

Institute for
Fiscal Studies



Personal taxes and distributional impact of budget measures

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What's coming up

- Pre-announced changes
- Yesterday's announcements
 - Income tax
 - VAT
- Distributional impact of measures

Tax rises already announced to reduce the deficit

- Big tax rises for the rich
 - 50p income tax rate since April
 - Withdrawal of income tax allowance above £100,000 since April
 - Restriction of tax relief on pension contributions from April 2011
- 1% increase in National Insurance rates in April 2011
 - Low earners compensated by increase in employee NI threshold under Labour's plans
 - Conservatives wanted to increase this further so that only those earning more than £35,000 paid more employee NICs, and increase employer National Insurance threshold
- Duty escalators to run until 2014
 - 1p/litre real increase each year in road fuel duties
 - 2% real increase each year in alcohol and tobacco duties

Income tax and National Insurance

- £21/week increase in employer NI threshold from Conservative manifesto: costs £3.1 billion
- Increase in income tax allowance for those aged under 65 in April 2011: costs £3.5 billion
 - Effects very similar to rise in employee NI threshold
 - Those with unearned income don't pay NI, but benefit from this measure
 - £1,000 nominal increase, £850 increase relative to pre-announced changes. Still less than £10,000, but long term aim to get to this level
 - Worth £170 for each taxpayer, slightly more generous than cut in Conservative manifesto worth £150
 - Reduction in higher rate threshold so higher-rate taxpayers don't benefit
- Basic rate limit to be frozen in April 2013
 - This and previous measure increase number of higher-rate taxpayers
 - Raises £740 million in a full year



VAT

- Increase in main rate from 17.5% to 20% from January 2011. Raises £12.1 billion in 2011–12
- More efficient than other tax rises?
 - Taxes past saving as well as current earnings, and past saving can't respond to tax change
 - Still a 'jobs tax' – increases wedge between employer cost and quantity of goods and services employees can buy
- One-off increase in price level of about 1%
 - Permanent reduction in value of future earnings and accumulated savings
- Creates a stimulus for the economy until the end of 2010
 - Spending in the future more expensive relative to spending today
 - Likely to increase consumption by about 1% for the rest of the year

VAT – distributional impact

- Often claimed that VAT is a regressive tax
- True if we measure household incomes at a point in time and express losses from VAT rise as a percentage of net income...

