

Don't take the **(tax)** credit

How a pay rise becomes an
income cut



Introduction

Next April the tax credit threshold and the taper will change.

Millions of people will be significantly worse off overnight.

According to the Treasury 'Red Book' these two changes alone will take £4,355m a year out of the pockets of those on low to middle incomes starting next April.

Many will find that their household income is cut by £1,000, £2,000 or even £3,000/year.

They will not see a penny of the enhanced minimum wage.

Every penny of that increase (and more) will end up in the coffers of the Treasury.

For many of them the £825 gain since April 2010 from raising personal tax allowances from £6,425 (in April 2010) to £10,600 (in April 2015) simply disappears overnight.

It will create chaos to the household budgets of people on low to middle incomes.

It will hit the people that politicians call 'strivers' - the people who go to work – but who only bring home the minimum wage, especially if they have children.

One Conservative MP (Guto Bebb, Times 10 August 2015) has described the tax credit changes that will take place next April as 'eye-wateringly painful'.

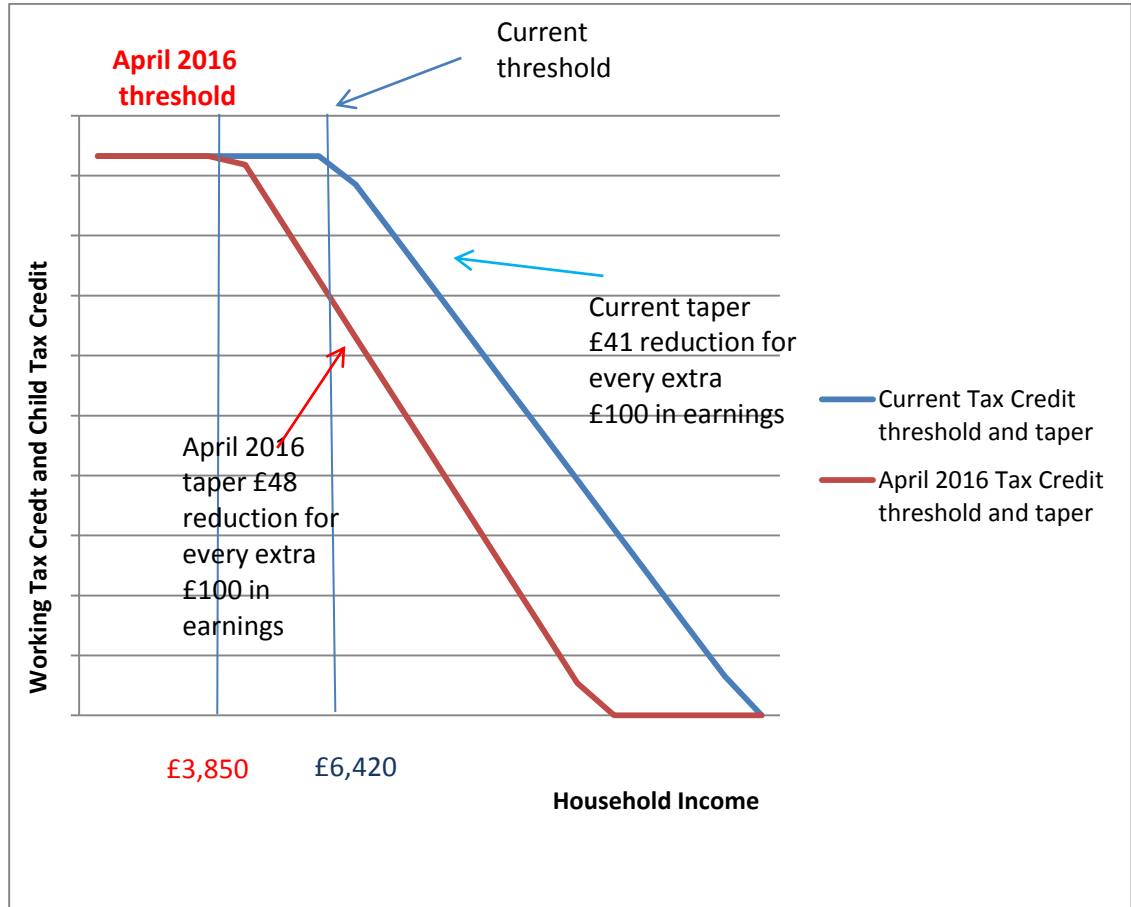
What are the changes?

