# Income tax : the 10p starting rate

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In its manifesto for the 1997 General Election the Labour Party proposed that in government the introduction of a 10p starting rate of income tax would be a long-term objective. Consequently in the 1999 Budget the then Chancellor Gordon Brown announced that a 10p rate would apply from April 1999, on the first £1,500 of each individual's taxable income. The 10p starting rate replaced an existing 20p lower rate, and, with a 1% cut in the basic rate of tax from April 2000, the three rates of income tax for the next eight years were: 10%, 22%, and the higher rate of 40%.

In his 2007 Budget the then Chancellor Gordon Brown announced a series of changes to personal tax to take effect from 6 April 2008, including the withdrawal of the 10% starting rate and a cut in the basic rate from 22% to 20%. It was estimated that 21 million households would be better off or no worse off as a result of these reforms, but that 5.3 million households would pay more in tax.[1] The Institute for Fiscal Studies calculated that 3.6 million households would lose by more than £1 a week.[2]

The following year the new Chancellor, Alistair Darling, confirmed these changes in his 2008 Budget. However, growing concerns about those households who would lose out lead to Mr Darling announcing a compensation package several weeks after his Budget statement, on 13 May 2008. Mr Darling proposed that the basic personal allowance would rise by a further £600 for the current tax year: all basic rate taxpayers would gain an extra £120. As Mr Darling said, "[this] will mean that 4.2 million households will receive as much, or more than, they originally lost. The remaining 1.1 million households will see their loss at least halved."[3]

In his Pre Budget statement in November 2008, Mr Darling confirmed that the £600 increase in the personal allowance would be maintained, and it would rise by a further £130 *above* indexation from April 2009.[4] In the Pre-Budget report which accompanied this statement, the Government stated that although prices were expected to *fall* in real terms over the coming

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1 HC Deb 18 October 2007 cc1266-70W
2 *The IFS Green Budget*, January 2008 p282
3 HC Deb 13 May 2008 cc1201-2
4 HC Deb 24 November 2008 cc 495-6

year, it would "maintain the additional £130 of personal allowance in April 2010."[5] As a consequence, it was estimated that the number of households paying more net tax as a result of the personal tax changes in Budget 2007 would be cut "from 5.3 million originally to 500,000 by 2011/12."[6] This note discusses the controversy over the abolition of the 10p rate, and the Labour Government's approach to answering concerns about the impact of this measure on lower-income households.

Since the Labour Government's reforms to income tax in the 2007 Budget, the basic and higher rates of income tax have remained 20% and 40%. An additional rate of 50% on incomes over £150,000 – first announced in the 2009 Budget – came into effect from April 2010.[7] The Coalition Government has taken a different approach to reducing the amount of income tax paid by those on lower incomes, by substantially increasing the personal allowance.[8] Controversially the present Government has also announced a cut in the additional rate of income tax to 45% from April 2013. There has been renewed interest in the merits of a 10p rate following a speech by the Labour leader, Ed Miliband, that in government, the Party would reintroduce a 10p rate, funded by a new annual levy on residential property over £2m in value – the so-called 'mansions tax'.[9]

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## 1 The introduction of a 10p starting rate

In its manifesto for the 1997 General Election the Labour Party announced that the introduction of a 10p starting rate of income tax would be a 'long term objective':

5 Cm 7484 November 2008 para 5.7. It was anticipated that the potential gain for higher rate taxpayers would be restricted by freezing the basic rate threshold for 2011/12.

6 Cm 7484 November 2008 para 5.10, 5.9

7 For more details see, *Income tax : the new 50p rate*, Library standard note SN249, 15 February 2013

8 The Government's approach to increasing the allowance is discussed in, *Income tax : recent increases in the personal allowance*, Library standard note SN6569, 7 March 2013

9 Debate over this proposal and the wider discussion of taxing land values is examined in, *Land Value Taxation*, Library standard note SN6558, 23 February 2013.

> To encourage work and reward effort, we are pledged not to raise the basic or top rates of income tax throughout the next Parliament. Our long term objective is a lower starting rate of income tax on ten pence in the pound … This goal will benefit the many, not the few. It is in sharp contrast to the Tory goal of abolishing capital gains and inheritance tax … We will also examine the interaction of the tax and benefits systems so that they can be streamlined and modernised, so as to fulfil our objectives of promoting work incentives, reducing poverty and welfare dependency, and strengthening community and family life.[10]

At this time income tax was charged at three rates: the lower rate of 20%, the basic rate of 23%, and the higher rate of 40%. The lower rate had been introduced in 1992/93, and applied to the first £2,000 of an individual's taxable income. Over the next five years, this threshold was increased substantially so that in 1997/98 the rate structure was as follows:

| **Taxable income** | **Tax rate** |
|---|---|
| First £4,100 | 20% |
| £4,100 to £26,100 | 23% |
| Over £26,100 | 40% |

Following the 1997 Election the new Chancellor, Gordon Brown, commissioned a report on work incentives from Martin Taylor, then chief executive of Barclays Bank.[11] Mr Taylor's final report was published alongside the 1998 Budget, and many of his recommendations were accepted as part of the Labour Government's welfare to work strategy.[12] Though Mr Taylor did not discuss the case for a 10p starting rate, he argued that making work "more financially attractive" was one of the principal ways the Government should it use to bring people into the labour force:

> **Why work incentives?**
> **1.17** Three major disadvantages arise from having large numbers of people outside the labour force. Aside from the cost to the public purse (and some items of the social security budget are increasing irrespective of the cyclical position of the economy), long periods out of work reduce the chances of future employment for many, entrenching low self-esteem and – since the phenomenon is widespread – entrenching the view that it is acceptable for able-bodied people to live off the state. I believe these psychological factors are significant.
>
> And of course the shortfall in the level of national output implied by below-par participation in the labour force affects the economy's potential. This factor is likely to become more significant over the next two decades, given present demographic trends.
>
> **1.18** These issues affect groups well beyond the registered unemployed. Indeed, attempts to tackle the problem are likely to lead to increases in the published unemployment figures as economically inactive people pass through the unemployment register on their way back to work. I urge the Government not to be

[10] *New Labour: because Britain deserves better*, April 1997 pp 12-13
[11] HM Treasury press notice 47/97, 19 May 1997
[12] For example, Mr Taylor's recommendations for the replacement of Family Credit – which saw the introduction of the Working Families Tax Credit in October 1999 – and reforms to the structure of National Insurance contributions – which were introduced over the period 1999-2001. The background to these changes is discussed in two Library papers published at the time(*Tax Credits Bill*, Research paper 99/3, 18 January 1999, and, *Social Security (Transfer of Functions, Etc.) Bill [HL]*, Research paper 99/12, 5 February 1999 pp 10-17).

deterred by this presentationally awkward statistical effect from taking the necessary action, which I see as essentially taking four forms:

- making work more financially attractive to the non-employed;
- making it easier for the non-employed to take work by environmental changes (for example better childcare for lone parents, improved training and guidance);
- requiring those who can work to participate in the labour market (for example by tightening the qualification rules for benefits);
- increasing the availability of work at the lower end of the labour market.

**1.19** I do not believe that the number of fundamentally unemployable people is as large as some argue. But I have particularly borne in mind the large number of people whose labour is not sufficiently well rewarded to allow them to support their families in an acceptable way. It seems to me far better that these people should be working, and receiving in-work benefits to top up their net pay, than that they should be idle. Moreover, once in work there is a greater likelihood that they will remain there. In general, therefore, I regard the expansion of relatively low-paying jobs as beneficial.[13]

At this time the Social Security Committee published a report on the reform of the tax & benefits system. The Committee supported the Government's general aims of improving work incentives, but raised concerns about whether a 10p starting rate would provide an effective method of achieving this:

We welcome the emphasis that the Government is placing on improving the workings of the tax and benefit system. We strongly believe that barriers to taking work should be systematically dismantled although we recognise that revenue neutral solutions cannot entirely achieve that end … The 10p starting rate of income tax is included in the set of Government commitments for reform of the tax and benefit system as outlined in the Pre-Budget Report. We would give overall support to reductions of taxation on lower paid people as a means of increasing incentives. It is too early to judge what effect a possible 10p tax rate would have in practice but its interaction with the range of other proposed measures would be crucial in judging its effectiveness. Unless properly constructed, there is a danger that those gaining most from the 10p rate might be those who need few incentives from tax reductions to work.[14]

In the Pre-Budget Report published in November 1998, the Labour Government stated that it would introduce a 10p rate "when it is economically right to do so", adding that it wished to "design the new 10p rate in the way that best meets its objectives of improving work incentives and promoting a fair and efficient tax system."[15] In its Green Budget in January 1999 the Institute for Fiscal Studies argued that cutting the starting rate of income tax would not be an effective way of achieving either of these policy goals:

The 1997 Labour Party manifesto proposed a 10% starting rate of income tax as a means of furthering these aims – the policy was claimed to promote both employment and 'fairness'. There are reasons to be sceptical about the policy's effectiveness on either count. The effect on employment is meant to arise through reducing effective marginal tax rates for those on low incomes, but, in practice, the benefit system is the dominant factor in determining tax rates for this group. In so far as 'fairness' in the tax

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13 HM Treasury, *Work incentives: a report by Martin Taylor*, March 1998 pp 7-8

14 *Tax and benefits: pre-Budget report*, 4 March 1998 HC 423 1997-98 p xii

15 Cm 4076 November 1998 p 66

> and benefit system is taken to mean progressivity, a 10p starting rate of tax is a poor way to deliver it. The poorest families would not gain at all, as they do not pay income tax, while those on high incomes would gain as much as anyone from this change.[16] In reality, a 10% starting rate of income tax would simply be a general cut in income tax of the kind implemented by the last government.

The authors went on to highlight the administrative complexities from adding a 10% rate to the structure of the tax:

> Even if such a cut is desirable, a 10% starting rate is a poor means of achieving it because of the administrative complexities, particularly with taxation at source, that arise from multiple marginal rates. The essential problem is that applying a particular rate of income tax at source is appropriate less often if there are multiple bands. The more bands there are, the more retrospective adjustments have to be carried out. Adjusting tax liabilities in this way is time-consuming for taxpayers and costly for the Revenue to administer. An alternative policy to achieve such a tax cut – increasing tax allowances – produces similar, though slightly more progressive, distributional results and avoids any administrative problems.

Nevertheless, if the Government were determined to bring in a 10p rate, the report commented that it would be better to scrap the 20p rate at the same time:

> If a 10% rate of tax is introduced, abolition of the 20% rate has two attractions.
>
> First, it would provide a source of revenue that could help to finance a 10% band of significant width. Second, combining the introduction of a new lower-rate band with the abolition of the existing one would leave the income tax system with three bands, rather than four.[17]

This proved to be prescient. In his Budget speech in March 1999, Gordon Brown announced that a new 10p rate would be introduced from April on the first £1,500 of income. The new rate structure for the coming tax year would be 10, 23, and 40. Furthermore the basic rate of income tax would be cut from 23% to 22% from April 2000. In his speech Mr Brown described the measure as one of a number of "tax cuts to encourage work and make work pay, tax cuts for a purpose" that would "help all middle and lower-income families" and were "being made at the best time for the economy.[18]

The Budget report set out these changes as follows:

> To put work first in the tax and benefit system, the Government will introduce a 10p rate of income tax. From 6 April this year, taxpayers will pay only 10 pence in the pound on their first £1,500 of taxable income. This is the lowest starting rate of tax since 1962-1963, and will reduce the marginal rate of tax from 20p to 10p for 1·8 million people.
>
> When the 10p rate is introduced, there will be three main rates of income tax - 10, 23 and 40 per cent. Basic and top rate taxpayers will gain £1·15 a week from the change. But those on the lowest incomes (below £8,835) will gain more, because the three rate

[16] See A. Dilnot and C. Giles (eds), *The IFS Green Budget: Summer 1997*, Commentary no. 61, Institute for Fiscal Studies, London, 1997, for a detailed discussion of where in the income distribution the gains from the 10p starting rate of income tax accrue.
[17] IFS, *The IFS Green Budget: Commentary 76*, January 1999 pp 55-57
[18] HC Deb 9 March 1999 cc 188-189

> structure helps to target the gains from the 10p rate on the lowest paid: 1·8 million people, of whom 1·5 million are low paid, will see their tax bill halved, and a further 300,000 people will be taken out of income tax altogether.
>
> The new 10p band will help to ease the poverty trap whereby people on low pay are discouraged from climbing the earnings ladder. At present, around 700,000 people lose more than 70 pence for every extra pound they earn. After the implementation of Budget 99, this figure will fall by around two-thirds … Taken with other measures announced since the Government took office, the new 10p band will help to make work pay and ease the unemployment trap …
>
> The cut in the basic rate to 22p will take effect in 2000-01. This is the lowest basic rate level for 70 years … These changes … create a modern income tax system to meet the challengers of today's labour market, and ensure fairness for all working people.[19]

The new 10p starting rate was estimated to cost £1.5bn in 1999/00, rising to £1.8bn in 2000/01. In comparison the 1% cut in the basic rate was estimated to cost £2.25bn in 2000/01, rising to £2.8bn the next year.[20] When this provision was scrutinised at the Committee stage of the Finance Bill, the then Financial Secretary, Barbara Roche, described the rationale for the new starting rate as follows: "Clause 19 meets the Government's commitment to bring in a new starting rate of income tax. It introduces a starting rate band of £1,500, which will be charged at 10 per cent.--the lowest rate for more than 35 years. The new starting rate of tax is part of a range of income tax and national insurance contributions measures designed to complement the national minimum wage by helping to make work pay, to encourage people into work and to ensure that they keep more of their earnings."[21]

The introduction of the 10p starting rate appears to have been generally welcomed although commentators raised a number of points about how this measure interacted with other changes to income tax in the Budget. First, the Chancellor proposed that income tax thresholds were all to be increased in line with inflation, so that even taxpayers whose marginal rate was 40% would get some benefit of the 10p rate.[22]

Second, initially the 20% rate was *retained* for savings income, which was criticised for introducing an unnecessary degree of complexity, and penalising some taxpayers whose income would derive largely from their savings – such as pensioners.[23] Subsequently the Chancellor extended the scope of the 10% rate to savings income, retrospectively, though this created certain administrative problems as well – as noted by the IFS:

> The taxation of interest income has been highly unsatisfactory since the introduction of the 20% lower-rate band by Norman Lamont in 1992. For most interest income, taxation occurs at source through the institution at which the savings are held. As these institutions do not have access to information on the account holder's full income tax liability, they deduct tax at a standard rate from all account holders.