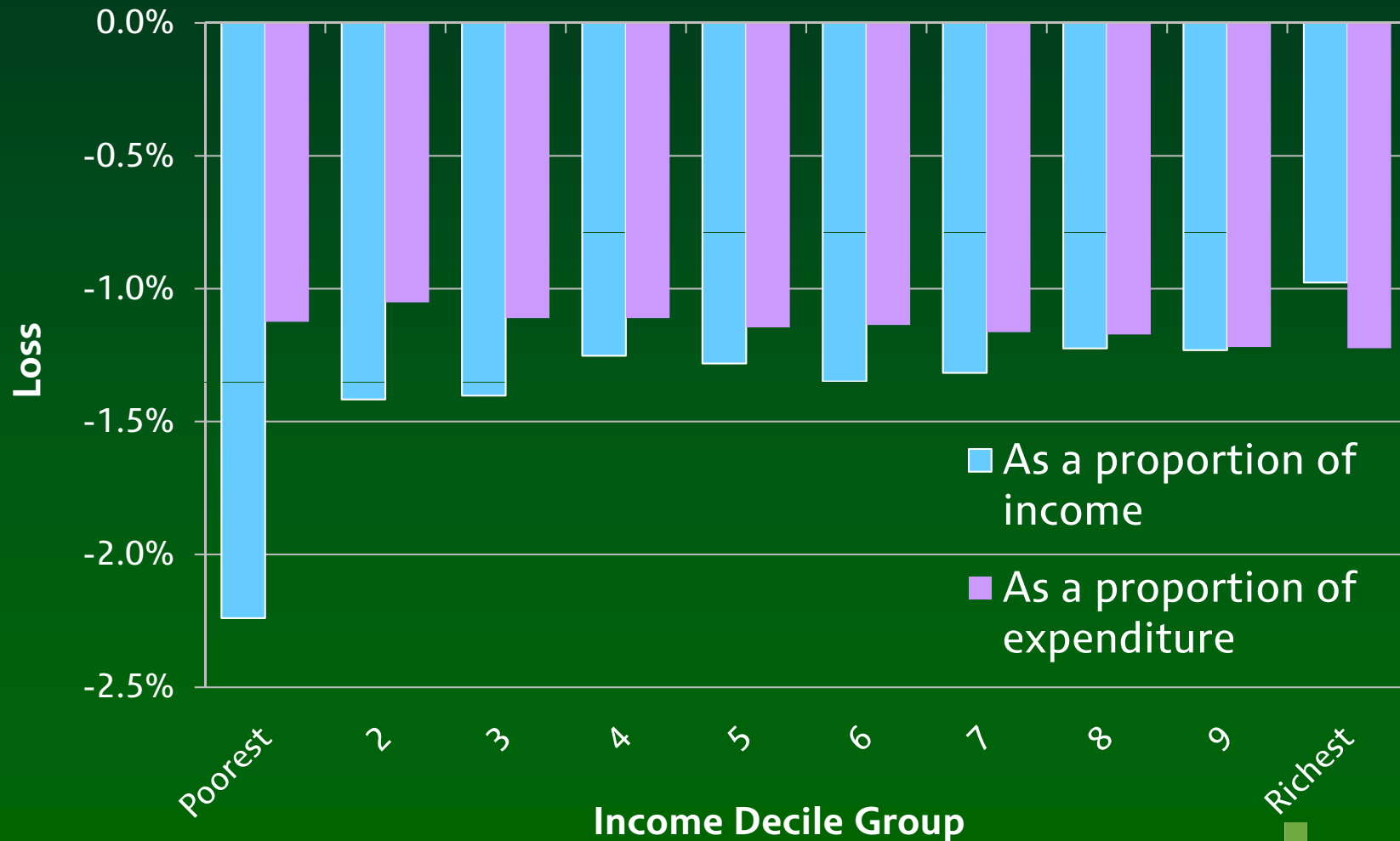
Distributional impact of increasing main VAT rate to 20% by income decile



VAT – distributional impact

- VAT hits those with high expenditures the hardest
- Those with low incomes tend to have high expenditures relative to their incomes. Showing losses as a proportion of expenditure gives a very different answer...