Two changes take place from April 2016

First the point at which tax credits start to be reduced (the threshold) will be cut from £6,420 today to £3,850 from next April.

Secondly the rate at which tax credits are reduced is being increased – instead of losing £41 for every £100 above the threshold – people will lose £48.

This illustration shows how the threshold and taper system works and the effect of the changes.



What does this mean for people on the national minimum wage?

In his speech the Chancellor said

"It's because we've taken...difficult decisions....that Britain is able to afford a pay rise. Because let me be clear: Britain deserves a pay rise and Britain is getting a pay rise."

It sounds great but when you look at his plans it turns out that low-paid workers will see their incomes *fall*, many by thousands of pounds. Any union negotiator would be ashamed to tell their members they were getting a pay rise and then deliver this deal.

The Chancellor announced that the National Minimum Wage, which is currently £6.50/hour and already due to rise to £6.70/hour in October, will be enhanced to £7.20/hour in April 2016.

Assuming 35 hours a week and 52 weeks a year that means the National Minimum Wage will rise from £11,830/year to £12,184/year in October and then to £13,104/year next April.

He also announced that the personal tax allowance would rise next April from the £10,600 it is now to £11,000 and that, as a result, basic rate taxpayers would pay £80/year each less in income tax. He went on to say that the personal tax allowance will then rise to £11,200 in April 2017 reducing the income tax for basic rate taxpayers by another £40/year.

But the changes to the tax credit threshold and taper more than wipe out any gain from the enhanced minimum wage and the increase in the personal tax allowance.

David Cameron's claims do not stand up to detailed analysis

Case 1

On Saturday 15 August 2015 the Prime Minister told the *Today* programme

"I would say if you look at a typical family where one person is on minimum wage with our changes to the national (living) minimum wage, to the fact that we are increasing the amount you can earn before you pay tax they will actually be better off"

A family with one earner (over 25) earning the minimum wage for a 35 hour week with 1 child

First let's look at the changes to the enhanced minimum wage and personal tax allowance but without the changes to the tax credit threshold and taper announced by the Chancellor in the Summer Budget 2015. (The left hand columns in the table) Today that family's net household income is £18,236.68. This is made up of £11,830 from earnings, £1,076.40 from child benefit and £6,028.68 from working tax credit and child tax credit. They pay £246.00 in income tax and £452.40 in national insurance.

In April 2016 they will see their pay increase by £1,274 a year. Good news, but as a result they will pay £174.80 more in income tax (taking account of the increase in personal tax allowance to £11,000), and they will also pay an extra £152.88 in National Insurance (assuming no change to the earnings limits). Under the current tax credit threshold (£6,420) and taper (41p in the £) they will also lose £141.78 in tax credits because the income figure used to calculate their tax credits has gone up.¹ Nevertheless they would still be £804.54/year or £15.47/week better off.

Now apply the changes to the tax credit threshold and taper announced by the Chancellor in the Summer Budget (The right hand columns in the table). Instead of tax credits reducing by £141.78 they reduce by £1,754.08. Instead of being £804.54/year or £15.47/week better off next April they will be £807.76 a year or £15.53/week worse off.

They lose £1612.30 as a result of the tax credit changes. Any gain the family makes from increases to the minimum wage and personal tax allowances goes straight back to the Treasury along with another £807.76 due the changes to the tax credit threshold and taper.

But it does not stop there. The way tax credits are calculated includes something called an 'income rise' disregard that delays part of the reduction that will flow from the changes to the tax credit threshold and taper by 12 months.

¹In calculating the tax credit award HMRC determine the 'relevant income'. HMRC consider current year income (CYI) and previous year income (PYI). If current year income (CYI) is more than previous year income (PYI) by less than the income rise disregard (£2,500 from 2016, £5,000 in 2015) the final award is based on PYI. In the example above CYI in 2015 is £11,830 and PYI is £11,484.20 using NMW of £6.50/hour and £6.31/hour respectively. In 2016 CYI is £13,104 and PYI is £11,830 using enhanced minimum wage of £7.20/hour and NMW of £6.50/hour respectively.