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19 *Budget 99* HC 298 March 1999 p60
20 *Budget 99* HC 298 March 1999 p112 (Table 1.11 – item 8 & 9)
21 SC Deb (B) 18 May 1999 c247
22 "'Generous' new 10p starting rate welcomed", *Financial Times*, 10 March 1999
23 "Elderly hit at failure to extend 10p tax rate to savings", *Financial Times*, 11 March 1999

> So, with the introduction of the 20% lower rate of tax in the 1992 Budget, all taxpayers were taxed on their savings income at the basic rate (then 25%), with higher-rate taxpayers liable to make further payments and lower-rate taxpayers able to apply for a tax rebate from the Inland Revenue. Few lower-rate taxpayers actually completed the necessary documentation, however. Therefore, in the November 1995 Budget, institutions were required to deduct tax at a rate of 20% (instead of 25%) and, to prevent basic-rate taxpayers facing additional tax charges, the basic rate of tax on savings income was reduced to 20%.
>
> The problems inherent in the pre-1995 system have resurfaced with the replacement of the 20% band by the new 10% starting rate of income tax. When this was announced in the March 1999 Budget, both the basic and starting rates of tax on savings income remained at 20%, so that savings income was taxed more heavily than other sources of income for starting-rate taxpayers and less heavily for basic-rate taxpayers. In order to address this inconsistency, the Chancellor announced in last November's Pre-Budget Report that all starting-rate taxpayers would face a marginal tax rate of 10% on their savings income with effect from April 1999.
>
> This returns us to the administrative problems that existed before 1995. Under the new scheme, banks will still deduct tax at source at 20%. Higher-rate taxpayers will be liable to an additional payment, administered through their annual income tax returns, while starting-rate taxpayers will be entitled to a refund to reduce their tax rate on savings income back to 10%. But the main reason for the changes in the November 1995 Budget was that few eligible taxpayers ever reclaimed their overpayments of tax. If this occurs again, the vast majority of the 2.5 million people that the government claims could potentially see a reduction in their tax bill (of £30 on average) will not actually benefit from this reform.[24]

Third, the Chancellor announced the abolition of the married couples allowance (MCA) – a tax relief given to all couples – from April 2000. (Only those couples who were 65 or over at this time were entitled to retain the allowance.) In place of the MCA, Mr Brown proposed a new tax relief for parents to be introduced the following year. This 'children's tax credit' was set to cost £1.4bn in its first year: 2001/02. By contrast the abolition of the MCA was set to *raise* £2.05bn in that year.[25]

As a consequence of these related changes to the tax system, an assessment of the financial impact of the 10p rate would depend not just on someone's income, but their personal circumstances, the nature of the household in which they lived, and the time frame chosen. This is by no means a novel phenomenon. Indeed an assessment of the abolition of the 10p rate – in 2008 – raised exactly the same questions. Certainly it is striking that in general press coverage at this time tended to focus on the 'winners' from the new 10p rate – in sharp contrast to the way its abolition was discussed eight years later.

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[24] *The IFS Green Budget*, January 2000 p74

[25] *Budget 99* HC 298 March 1999 p112 (Table 1.11 – item 17 & 18). As it transpired the new relief was wound up into the tax credits system from April 2003 (for more details see, *Married couple's allowance*, Library standard note 870, 19 October 2009).

## 2 Budget 2007 : personal tax reforms from April 2008

In his Budget speech on 21 March 2007 the then Chancellor Gordon Brown announced a series of changes to personal taxation: changes to tax credits, personal allowances for those over 65, tax thresholds as well as changes in the rates of income tax; extracts from Mr Brown's speech, setting out the case for this major reform, are reproduced below:

> I turn to the tax incentives with which we propose to help more people into jobs, and to make work pay … In making work pay, we ensure that people on low incomes get more benefit from the working tax credit than either the minimum wage or any other tax measure, whether it be the 10p rate or personal allowances. If I invested a billion pounds in helping low-income workers by raising personal allowances, they would be only 68p a week better off. If I used the same money to lower the 10p rate, they would be just 67p a week better off. But the use of the same money to extend the working tax credit means that they are £7.10 a week—£370 a year—better off. That is a clear incentive to take jobs, to gain skills, and to work your way up from a lower-paid to a better-paid job. This Budget will invest over £1 billion a year in raising the value of the working tax credit, so that—building on the minimum wage of £5.52 from October—for the parent in full-time work with one child it will rise to £7.70 per hour …
>
> Help for the poorest children, which in 1997 was £28 a week and is today £61, will now rise in three successive stages by more than 25 per cent. to £75 a week, almost three times the 1997 level. That measure will, with others, lift out of poverty 200,000 more children … I am also able today to take several hundred thousand of today's pensioners out of income tax … For those under 75, the tax-free allowance will rise in three stages from £7,280 to £8,990 to £9,500 and then to £9,770 in 2011—a tax-free allowance of almost twice as much as in 1997. For those over 75, the tax-free allowance will rise annually from £7,400 to, by 2011, £10,000 …
>
> Having put in place more focused ways of incentivising work and directly supporting children and pensioners at a cost of £3 billion a year, I can now return income tax to just two rates by removing the 10p band on non-savings income. I can also announce that the point at which people start paying top rate income tax will from April 2009 be an annual income not of £38,000, but of £43,000; and I will align the income tax system with the national insurance system, with its ceiling set at the same threshold of £43,000, thereby creating a tax system for income that has just two rates and two thresholds. As a result of today's measures, 58 per cent. of pensioners over 65 will not pay income tax; 6 million out of 7 million families with children are better off; and the incentive to work is increased by, for many, up to £350 a year …
>
> This is a Budget for Britain's families; it is a Budget for fairness; it is a Budget for the future; and I have one further announcement. With the other decisions I have made today, we are able to hold to our pledge made at the election not to raise the basic rate of income tax. Indeed, to reward work, to ensure working families are better off and to make the tax system fairer, I will from next April cut the basic rate of income tax from 22p to 20p, the lowest basic rate for 75 years. I commend this Budget to the House.[26]

At this point it may be helpful to set out how Mr Brown's reform package was to alter the structure of income tax and National Insurance contributions, to grasp how these changes were to affect taxpayers.

[26] HC Deb 21 March 2007 cc823-4, c825-6, c826, cc826-7, c828

The withdrawal of the 10p rate meant that income tax on earned income would be charged at two rates: the basic rate of 20%, and the higher rate of 40%. The 20% basic rate applies to taxable income up to the basic rate limit. (Taxable income excludes personal allowances, which represent the amount of money someone may receive free of tax.) Taxable income in excess of this threshold is charged at the higher rate of 40%. The Chancellor also proposed that the basic rate limit would be increased the next year in line with inflation. As a consequence, the structure of the tax was to change as follows:

| **2007-08** | | **2008-09** | |
|---|---|---|---|
| **Taxable income** | **Tax rate** | **Taxable income** | **Tax rate** |
| **£0 - £2,230** | **10%** | | |
| **£2,231 - £34,600** | **22%** | **£0 - £36,000** | **20%** |
| **Over £34,600** | **40%** | **Over £36,000** | **40%** |

The new two-rate structure covered all non-savings income: earnings, pensions, taxable social security benefits, trading profits and income from property. However, the 10% starting rate was *retained* for savings income: that is, bank and building society interest. From April 2008, savings income would be charged at 10% for income up to a new starting rate limit, set at £2,320. Above this limit savings income would be charged tax at the 20% basic rate, up to the basic rate limit threshold of £36,000. Savings income above this limit would be charged at the 40% higher rate. If an individual's non-savings income exceeded the new starting rate limit for savings, the 10% starting rate would not be available for their savings income.

The Chancellor's reform package also made changes to the personal allowance, which is the amount all taxpayers may set against any type of income for tax purposes. Two additional levels of the allowance are provided for the elderly. Mr Brown proposed that the basic personal allowance should rise in line with inflation, but that the two age-related allowances should increase by £1,180 in real terms – as shown below:

| **2007-08** | | **2008-09** | |
|---|---|---|---|
| **Under 65** | **£5,225** | **Under 65** | **£5,435** |
| **65 – 74** | **£7,550** | **65-74** | **£9,030** |
| **75 and over** | **£7,690** | **75 and over** | **£9,180** |

The age-related addition to the personal allowance is gradually withdrawn from taxpayers whose incomes exceed a given limit – which was set at £21,800 for 2008/09. This progressive reduction continues until the allowance is equal in value to the ordinary personal allowance.[27] Increasing these allowances meant that elderly taxpayers were protected, for the most part, from losing out from the withdrawal of the 10p rate – a decision which is discussed in more detail below.

[27] In the 2012 Budget the Coalition Government proposed freezing age-related allowances from April 2013, as prelude to their withdrawal when the personal allowance has increased sufficiently to be aligned with them: for details see, *Age-related personal allowance*, Library standard note SN6158, 15 May 2012

Mr Brown also proposed changes to National Insurance contributions (NICs), to more closely align the structure of NICs with that of income tax. Briefly, employees pay primary Class 1 contributions on their earnings if they exceed the lower earnings limit (LEL). This was set at £87 a week for 2007/08. A zero rate of NICs is charged on earnings between the LEL and the primary threshold (PT), set at £100 a week.[28] Earnings above the PT are charged NICs at a standard rate – then 11% - subject to a cap at the upper earnings limit (UEL). This was set at £670 per week. Earnings above the UEL are charged NICs at a reduced rate – which at this time was 1%.[29] In his speech, Mr Brown announced that the UEL would be aligned with the higher rate threshold over two years, to "create "a tax system for income that has just two rates and two thresholds."[30]

To appreciate the implications of the Chancellor's announcement, one needs to look at the combined effect of income tax and NICs over the range of someone's possible earnings. Taking account of the basic personal allowance, for 2007/08 employees would be charged income tax at: 10% on earnings between £100 and £143 a week; 22% on earnings between £143 and £766 a week; and 40% on earnings above £766 a week. Ignoring tax credits, the marginal rate of deduction – combining income tax and NICs – was as follows:

| Earnings (£ per week) | Marginal rate |
|---|---|
| £100 - £143 | 21% |
| £143 - £670 | 33% |
| £670 - £766 | 23% |
| Above £766 | 41% |

Aligning the UEL with the point at which individuals start to pay income tax at the higher rate – the 'higher rate threshold' – would remove the 'dip' in the marginal rate. Mr Brown proposed that this would be done in two steps:

- In 2008/09 the UEL would rise by £75 a week, above indexation, to £770.
- In 2009/10 the higher rate threshold would rise by £800 above indexation, and the UEL would be further increased to align it with this threshold.

While the UEL was increased by £75 a week more than indexation, both the LEL and the PT were increased in line with inflation from April 2008. The rates of NICs were unchanged. These three thresholds for NICs are set each year by secondary legislation, though the UEL was subject to a statutory limit, so that it had to be set at between 6½ and 7½ times the PT. Under the *National Insurance Contributions Act 2008*, this restriction was removed, to allow this two-stage increase in the UEL.[31]

[28] No NICs are actually payable but a notional primary Class 1 NIC is deemed to have been paid in respect of earnings between the LEL and the PT to protect benefit entitlement.

[29] Employers pay secondary Class 1 NICs on employee earnings above the secondary threshold (ST), which was also set at £100 a week for 2007/08. The rate was set at 12.8% of earnings. There is no upper ceiling on secondary Class 1 NICs. At this time, both the PT and ST were aligned with the personal tax allowance.

[30] HC Deb 21 March 2007 cc827-8

[31] For more details see the Library papers on the Bill, and on the Bill's Committee stage in the Commons (Research paper 07/88, 11 December 2007; Research paper 08/07, 24 January 2008).

