Briefing: The draft Tax Credits (Income Thresholds and Determination of Rates) (Amendment) Regulations 2015

Summary note

What the changes mean

From April 2016, proposed changes to tax credits (chiefly reducing the amount people can earn before credits begin to be withdrawn, and increasing the rate of withdrawal) will:

- Push an extra 200,000 children (mainly from working households) into poverty overnight, as 3 million families see their incomes plummet by an average of £1,000 a year
- Disproportionately affect single parent families – single parents make up 56% of families receiving both working tax credit and child tax credit
- Discourage many low income workers from increasing their earnings and/or hours, as the rewards from additional pay are sharply reduced by losses of tax credits or universal credit – undermining the government's aim of making work pay.

Why other policies won't compensate for these cuts

The government argues that other tax and benefit changes – for example increasing wages and providing further free childcare – will ensure that most people will benefit overall. However, analysis has shown the potential increased income from these policies will not "make good" the drop in income families' face

- Increased wages: 3 in 4 households receiving in work support i.e. working tax credits **will not be benefit from the increase in the NMW** *(point 13, page 7)*

- Reduced taxes: Increasing the personal tax allowance (PTA) **will not support least well off workers particularly,** not reaching those earning too little to pay tax and benefitting tax payers across the spectrum more than the low paid in particular *(point 16, page 8)*

- 30 hours free childcare: this will be available only to those with children aged three and four, and must be set against the losses parents of children born after April 2017 onwards will experience from the removal of the "family premium element" of child tax credit and the "two child limit" on support (measures contained in the Welfare Reform and Work Bill). **Considering just the tax credits cuts scheduled for April 20106, these are set to save an estimated £4.4 billion – while the extra childcare spending is estimated to cost £700 million**. (*point 15, page 7)*

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- If these regulations go ahead, from April 2016 over 3 million families will be poorer by an average of just over £1,000 per year[1]
- The changes they introduce will cause an “overnight shock” to many families’ incomes, causing an extra 200,000 children (mainly from working households) to fall into poverty overnight and many more experience the abrupt impact of a lower income [2]
- Together with parallel changes to universal credit, they will mean that, from next year, lower paid families keep less of every extra pound they earn, undermining the goal of making work pay
- Other government measures between now and 2020 – a cut in income tax, increases in the minimum wage, and proposed extra help with childcare costs - will not “make good” the drop in income experienced by many single parent families losing significant tax credit income
- The sudden financial losses will threaten the fragile budgets of many single parent families who combine working with the day-to-day responsibilities for their children.

Introduction

1. We understand that, for working families, the government aims to “move from a low wage, high tax, high welfare society to a higher wage, lower tax, lower welfare society”[3]. But this should not be done by reducing the incomes of low-paid working families, whose finances are already fragile. Under the Tax Credit Regulations currently before Parliament, the net rewards for working for the majority of single parents will be reduced not improved – even after the introduction of the higher “national living wage” and other changes announced in the Summer 2105 Budget. This briefing highlights how the government’s proposed tax credits changes due to take effect next April will:

    - make many hard-working single parents trying to do the best for their children poorer for years to come, and
    - make it harder, not easier, for them to work their way out of poverty.

[1] IFS, Budget Analysis *Benefit Changes and distributional analysis* July 2015 http://www.ifs.org.uk/people/profile/612?year_published[start]=&year_published[end]=&page=1&
[2] Finch D, *A poverty of information*, Resolution Foundation, Oct 2015 http://www.resolutionfoundation.org/publications/a-poverty-of-information-assessing-the-governments-new-child-poverty-focus-and-future-trends/
[3] Summer 2015 Budget , HM Treasury https://www.gov.uk/government/publications/summer-budget-2015/summer-budget-2015#rewarding-work-and-backing-aspiration

Single parents, work and tax credits

In the last decade, single parents have moved into work faster than any other group, with almost two-thirds (64.4%) of the UK's two million single parent families[4] now working[5].

- However, a fifth of children whose single parent works full-time still live in poverty – among single parents working part-time this rises to a third (32%) of children[6]
- Because wages paid by an employer do not reflect family size or a parent's costs of working (eg paying for childcare if a single parent), the in-work support and help with childcare costs provided by tax credits play an important part in making work pay for those with children, especially those raising children on their own
- There are 991,000 single parents currently receiving a combination of working tax credits (WTC) (which includes help with childcare) and child tax credits (CTC)[7]. They make up 56% of families getting WTC and CTC[8].

What changes will the draft tax credits regulations make?