To illustrate this, assume the Chancellor repeats what he did in the Summer Budget and enhances the national minimum wage by another 50p/hour in April 2017 to £7.70/hour. The family will see their pay rise by another £910/year in April 2017. Good news, but they will pay £142.00 more in income tax (taking account of the increase in personal tax allowance to £11,200) and they will also pay an extra £109.20 in National Insurance. They will also lose £611.52 in tax credits as the delayed impact of the 'income rise' disregard kicks in and they now lose 48p of every £1 that they gained from the enhanced minimum wage in April 2016 (Remember their pay went up by £1,274). They would have lost £522.34 under the old 41p taper. In April 2017, without the changes to the tax credit threshold and taper, they would be £941/year better off than they are today, but the changes to the tax credit threshold and taper mean that in 2017 they will actually be £760.48 worse off than they are today. In 2017 they would lose £1,701.48 because of the changes.

<u>Without the April 2016 changes to the tax credit threshold and taper</u>							<u>With the April 2016 changes to the tax credit threshold and taper</u>							
April 2016 Better Off (compared with April 2015)		£804.54/year or £15.47/week						April 2016 Worse Off (compared with April 2015)		£807.76/year or £15.53/week				
April 2017 Better Off (compared with April 2015)		£941.00/year or £18.10/week						April 2017 Worse Off (compared with April 2015)		£760.48/year or £14.62/week				
Single Earner Family (over 25), Couple 1 child, 1 x 35 hours NMW (enhanced NMW from 1 April 2016)							Single Earner Family (over 25), Couple 1 child, 1 x 35 hours NMW (enhanced NMW from 1 April 2016)							
	April 2015	April 2016	April 2017	April 2016 change from April 2015	April 2017 change from April 2015	Note		April 2015	April 2016	April 2017	April 2016 change from April 2015	April 2017 change from April 2015	Note	
Gross Income	£11,830.00	£13,104.00	£14,014.00	£1,274.00	£2,184.00	1,7	Gross Income	£11,830.00	£13,104.00	£14,014.00	£1,274.00	£2,184.00	1,7	
Income Tax	-£246.00	-£420.80	-£562.80	-£174.80	-£316.80	2	Income Tax	-£246.00	-£420.80	-£562.80	-£174.80	-£316.80	2	
National Insurance	-£452.40	-£605.28	-£714.48	-£152.88	-£262.08	3	National Insurance	-£452.40	-£605.28	-£714.48	-£152.88	-£262.08	3	
Child Benefit	£1,076.40	£1,076.40	£1,076.40	£0.00	£0.00	4	Child Benefit	£1,076.40	£1,076.40	£1,076.40	£0.00	£0.00	4	
Working Tax Credit and Child Tax Credit	£6,028.68	£5,886.90	£5,364.56	-£141.78	-£664.12	5	Working Tax Credit and Child Tax Credit	£6,028.68	£4,274.60	£3,663.08	-£1,754.08	-£2,365.60	6	
Total Income	£18,236.68	£19,041.22	£19,177.68	£804.54	£941.00		Total Income	£18,236.68	£17,428.92	£17,476.20	-£807.76	-£760.48		

Case 2

On 15 July 2015 David Cameron told Parliament

“First, let us deal with the effects of this Budget and let me give the right hon. and learned Lady the figures. A family with two children where both parents work full time on the minimum wage will be better off by 2020 by a full £5,500.”

Family with 2 children and both adults (over 25) working 35 hours a week on the national minimum wage

First let's look at the changes to the enhanced minimum wage and personal tax allowance but without the changes to the tax credit threshold and taper announced by the Chancellor in the Summer Budget 2015. (The left hand columns in the table) Today their net household income is £28,152.16. This is made up of £23,660 from their joint earnings, £1,788.80 from child benefit and £4,100.16 from working tax credit and child tax credit. They each pay £246.00 in income tax and £452.40 in national insurance.

In April 2016 they will each see their pay increase by £1,274 a year giving a total annual pay increase of £2,548.00. Good news, but they each pay £174.80 more in income tax (even though the personal tax allowance is increased to £11,000). Each of them also pays an extra £152.88 in National Insurance. Under the current threshold (£6,420) and taper (41p in the £) they will lose £303.24 in tax credits because the income figure used to calculate their tax credits has gone up. This is due to increase in the NMW from £6.31 in 2013 to £6.50 in 2014.²³ Nevertheless they would be £1,589.40/year or £30.57/week better off.

Now also apply the changes to the tax credit threshold and taper announced by the Chancellor in the Summer Budget (The right hand columns in the table).

² The maximum tax credit for this household is (Basic element (£1,960) + Couple element (£2,010) +30 hour element (£810) + Child element (£2,780) + + Second child element (£2,780) +Family element (£545)) = £10,885. In April and October 2015 the threshold of £6,420 and taper of 0.41 are then applied. In April 2016 the threshold of £3,850 and taper of 0.48 are then applied.