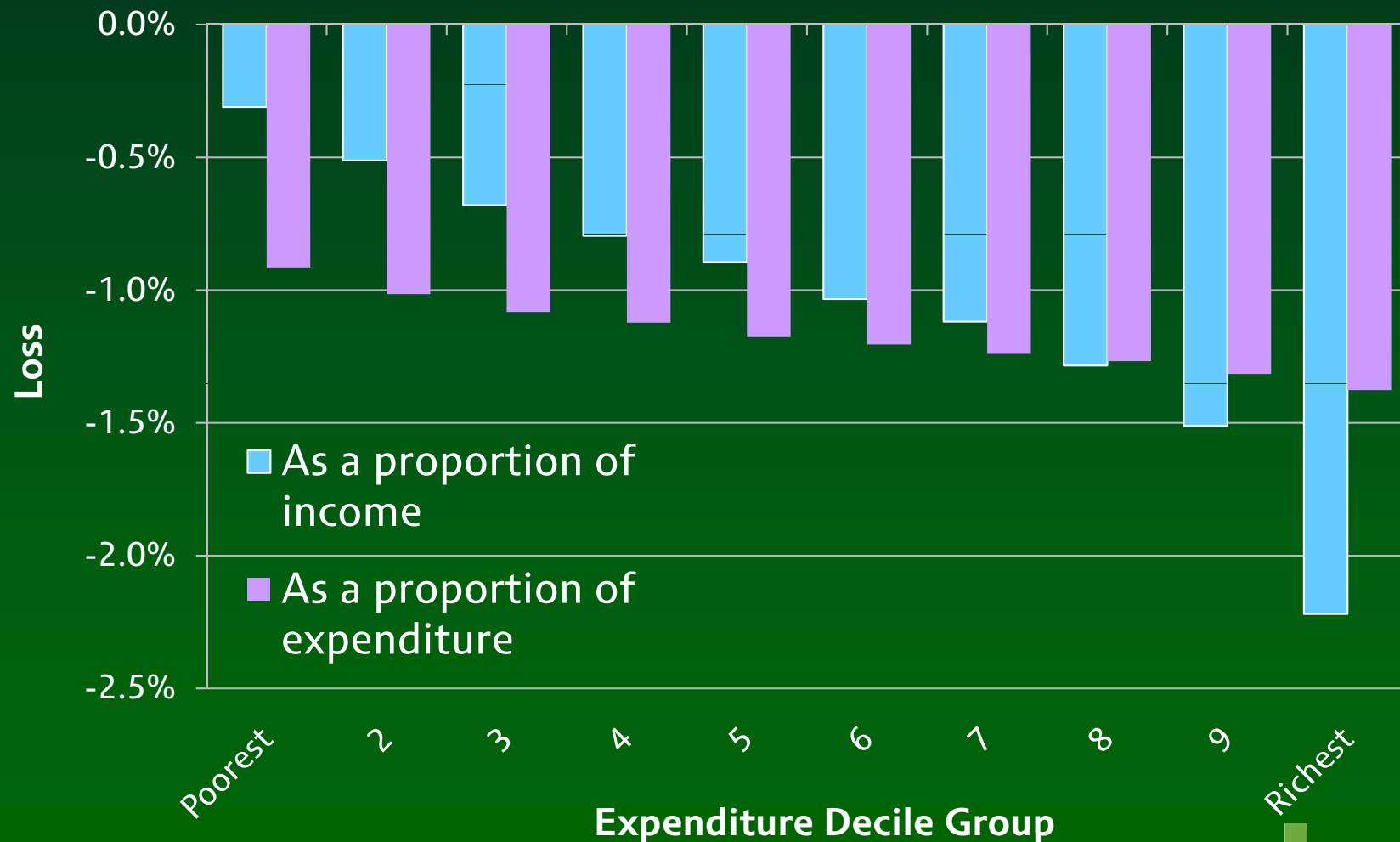
Distributional impact of increasing main VAT rate to 20% by income decile



VAT – distributional impact

- VAT hits those with high expenditures the hardest
- Those with low incomes tend to have high expenditures relative to their incomes. Showing gains as a proportion of expenditure gives a very different answer...
- Many households with low incomes currently are not those we would normally think of as ‘poor’, e.g.
 - Pensioners living on savings
 - Temporarily not working
 - Those with volatile earnings
- Total expenditure arguably a better guide to lifetime living standards. Ranking households by expenditure gives a different answer again...

Distributional impact of increasing main VAT rate to 20% by expenditure decile



Overall distributional analysis

- Treasury presented distributional analysis of all measures to be introduced between now and 2012–13
 - See Annex A of the Budget document
- Here we split announcements into yesterday's announcements and pre-announced measures
- Also look at distributional impact of all tax measures since the crisis began
- And look at impact in 2014–15