- Increase the rate at which tax credits are withdrawn as earnings increase, from 41 pence for each additional £1 of income to 48 pence

- Sharply reduce the income threshold at which this taper starts to apply for Working Tax Credits (WTC) from £6,420 to £3,850. (This reduction will also apply to universal credit (UC) through a reduction in the work allowance)[1]

- Reduce from £5,000 to £2,500 the tolerance for in-year income rises which, when retrospectively finalising a family's "provisional" annual tax credit award made a year earlier, allows HMRC to ignore past increases in in-year income up to this level. The margin exists to ease retrospective overpayments – smoothing HMRC administration and preventing family hardship.

Other reductions in tax credits are proposed in the Welfare Reform and Work Bill currently before Parliament. For new applicants from April 2017, the Bill proposes the removal the higher child allowance paid for a first child (the "family premium element") and limits total Child Tax Credits to two children only.

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[4] ONS (2015) *Working and workless households* http://www.ons.gov.uk/ons/rel/lmac/working-and-workless-households/2015/index.html
[5] ONS (2014) *Families and Households*)
[6] DWP (2015) Households below average income, 1994/95-2013/14. Table 4.14ts
[7] HMRC (2015) Child and Working Tax Credits Statistics: Finalised annual awards – 2013-2014
[8] Ibid

The financial impact of the tax credits reductions from next April

2. The April 2016 increase in the taper rate to 48% and reduced WTC income threshold and universal credit work allowance will take £4.355 billion from the incomes of working families from that date[9]

3. The IFS has calculated that the cut in income thresholds and the universal credit work allowance will affect about 3 million families, who will lose an average of just over £1,000 on average per year[10]

4. The Resolution Foundation calculates that, despite a higher minimum wage for over-25s – the "national living wage" (NLW) – from April 2016, the cuts to tax credits and universal credit next April will create an "overnight shock" to family incomes, plunging around 200,000 children into poverty at that point – mostly from working households[11]

5. It has been estimated that an average single parent with one child working 26 hours per week for £8.53 per hour will lose £1,511 in 2017/18 despite the higher NLW. By 2020/21, the loss will still be over £1,000 (£1,151)[12]

6. Finally, in a world of zero-hours contracts, short-term insecure jobs and fluctuating work patterns, reducing the margin of tolerance when reviewing a previous year's "provisional" tax credits award is likely to lead to more overpayments of tax credits. This will complicate the lives of low-earning parents whose working patterns vary during the year and increase the administrative burden on HMRC.

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[9] House of Commons Library Briefing Paper Number CBP7300, 11/09/2015, http://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7300

[10] 2015 Budget Analysis *Benefit Changes and distributional analysis*, IFS, July 2015 http://www.ifs.org.uk/people/profile/612?year_published[start]=&year_published[end]=&page=1&

[11] Finch D, *A poverty of information*, Resolution Foundation, October 2015 http://www.resolutionfoundation.org/publications/a-poverty-of-information-assessing-the-governments-new-child-poverty-focus-and-future-trends/

[12] National Institute of Economic and Social Research, *Taxes, tax credits and welfare spending* 8 July 2015

The financial impact on single parents and their children

7. Single parents have already been the household type hardest hit by previous tax and benefit changes.[13] The sudden loss of tax credits from next April will threaten the already stretched budgets of many single parents in low-paid employment, where every penny counts. Working single parents are telling Gingerbread how worried they are about how they will manage from next April.

Examples

A single parent with one child working part-time as a civil servant and earning £8,500 told Gingerbread she does not know how she will cope with an expected loss of tax credits of £26 per week. At present she can only just afford her outgoings, including keeping her car on the road to get to work and paying for school meals.

Another single parent told Gingerbread that she was very grateful for the tax credit help she got which helped pay for afterschool childcare for her two youngest children. Her work involved a two day per week teaching job plus supply teaching for the remainder of the week when available. Managing financially on her own had been tough after she was left alone to bring up her children, her husband having developed serious mental health problems. Tax credits had made a difference, but – already stretched in the hours she worked – she said getting less for every hour would make her seriously question the point of working so hard.

One single parent told Gingerbread that she worked as much as she could, whilst being able to afford the cost of childcare. She worried about being able to afford to keep her home if the tax credit income she relied on was reduced.

The measures will make it harder for many single parents to make work pay

8. The lower WTC income threshold and reduced universal credit work allowance, plus greater clawback as earnings rise will seriously weaken the financial return many hard-working families get from working more hours. Above £3,850 families will lose 48 pence for every pound up to the National Insurance (NI) threshold, rising to 59 pence per pound for families paying NI but below the tax threshold, and 79 pence in the pound if above the tax threshold, but still receiving tax credits or universal credit[14].