³ The relevant income used in the calculation of tax credits normally involves a comparison between income for the current year and previous year. If current year income (CYI) is greater than previous year income by no more than the 'income rise' disregard the final award is based on previous year income. In this example the previous year income for the 2015/16 tax credit calculation is taken as £11,484.20 based on the national minimum wage from October 2013 of £6.31/hour, 35 hours/week and 52 weeks.

Instead of tax credits reducing by £303.24 they reduce by £2,747.00. Instead of being £1,589.40/year or £30.57/week better off next April they will be £854.36 a year or £16.43/week worse off. They lose £2,443.76 as a result of the tax credit changes. Any gain the family makes from increases to the minimum wage and personal tax allowances goes straight to the Treasury along with another £854.36 due the changes to the tax credit threshold and taper.

But it does not stop there. The way tax credits are calculated includes something called an 'income rise' disregard that delays part of the reduction that will flow from the changes to the tax credit threshold and taper by 12 months.

To illustrate this, assume the Chancellor repeats what he did in the Summer Budget and enhances the national minimum wage by another 50p/hour in April 2017 to £7.70/hour. The family will see their pay rise by another £1820/year in April 2017. Good news, but they will each pay £142.00 more in income tax (taking account of the increase in personal tax allowance to £11,200) and they will also pay an extra £109.20 in National Insurance each. They will also lose £1200.00 in tax credits⁴ as the delayed impact of the 'income rise' disregard kicks in and they now lose 48p of every £1 that they gained from the enhanced minimum wage in April 2016 (Remember their combined pay went up by £2,548).

The In April 2017, without the changes to the tax credit threshold and taper, they would be £1,726.20/year better off than they are today. But the changes to the tax credit threshold and taper mean that in 2017 they will be £736.76 worse off than they are today. In 2017 they would lose £2,462.96 because of the changes.

⁴ HMRC determine the 'relevant income'. HMRC consider current year income (CYI) and previous year income (PYI). If current year income (CYI) is more than previous year income (PYI) by less than the 'income rise' disregard (£2,500 from 2016, £5,000 in 2015) the final award is based on PYI. In the example above CYI in 2015 is £11,830 and PYI is £11,484.20 using NMW of £6.50/hour and £6.31/hour respectively. In 2016 CYI is £13,104 and PYI is £11,830 using enhanced minimum wage of £7.20/hour and NMW of £6.50/hour respectively..PYI is used in the tax credit calculation but with two earners current year income is £2,548 more than previous year income so £2,500 is disregarded and the taper is also applied to £48.

	Without the April 2016 changes to the tax credit threshold and taper								With the April 2016 changes to the tax credit threshold and taper						
	April 2016 Better Off (compared with April 2015)		£1,589.40/year or £30.57/week						April 2016 Worse Off (compared with April 2015)		£854.36/year or £16.43/week				
	April 2017 Better Off (compared with April 2015)		£1,726.20/year or £33.20/week						April 2017 Worse Off (compared with April 2015)		£736.76/year or £14.17/week				
	Couple (over 25),2 children,2 x 35 hours NMW (enhanced NMW from 1 April 2016)								Couple (over 25),2 children,2 x 35 hours NMW (enhanced NMW from 1 April 2016)						
		April 2015	April 2016	April 2017	April 2016 change from April 2015	April 2017 change from April 2015	Note			April 2015	April 2016	April 2017	April 2016 change from April 2015	April 2017 change from April 2015	Note
Couple First Earner	Gross Income	£11,830.00	£13,104.00	£14,014.00	£1,274.00	£2,184.00	1,7		Gross Income	£11,830.00	£13,104.00	£14,014.00	£1,274.00	£2,184.00	1,7
	Income Tax	-£246.00	-£420.80	-£562.80	-£174.80	-£316.80	2		Income Tax	-£246.00	-£420.80	-£562.80	-£174.80	-£316.80	2
	National Insurance	-£452.40	-£605.28	-£714.48	-£152.88	-£262.08	3		National Insurance	-£452.40	-£605.28	-£714.48	-£152.88	-£262.08	3
Couple Second Earner	Gross Income	£11,830.00	£13,104.00	£14,014.00	£1,274.00	£2,184.00	1		Gross Income	£11,830.00	£13,104.00	£14,014.00	£1,274.00	£2,184.00	1
	Income Tax	-£246.00	-£420.80	-£562.80	-£174.80	-£316.80	2		Income Tax	-£246.00	-£420.80	-£562.80	-£174.80	-£316.80	2
	National Insurance	-£452.40	-£605.28	-£714.48	-£152.88	-£262.08	3		National Insurance	-£452.40	-£605.28	-£714.48	-£152.88	-£262.08	3
	Child Benefit	£1,788.80	£1,788.80	£1,788.80	£0.00	£0.00	4		Child Benefit	£1,788.80	£1,788.80	£1,788.80	£0.00	£0.00	4
	Working Tax Credit and Child Tax Credit	£4,100.16	£3,796.92	£2,616.12	-£303.24	-£1,484.04	5		Working Tax Credit and Child Tax Credit	£4,100.16	£1,353.16	£153.16	-£2,747.00	-£3,947.00	6
	Total Income	£28,152.16	£29,741.56	£29,878.36	£1,589.40	£1,726.20			Total Income	£28,152.16	£27,297.80	£27,415.40	-£854.36	-£736.76	

