer Budget proposals the tax credit award of a family in these circumstances will start to be reduced, compared to current tax credit arrangements, once their income exceeds the new £3,850 threshold. Under Mr Field's proposals this family's award starts to be reduced once their income exceeds the existing £6,420 threshold – as is the case under current arrangements.

22 Letter from Rt Hon Frank Field MP DL to Rt Hon George Osborne MP, 29 September 2015

23 Source: House of Commons Library calculations

However, once the income of this family exceeds Mr Field's proposed £13,100 threshold their award will be tapered at a greater rate (65%) than under either current or Summer Budget arrangements. A family of these circumstances with gross earnings of £23,110 per annum will receive a tax credit award of £1,640 under both Summer Budget and Mr Field's proposals. Under Mr Field's proposals, this family's award is finally tapered to £0 once their income exceeds £25,630; under Summer Budget arrangements, their award is tapered to £0 once their income equals £26,530 per annum or greater.

Figure 8 Tax credit award received by full-time single earner family (couple or lone parent), two children, at selected earning levels

	Tax Credit award received (WTC & CTC)				
Gross earnings	Current Award	Summer Budget Award	Mr Field's proposal	Summer Budget vs current	Mr Field's proposals vs current
£3,860	£10,885	£10,880	£10,885	-£5	£0
£6,420	£10,885	£9,651	£10,885	-£1,234	£0
£13,100	£8,146	£6,445	£8,146	-£1,701	£0
£16,000	£6,957	£5,053	£6,261	-£1,904	-£696
£20,000	£5,317	£3,133	£3,661	-£2,184	-£1,656
£23,110	£4,042	£1,640	£1,640	-£2,402	-£2,402
£25,630	£3,009	£431	£2	-£2,578	-£3,007
£26,530	£2,640	£0	£0	-£2,640	-£2,640

Source

House of Commons Library calculations

Also note that, under Mr Field's proposals, the incentive for families receiving tax credits and earning over £13,100 per annum to increase their earnings would be reduced compared to both pre- and post-Budget arrangements.

Under Mr Field's proposals the Marginal Effective Tax Rate – the proportion of every additional pound earnt that an individual loses due to income tax, National Insurance contributions and any deductions in tax credits and reduced welfare entitlements – for someone receiving tax credits and subject to income tax and National Insurance contributions would increase to close to 100%. (Meaning that, for every extra £1 earned, £1 is lost due to income tax, National Insurance contributions and reduced tax credits and welfare entitlements).

10. Lords Secondary Legislation Committee report

The House of Lords Secondary Legislation Scrutiny Committee looks at every Statutory Instrument laid before Parliament to determine whether raise issues which merit further debate or consideration. The Committee's ninth report of this Session, published on 15 October, draws the draft *Tax Credits (Income Thresholds and Determination of Rates) (Amendment) Regulations 2015* to the special attention of the House of Lords on the grounds that they are "politically important and give rise to issues of public policy likely to be of interest."[24]

The Committee's report comments that the original Explanatory Memorandum from HMRC accompanying the draft regulations "offered little explanation of the policy background", save state that the regulations changed income thresholds and taper rates, following the announcement of further welfare savings in the Government's election manifesto and the Summer Budget announcements. The report states:

> In our view, the EM laid in September by HMRC contained minimal information, given our general expectation that an EM should provide members of Parliament and the public with an adequate explanation of the effect of the instrument which it accompanies, and why it is necessary. Soon after the draft Regulations were laid, we requested additional information from HMRC, about why the Government had not published an impact assessment, and whether the Government had prepared some other assessment of the effect of the changes proposed.[25]

On 12 October the Chancellor of the Exchequer replied to the Committee, enclosing an Impact Assessment for the regulations (the letter is included in Appendix 1 of the Committee's report, and the Impact Assessment is available at the parliamentary website).

In his letter, the Chancellor reiterates the case for making the tax credit changes, which he says are "an integral part of the new deal this Government offers to working people." He continues:

> It means Britain moving from a high-welfare, high-tax, low-wage economy to a lower-welfare, lower-tax and higher-wage one. This Government was elected with a clear mandate to bring about this change.
>
> Tax credit expenditure more than trebled in real terms between 1999 and 2010; and increased by £9.6 billion a year in real terms between 2004/05 and 2014/15. In 2010 nine in ten families with children were eligible for tax credits, reduced to six in ten following the coalition's reforms in the last Parliament. The reforms we now make will reduce this to five in ten, and wind tax credit spending back only to what it was in 2008.
>
> Alongside the changes to tax credits, we are introducing the National Living Wage, which will be worth over £9 an hour by

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24 HL 38 2015-16

25 Ibid. para 4

> 2020, and increasing the personal tax allowance, as part of a single, thought-through coherent plan.
>
> Taking tax and benefit changes into account, it means a renting family with two children where both parents work 35 hours a week on the minimum wage will see their income increase in cash terms by more than £5,500.
>
> The Office for Budget Responsibility also predicts a wider ripple effect of the National Living Wage, as it pushes wages up across the income scale, benefiting six million people. Already we see over 200 companies agreeing to pay at or above the National Living Wage early, helping to fuel wage growth of 4.4 per cent in the private sector, according to the latest figures.[26]

The Impact Assessment gives further information on the rationale for the changes, and on the expected impact of the National Living Wage. It also provides some further analysis of the distributional impact – a chart showing the share of the total savings from the tax credit changes in 2016-17, for each income decile of the distribution of tax credits claimants (including out-of-work families). The Impact Assessment comments that "60% of the tax credit savings come from the half of tax credit claimants with the highest income." This is as one would expect given that the changes mainly affect in-work tax credit claimants (see section 5 of this Library briefing).

The Committee's report comments (original emphasis):

> **The Chancellor's letter of 12 October 2015 and the enclosed Impact Assessment shed more light on the effects of the proposed changes than was provided by the Explanatory Memorandum laid on 7 September. When it considers the draft Regulations, the House will wish to reach a view on the adequacy of the information about their impact with which we have been provided.**[27]

[26] Ibid. Appendix 1
[27] Ibid. para 6

11. Further comment and analysis

For further comment and analysis see:

- Welcome boost on low pay but severe welfare cuts will mean big losses for many low-income working families, Resolution Foundation press release, 8 July 2015
- Social Market Foundation, Will the new Living Wage make up for the cuts to Tax Credits? Yes and No, July 2015
- Unison, Don't take the (tax) credit: How a pay rise becomes an income cut, September 2015

Further tax credit statistics are available from HMRC, including:

- Personal tax credits statistics (HMRC Tax Credits statistics landing page)
- Child and Working Tax Credits Statistics April 2015 (latest available, provisional, UK Tax Credit statistics)
- Child and Working Tax Credits statistics: provisional awards geographical analyses (latest available, provisional, geographic data)
- Child and Working Tax Credits statistics: finalised annual awards 2013 to 2014
- Child and Working Tax Credits statistics finalised annual awards geographical analysis

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