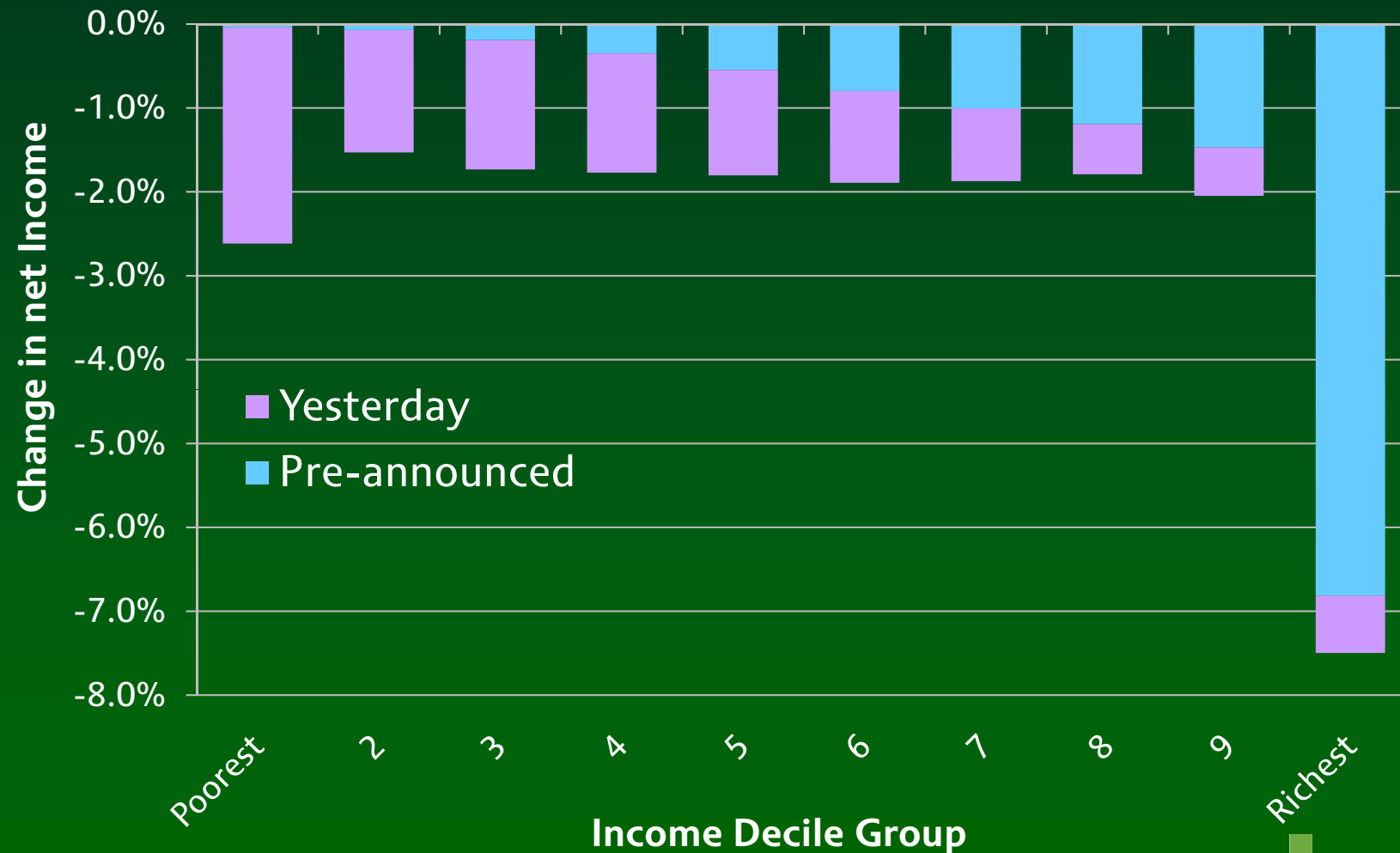
Measures we model

- Both we and the Treasury can model changes to income tax, NI, VAT, benefit rates, council tax etc.
- Neither of us examine taxes that are difficult to assign to particular households or where our data is insufficient, e.g.
 - Corporate taxes
 - Capital Gains Tax reforms
 - Housing Benefit reforms
 - DLA gateway reform
 - Reforms to in-year changes to tax credits
- But, unlike the Treasury, we include employer NI in our analysis, assuming it is incident on workers in the form of lower wages
- We also account for tax relief on pension contributions for those on high incomes, assuming it is all incident on the top decile