Iain Duncan Smith's claim does not stand up to detailed analysis

On 9 July 2015 the Secretary of State for Work and Pensions told Parliament

"I want to get the figures right. A lone parent with two children, who works 16 hours on the minimum wage, will, when we add in everything including childcare, actually be better off on the net figures after the Budget."

Lone Parent (over 25) with 2 children working 16 hours a week on the national minimum wage

First let's look at the changes to the enhanced minimum wage and personal tax allowance but without the changes to the tax credit threshold and taper announced by the Chancellor in the Summer Budget 2015. (The left hand columns in the table)

Today the lone parent's income is £17,271.80. This is made up of £5,408 from earnings, £1,788.80 from child benefit and £10,075.00 from working tax credit and child tax credit.⁵ No income tax or national insurance liability arises because pay is too low.

In April 2016 their income will be £17,854.20. They will see their annual pay increase by £582.40 to £5,990.40 as a result of the increase in the minimum wage from £6.50/hour to £7.20/hour. Good news. Despite the pay increase, no income tax or national insurance liability arises because pay is still too low. Under the current threshold (£6,420) and taper (41p in the £) they will not see any reduction in their tax credits because their increased pay is still less than the threshold so no reduction is made. They would be £582.40/year or £11.20/week better off.

Now also apply the changes to the tax credit threshold and taper announced by the Chancellor in the Summer Budget (The right hand columns in the table). By reducing the threshold from £6,420 to £3,850 this lone parent, some of this single parent's income is now subject to the taper. The tax credit calculation for 2016 uses the previous year income (£5,408). This is now £1,558 above the threshold so the tax credit is reduced by £747.84.

£638.78 of this is due to the threshold being reduced and the remaining £109.06 flows from the increase in the taper from 41p to 48p.

In April 2016 their net income will now be £17,106.36. This is made up of £5,990.40 from their earnings, £1,788.80 from child benefit and £9,327.16 from working tax credit and child tax credit. This is a drop of £165.44 or £3.18/week.

⁵ The maximum tax credit for this household is (Basic element (£1,960) + Single parent element (£2,010) + Child element (£2,780) + Second child element (£2,780) + Family element (£545)) = £10,075. In April 2015 the threshold of £6,420 and taper of £0.41 are then applied. In April 2016 the threshold of £3,850 and taper of £0.48 are then applied

Instead of being £582.40/year or £11.20/week better off next April they will be £165.44/year or £3.18/week worse off. This single parent loses £747.84/year as a result of the changes to the tax credit threshold and taper. Any gain the lone parent makes from the increase to the minimum wage goes straight to the Treasury.

But it does not stop there. The way tax credits are calculated includes something called an 'income rise' disregard that delays part of the reduction that will flow from the changes to the tax credit threshold and taper by 12 months. To illustrate this, assume the Chancellor repeats what he did in the Summer Budget and enhances the national minimum wage by another 50p/hour in April 2017 to £7.70/hour.

The lone parent will see their pay rise by another £416/year in April 2017. Good news. Their income is still too low for them to be liable for tax or national insurance. They will also lose £279.55 in tax credits as the delayed impact of the 'income rise' disregard kicks in and they now lose 48p of every £1 that they gained from the enhanced minimum wage in April 2016 (Remember their pay went up by £582.40). They would have not have lost anything if the threshold had not changed. In April 2017, without the changes to the tax credit threshold and taper, they would now be £998.40/year better off than they are today. But the changes to the tax credit threshold and taper mean that in 2017 they will be £28.99/year worse off than they are today. They would lose £1,027.39 because of the changes.