# 3 Winners and losers from Budget 2007

The *Budget 2007* report listed all of the elements of the personal tax package announced in Mr Brown's Budget speech as follows:

**Box 5.1: Modernising Britain's tax and benefit system - summary of changes**

The reforms announced in this Budget represent the next stage in the Government's programme of reform to the tax and benefit system. The Government will:

- remove the starting rate and cut the basic rate of income tax from 22 pence to 20 pence, creating a simpler structure of two rates:[a] a 20 pence basic rate and a 40 pence higher rate from April 2008;
- increase the upper earnings limit for national insurance by £75 a week above indexation in April 2008, and then from April 2009 fully align it with the higher rate threshold – the point at which taxpayers start to pay the higher rate of income tax, further simplifying the system;
- raise the aligned higher rate threshold and upper earnings limit by £800 a year above indexation from April 2009;
- increase the higher personal allowances for those aged 65 or over by £1,180 above indexation from April 2008;
- raise the child element of the Child Tax Credit by £150 a year above earnings indexation in April 2008, making further progress in helping families and tackling child poverty, and raising the child element to £2,080 a year;
- increase the threshold for Working Tax Credit by £1,200 to £6,420 a year in April 2008, further increasing the incentives to work for families with children and low income working households; and
- raise the withdrawal rate on tax credits by 2 per cent to 39 per cent in April 2008, helping to retain their current focus.

Once fully implemented, these reforms to the direct tax system mean that by April 2009:

- a single-earner family with two children on male mean earnings (£35,900) will be £320 a year better off, with the direct tax burden on the family falling to 20.1 per cent, lower than any year of the 1980s and 1990s;
- a single-earner family with two children on median earnings (£27,000), will be around £500 a year better off;
- a single-earner couple without children on half median earnings (£13,500) and receiving the Working Tax Credit will be £175 a year better off;
- the numbers of children in relative poverty will be around 200,000 lower as a result of these changes;
- around 580,000 fewer pensioners will pay income tax than would otherwise be the case, so that in total only 43 per cent of pensioners will be taxpayers; and
- the tax burden on small unincorporated businesses will be reduced by £50 million in 2009-10, as the self-employed pay income tax and NICs on their business profits.

[a] For all income other than savings and dividend income.

The report focused on those households who were going to be *better off* from these changes. A simply way to show how some households would *lose out* is to assume, first, the 10p rate was retained, and second, the basic rate threshold rose in line with inflation. If so, the starting rate would have applied to the first £2,320 of taxable income for 2008/09. Considered in isolation, the withdrawal of the 10% rate could cost someone £232 at most: ie, an individual who had an income just sufficient to make full use of the 10% band. Those with incomes above this limit would be compensated by the cut in the basic rate from 22% to 20%. Individuals under the age of 65 would be fully compensated if their earnings exceeded around £19,355.[32] For someone with an income of around £10,000, the removal of the 10% band, and the new 20% basic rate, assuming no other changes to their position, would leave them about £187 worse off, over the whole year.[33]

One difficulty with making precise predictions as to 'winners' and 'losers' was that the Budget made a series of changes which, when taken together, affected individuals and households differently: for example, abolition of the starting rate *along with* increases in the age-related allowances; the cut in the basic rate *along with* the rise in the upper earnings limit; increases in the child tax credit and the threshold of the working tax credit *along with* an increase in the tax credit withdrawal rate. As a consequence the redistributive effects of the tax package were very much dependent on someone's income *and* their household circumstances.

A second point to make is that, as Mr Brown said in his Budget speech, "the changes that I make today will be broadly neutral for the public finances."[34] Taken together all the measures in the Budget were estimated to cost the Exchequer £525 million in 2007/08, and raise £280 million in 2008/09 – although some of these changes involved very significant gains or losses. The removal of the starting rate was estimated to raise £8.63 billion in 2009/10, whereas the cut in the basic rate was estimated to cost £9.64 billion in the same year.[35] Following the Budget, the Institute for Fiscal Studies (IFS) estimated that combining all the changes to personal taxes – to income tax rates and thresholds, personal allowances, tax credits and NICs – represented a net giveaway of £2.4 billion in 2009/10.[36]

At the time there was some criticism that the presentation of these changes had been misleading,[37] though, as the director of the IFS Robert Chote observed, "it is somewhat unfair to criticise the Chancellor for having given with one hand and taken with another in this Budget. He said clearly and with good reason that the public finances required him to deliver a neutral Budget and we often complain that Chancellors fight shy of revenue neutral tax reforms because of the fear of creating losers." Mr Chote was also positive about the changes to the structure of income tax:

> The income tax and national insurance changes are a welcome simplification of the untidy way in which the rates of these two taxes interact. My predecessor criticised Mr Brown's decision to introduce the 10p lower rate in the first place as an unnecessary complication that would do less to help the poor than the Government claimed at the

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32 ie, [232/0.02] + £7,755.

33 Their income tax liability in 2008/09 would be £913: ie, 0.2 x (£10,000 - £5,435). Without these changes, their liability would be £726: ie, (£10,000 - £7,755) x 0.22 + £232

34 HC Deb 21 March 2007 c819

35 HC 342 March 2007 p209

36 Institute for Fiscal Studies, *Post-Budget Briefing 2007: Mike Brewer – The Distributional Impact*, 22 March 2007; "Fiscally neutral swings and roundabouts", *Financial Times*, 23 March 2007

37 For example, "Brown cuts basic rate of income tax by 2p but average gain will be only £1 a week", *Guardian*, 22 March 2007

> time;[38] so it would be churlish not to welcome its abolition now. The new rate structure is not quite as simple as it looks because the lower rate remains for savings income, a decision for which there is no obvious logical explanation. And differences in the definitions of income subject to tax in the two systems may be more important sources of complexity than a higgledy-piggledy rate structure.
>
> But this is a useful and significant step in the right direction, bringing us closer to the day when a bold Chancellor may have the nerve to abolish national insurance altogether and fold it into income tax – a change that would certainly create further distributional challenges, but which would deliver real gains in transparency and reduced administrative and compliance costs … The income tax and NI package has been cleverly designed to limit the number of losers to one-household-in-five at a modest overall cost to the Exchequer that has been recouped elsewhere without much difficulty. It is not one of Mr Brown's Robin Hood Budgets, deliberately taking from the rich to give to the poor. Most losers are in the middle of the income distribution, but lose only small amounts. This is a genuinely simplifying Budget, with the losers necessarily determined by where the complexities are that have to be removed. To reform the system in a useful way within tight financial constraints and with only modest gains and losses should be a cause for congratulation rather than criticism.[39]

The Government's decision to substantially increase the age-related personal allowances for taxpayers over 65 very much mitigated the impact of the abolition of the starting rate for elderly taxpayers. However, this was not of help for those who had retired before reaching this age, and this affected many women as, at this time, the state pension age for women was 60, but 65 for men.[40]

Following the Budget, Robert Chote appeared before the Treasury Committee, when he summarised the impact of these reforms: about 5.3 million families would see some decline in their income after tax, including, "0.3 million losers who would be tax paying women between the ages of 60 and 64 who do not get tax credits and are too young to be compensated by the rise in the pensioner tax allowance." Mr Chote had been asked by Michael Fallon MP about the pattern of winners and losers from these changes, and it is worth quoting this exchange at some length:

> **Mr Chote:** The estimate of the winners and losers if you look just at income tax and national insurance is that you have a group of losers on earnings between around £5,000 and around £18,000 and another around £40,000. If you look at the overall number of households affected by the income tax, national insurance and tax credit changes altogether, you probably have on our estimate about 5.3 million families losing in total. Of those, 2.2 million would be single working people with no children who are not getting the working tax credit. They may not be getting the working tax credit, most of them, because they earn more than 12,500 but less than the 18,000. It depends a bit on what you define as low income, but there is clearly a chunk of people in that category. They may also not get the working tax credit because they work fewer than 30 hours or because they are too young. The losers within that group lose about £125 per year on average per family.
>
> You then have about 1.2 million losers who will be two earner couples with no children. They may not qualify for the working tax credit or they may fail to take it up. They may

38 [For example see, *The IFS Green Budget: Commentary 76*, January 1999 pp 55-57]

39 Institute for Fiscal Studies, *Post-Budget Briefing 2007: Opening Remarks*, 22 March 2007

40 The state pension age for women is due to be raised to 65 between April 2010 and November 2018. For more details see, *State Pension age – background*, Library standard note SN2234, 10 May 2012.

also be in the position where the two earners both lose from the income tax and national insurance changes but there is only one gain from the tax credit which is assessed on the household. You can imagine that the biggest loss would be £446, I think, if you had a couple, both of whom were on £7,445, that is where you get the maximum loss from the increase in the lower rate from 10 to 20, and not getting the working tax credit.

You have another 0.4 million losing households who are one earner couples without children, most of them because they will be in a range of about £17,000 to £18,500 where they are not compensated. You get 0.7 million two earner couples with children who lose again twice from the income tax and national insurance changes but maybe only gain once from child tax credit/working tax credit. You have 0.3 million losers who would be tax paying women between the ages of 60 and 64 who do not get tax credits and are too young to be compensated by the rise in the pensioner tax allowance and a final 0.5 million non-workers who pay more tax on their taxable benefit or pensions than they gain. Those might be early retirees or incapacity benefit claimants.

That is roughly how you get to the 5.2 million total household losers, although most of them don't lose very much. It has to be said that this is an estimate based on much crunching over the last few days and, like shares, it may go up or down. That is our best guess at the moment.

**Q62 Mr Fallon:** The Treasury says some of these people could of course now go out and claim tax credits but their assumption presumably is that not all of them will. Is it possible to estimate from the Red Book what the Treasury's assumption of take-up actually is?
**Mr Chote:** I do not think you can estimate from the Treasury book that there is a particular increase in the take-up that is being relied upon. For example, the figures I have just given you assume that there is full take-up of the working tax credit. The working tax credit is notably not taken up very highly by people who do not have children. Take-up is about 19% by caseload, 25% by value. If no one without kids took up the working tax credit, you would get about 5.9 million losers rather than 5.3 million. It is not a huge difference from realistic amounts of non-take-up because presumably the answer will be somewhere between the full and no take-up at all. It would make some difference to the number of losers at the margin but not necessarily an enormous one, I think.[41]

Mr Fallon raised this issue in a later evidence session with Mark Neale, Managing Director, Budget, Tax and Welfare, at HM Treasury:

**Q189 Mr Fallon:** Mr Neale, Mr Chote gave evidence to us on Monday and said that there were about 5.3 million families losing out from the Budget. What is your figure?
**Mr Neale:** I think the figure that Robert Chote gave you is in the right ball-park and is consistent with the Chancellor's statement that four out of five households either gain or remain in the same position as a result of the Budget measures, with an average gain per household of about £100 …

**Q191 Mr Fallon:** Of those, 4.4 million are people without children, either singletons or couples earning without children. Some of those presumably are now entitled to apply for working tax credit. Working tax credit take-up in your last figures from HMRC was around 20%. What is the increase in the take-up rate that you expect?

41 Treasury Committee, *The 2007 Budget*, 23 April 2007 HC 389-II 2006-07 Ev 11

**Mr Neale:** The latest figures for the take-up of the working tax credit by entitlement is around 25% and it is showing a steady increase and HMRC is very much looking to boost the take-up of the working tax credit.[42]

When the then Chancellor, Gordon Brown appeared before the Committee, he emphasised the fact that people on low incomes would be compensated for the loss of the 10p starting rate through child benefit and tax credits:

> On the personal tax system, it seems to me to have two rates and two thresholds is something that has eluded every government for the last 40 years, even when they have tried to do this ... That is a major change that any Chancellor would like to have done were the resources available to do so ... Because we can provide money through the child benefit and child tax credits, through pensioner tax allowances and through the pension credit, and through the working tax credit, because these three instruments are now available to us, it is possible to move from 22 pence to 20 pence without having a 10 pence rate which in a sense was a transitional rate while we got the new system into being. I believe that over time very few people will want to change this two rate and two threshold system of income tax.[43]

In their final report the Treasury Committee suggested that, "an important part of any change to the personal taxation regime must be that both winners and losers can identify, with ease, how they are affected by the changes stated within a Budget package. We recommend that, in future, this information be provided within the Red Book."[44] At the time the Labour Government's response was the following:

> The reforms announced in Budget 2007 included eight separate measures designed to simplify the system, help pensioners, tackle child poverty and make work pay. The overall effect on a household will depend on the interactions between the different elements. So whether, or by how much, one might gain from these changes will depend on both individual and household characteristics. Therefore in this case it was not feasible in the space available to set out comprehensive tables of the effects of all the measures. However, HMRC will, as usual, produce their specimen tables following Budget 2008 once all the tax, national insurance other parameters have been finalised. In addition, HM Treasury has provided detailed answers to Parliamentary Questions of the impact in specific circumstances that the Committee might find helpful.[45]

At the report stage of the Finance Bill in June 2007, Frank Field MP tabled a new clause. Mr Field proposed that "before the House of Commons considers measures that affect our constituents' living standards … the Government should give us the information as part of the Budget, so that we know the numbers and the extent to which that cut in income is taking place" In addition, the House should be given "a guarantee that, before the proposed measures came into effect with the next Finance Bill, some transitional form of relief would be announced for people who were going to lose money."[46]