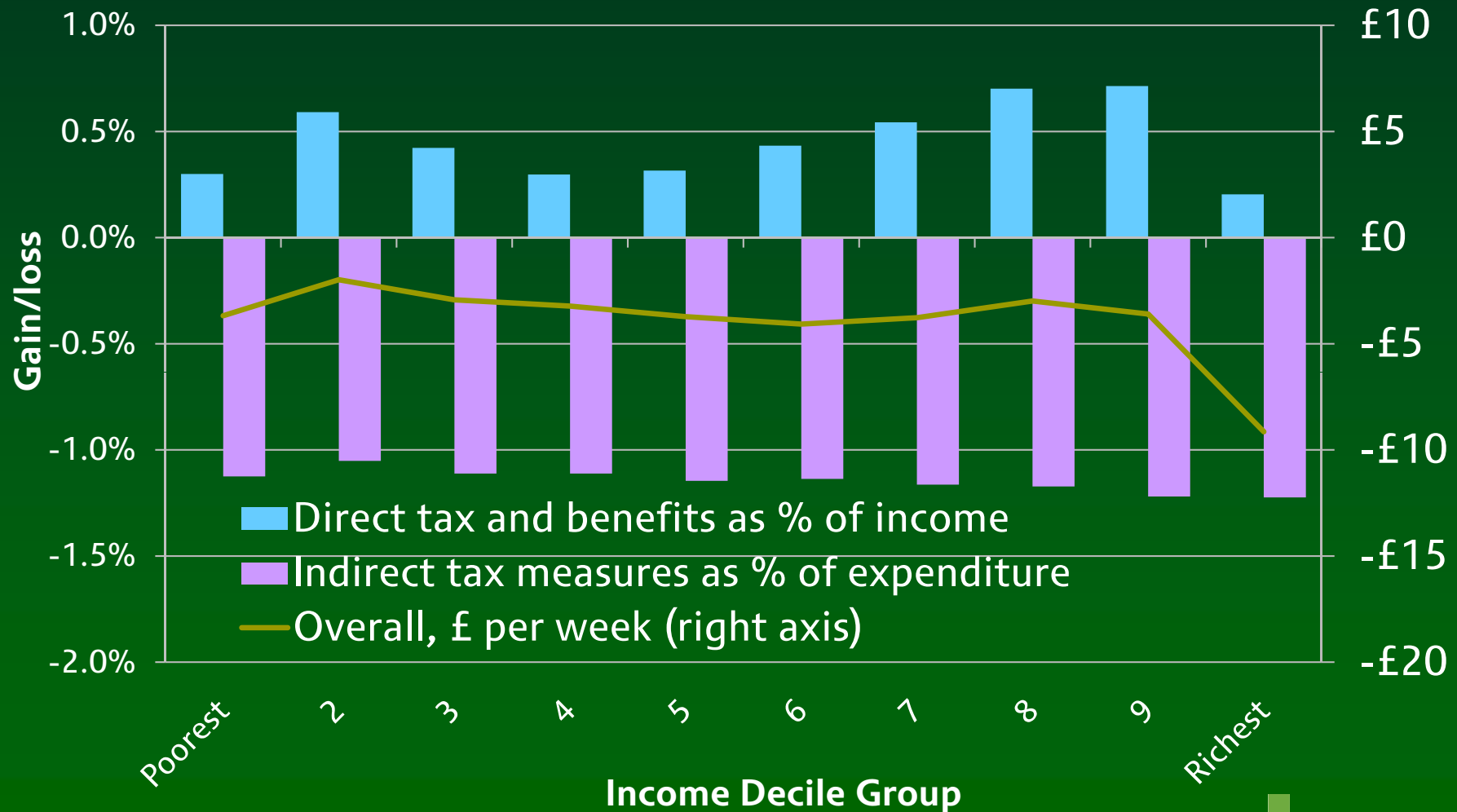
Distributional impact of tax and benefit measures to be in place by 2012–13