Without the April 2016 changes to the tax credit threshold and taper							With the April 2016 changes to the tax credit threshold and taper						
April 2016 Better Off (compared with April 2015)				£582.40/year or £11.20/week			April 2016 Worse Off (compared with April 2015)				£165.44/year or £3.18/week		
April 2017 Better Off (compared with April 2015)				£998.40/year or £19.20/week			April 2017 Worse Off (compared with April 2015)				£28.99/year or £0.56/week		
Working Lone Parent (over 25),2 children,1 x 16 hours NMW (enhanced NMW from 1 April 2016)							Working Lone Parent (over 25),2 children,1 x 16 hours NMW (enhanced NMW from 1 April 2016)						
	April 2015	April 2016	April 2017	April 2016 change from April 2015	April 2017 change from April 2015	Note		April 2015	April 2016	April 2017	April 2016 change from April 2015	April 2017 change from April 2015	Note
Gross Income	£5,408.00	£5,990.40	£6,406.40	£582.40	£998.40	8,9	Gross Income	£5,408.00	£5,990.40	£6,406.40	£582.40	£998.40	8,9
Income Tax	£0.00	£0.00	£0.00	£0.00	£0.00	10	Income Tax	£0.00	£0.00	£0.00	£0.00	£0.00	10
National Insurance	£0.00	£0.00	£0.00	£0.00	£0.00	11	National Insurance	£0.00	£0.00	£0.00	£0.00	£0.00	11
Child Benefit	£1,788.80	£1,788.80	£1,788.80	£0.00	£0.00	4	Child Benefit	£1,788.80	£1,788.80	£1,788.80	£0.00	£0.00	4
Working Tax Credit and Child Tax Credit	£10,075.00	£10,075.00	£10,075.00	£0.00	£0.00	12	Working Tax Credit and Child Tax Credit	£10,075.00	£9,327.16	£9,047.61	-£747.84	-£1,027.39	6
Total Income	£17,271.80	£17,854.20	£18,270.20	£582.40	£998.40		Total Income	£17,271.80	£17,106.36	£17,242.81	-£165.44	-£28.99	

Penalising under 25s

The minimum wage rises from £6.50/hour to £6.70/hour in October 2015 but the Chancellor announced that the enhanced minimum wage (7.20/hour) would only apply to people over the age of 25.

A family with one earner (under 25) earning the minimum wage for a 35 hour week with 1 child

First let's look at the changes that flow from a minimum wage of £6.70/hour and personal tax allowance but without the changes to the tax credit threshold and taper announced by the Chancellor in the Summer Budget 2015. (The left hand columns in the table)

Today their net household income is £18236.68. This is made up of £11,830 from earnings, £1,076.40 from child benefit and £6,028.68 from working tax credit and child tax credit.⁶ They pay £246.00 in income tax and £452.40 in national insurance. They will see their pay increase by £364 a year due to the rise in the hourly rate to £6.70/hour. They pay £7.20 less in income tax (as the increase in the personal tax allowance, from £10,600 to £11,000 is more than their increase in pay), they also pay an extra £43.68 in National Insurance. Under the current threshold (£6,420) and taper (41p in the £) they lose £141.78 in tax credits because the income used in the tax credit calculation has gone up. Nevertheless they would be £185.74/year better off.

Now apply the changes to the tax credit threshold and taper announced by the Chancellor in the Summer Budget. (The right hand columns in the table)

Instead of tax credits reducing by £141.78 they reduce by £1,754.08. Instead of being £185.74/year or £3.57/week better off next April they will be £1,426.56 a year or £27.43/week worse off.

They lose £1612.30 as a result of the tax credit changes. Any gain the family makes from increases to the minimum wage (not the enhanced minimum wage) and personal tax allowances goes straight back to the Treasury along with another £1,426.56 due the changes to the tax credit threshold and taper.

But it does not stop there. The way tax credits are calculated includes something called an 'income rise' disregard that delays part of the reduction that will flow from the changes to the tax credit threshold and taper by 12 months. To illustrate this, assume the minimum wage (not the enhanced minimum wage) is next increased by the Low Pay Commission from the £6.70/hour that will apply from October 2015, to £7.20/hour. This rate would apply from October 2016. It would represent the biggest increase in the last 5 years, but in 2017 it would meet the government's new policy of ensuring that the personal tax allowance is more than 30 hours times the minimum wage.