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[42] HC 389-II 2006-07 Ev 29, At this time the Government announced a number of measures to improve take-up of tax credits (HC 342 March 2007 p 111).
[43] HC 389-II 2006-07 Ev44 Q296. The 2007 Budget report gave some details of the Government's efforts to improve take-up of tax credits (HC 342 March 2007 p111).
[44] HC 389-I 2006-07 para 41
[45] Treasury Committee, *Fifth special report*, 25 June 2007 HC 696 2006-07 p7
[46] HC Deb 25 June 2007 c109

Speaking for the Conservatives, Theresa Villiers explained the Opposition could not support this measure "because we are concerned how it would work in practice were it actually to be written into legislation … [it] might mean that almost all tax changes would have to be subjected to phased implementation, and while such measures would certainly be justifiable and welcome in some contexts, we hesitate to impose a blanket obligation in all cases."[47] The then Chief Secretary to the Treasury, Stephen Timms, also opposed the new clause:

> The new clause would require transitional relief measures so that any adverse effects of personal tax measures are phased in over a period. That would not be the right thing to do for two reasons. The first is complexity … Transitional, and thus temporary, changes would add significant complexity to a system that is central to Government finances and to the maintenance of strong public services … [Second], I do not think that there are any practical transitional measures that we could adopt. If the House were to legislate, there would have to be transitional relief measures. We would need to have some idea that a practical package were available for us to implement and I do not think there is one … The elements of the personal tax package in the Budget were designed to ensure that, overall, low income groups were effectively protected, and the Institute for Fiscal Studies analysis confirms that they have been ... As far as I can see, where losses accrue to some as a result of the changes, they are small.[48]

Finally, it is worth noting that the 2007 Budget retained the 10% starting rate for savings income. When he appeared before the Treasury Committee after the 2007 Budget, John Whiting at PricewaterhouseCoopers, was asked by the Committee chairman John McFall, why he thought the Treasury had done this; part of his answer is reproduced below:

> I think that is entirely to make sure that the pensioner community in particular are protected from the withdrawal of the 10% main band … I question whether it is sufficient or worthwhile given the phone-in I have just come from and the amount of confusion that it is already engendering. It does make you wonder whether it really is going to achieve its objective and whether it would not have been easier just to give the pensioner community that bit extra by way of personal allowance, combine the 65-plus and 75-plus amounts into one figure and have done, although actually there will be others on low income, apart from pensioners, who will benefit from the retention of that savings band.

In turn, Mr Chote at the IFS speculated about why the Government had done this:

> There is probably a presentational issue in that in terms of labour income the Chancellor could say that people were compensated from raising the 10p rate to 20 by the cut in the basic rate from 22 to 20 but for savings the basic rate was already 20 so there was no equivalent cut there ... that you could not tell the same story of taking with one hand and giving back with the other.[49]

In Budget 2007 the Government had not set personal allowances and income tax thresholds for 2008/09. Although there were no major surprises when these figures were announced in

47 *op.cit.* cc110-11
48 *op.cit.* cc 119-20. The new clause was negatived by 269 votes to 67. The Conservatives appear to have abstained (c 122).
49 HC 389-II 2006-07 Ev10 Qs55-6

October 2007,[50] more detailed estimates of winners and losers from the 2007 tax package could be made, and these were published in a series of written answers. An extract from these PQs is given below: [51]

> As a result of the personal tax reforms announced in Budget 2007 21 million households are better off or no worse off. Of those households that will see their income rise due to the reforms, the following table shows the distribution of households by change in their weekly income.

| *Change in weekly income* | *Number of households (million)* |
|---|---|
| Increase by less than £1 | 3.0 |
| Increase between £1 and £3 | 4.7 |
| Increase between £3 and £5 | 3.2 |
| Increase between £5 and £10 | 4.0 |
| Increase by more than £10 a week | 1.0 |

> Of the 5.3 million households that will pay marginally more in net tax—on average less than a half per cent. of net income—the following table shows the distribution of households by change in their weekly income.

| *Change in weekly income* | *Number of households[1] (million)* |
|---|---|
| Decrease by less than £1 | 1.5 |
| Decrease between £1 and £3 | 2.2 |
| Decrease between £3 and £5 | 1.1 |
| Decrease between £5 and £10 | 0.4 |
| Decrease by more than £10 a week | 0.0 |

(1) Rows may not sum to total due to rounding.

Further to this the Treasury Committee published evidence in their report on the 2008 Budget from the department, looking specifically at the numbers of people with earnings under £18,000 who would see a fall in their incomes:

> Estimates are that 0.8m single earners with income under £18,500 will see their income decrease by around £1.45 a week on average ... The maximum amount any single individual could be worse off by is £232 per year (£4.46 per week)—about 3% of net income. This loss would be completely offset by increases in Working Tax Credits for those eligible to claim. For those not eligible for WTC it is possible that households around or under the level of income achieving the maximum loss could be receiving Housing and/or Council Tax Benefits and could therefore have up to 85% of this loss offset by increases in HB/CTB. For households that are worse off, the average loss is about £2 per week.[52]

At the time of the 2008 Budget, the IFS published a report on this issue, commenting that the fact that the tax package did little for childless adults of working age “is entirely consistent with Mr Brown’s previous reforms” to the tax and benefits system:

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50 The reason for this delay is that income tax legislation has required the main allowances and thresholds to be increased in line with the Retail Prices Index (RPI) unless Parliament determines otherwise. For this purpose the relevant inflation rate is the increase in the RPI in the year to September, so allowances and thresholds for 2008/09 could be announced after this was known.

51 HC Deb 18 October 2007 cc 1266-70W

52 *The Budget 2008*, 7 April 2008 HC 430 2007-08 Ev 63. It has been stated that “it is not possible to provide reliable estimates of the impact of tax reforms at constituency level” (HC Deb 29 April 2008 c381W).

> Most of the losers [from the 2007 tax package] are of two sorts. First, childless single people who do not qualify for the working tax credit because they are under 25, work less than 30 hours a week, or earn too much. Second, childless couples who lose twice from the income tax changes, but gain at most once from the working tax credit because it is a family payment rather than an individual one. Another vocal category of loser is early retirees, who do not receive tax credits, but who are too young to benefit from the increase in the tax allowance for those aged 65 and over …
>
> Look at the cumulative impact of Labour's tax and benefit changes since 1997: they have increased the average incomes of the poorest tenth of the population by 12% and cut those of the richest tenth by 6%. But, within the poorest tenth, pensioners have gained 24% and families with children 18%, while childless working-age adults have gained only 1%. Indeed, childless working-age adults lose on average from Labour's tax and benefit changes across nine-tenths of the income distribution. This has had a predictable effect on poverty. Measured as the number of individuals living in households with incomes below 60% of that enjoyed by the average (median) household, poverty has fallen by 600,000 among children, 200,000 among working-age parents and 200,000 among pensioners since 1996-97. But poverty has increased by 500,000 among working age adults without children.
>
> You can certainly make a case for focusing help on pensioners and parents. The former have little scope to increase their incomes. And helping the latter helps their children, who are powerless to alter their own circumstances. You could also argue that many poorer childless working age adults will only be so temporarily, as they will climb the earnings ladder, have children, or reach pension age. But that is of little comfort to those feeling the hit in their pay packets this month.[53]

## 4 Debate on the abolition of the 10p rate

In June 2007 Alistair Darling was appointed Chancellor by Gordon Brown, now Prime Minister. In his first Budget speech on 12 March 2008 Mr Darling did not mention the withdrawal of the 10p rate. The issue came up when, after the Budget, Mr Darling appeared before the Treasury Committee a few days later. On this occasion Jim Cousins MP asked him whether he accepted "that there are millions of workers who cannot go on tax credits or who choose not to, whose incomes are likely to fall in these next few months." Mr Darling replied:

> There are particular groups who would be eligible for the working tax credit who are not taking it up and that is something that we need to do something about. Sometimes people do not know about it. There may be other reasons as well but if it is available for people in work then I would like to see them take advantage of that. Of course in addition to that, the fact is that there are more people in work who have increased their incomes … I accept that we still have more to do to make sure that progressively through the system, as people go into work, it actually pays to work.[54]

In its report the Committee argued that, "the group of main losers from the abolition of the 10 pence rate of income tax seem an unreasonable target for raising additional tax revenues" to

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[53] Institute for Fiscal Studies press notice, *Abolition of the 10p starting rate*, 21 April 2008. The IFS published a detailed analysis of the distributional impact of tax and benefit changes since 1997 in *The IFS Green Budget*, January 2008 pp268-88 (Chapter 14 of the report).

[54] Treasury Committee, *The Budget 2008*, 7 April 2008 HC 430 2007-08 Ev 51 Qs 378-9. The issue of take-up was also discussed in the 2008 Budget report (HC 388 March 2008 pp60-62).

help fund, among other measures, the cut in the basic rate, the increase in tax credits, and a one-off increase in the winter fuel payment made to pensioner households, which was also announced in Budget 2008.[55] Given the impact of this change on low earners, the Committee were particularly concerned about the take-up rate for working tax credit:

> Despite tax credits being identified as one of the ways of mitigating the loss of the 10 pence starting rate of income tax, as Treasury officials acknowledged, there has been a continuing problem of low take-up rates of working tax credits [Q232]. As we noted last year, the problem of low take-up rates is especially acute among families without children, where the central estimate of the take-up rate of working tax credits was 22% for the financial year 2005-06.[56] Treasury officials pointed out that "take-up of the working tax credit, which I agree has not been as good as we would have liked, is increasing. That is also an important reality to bear in mind, and steps are being taken to draw the attention of people who can claim that tax credit to the fact that it is available, and that is having some success. More people are claiming the working tax credit" [Q238] …
>
> We are concerned by the poor take-up rate of working tax credit among eligible families without children, especially given that working tax credits are intended to mitigate for low-income households the effect of the removal of the 10 pence starting rate of income tax. We expect the Treasury and HM Revenue & Customs to galvanise their efforts in this area in coming months and years. We recommend that the Government report regularly in Budgets and Pre-Budget Reports, starting with the 2008 Pre-Budget Report, on progress in increasing the take-up rates of working tax credits for those sections of society with particularly low take-up rates. We further recommend that the Treasury commission research into whether the withdrawal of the 10 pence income tax band and high marginal deduction rates are creating disincentives that could frustrate the Government's welfare to work objectives.[57]

At this time the press reported concerns of a number of Labour Members on this issue, as well as the launch of a campaign by the Conservatives to oppose the abolition of the 10p rate,[58] though in press briefings the Prime Minister's spokesman reiterated that the Government's position was unchanged.[59] On 2 April Greg Pope put down an EDM on the 10p rate, signed by 30 Members:

> That this House notes that, despite assurances to the contrary, many people are being made worse off by the abolition of the 10 pence tax rate; notes with concern that this is having a disproportionate impact on people who can ill afford to be made worse off; accepts that this was not the intention of the Government but is dismayed at the response to the plight of those adversely affected; and calls on the Chancellor of the Exchequer to bring forward measures to correct this damaging change to the taxation system.[60]

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55 This is an annual payment to help people aged 60 and over with the costs of their winter fuel bills, set at £200 for households with someone over 60, and £300 for households with someone over 80. In 2008-09 these payments were £250 and £400 respectively.

56 HM Revenue & Customs, *Child Tax Credit and Working Tax Credits: Take-up rates 2005-06*, p 12, Table 10; HC (2006-07) 389-I, paras 44-45

57 *The Budget 2008*, 7 April 2008 HC 430 2007-08 paras 61-2

58 For example, "Brown defies rebels over tax reforms", *Financial Times*, 8 April 2008; "Cameron vows to join forces with Labour rebels over 10p tax rate", *Independent*, 8 April 2008

59 See for example, 10 Downing Street, *Morning Press Briefing*, 3 & 7 April 2008

60 EDM 1308 of 2007-08, 2 April 2008. Mr Pope withdrew the motion two days later, as, in his own words, he had "received assurances that the issue of how the abolition had an impact on less well off people would be looked at" (Greg Pope press notice, *10p tax rate update*, 7 April 2008).