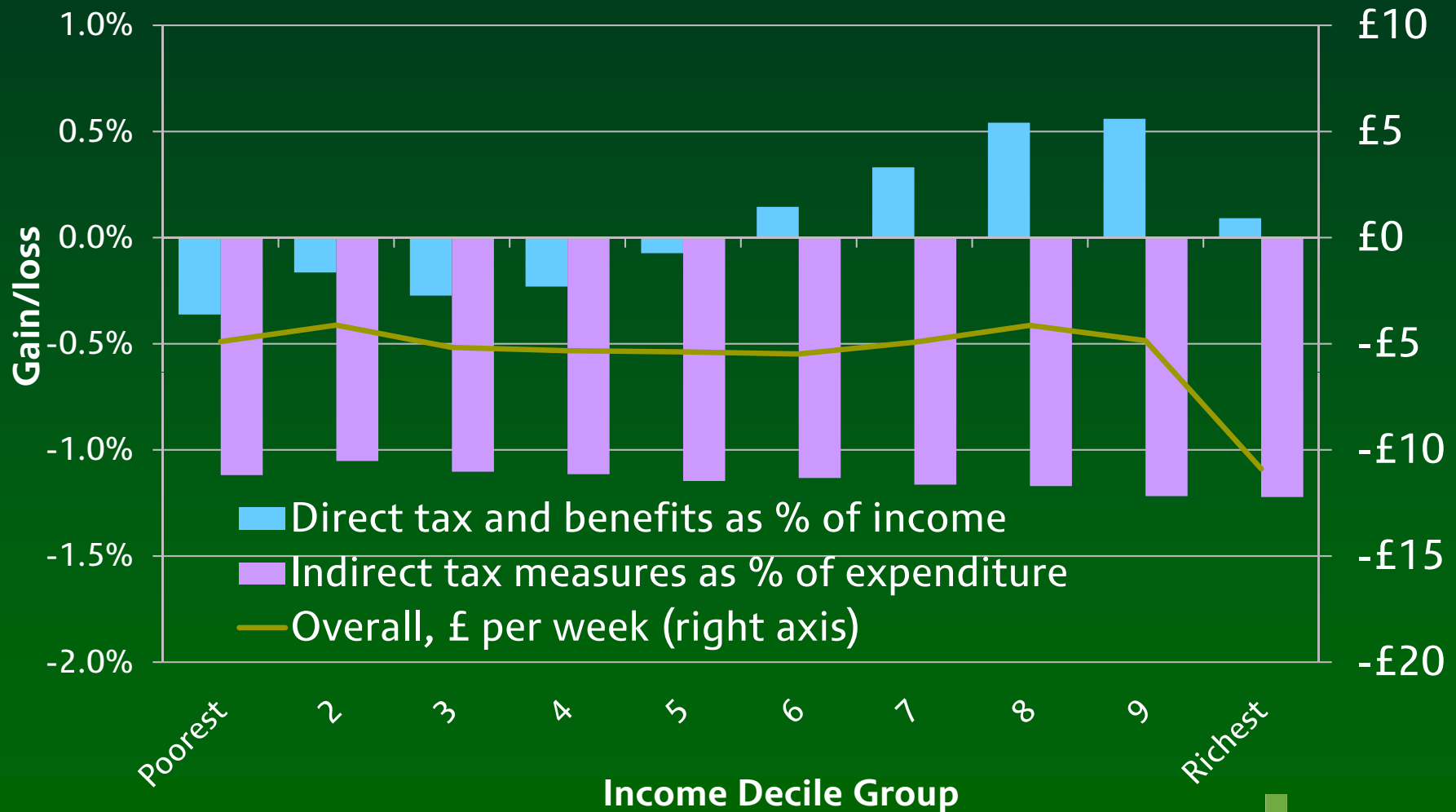
Distributional impact of tax and benefit measures since the crisis in 2014–15