⁶ The maximum tax credit for this household is (Basic element (£1,960) + Couple element (£2,010) +30 hour element (£810) + Child element (£2,780) + Family element (£545)) = £8,105. In April and October 2015 the threshold of £6,420 and taper of 0.41 are then applied. In April 2016 the threshold of £3,850 and taper of 0.48 are then applied.

Without the April 2016 changes to the tax credit threshold and taper							With the April 2016 changes to the tax credit threshold and taper						
April 2016 Better Off (compared with April 2015)				£185.74/year or £3.57/week			April 2016 Worse Off (compared with April 2015)				£1426.56/year or £27.43/week		
April 2017 Better Off (compared with April 2015)				£695.30/year or £13.37/week			April 2017 Worse Off (compared with April 2015)				£942.48/year or £18.12/week		
Single Earner Family (under 25), Couple ,1 child, 1 x 35 hours NMW							Single Earner Family (under 25), Couple ,1 child, 1 x 35 hours NMW						
	April 2015	April 2016	April 2017	April 2016 change from April 2015	April 2017 change from April 2015	Note		April 2015	April 2016	April 2017	April 2016 change from April 2015	April 2017 change from April 2015	Note
Gross Income	£11,830.00	£12,194.00	£13,104.00	£364.00	£1,274.00	1,13	Gross Income	£11,830.00	£12,194.00	£13,104.00	£364.00	£1,274.00	1,13
Income Tax	-£246.00	-£238.80	-£380.80	£7.20	-£134.80	2	Income Tax	-£246.00	-£238.80	-£380.80	£7.20	-£134.80	2
National Insurance	-£452.40	-£496.08	-£605.28	-£43.68	-£152.88	3	National Insurance	-£452.40	-£496.08	-£605.28	-£43.68	-£152.88	3
Child Benefit	£1,076.40	£1,076.40	£1,076.40	£0.00	£0.00	4	Child Benefit	£1,076.40	£1,076.40	£1,076.40	£0.00	£0.00	4
Working Tax Credit and Child Tax Credit	£6,028.68	£5,886.90	£5,737.66	-£141.78	-£291.02	5	Working Tax Credit and Child Tax Credit	£6,028.68	£4,274.60	£4,099.88	-£1,754.08	-£1,928.80	6
Total Income	£18,236.68	£18,422.42	£18,931.98	£185.74	£695.30		Total Income	£18,236.68	£16,810.12	£17,294.20	-£1,426.56	-£942.48	

Summary

A family with one earner (over 25) earning the minimum wage for a 35 hour week with 1 child	<u>Without the April 2016 changes to the tax credit threshold and taper</u>		A family with one earner (under 25) earning the minimum wage for a 35 hour week with 1 child	<u>Without the April 2016 changes to the tax credit threshold and taper</u>	
	April 2016 Better Off (compared with April 2015)	£804.54/year or £15.47/week		April 2016 Better Off (compared with April 2015)	£185.74/year or £3.57/week
	April 2017 Better Off (compared with April 2015)	£941.00/year or £18.10/week		April 2017 Better Off (compared with April 2015)	£695.30/year or £13.37/week
	<u>With the April 2016 changes to the tax credit threshold and taper</u>			<u>With the April 2016 changes to the tax credit threshold and taper</u>	
	April 2016 Worse Off (compared with April 2015)	£807.76/year or £15.53/week		April 2016 Worse Off (compared with April 2015)	£1426.56/year or £27.43/week
	April 2017 Worse Off (compared with April 2015)	£760.48/year or £14.62/week		April 2017 Worse Off (compared with April 2015)	£942.48/year or £18.12/week
Family with 2 children and both adults (over 25) working 35 hours a week on the national minimum wage	<u>Without the April 2016 changes to the tax credit threshold and taper</u>		Lone Parent (over 25) with 2 children working 16 hours a week on the national minimum wage	<u>Without the April 2016 changes to the tax credit threshold and taper</u>	
	April 2016 Better Off (compared with April 2015)	£1,589.40/year or £30.57/week		April 2016 Better Off (compared with April 2015)	£582.40/year or £11.20/week
	April 2017 Better Off (compared with April 2015)	£1,726.20/year or £33.20/week		April 2017 Better Off (compared with April 2015)	£998.40/year or £19.20/week
	<u>With the April 2016 changes to the tax credit threshold and taper</u>			<u>With the April 2016 changes to the tax credit threshold and taper</u>	
	April 2016 Worse Off (compared with April 2015)	£854.36/year or £16.43/week		April 2016 Worse Off (compared with April 2015)	£165.44/year or £3.18/week
	April 2017 Worse Off (compared with April 2015)	£736.76/year or £14.17/week		April 2017 Worse Off (compared with April 2015)	£28.99/year or £0.56/week

Looking forward to 2020

This report has already shown that the examples cited by David Cameron and Iain Duncan Smith and other typical examples will see their income cut in April 2016, but what is the impact during the rest of the parliament.