9. The risk is that single parents get stuck at low levels of earnings, with little financial incentive to work more.

[13] De Agostini, P., et al (2014) *Were we really all in it together? The distributional effects of the UK coalition government's tax-benefit policy changes*. London: CASE, LSE. See also: Browne, J. and Elming, W. (2015) *The effect of the coalition's tax and benefit changes on household incomes and work incentives*. London: IFS.

[14] National Institute of Economic and Social Research, *Taxes, tax credits and welfare spending* 8 July 2015

Why can't single parents just work harder to make up for lost credits?

10. It has been argued that changes will encourage "behaviour change" whereby parents will be incentivised to work longer hours to make up the fall in their tax credits/UC. But, as set out above, the high withdrawal rates as earnings rise make it extremely hard for parents to work their way back to their pre-cuts position.

The Resolution Foundation have calculated that, taking account of all relevant Budget 2015 changes, by 2020 a single parent with one child, working 20 hours per week on the NLW and with rent of £100, will be £1,000 worse off per year. To offset this fall would require an increase of £3,400 in earnings – equivalent to a one-off 35% rise in earnings, 15 years of steady two % pay rises, or working seven hours more per week[15].

11. Single parents face additional barriers in working longer hours due to the challenges in combining working with sole responsibility for their children. These barriers can include:

- Finding work and hours that can fit around parenting responsibilities
- Finding suitable quality childcare that fits with hours of work available, including after school, evenings, weekends and school holidays
- The increased cost of childcare, when set against the earnings reward if working more
- Suitable jobs that meet single parents' needs can be hard to come by – it isn't necessarily easy to get an employer to give increased hours
- Last but not least, wanting to do a good job as a parent and the need for parenting time so that children can thrive, eg helping their children with homework – important for reaching educational attainment targets.

Example

Judith has a daughter aged 12. She works as a self-employed administrator and telemarketer, working on average 18 hours per week and gets tax credits. She told Gingerbread: ""I work part-time from home because of the lack of available jobs with the right hours and pay, the lack of facilities for children aged 12 after school.

"…Although I do earn above the minimum wage, my fees have to be at a level which my clients are prepared to pay, so increasing my fees is not the answer, (I tried that before and noticed a decrease in interest in my services and invites to bid for jobs).

"…I can flex my hours and workload but that is not always as easy as it sounds. There are times when projects and contracts end and trying to replace those takes time… sometimes I only get 1-2 weeks' notice [when a job finishes] and my main website of choice has lots of applicants and it's pure luck whether you get the jobs."

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[15] Resolution Foundation 'Welcome boost on low pay but severe welfare cuts will mean big losses for many low-income working families' 8 July 2015

Will higher pay and extra help with childcare outweigh the losses?

12. The Government argues that other welfare changes, such as the new NLW, 30 hours' free childcare, and a higher personal tax threshold will ensure that most people will benefit overall. However, these arguments do not stand up to scrutiny, particularly for single parents:

13. *A higher "national living wage" from April 2016*[16]

   - Although the rise in the minimum wage for workers aged 25 and over is a welcome step, the measure is ill-targeted in terms of reaching low-income working families, as WTC and universal credit do. Only 26 % of households gaining from the NLW are entitled to in-work support[17]
   - Moreover, the new NLW will not reach certain tax credits recipients at all: those under 25, the self-employed, and those already earning above the NLW, but still eligible for tax credits – for example, due to childcare costs
   - Those in paid work and eligible for benefits or tax credits will, on average, be compensated for just 26 % of their losses in tax credits and benefits as a result of the new NLW[18].

14. The Director of IFS commented: "*the key fact is that the increase in the minimum wage simply cannot provide full compensation for the majority of the losses that will be experienced by tax credits recipients. That is just arithmetically impossible.*"[19]

15. *The offer of 30 hours' free childcare for three and four year-olds from 2017*

- The new provision is limited in applying only to pre-school children aged three and four, therefore parents losing tax credits who have older children will not gain financially
- The provision will only be available nationally from September 2017 – fifteen months after tax credits are reduced. Serious questions are also being raised about the lack of funding to make the proposal a reality[20]
- For those families who do benefit, the Resolution Foundation calculates that by 2020, the additional free hours' childcare will mean an effective boost to income

[16] In 2016/17 there will be a NLW of £7.20 per hour for workers aged 25 or more. This is intended to increase to reach 60 % of median hourly wages by April 2020, which the Office for Budget Responsibiilty calculate will be approximately £9.35 per hour in 2020/21

[17] D'Arcy, C., Corlett, A., Gardiner, L.,(2015) *Higher ground, Who gains from the National Living Wage?* Resolution http://www.resolutionfoundation.org/publications/higher-ground-who-gains-from-the-national-living-wage/

[18] Elming, W. et al (2015) An assessment of the potential compensation provided by the new 'National Living Wage' for the personal tax and benefit measures announced for implementation in the current parliament. London: IFS