Following this the Trades Union Congress argued for compensation to be given to those who have lost out from the change,[61] and in an interview with the *Financial Times* Tessa Jowell, Minister for London, suggested that the Government would reconsider the issue in the autumn, as part of the Pre Budget Report, if "this does turn out in practice to be unfair."[62] The Prime Minister signalled a change on the Government's position on 21 April, at a widely reported meeting with Labour MPs.[63] Although no specific details were given, the Government stated that it wished "to do more to help low income people in future Budget and Pre-Budget reports."[64]

However, as the Institute for Fiscal Studies commented, some of the possible solutions to reducing the number of losers would create further logistical problems, and none of the solutions to reduce their numbers significantly would be cheap. Arguably the simplest method to removing nearly all of the losers would be to increase the personal allowance by about £750 – a form of compensation which would cost the Exchequer around £6 billion:

> Restoring the 10p rate would cost nearly £7 billion - money the Government does not have to spare ... If Mr Brown does feel the need to reduce the number of families losing, one candidate would be to extend the working tax credit to the under 25s and/or those working less than 30 hours. To do both would cost £2.2 billion and remove 1.2 million losers if everyone took up the working tax credits to which they were newly entitled. In practice, the cost and the number of losers removed might be much smaller. And some of those no longer losing would be over-compensated and gain a lot. A similar option would be to increase the working tax credit for single people without children by 50%. This would cost around £600m and remove 300,000 losers, again implausibly assuming full take-up. But in neither case would the Government necessarily derive much political benefit. Constituents complaining about the removal of the 10p band frequently add that they do not wish to become entangled in a tax credit system that they see as complex, bureaucratic and stigmatising.
>
> A more popular way to reduce the number of losers would be to increase the personal allowance ... This would also be more cost-effective, as it would in effect partially unwind the Budget reform that created the losers in the first place. Increasing the income tax and NICs allowance by £100 would remove 1.3 million losers and cost £800 million; increasing it by £300 would remove 3.3 million losers and cost around £2.5 billion; increasing it by £750 would remove almost all the losers and cost around £6 billion.
>
> None of these options are cheap. Raising the personal allowance would be the most cost effective way to reduce the number of losers, although it is not the way Mr Brown would usually target money on the groups he favours. The political calculation is whether he could compensate enough losers to stem the protests, without having to spend so much money that he would need to do something even more unpopular to pay for it.[65]

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[61] TUC press notice, *TUC calls for rescue package to help low-paid workers hit by new tax regime*, 11 April 2008
[62] "Jowell breaks ranks on 10p tax", *Financial Times*, 12 April 2008
[63] "I share your pain, Brown tells MPs as he tries to buy off 10p tax rebels", *Times*, 22 April 2008
[64] 10 Downing Street, *Afternoon Press Briefing*, 21 April 2008
[65] Institute for Fiscal Studies press notice, *Abolition of the 10p starting rate*, 21 April 2008

# 5 Finance Bill 2008

On 21 April 2008 the Finance Bill received its second reading and, as expected, the withdrawal of the 10p rate was raised by many Members, dominating the debate.

The then Chief Secretary to the Treasury, Yvette Cooper, acknowledged that some households would lose out from the personal tax package, but that "if we look at the Budgets as a whole since 1997, we see that even those who are paying more in this year's Budget have still benefited significantly overall since 1997 … on average, those who will pay more this year are still about £500 a year better off than they would have been under the 1997 personal tax and benefits system."[66] The Minister went on to say that as part of the Government's ongoing work to reduce child poverty,[67] "we will now extend that work to include consideration of households on low incomes without children …[and] that work will initially feed into the pre-Budget report and then future Budgets as well."[68]

Speaking for the Conservatives Philip Hammond argued the Government "have to go back to the drawing board and unpick this £20 billion package of income tax rates, income tax thresholds, tax credits and national insurance bands in order to mitigate the most negative effects … on the poorest families."[69] Speaking for the Liberal Democrats Jeremy Browne argued that, "low earners are affected, but not just low earners … right across my constituency, people such as farm labourers, hotel receptionists and those who work in service industries are adversely affected by the proposals that are being introduced."[70]

By contrast Stuart Bell argued that "the tax credits system – a minus rate of income tax – is the best way to help people out of poverty … the 10p rate is not a targeted tax measure as all taxpayers benefit from it."[71] Russell Brown took issue with this analysis: "if a pensioner pays an extra £1 a week, or £52 a year, we may try to offset that with a winter heating allowance increase, but the reality is that that does not matter to them. All that they are concerned about is the fact that they are paying additional income tax." Mr Brown went on to note that the problem had "no quick fix"; for example, increases in the national minimum wage would help low earners "but that is no good for women pensioners under 65 years of age, or anyone who has retired early on the grounds of ill health."[72]

John McFall, then chairman of the Treasury Committee, noted the Committee's concern that "those who do not gain from the measures on child poverty, fuel poverty and incentives to work will lose out, and we are talking largely about those on incomes of about £18,500 a year and less." Mr McFall also said that the impact of withdrawing the 10p rate was being raised now because at the time of the 2007 Budget "no specific information identified the winners and losers," and that he would suggest to the Committee that they re-examine the impact of this change.[73] The following day the Committee confirmed that it would launch a new inquiry, to be completed for the report stage of the Finance Bill, "to analyse the effects of the abolition

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66 HC Deb 21 April 2008 c1066
67 For details see *Budget 2008* HC 388 March 2008 paras 4.16-21
68 HC Deb 21 April 2008 c1067
69 HC Deb 21 April 2008 c1079
70 *op.cit.* c1096
71 *op.cit.* c1102
72 *op.cit.* c1118
73 *op.cit.* c1086, 1088

of the 10 pence rate of income tax on particular groups and overall … [and] consider possible future measures in this area."[74]

Winding up the debate the then Financial Secretary, Jane Kennedy, also referred to the difficulties of compensation:

> We are acutely conscious of the possible impact on the low paid. We have of course considered ways of compensating those groups. However, that would not only be difficult to achieve, but be disproportionately expensive in many cases … We cannot target tax measures at the specific groups that have lost out, and so any changes would also benefit people who have already gained from the package, taking valuable resources away from elsewhere … If we were to amend the criteria for tax credits, for example, to make more people eligible, we would also reduce their effectiveness in specifically targeting those at the greatest risk of poverty, such as low-income families with children. Again, those changes would also be expensive.

The Minister went on to argue that, "it would be fiscally irresponsible to unpick the package presented in this Finance Bill", though "my right hon. Friend the Chancellor has made it clear that he understands the concerns expressed and that we want to do more to help many of those who do not benefit from the package."[75]

On 21 April Frank Field tabled an amendment to the Bill, to prevent abolition of the 10p rate until the Government had taken measures "to ensure that no person is worse off by reason of the person's income not being sufficient to secure that the effect of the abolition of the starting rate is offset by the reduction of the basic rate." In a newspaper article Mr Field argued the amendment was "a double lock to protect the low paid."[76] In an interview with the *Guardian* the next day Mr Field gave some indication of the scale of compensation he thought would be necessary: "Most estimates suggest the losses on average are £2 a week, but let's say it is £4 a week, so that means the government needs to find between £500m and £1bn, since at most there are 5 million losers … There is unclaimed £1.2bn in working tax credit, and Brown set up that credit specifically to help workers on lowish incomes. Why can't those monies be used to finance the compensation package for this year?"[77]

On 23 April Mr Darling sent a public letter to Mr McFall, welcoming the Treasury Committee's decision to hold a new enquiry, and setting out "the work the Treasury has underway in this area" on proposals to help other low paid workers without children and pensioners under 65. An extract is reproduced below:

> For pensioners aged 60-64, whose incomes tend to be more stable, we have put in hand work to see if those households who have lost out from the removal of the 10p starting rate of income tax can be helped through the mechanism that already exists to pay the Winter Fuel Allowance. As a sign of the Government's intent, we do not wish to wait unnecessarily until November. Whatever conclusions we come to, all the changes will be backdated to the start of this financial year.

74 Treasury Committee press notice, *Treasury Committee announces new inquiry: Budget measures and low-income households*, 22 April 2008

75 HC Deb 21 April 2008 c1152, 1154

76 Frank Field press notice, *News of the World article: No Labour MP wants to wreck the Budget*, 20 April 2008. In addition to Mr Field, 38 Labour Members signed the amendment.

77 "£1bn package would end tax row, say rebels", *Guardian*, 23 April 2008

For other low paid families currently outside the working tax credit system, while we will examine in our review all practical propositions, our focus is on potential changes to the tax credits system to allow the average losses from the removal of the 10p starting rate of income tax to be offset. At the same time the Secretary of State for Business, Enterprise and Regulatory Reform and I have asked the Low Pay Commission to report on what changes could be made to the minimum wage regime to support younger workers . We will look at other measures alongside this.[78]

Mr Darling also confirmed that he would report back to the House in the Pre-Budget Report in autumn 2008. In turn Mr Field withdrew his amendment, saying "the Government has listened, and more importantly acted upon what many Labour MPs have been saying."[79] The following day Mr Darling reiterated his position at Treasury Questions, when he was asked whether all compensation would be backdated to the beginning of the tax year:

As I said in my letter yesterday, the first area in which we can take action is in relation to 60 to 64-year-olds. On the others [who will lose from the tax package] … I said that our focus is on allowing that the average losses from the abolition of the 10p band can be offset. I want to do that for this year. Because the groups concerned are diverse, and because the effect of any change to the tax system can be quite complex, it will take time—this is why it will not be until the pre-Budget report that I can come back to it—to work out in which way we can help groups.[80]

Although it is clear that this announcement was welcomed by many of those raising concerns about the withdrawal of the starting rate, there remained questions about how a compensation package would work in practice.[81] A report by the Social Market Foundation published at this time argued that as it would be hard to target compensation for losers and the Government's resources were tight, any package would "help less than ¼ of the losers, and will involve using mechanisms like the minimum wage and the pensioners' winter fuel payments for things they were not really designed to do."[82] Mike Truman, editor of *Taxation* magazine, argued that it would very hard to give any compensation to one group of losers:

Childless two-earner couples, where both partners work around 30 hours a week but for minimum wage … seem to me to be particularly badly hit … A single childless person on £17,500 a year is actually paying around £33 less in tax and NI this year compared to last, so arguably does not need to be compensated. However, a couple who each earn £8,500 have each lost just under £150 a year. Neither household can at present claim tax credits, and any change that allows the couple to claim will also almost certainly allow the single person to claim. It is hard to see how any of the mechanisms proposed so far will allow the Chancellor to target his compensation package with any degree of accuracy.[83]

Initially clause 3 of the Bill made provision to withdraw the 10p rate, and this was debated by the Committee of the Whole House on 28 April. Speaking for the Conservatives Philip Hammond argued the abolition of the 10p rate, alongside the cut in the basic rate, was

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78 Letter from Alistair Darling, Chancellor of the Exchequer, to Rt Hon John McFall MP, Chairman of the Treasury Committee, 23 April 2008 [Deposited paper DEP2008-1072].

79 Frank Field MP press notice, *Statement issued by Frank Field MP*, 23 April 2008. The Prime Minister reiterated the Government's position at PMQs the same day (HC Deb 23 April 2008 c1302).

80 HC Deb 24 April 2008 c1457

81 See, for example, "Leader: rebels no more", *Guardian*, 24 April 2008

82 Social Market Foundation, *SMF report: Abolition of the 10p tax band*, April 2008 p1. see also, "PM's retreat prompts election fears", *Financial Times*, 25 April 2008

83 "10% turmoil", *Taxation*, 1 May 2008

"cynical and short term" as it had abandoned "a long-term Labour party objective and a 1997 manifesto commitment." He proposed an amendment to require that specific measures to compensate those who had lost from those two rate changes be approved by the House by the end of the year.[84]

Speaking for the Liberal Democrats, Jeremy Browne argued that the Government had not addressed the "issue of cash flow. There are many people on low and low-to-middle incomes, and if they receive money in November that is backdated six months, it will not pay today's supermarket, gas or council tax bill." Mr Browne also raised the question whether compensation would "apply for one year only." [85] At a later stage of the debate Steve Webb suggested that "given that the root of this problem was an attempt to deceive people and to portray something in one way that came across in another, the worry is that the presentation of this compensation package is already being spun."[86]

In his contribution Frank Field noted that compensation was not "going to be an easy exercise" underlining the point that "no party is advocating the reintroduction of the 10p rate." Mr Field also noted that no government would "be able to strike an overall deal on the basis of 5.3 million personalised deals; whatever is done will be done to groups and to averages."[87] Kenneth Clarke argued that the "real problem" with the Government's tax package was that "the then Chancellor was cutting the standard rate when he could not afford to do so" even though "all of us, including myself, did not [at the time of the 2007 Budget] have to nerve to say … 'why don't you put it back up again?'" Mr Clarke went on to argue "all the mechanisms that we have identified [for compensation] are extremely complicated and unsatisfactory:"

> Since the announcement but before the change came into effect, while earnings have not been moving significantly, utility bills and council tax have increased and food bills are rising very rapidly, so everybody's discretionary income is being squeezed and the current situation of the people concerned is worse than we could have contemplated when this measure was first announced. Therefore, the sums— comparatively small, though they might sound to us—that [constituents]… complain about when they come to see us are a big blow to those people's budgets at a difficult time.[88]

Responding to the debate the then Financial Secretary, Jane Kennedy, opposed the Conservative amendment, on the grounds that the tax authorities "would have no legal power to collect any tax on the first £2,320 of taxable income from the start of the tax year." On the impact of the personal tax package the Minister said:

> Removing the 10p rate has enabled us to introduce further measures that reduce child poverty and remove pensioners from tax, but we have also produced a tax system with only two main tax rates applying to the same income as the two main rates of national insurance. This is now one of the simplest personal tax systems in the developed world. … I acknowledge that, as a consequence of redirecting resources as I have described, some households have less income as a result, and that those households are often on a low income. I regret that that is an effect of those changes, which is why we would have looked to help such households in the future anyway, and we intend to do that very thing in the next days and weeks.

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[84] HC Deb 28 April 2008 c94
[85] HC Deb 28 April 2008 cc103-4, c106
[86] *op.cit.* c121
[87] HC Deb 28 April 2008 c113, c115
[88] *op.cit.* c118, cc119-20

When asked, the Minister declined to say whether compensation would be backdated for all affected groups: "I do not wish to be drawn on the outcome of this further work. I say that advisedly, not intending in any way cynically to avoid the question that is being put, but it is only right and proper to undertake the work of reviewing what can be done properly and seriously."[89] At the end of the debate, the House rejected the Opposition amendment and then approved Clause 3 by 304 votes to 262.