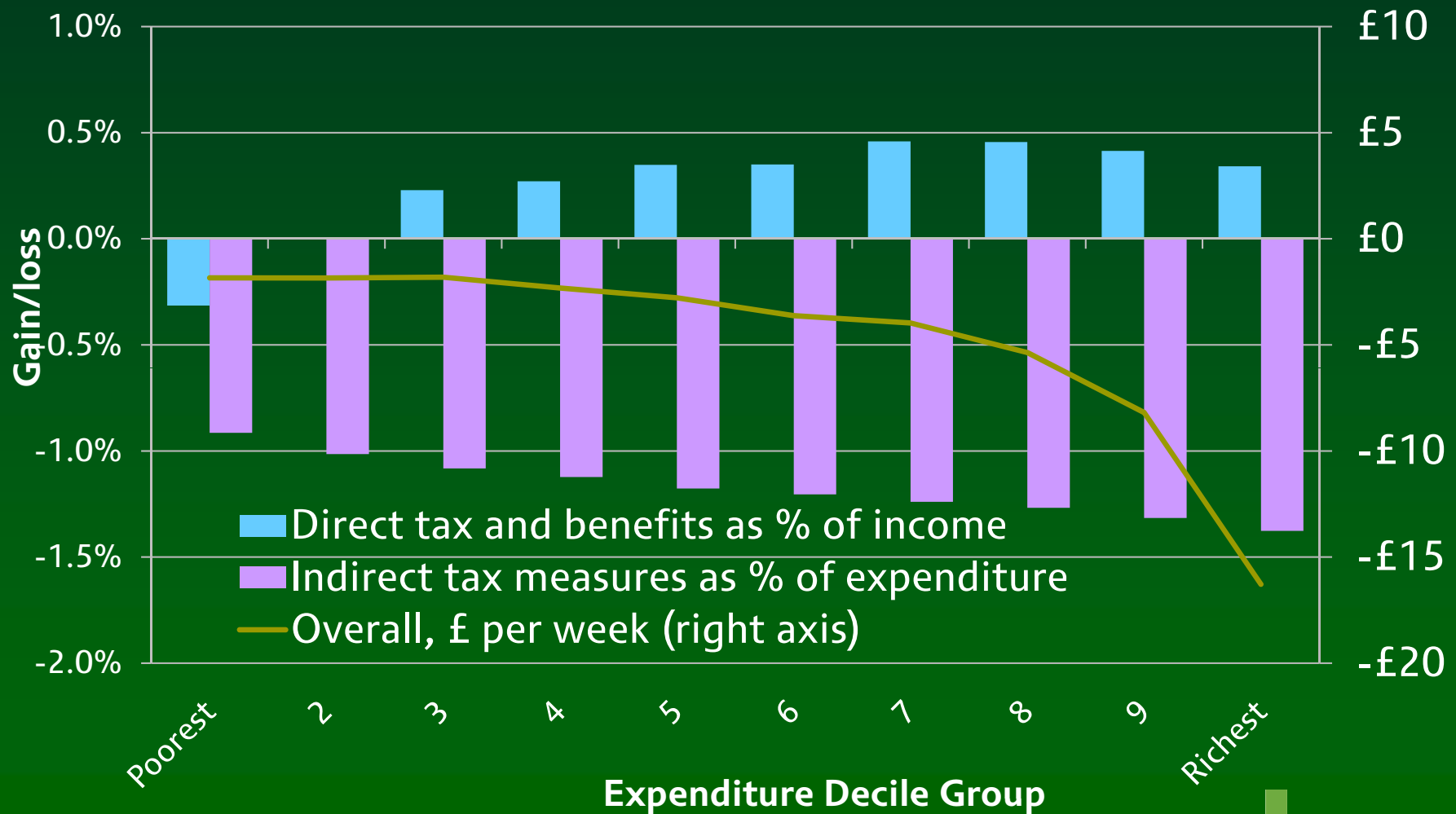
A look at yesterday's measures for 2012–13 in more detail