[19] Paul Johnson, Director of IFS, 9/7/2015

[20] See Cory G, *Extending the Early Years Entitlement*, IPPR Oct 2015 http://www.ippr.org/files/publications/pdf/extending-the-early-years-entitlement-costings-concerns-and-alternatives-oct2015.pdf?noredirect=1

of £11 per week[21]. Therefore, for these families, part of any tax credit losses will be offset. A big proviso, however, is that – by 2020 – increasing numbers of families will have been affected by a further cut: the removal of the family premium of tax credits (and the universal credit equivalent). This reduction is set to apply to all new claims from April 2017[22]. Resolution Foundation estimate this change will amount to an £11 per week reduction in income from credits.

- The extra spending on this offer will cost £700m. When set against the £4.355 billion cuts to tax credits in 2016 alone and the £12 billion in total cuts to welfare by 2020, it is clear that the 30-hour childcare offer will do little to mitigate the losses for most low paid working families.

16. *Rise in personal tax allowances*[23]

- Increases in the personal tax allowance (PTA) are poorly targeted for people on the lowest incomes. Almost six million of the lowest earners earn too little to pay tax and therefore will not gain from the planned increases. Moreover, for recipients of universal credit, any gains from the PTA increase will be significantly offset (by 65p per pound) by losses of UC[24]
- Only around 1% of the cost of the planned increases in personal tax allowances will be spent to take the lower earners out of tax – the remainder benefits all taxpayers.[25]

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[21] The calculation is based on the cost of a nursery place as given in the annual childcare survey of the Family and Childcare Trust 2015, increased by projections of CPI inflation to 2020, and taking account of the higher percentage of childcare costs met under UC compared to WTC (85 per cent) as opposed to 70 per cent. See Resolution Foundation Briefing *A Budget for Workers,* July 2015 http://www.resolutionfoundation.org/wp-content/uploads/2015/07/Work-incentives-briefing.pdf

[22] Clause 11 and 12 of the Welfare Reform and Work Bill 2015

[23] Personal tax allowances will rise to £11,000 in April 2016 with further increase in future years, with the aim of reaching £12,500 by 2020.

[24] See *Unintended consequences*, Gingerbread 2012 http://www.gingerbread.org.uk/news/167/tax-allowance-increase

[25] Gavin Kelly, *Will wages fill the tax credits gap? Don't Budget for it* *http://www.resolutionfoundation.org/media/blog/will-wages-fill-the-tax-credit-gap-dont-budget-for-it/*

Conclusion

17. The vision of a "high wage, low tax and low welfare society" is a good one for society to work towards, but the route to achieving this must not be done by sacrificing financially fragile working families. Taking over £4billion in 2016 alone from low-income families already struggling hard to work and raise their children well is too cavalier approach to the impact on real people's lives.

18. Expert analysis clearly shows that, among working families, the losers from cuts to WTC and universal credit far outweigh the winners, even when the government's "national living wage", proposed rises in the personal tax allowance and a system of 30 hours' free childcare for three and four year-olds are fully rolled out by 2020. Single parents will be among the biggest losers due to the extra challenges they face in both working and raising children.

19. There are other choices that could be made to achieve the government's goals. We recommend reallocating some or all of planned future spending on increasing the personal tax allowance to a series of measures better targeted specifically at low income households – increasing the work allowance, raising the maximum cap on help with childcare costs within WTC and universal credit (which has remained the same for ten years whilst costs have rocketed) or piloting the impact of reducing the universal credit taper from 65 % to 62 per cent[26].

20. Whilst cuts to WTC and universal credit will certainly achieve savings, the government is failing to consider the wider, long-term implications of the damage the measures will do to incentives to work and to progression in work. Research by Gingerbread has already shown that getting more single parents into work would have significant positive effects for the Exchequer, with a 5% increase in the employment rate resulting in a £436 million annual saving.[27] Yet the cuts threaten to trap parents with care of children in low-paying often insecure jobs with no realistic chance of improving their circumstances. This is something the country can ill-afford going forward – for the economy's sake and children's futures.

21. At the very least, the proposed changes should be delayed until the impact on the effectiveness of work incentives under universal credit can be properly assessed, so that the government's significant investment in this flagship policy to make work pay is not undermined.

[26] See *Unintended consequences: how the structure of Universal Credit undermines the coalition commitment to support low income workers through raising the personal tax allowance*, Gingerbread 2012 http://www.gingerbread.org.uk/news/167/tax-allowance-increase

[27] Brewer M, and DeAgostini P, *Credit crunched: Single parents, universal credit and the struggle to make work pay,* Gingerbread 2014