## 6 The Chancellor's statement on 13 May 2008

On 13 May 2008 Alistair Darling gave a statement to the House on how he would "deal, this year, with the consequences of the withdrawal of the 10p starting rate of tax." He noted that in his letter to the Treasury Committee on 21 April, he had explained that options for the longer term would be set out in the Pre-Budget report, and that his focus "would be on changes to offset the average loss of £120 per household and that whatever conclusions we came to, the changes would be backdated to the start of this financial year. But I also said that I would not wait unnecessarily until November before setting out how we intended to proceed." Mr Darling went on to explain why he had ruled out the use of a rebate scheme or changes in tax credits to achieve these ends, but had decided to increase the basic personal allowance:

> "[In my letter] I said that I would look at the administrative practicalities of other options that some right hon. and hon. Members have suggested, including a one-off rebate or compensatory payment, as well as changes to the tax credit system to allow the average losses to be offset. Having looked at this further, I believe that a rebate scheme would be complex and expensive to administer. It would also take time to set up and, in any event, changes to the eligibility for tax credits could not be introduced this year.
>
> However, I can bring forward a proposal for this year that will offset the average loss and that will provide financial support more fairly, quickly and efficiently than any one-off rebate scheme—provided we legislate for it now in this year's Finance Bill. For that reason, I am proposing to bring forward one measure from the pre-Budget report now.
>
> I want to help families on low and middle incomes as soon as possible. But my proposal for this year will not only help those on low incomes who lost out, but do more to help all basic rate taxpaying families at a time when oil and food prices have been rising in every part of the world. So, at a cost of £2.7 billion, I will increase the individual personal tax allowance by £600 to £6,035 for this financial year, benefiting all basic rate taxpayers under 65.
>
> That will mean that 22 million people on low and middle incomes will gain an additional £120 this year. It will mean that 4.2 million households will receive as much, or more than, they originally lost. The remaining 1.1 million households will see their loss at least halved. In other words, 80 per cent. of households are fully compensated, with the remaining 20 per cent. compensated by at least half. In addition, 600,000 people on low incomes will be taken out of income tax altogether.
>
> People aged between 60 and 64, whose average loss was £100, will also get the advantage of the increased personal allowance worth up to £120. They will also

[89] *op.cit.* c125, c126

> receive the additional £50 winter fuel payment for this year, which I announced in the Budget. The increased personal allowance will apply to all income for this tax year and so will be backdated to 6 April. As a result, from September, basic rate taxpayers will see a one-off increase in their monthly income of £60 and then an increase of £10 per month for the rest of the financial year.
>
> Higher rate taxpayers were largely unaffected by the reforms that were announced last year. So it is fair to focus this additional support on basic rate taxpayers only. However, as the £600 increased personal allowance applies not just to basic rate taxpayers but also to those paying tax at a higher rate, I am reducing the threshold at which an individual starts to pay tax at the higher rate by £600.
>
> The net effect of these changes is that the tax liability of everyone who currently pays tax at 40 per cent. will be unaffected by the increase in the personal allowance. Those brought into the higher rate will gain by up to £120 this year.[90]

Almost all basic rate taxpayers gained £120 from this change.[91] For most people the change in their personal allowance was made through a change in their tax code from September 2008. One point to underline here is that in his statement the Chancellor is referring to the 'higher rate threshold', the point at which customers start to pay higher rate income tax, which is the *total* of the personal allowance and the basic rate limit. As the personal allowance was increased by £600 for all taxpayers, the basic rate limit was cut by £1,200 – to £34,800 for 2008-09 – to ensure higher rate taxpayers were no better off.[92]

The Chancellor went on to explain that provision for this change would be made in the Finance Bill currently before the House, before stating that the cost of this measure would be met entirely through an increase in government borrowing:

> I propose to legislate for these changes in this year's Finance Bill so that taxpayers will get the benefit of the change from September. Raising the personal allowance is simpler than other solutions, and also retains the benefit of a simpler tax system and allows basic rate taxpayers to see the benefits as soon as possible, and for the whole of this financial year.
>
> My proposal will also provide additional support for individuals and families this year, including those on middle incomes who have benefited from other reforms announced in 2007. We are providing that support at a time when they are facing additional costs. I have brought forward this measure from the pre-Budget report in order to ensure that people get the benefit as soon as possible. I shall set out proposals for next year and beyond at that time.
>
> As I made clear at the time of the Budget, it is right and sensible to allow borrowing to rise and investment to be maintained as the economy slows. Debt is lower than it was in the past and low by international standards. Our fiscal policy, like our monetary policy, is designed to support stability in these uncertain economic times generated by the turbulence in world financial markets and global commodity-price inflation. I am able to finance the proposal through borrowing this year, ensuring that we do not take money out of the economy at this time.

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[90] HC Deb 13 May 2008 cc1201-2. The statement was not accompanied by a press notice.
[91] Some individuals would not have earned enough in 2008/09 to make full use of the extra personal allowance to cut their tax bill (ie, they earned between £5,435 to £6,635).
[92] HM Revenue & Customs, *13 May 2008 Chancellor's Announcement*, 13 May 2008

> I will, of course, set out my fiscal projections and decisions in the pre-Budget report as usual, consistent with the fiscal rules and in line with the requirements of the code for financial stability. For future years, our aim is to continue the same level of support for those on lower incomes and I shall bring forward proposals to do that in the pre-Budget report.[93]

Speaking for the Conservatives, George Osborne argued that although his party would welcome "any genuine compensation that is offered" but that this measure "was a one-off change only, for this year only." John McFall, chairman of the Treasury Select Committee, suggested that "it is nothing but churlish and mean not to welcome a statement that benefits everyone on basic rate taxation and which takes 600,000 people out of tax altogether."[94] Speaking for the Liberal Democrats, Vincent Cable stated that "it is welcome that [the Chancellor] is moving in the direction of lifting [low-paid workers] out of tax", but asked why a tax rebate scheme had been rejected. In answer to this point, the Chancellor said:

> I considered the issue of rebates, and I saw that that would be horrendously complicated. We would have to set up a new system. In addition to that, the Inland Revenue tells me that every year about half a million people move, and the Revenue does not know their addresses, so their cheques would go missing. When I looked at the proposal, and at the comparative costs, which are not actually that different, I decided that it would be far better to do something simpler and easy to understand.[95]

The Chancellor's statement was welcomed by many Labour Members, including Frank Field who congratulated Mr Darling "on putting an end to the issue."[96] In their report on the issue, published a few weeks later, the Treasury Committee took the view that this was "probably the least bad option, with the benefits of simplicity, transparency and greater incentives to work on the basis that fewer taxpayers face high marginal deduction rates. However, £2 billion of the £2.7 billion committed to that measure in the current financial year is not devoted to compensating losers from the removal of the starting rate of income tax."[97] (The Committee's report also provides a detailed breakdown of households not fully compensated by this change.[98]) In its response to the Committee's report, the Government observed that, "it would not have been able to exclude individuals who had gained from original reforms as there was no way of identifying these people in the income tax system."[99]

There was a more mixed reaction in the press and other commentators. An editorial in the *Guardian* commented, "crude, simple and costly, yesterday's tax cut epitomises the brand of economic populism that Mr Brown has, over two decades, defined himself against."[100] The *Financial Times* argued that "in policy terms, the plan to put up personal allowances makes sense … but the political cost is heavy. It has shattered any residual idea that Mr Brown's administration can run an orderly fiscal policy."[101] Similarly the *Times* argued that "on the substance of the shift, Mr Darling has probably made the correct decision [though] … this is

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93 HC Deb 13 May 2008 c1202
94 *op.cit.* c1204
95 *op.cit.* c1205-6
96 *op.cit.* c1206
97 *Thirteenth report: Budget Measures and low-income households*, 28 June 2008 HC 326 2007-08 par 97
98 HC 326 2007-08 Ev132-4
99 Treasury Committee, *First special report: Government's response to the Committee's thirteenth report of 2007-08*, 15 December 2008 HC 69 2008-09 p3
100 "Editorial: Income tax – cut now, pay later", *Guardian*, 14 May 2008
101 "Editorial: Darling's desperate tax giveaway", *Financial Times*, 14 May 2008

manifestly a short-term fix." It went on to suggest "the broader damage, though, is to the reputation of this administration … [The Government] has now overturned a key section of the 2007 Budget after a year of insisting that there was absolutely no need to do so."[102]

Writing on the BBC news site, John Whiting, of PricewaterhouseCoopers, noted "of those who stood to lose, i.e. those with incomes under £16,500, many will now be better off. But some - those on the every lowest income - will still be out of pocket. For example, someone on an income of £8,000 was losing about £170 over the year; they are still £50 worse off." Mr Whiting also noted there was a further question about whether allowances would be uprated next year or not, using the new allowance as the baseline.[103]

The editor of *Taxation*, Mike Truman, observed "the 20% of people who still are not fully compensated by the new package will be the ones who were hardest hit in the first place: those earning just over £8,000." The magazine also quoted Chas Roy-Chowdhury, head of taxation at the Association of Chartered Certified Accountants (ACCA), as describing the measure as "a step in the right direction", but noting the downside: "business' systems and processes will have to be updated halfway through the tax year. SMEs represent over 99% of UK businesses, and they will have to change their PAYE codes and tax systems."[104] The impact on employers from the change in tax codes was raised in a PQ at the time:

> **Mr. Philip Hammond:** To ask the Chancellor of the Exchequer what estimate he has made of the cost to (a) private businesses and (b) public sector employers of implementing his decision to increase income tax personal allowances in 2008; and if he will publish a full impact assessment.
>
> **Jane Kennedy:** HM Revenue and Customs (HMRC) and employers' representatives have long established processes in place to ensure any changes to tax can be implemented by businesses as soon and simply as possible. HMRC is talking to employers' representatives about the smooth and timely implementation of the changes announced by the Chancellor. Each year, HMRC sends tools to employers so that they can automatically implement the annual Budget changes. HMRC are following this well-understood process in implementing the changes announced by the Chancellor. HMRC are issuing updated tools to employers, which will include all the details to enable an employer to automatically implement the changes. For smaller employers who continue to operate their payrolls manually, HMRC will provide tax tables to help them deal with the changes.[105]

One further point to make is that the Chancellor's statement made no changes to the structure of National Insurance contributions (NICs). As noted above, employees are charged Class 1 NICs if their weekly earnings exceed the primary threshold – set at £105 for 2008/09. Similarly employers pay secondary Class 1 NICs on any employee's earnings, if they exceed the second threshold, also set at £105. Both thresholds had been aligned with the personal tax allowance – so that employers operating PAYE would start deducting income tax and NICs from an employee's earnings at the same point. This alignment was part of a wider reform to simplify NICs and reduce employers administrative costs announced

102 "Leader: Making allowances: a belated shift in policy that leaves ministers without credit", *Times*, 14 May 2008
103 "Tax change winners and losers: Analysis", *BBC News site*, 14 May 2008 http://news.bbc.co.uk/1/hi/business/7400115.stm
104 "News: Higher rate change 'clarified'" & "News: Allowance rise met with doubt", *Taxation*, 13 May 2008
105 HC Deb 22 May 2008 c437W

in the March 1998 Budget; aligning the thresholds with the personal allowance was achieved in a two-step increase in the thresholds in April 2000 and April 2001.[106]

Raising the personal allowance by £600 for 2008/09 meant that employers were required to deduct NICs from earnings above £105 a week, and income tax from earnings at £116 a week. Clearly one option before the Chancellor would have been to increase both the primary and secondary thresholds, in line with the rise in the personal allowance. However, this would have had substantial Exchequer costs; the IFS estimated that realigning these earning thresholds with the personal allowance for 2009/10, while maintaining statutory indexation, would have cost about £2.7 billion a year.[107]

Writing in *Taxation*, Mike Truman noted that the Chancellor's decision to cut the basic rate limit also had implications for the Government's aim to align the point at which individuals became liable to pay the higher rate of income tax with the UEL.[108] Initially this was to have been done in two steps:

- In 2008/09 the UEL would rise by £75 a week in real terms, to £770 – which is equivalent to £40,040 a year. The basic rate limit would rise in line with inflation, so, the higher rate threshold would be £41,435 (ie, £5,435 + £36,000).
- In 2009/10 the higher rate threshold would rise by £800 in real terms, and the UEL would be further increased to align with it.[109]

In his article Mr Truman commented that "the two year alignment referred to above was meant to be at a significantly increased level for NI":

> The higher rate tax limit was intended to increase by inflation while the NI upper earnings limit caught up with it in two stages, thus ensuring that no-one taxed at higher rates lost out year on year (strange that no such attention was paid to the lower paid). The need to reduce the basic rate band by £1,200 has significantly altered the picture. The upper earnings limit at £40,040 is now closer to the point at which higher-rate tax is due, gross income of £40,835 [ie, £6,035 + £34,800]. So, whereas we previously had the NI and income tax limits aligned as best they could be at the bottom of the pay scale but £1,400 apart at the top, they are now out by £600 at the bottom and £800 at the top. That doesn't look like progress to me.[110]

Following the Chancellor's statement the IFS published a substantive report on the Government's options for the next year; in this, the authors suggested that "the Government will find it hard to reduce significantly the number of residual losers from the abolition of the 10p rate at a cost that it would find acceptable":

> It will also be difficult to recoup much of the £2.7 billion cost of the higher personal allowance for 2008–09 in future years without leaving many middle-income families

[106] The background to this reform is discussed in, *National Insurance contributions: an introduction*, Library standard note: SN4517, 6 February 2012 pp13-16.