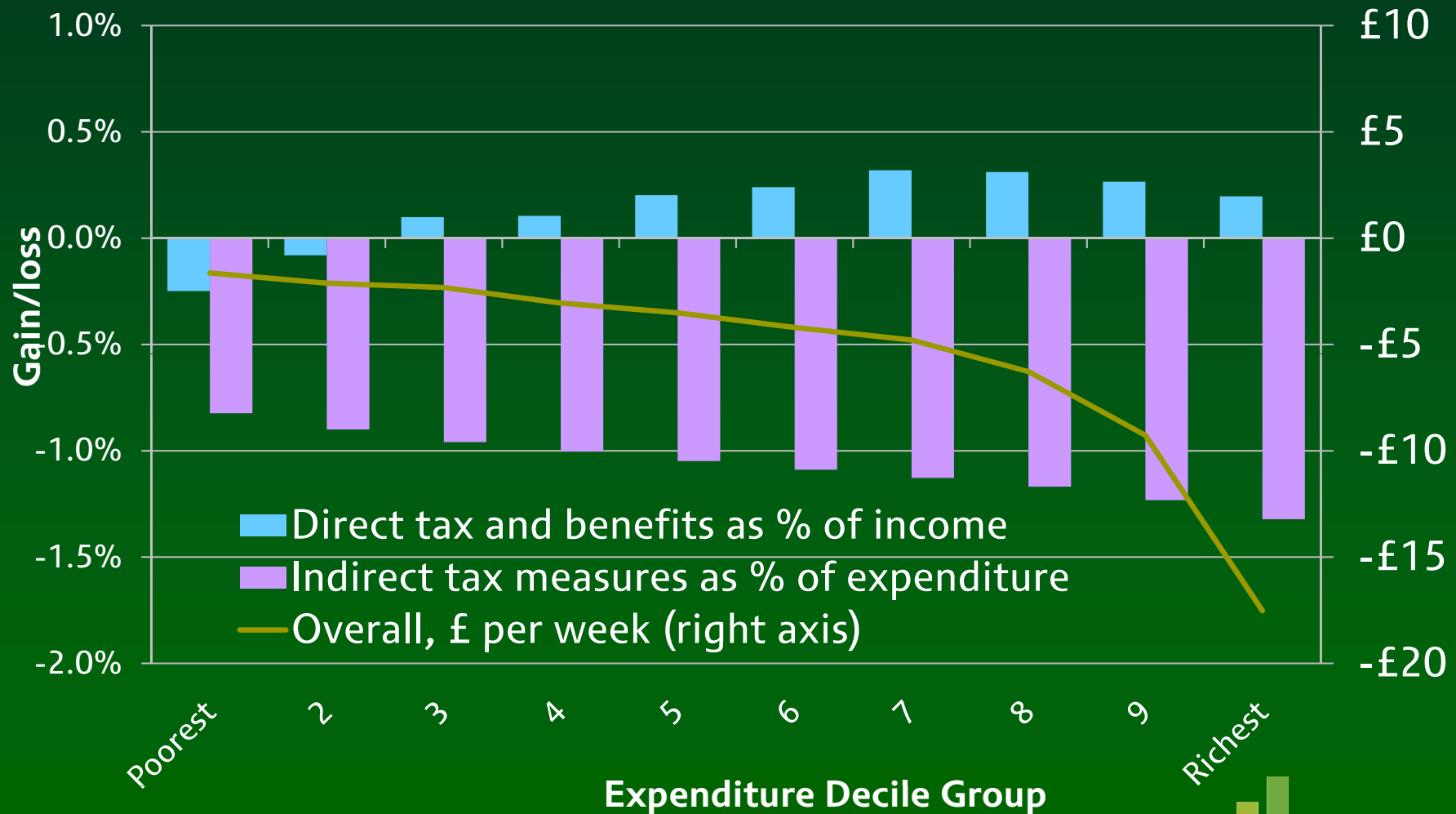
A look at yesterday's measures for 2014–15 in more detail



A look at yesterday's measures for 2012–13 in more detail



A look at yesterday's measures for 2014–15 in more detail



Summary of distributional impact of tax and benefit reforms

- Treasury said that reforms to be implemented between now and 2012–13 progressive, but
 - This is mainly because of reforms announced by the previous government
 - They only look at reforms to 2012–13 – benefit cuts announced yesterday for subsequent years hit the poorest hardest
 - They (and we) do not account for cuts to housing benefit, DLA and reforms to in-year changes to tax credit awards. These are all likely to hit the poorest half more than the richest half. CGT reform will hit higher-rate taxpayers, but small
- So likely that overall impact of yesterday's measures was regressive