[107] IFS, *The 10% tax rate: where next? IFS Briefing Note No.77*, May 2008 p32. see also, "'One-off' 10p tax aid would hit millions", *Financial Times*, 21 May 2008.

[108] In 2007-08 the UEL was £670 a week, equivalent to £34,840 a year. The higher rate threshold was £39,825 a year (the personal allowance of £5,225 + the basic rate limit of £34,600).

[109] The two-stage increase in the UEL was estimated to raise £1.1 billion in 2008/09, and £1.49 billion in 2009/10. This tax increase would be mitigated by the real terms increase in the basic rate limit from April 2009, estimated to cost £250 million (*Budget 2007* HC 342 March 2007 p213, p208).

[110] "Flip a coin", *Taxation*, 22 May 2008

(and perhaps some low-income ones) worse off over the next two years than they are this year. Given the political pressures it faces, this suggests that the Government may well decide to borrow more to maintain the higher level of the personal allowance in coming years, just as it has chosen to do this year. This would leave taxpayers to pick up the bill in future years.

The authors noted 0.9 families would still lose more than £1 a week in 2008-09, including:

- 500,000 childless single adults under 25 (almost all living in a household with other adults);
- 140,000 childless couples where at least one is aged 25 to 55, and;
- 115,000 childless single adults aged 25 to 55.[111]

However, these numbers are relatively small compared with the *18 million* families that the IFS calculated would be worse off, by an average of more than £150, if the Government reversed the £600 increase in the personal allowance, and the extra winter fuel allowance, for the 2009/10 tax year. The report went on to explore a number of options for maintaining some support at a reduced cost, including tapering the allowance for those with higher incomes, increasing the rate of National Insurance contributions for employees, or freezing the allowance at its current level. The authors concluded that it was hard to assess the relative benefits of these options, as determining what the Government was "trying to achieve … is not easy":

> The originally stated objectives of Budget 2007 were to simplify the income tax and NICs system – which we applauded at the time (while pointing out the inconsistency of retaining the 10% band for savings income) and to lower the basic rate of income tax. It was the decision to fund the latter by doing the former that has created losers from what was a giveaway personal tax package overall.
>
> The stated objective of the 13 May announcement on personal allowances was to compensate most of the low-income losers from the abolition of the 10p rate and to provide additional support to middle income families who are suffering a squeeze on their living standards from rising prices.[112] A third, unspoken, objective of both Budget 2007 and the 13 May announcement was to avoid either big gains or big losses for higher-rate taxpayers.
>
> As the Government is now discovering to its cost, it is very expensive to bring about structural changes to income tax and NICs if you are constrained not to inflict losses either on low-income families or on higher-rate taxpayers. By borrowing to finance part of the reform, the cost is simply being pushed onto an as yet unidentified group of taxpayers in future years. Added to the Government's partial U-turn on capital gains tax,[113] the events of the last 18 months do not bode well for the prospects of structural tax reform.[114]

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[111] In this context, the IFS define a family (or 'benefit unit') as a single adult or couple living together, plus any dependent children, and describe a family as losing if it loses more than £1 a week and gaining if it gains more than £1 a week. (IFS press notice, *18 million families set to lose if 'one-off' giveaways not extended*, 21 May 2008).

[112] In fact, the tax and benefit system already provides support to families as prices rise, as income tax allowances and many state benefits and tax credits are increased in line with various measures of inflation.

[113] [see, *Capital gains tax (CGT) : reforms from April 2008*, Library standard note SN4652, 10 June 2010.]

[114] *IFS Briefing Note No.77*, May 2008 pp 29-30. A second note examined the implications for public spending of these options: *Alistair Darling's mini-Budget: can he afford it? IFS Briefing Note No.78*, May 2008.

The Government tabled two new clauses to the *Finance Bill*, to set the personal allowance at £6,035 and the basic rate limit at £34,800 for 2008-09, which were debated, and agreed to, at the Report stage of the Bill on 1 July.[115] Speaking for the Conservatives, Philip Hammond argued that "something must be done, both this year for the 1.1 million families who are still worse off, and in future years for those who have been compensated by the increase in the personal allowances but do not yet know if they will get the increase next year" – though he declined to suggest the best way to do this: "there are many different solutions, but we do not have the resources that the Treasury has and I do not pretend to have the answers to the dilemma in which the Government find themselves."[116]

John McFall, chairman of the Treasury Committee, concurred that the proposals announced on 13 May were "the start of the process, not the end." Mr McFall discussed the conclusions of the Committee's report on this issue, which he had first announced at the Second Reading debate on the Bill.[117] In the Committee's view, "the only way to reach all those who have lost out … is through the tax system … the Government should not meddle with tax credits or anything else." Mr McFall also highlighted two other conclusions drawn by the Committee:

> We seek to identify lessons from the 10p tax saga for future Budget policy making, and draw two main conclusions. First, the Government must be clearer and more open about the distributional effects of their policies, and we recommend that a household impact assessment accompany each Budget and PBR. If such an assessment had been compiled when Budget 2007 was produced, the Treasury Committee would have had time to study it at our leisure. We would have identified both winners and losers, and we would have known where we were going …
>
> The Committee's report also emphasises the benefits of proper consultation about personal tax measures. We return to a theme that we have identified before—that the Government can and must use the PBR more as a tool for consultation. The outcome would have been better if that approach had been adopted in respect of capital gains tax, inheritance tax and the non-doms—and I could list more examples. The Government should not use the PBR as an early Budget. They should not spring surprises on us: instead, they should use the PBR for consultation purposes, as it was intended. Then, people will not be surprised or disappointed by the content of the Budget when it is announced, because the appropriate the consultation will have taken place. That is an extremely important lesson for the Government to learn.[118]

In her response to the debate, the then Financial Secretary, Jane Kennedy, reiterated the Government's commitment to return to the issue in the pre-Budget report, saying, "yes, there will be concrete proposals. Yes, they will address the point. Yes, they will be targeted. Yes, they will be implementable as soon as possible."[119]

[115] HC Deb 1 July 2008 cc737-780. These provisions now form ss2 & 4 of the *Finance Act 2008*; s5 of the Act abolishes the starting rate on all non-savings income.
[116] HC Deb 1 July 2008 c746-7, c746
[117] *Thirteenth report: Budget Measures and low-income households*, 28 June 2008 HC 326 2007-08
[118] HC Deb 1 July 2008 cc772-3
[119] HC Deb 1 July 2008 c779

# 7 The 2008 Pre-Budget Report

In his Pre Budget statement on 24 November 2008, Mr Darling confirmed that the £600 increase in the personal allowance would be maintained, and it would rise by a further £130 *above* indexation – to £6,475 – from April 2009; the two age-related allowances and the basic rate threshold would rise in line with inflation. The Chancellor also proposed further changes to income tax and National Insurance contributions for the two years *after* 2009/10:

> In May, I announced an increase, for this year alone, in the income tax personal allowance—a benefit of £120 a year for basic taxpayers. I have decided to make that temporary tax cut permanent, and I have also decided to increase it to £145 a year in April. That will benefit 22 million basic-rate taxpayers. My announcement in May helped 4.2 million households that were affected by the abolition of the 10p rate, and this announcement will help another half a million households—not just this year, but for good.
>
> Along with those immediate steps to help businesses and families now, I am also announcing measures to ensure sustainable public finances in the medium term. I have considered a number of options to raise revenue in future years, and I have chosen those that are fairest and affect those who have done best out of the growth of the past decade. … I propose from April 2011 to increase by ½ per cent. all rates of national insurance contributions for both employees and employers.
>
> To ensure that the increase does not fall on those on low or modest incomes, I have decided, at the same time, to raise the starting point for national insurance to align it with that for income tax, so that no one on under £20,000 will pay any more national insurance contributions as a result. Secondly, those with the highest incomes have seen their earnings almost double since 1996, so—again from April 2011—I intend, only on income over £150,000, to introduce a new rate of income tax of 45 per cent. This higher rate of tax will affect only the top 1 per cent. of incomes.
>
> I also intend to withdraw the long-standing anomaly of the income tax system under which the personal allowance is worth twice as much to higher-rate than to basic-rate taxpayers. Again, I will protect those on middle incomes; this will affect only those earning over £100,000—that is, the top 2 per cent. So from April 2010, those with incomes between £100,000 and £140,000 will see the value of their personal allowance reduced, so that they get the same benefit as basic-rate taxpayers. For people with incomes above £140,000, I will withdraw the full value of that personal allowance.[120]

In the Pre-Budget Report, the Government explained that it expected prices to *fall* in real terms over the next year, but that it would "maintain the additional £130 of personal allowance in April 2010." In addition, "to reduce the gain for higher rate taxpayers" from this change, the basic rate limit would be "held at its 2010-11 value in 2011/12."[121] On the question of winners and losers, the report stated that, "these reforms, and the measures announced in May, will permanently reduce the number of households paying more net tax as a result of Budget 2007 personal tax changes from 5.3 million originally to 500,000 by 2011-12 … people with incomes below £40,000 will not pay more income tax and NICs in April 2011 than in April 2008."[122]

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[120] HC Deb 24 November 2008 cc 495-6
[121] Cm 7484 November 2008 para 5.7
[122] Cm 7484 November 2008 para 5.10, 5.9

In general most commentators focused on the future increases in National Insurance from 2011, the new 45% higher rate of tax, or on other aspects of Mr Darling's statement – such as the temporary cut in the standard rate of VAT, or the sharp increases in the Government's projected figures for public sector borrowing and debt.[123] However, at a briefing after the Pre-Budget report, IFS researchers Mike Brewer and James Brown took issue with the department's claim that no-one earning below £40,000 would pay more tax/NICs "in April 2011 than in April 2008". This was true if only one compared the situation in April 2008 *prior* to the statement on 13 May setting the personal allowance for 2008-09; they suggested that it might be more accurate to count the numbers of winners and losers using April 2007 as one's starting point.[124]

There was also a short exchange of views on 'winners and losers' when the Treasury Committee took evidence from Mr Brewer and others on the PBR on 4 December:

> **Q78 Mr Stephen Crabb**: …. By making permanent the changes to personal tax allowances that were announced in May by way of compensation for the abolition of the 10p tax band has the Chancellor effectively cured his headache that was caused by the abolition of that 10p band?
>
> **Mike Brewer from the Institute for Fiscal Studies** : No, not really, in the sense that even after the rise in the personal allowance there were still some 10p losers, around a million, according to the Treasury and according to us. He has just confirmed that that will be the situation in the future by confirming the rise in the personal allowance in the future. The additional thing in the Budget was the rise in the primary threshold which goes some way to reducing the number of 10p losers from around the million mark. The Treasury thinks it gets the number of 10p losers down to around half a million households … There are still 10p losers but I think in the grand scheme of things very few losers and they are losing very small amounts of money after the rise in the primary threshold in 2011.
>
> **Q79 Mr Crabb:** … can you give us a sense of the characteristics of the households among those 500,000 who will still lose out as a result of the changes?
>
> **Mr Brewer:** ... When we looked for you in May at who was losing it showed that it was predominantly single adults under 25 if you are looking at the characteristics of the individuals, many of whom live in households with other adults. I am certain that will still be the problem group of people who are losing, low earning people without children, typically young but also typically living with other people in the household who are probably better off as a result of the rise in the personal allowance ...
>
> **John Whiting, PricewaterhouseCoopers and the Chartered Institute of Taxation:** There is an important cadre of early retirees, people who have stopped work before 65, because obviously if you are post-65 you earn much higher age allowances which were part of the compensation package, so there is this group of 50-65 year olds with relatively small amounts of income. They, of course, have stopped work and by definition will not be benefiting from national insurance adjustments, so there are still some there and, obviously, … they can lose out on their relatively small incomes.
>
> **Peter Kenway from New Policy Institute :** Can I just come back, Mr Crabb, on the way you opened with that question? Perhaps (or perhaps not) this has solved the

[123] For example, "After the gain comes pain", *Guardian*, 25 November 2008; "Tax to fund £20bn boost", *Financial Times*, 25 November 2008

[124] *IFS Pre-Budget Briefing: Tax and benefit changes – distributional analysis*, November 2008

> immediate short-term problem. The way I read the whole 10p thing when we finally woke up to it was that it is actually a sign of a much deeper problem, which is this problem generally of in-work poverty, the extent to which families with and without children are below the poverty line despite all that has been done and are working. That problem remains with us, and to the extent that we have recent data (it is only up to April 2007) it suggests that that problem at that time was continuing to get worse.[125]

At this time the Government gave its response to the Treasury Committee's report on the 10p rate, which had come out in June 2008; this gave more detail on the Government's reasons for using a second increase in the personal allowance as compensation:

> The Government has carefully examined the options. Extending eligibility to Working Tax Credit for those without children (currently available to those aged 25 or over working 30 or more hours a week) would not have a significant effect on the number of households that are paying more net tax following the Budget 2007 reforms. In addition, it would work against the original policy aims for the targeting of the Working Tax Credit. This fully supports the Committee's conclusions on extending the scope of Working Tax Credit.
>
> The Government has also explored the option of an additional 'tapered personal allowance'. While this would in theory be a well-targeted way of providing additional financial support to low-income people, it does have a number of significant downsides:
>
> - it would increase marginal effective tax rates over a large range of income, affecting millions of taxpayers (there are currently around 11 million taxpayers with incomes between £10,000 and £20,000);
> - all people subject to the taper would face new administrative burdens as they would need to provide information to HM Revenue and Customs on their incomes (for example, by completing a self assessment tax return); and
> - as income would only be known at the end of the year, this is likely to lead to over- or underpayments of tax.
>
> These arguments do not carry the same weight for the restriction of the personal allowance for people with incomes above £100,000:
>
> - while there is a higher effective tax rate as the value of the personal allowance is restricted, this affects only relatively narrow bands of income, which only have a relatively small number of people in them. It therefore applies to relatively few taxpayers;
> - virtually all taxpayers with incomes above £100,000 are already in the self assessment system; and
> - these taxpayers are most likely to be the ones where the self assessment process already identifies under and overpayments of tax, so any additional under and overpayments are likely to be manageable.
>
> The reforms announced in the 2008 Pre-Budget Report reduce the number of households paying more net tax from 1.1 million to around 500,000. The Government will continue to reform the UK's tax and benefit system consistent with its overall aims and objectives.[126]

In the months after the 2008 PBR, there was relatively little discussion of the 10p tax rate, as political debate focused on concerns about the economy as a whole. In their Green Budget

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125 *Second report: Pre-Budget Report 2008*, 28 January 2009 HC 27 2008-09 Q79 Ev14-15
126 *First special report*, 15 December 2008 HC 69 2008-09 pp12-3

published in January 2009, the IFS looked at income tax, but primarily in relation to the proposal for a new 45% higher rate, and the two-stage withdrawal of the personal allowance from high earners.[127] In their report on the PBR, the Treasury Committee discussed personal tax reform, but in relation to child poverty, fuel poverty and the poverty trap.[128] All told one could be forgiven for assuming that, in the words of Stephen Crabb MP quoted above, the Chancellor had indeed cured his headache caused by the abolition of the 10p band.

## 8 Abolition of the 10p rate – the postscript

In his 2009 Budget the then Chancellor Alistair Darling confirmed the changes to the personal allowance, and to the rates of National Insurance he had set out in his PBR six months before. However, he made two major changes to his proposals regarding an additional higher rate of income tax, and the restriction of the personal allowance, for the highest earners:

> I am not proposing to increase taxes on income for this year. However, as the economy recovers and wages start to grow again, it is right that we take additional steps. I believe that it is fair that those who have gained the most should contribute more. Only those with incomes over £100,000 a year—or 2 per cent. of the population—will be affected.
>
> In November, I announced a new rate of income tax of 45 per cent. on incomes above £150,000—the top 1 per cent. of taxpayers. In order to help pay for additional support for people now and to invest in the future, I have decided that the new rate will be 50 per cent., and will come in from April next year—a year earlier. In November, I also announced that I was reducing personal allowances for the very highest earners with incomes over £100,000. These allowances are worth twice as much as those of basic rate taxpayers. I have now decided to withdraw fully the benefit of that allowance for those with incomes over £100,000 from next April. These measures are necessary to build our recovery and secure our country's economic future.[129]

The Budget report noted that "as announced on 13 May 2008, the personal allowance was increased by £600 to £6,035 in 2008-09. As part of this, the basic rate limit was reduced by £1,200. The increase to the personal allowance has been made permanent in 2009-10, with a further increase of £130 above indexation. This extra support will be maintained for 2010/11." The report estimated that this measure would cost £3.74bn in 2009/10, rising to £3.87bn in 2010/11. By comparison, the new 50p rate, and the tapered personal allowance, were estimated to raise £1.13bn, and £890m, respectively, in 2010/11.[130]

The Chancellor's announcement of a new 50p rate dominated initial reactions to the Budget. In its report on the Budget, the Treasury Committee focused on the new higher rate, as well as the proposed restriction on tax relief for pensions[131] – though the continued impact of the 10p rate withdrawal was the subject of an EDM tabled by Frank Field just before the Budget:

[127] James Browne, "Income tax and National Insurance", in *Green Budget 2009*, IFS January 2009 pp213-226
[128] HC 27 2008-09 pp37-47
[129] HC Deb 22 April 2009 c244
[130] These figures *combine* estimates for the yield from the PBR 2008 changes, with the 2009 Budget changes. The projected yield of the 50% rate, and the tapered personal allowance, for 2012-13 is £2.4bn and £1.5bn, respectively. HC 407 April 2009 pp153-5 (Para A.6, Tables A1 & A2; also Table A1 – footnotes 2&3).
[131] *Eighth report: Budget 2009*, 6 May 2009 HC 438 2008-09 (see pp41-5).

> That this House records with real disappointment that up to 3.8 million individual taxpayers are still worse off as a result of the abolition of the 10 pence tax rate; registers that the two measures the Government have since announced do not yet compensate them fully; and calls on the House to secure justice for this group of low tax paying workers at the next Budget.[132]

Sixty Members signed the Motion, many of them Labour Members – though the Financial Secretary, Stephen Timms, took issue with the figure cited here, when asked about the EDM during the Committee stage of the Finance Bill in May:

> The hon. Member for South-West Hertfordshire [David Gauke] asked me about the early-day motion and the reference to 3.8 million people. I am aware of that figure, but I cannot confirm it as I have not seen the analysis and I am not sure of the basis that underpins it. However, the number of households that have lost out as a result of the changes has been reduced from over 5 million—which was the initial announcement, as the hon. Gentleman said—to 600,000 this year, and 500,000 by 2011-12. It will therefore have been reduced by 90 per cent. by that time. The losses that we are talking about are less than £1 a week on average this year. We have made a great deal of progress in addressing the concerns that were raised in the Committee and elsewhere a year ago.[133]

In answer to a PQ at this time, the Government showed no inclination to consider further compensation:

> **Mr. David Anderson:** To ask the Chancellor of the Exchequer (1) what estimate he has made of the number of people who have not been fully compensated for losses they incurred as a result of the abolition of the 10 pence tax rate; (2) what plans he has to provide further recompense to people who have not been fully compensated for losses they incurred as a result of the removal of the 10 pence tax rate.
>
> **Mr. Timms:** An assessment of the impact of the Budget 2007 personal tax changes, and the subsequent reforms made to income tax, were included in the 2008 pre-Budget report at paragraph 5.10. The Government have set out, in the 2008 pre-Budget report and Budget 2009, the changes that it will make to the personal tax system through to 2011-12.[134]

Nevertheless several Labour Members continued to raise concerns about the issue,[135] and Mr Field tabled a new clause, signed by 44 Members, for consideration at the Report stage of the Finance Bill. The purpose of Mr Field's clause was to defer the provision made in the Bill to charge income tax for the current year, until the Chancellor had laid "a statement that, in his opinion, measures have been taken to ensure that no person is worse off by reason of the person's income not being sufficient to secure that the effect of the abolition of the 10p starting rate has been entirely offset by the reduction of the basic rate, which took effect in the tax year 2008-09." Mr Field argued that the Government's decision to increase the personal allowance for 2008-09 had been flawed because "that increase should [have been] clawed back from all of us who had been the gainers from the 2p [cut in the basic rate] by

[132] EDM 1279 of 2009-10, 2 April 2009
[133] Public Bill Committee (Finance Bill) 19 May 2009 c9
[134] HC Deb 2 June 2009 c413W
[135] "Budget could be blocked by Labour rebels over 10p tax", *Independent*, 29 June 2009

increasing national insurance." He went on to suggest the losses from the 10p rate withdrawal remained significant:

> Were the increases in the tax allowances—the £600 and then the £130—really meant to help those who lost out in the abolition of the 10p rate? The following figures come from the Treasury. By 2010-11—not today, but then; these figures presumably take into account some other changes that might be made—500,000 households will still be losers from this abolition, within those households there will be about 1.3 million individual losers, and the average sum that they will lose will be between £2 and £3 a week. I hope that most of us would think that £2 or £3 a week is a substantial sum for us, but it is huge for people whose earnings are low …[Moreover] those Treasury figures on the losers still assume a 100 per cent. take-up rate for tax credits.[136]

Mr Field noted he had been told that the new clause was equivalent to "pushing the nuclear button" because, if passed, "the Government will not be able to raise revenue after 6 o'clock tonight", but was he was sure that they had "a plan 2 ready" to ensure this would not happen. (This is explained in a little more detail below.) Speaking for the Conservatives, Mark Hoban supported the new clause on the grounds that the Government had committed "to act in the pre-Budget report and yet [had failed] to do so, [and] it is time for the Government to be held to account by Parliament." Speaking for the Liberal Democrats, Jeremy Browne, also supported the clause, arguing that the decision to raise the personal allowance for 2008/09 was "the most extraordinary act of extravagance, but it was very badly targeted."[137]

Responding to the debate the Financial Secretary, Stephen Timms, rejected the suggestion that the Government had failed to meet its commitment to provide further compensation:

> In the PBR … we rolled forward the increase to the personal allowance announced in May, increasing it by a further £130 above inflation. Those changes now fully compensate over 90 per cent. of the 5.3 million households who would otherwise have been paying more, reducing the number to around 500,000 households in 2011-12. The maximum individual loss is now £92 a year, or £1.77 per week, if there is no offsetting tax credit gain. The average loss for a household is now less than £1 a week. I agree with those who have said that even a loss of that size is significant for some of the people we are talking about, but it is important to make it clear that we are not talking about average losses of £2 or £3 as has been suggested …
>
> It is not the case that all these losing households are low-income households. Relatively few are in the lowest income decile, because many in that group do not pay income tax, and we have taken an additional 800,000 people out of income tax altogether through the steps we have taken. Of the 500,000 households that remain, some 100,000 are in the highest income decile. For example, if a household comprises a City banker and a second earner who lost out from the abolition of the 10p rate, that household is included in the 500,000. There are 100,000 of the 500,000 in that category … At the 2008 PBR, we acknowledged that, although the number of losing households had been reduced by 90 per cent., there would still be some who lost out. Although public concern has not been completely eradicated, it has certainly been substantially allayed by the changes we have made.[138]

[136] HC Deb 7 July 2009 cc864-5
[137] *op.cit.* cc867-8, c873, c880
[138] *op.cit.* cc889-90

Mr Timms added that Treasury Ministers would "be happy to discuss any ideas …[Members] might want us to consider before the pre-Budget report, and to see if we can go further", with specific reference to the position of "women who retired at 60 … and who now pay more tax than they had expected until the age of 65." He also explained why the new clause would prevent the authorities from collecting income tax:

> Income tax is an annual tax that needs to confirmed annually in each Finance Bill … the power to collect income tax ahead of Royal Assent is founded on the Provisional Collection of Taxes Act 1968, section 1 of which provides that a resolution under the Act has statutory effect for a specified period. One of the things that brings that specified period to an end is rejection of the provisions of the Bill reflected in the resolution, so we would not have until 5 August to carry on collecting income tax ... If the new clause were carried, without some rather desperate measures we would be unable to collect income tax this year, and income tax already collected would have to be repaid. The chaos does not bear thinking about.[139]

Mr Field persisted, suggesting that if the clause were carried, "any rational, sensible Government … would immediately come back and say that they would have vote of confidence now and insist that it is passed, and one would hope that, with a little humility, they might come back with the measures we are all asking for."[140] However, in the event the House rejected Mr Field's new clause by 311 votes to 268.

In the event this vote proved an end to the issue, as public debate moved to debates over the potential impact of the new 50p rate from April 2010 and wider concerns about the impact of the recession on the public finances. In his memoirs Alistair Darling recalled when, after having been appointed Chancellor, the political impact of the 10p rate first became apparent to him:

> When it was abolished in the 2007 Budget, Gordon announced measures that compensated many taxpayers, mostly those with children. But a few months later, when I sat in his old seat in the Treasury, looking over the books, I saw advice that painted an extremely bleak picture. While 80 per cent of households would see no effect on their incomes or would even benefit from the change, about five million households stood to lose out. The loser range from those on pretty low incomes through to households where there was one earner who could be earning more than £100,000 but with a partner who had lost out. Alarm bells had rung when I received a letter from an elderly constituent just after Gordon's final Budget. She was aged over sixty and had calculated to the last penny how much she was going to lose. What was surprising was that so few others had picked up on the problem until the following spring, just as it was due to come into effect.

As Mr Darling concludes, "in tax matters, the devil is in the detail, and you cannot safely make big changes in a hurry without thinking through the consequences for taxpayers at every level."[141]

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[139] HC Deb 7 July 2009 c891, cc890-1
[140] *op.cit.* c892
[141] Alistair Darling, *Back from the brink: 1,000 days at Number 11*, 2011 p45, p44