The 2015 Conservative Manifesto said

“we will take everyone earning less than £12,500 out of Income Tax altogether and pass a law to ensure we have a Tax-Free Minimum Wage in this country”

“we will pass a new law so that nobody working 30 hours on the Minimum Wage pays Income Tax on what they earn”

“A Conservative Government will not increase the rates of VAT, Income Tax or National Insurance in the next Parliament. Instead, we will ease the burden of taxation by raising the tax-free Personal Allowance – the amount you can earn before you start paying tax – to £12,500.

This will ...take everyone who earns less than £12,500 out of Income Tax altogether. That means by the end of the decade, one million more people on the lowest wages will be lifted out of Income Tax, and people who work for 30 hours a week on the increased National Minimum Wage will no longer pay any Income Tax at all. We will pass a new law so that the Personal Allowance automatically rises in line with the National Minimum Wage. The new Tax Free Minimum Wage law will be applied from the first Budget after the General Election”

In the Summer Budget the Chancellor said “The Britain deserves a pay rise and Britain is getting a pay rise. I am today introducing a new National Living Wage. We’ve set it to reach £9 an hour by 2020.Working people aged 25 and over will receive it. It will start next April, at the rate of £7.20”

Of course it is not a living wage which outside London is already £7.85/hour. But an enhanced minimum wage of £7.20/hour from April 2016 reaching £9/hour by 2020 will raise pay levels for people over 25 on the national minimum wage.

Precisely when the personal tax allowance will reach £12,500 is not entirely clear. In the July 2015 budget the chancellor announced that the personal tax allowance in 2016/17 would be £11,000 rising to £11,200 in 2017/18.

So this report makes assumptions about what will happen during the lifetime of this parliament. It assumes that the personal tax allowance will reach £12,500 from April 2019 and that the enhanced minimum wage reaches £9.00/hour from April 2020.

Assumptions						
Assumptions	April 2015	April 2016	April 2017	April 2018	April 2019	April 2020
Minimum Wage (Enhanced from April 2016) Hourly Rate	£6.50	£7.20	£7.70	£8.10	£8.60	£9.00
Personal Tax Allowance reaches £12,500 from April 2019 and rises to £13,000 from April 2020	£10,600.00	£11,000.00	£11,200.00	£11,800.00	£12,500.00	£13,000.00

The Chancellor has already announced that child benefit will be frozen as well as in work benefits which means the elements of the tax credit system will be frozen and the calculations also assume no change to the earnings limits for national insurance contributions.

Now examine what happens over the lifetime of the parliament to the family David Cameron referred to.

A family with one earner (over 25) earning the minimum wage for a 35 hour week with 1 child

Without the changes to the tax credit threshold and taper this family would expect to see small gains to their household income each year as a result of the enhanced minimum wage and increases in the personal tax allowances. By April 2020 their income would have risen by £2,171.20/year.

Without the changes to the tax credit threshold and taper						
Single Earner Family with one child, 1 x 35 hours NMW (enhanced NMW from April 2016)						
	April 2015	April 2016	April 2017	April 2018	April 2019	April 2020
Gross Income	£11,830.00	£13,104.00	£14,014.00	£14,742.00	£15,652.00	£16,830.00
Income Tax	-£246.00	-£420.80	-£562.80	-£588.40	-£630.40	-£766.00
National Insurance	-£452.40	-£605.28	-£714.48	-£801.84	-£911.04	-£1,052.40
Child Benefit	£1,076.40	£1,076.40	£1,076.40	£1,076.40	£1,076.40	£1,076.40
Working Tax Credit and Child Tax Credit	£6,028.68	£5,886.90	£5,364.56	£4,991.46	£4,692.98	£4,319.88
Total Income	£18,236.68	£19,041.22	£19,177.68	£19,419.62	£19,879.94	£20,407.88

But if the changes to the tax credit threshold and taper are included this family's income will only be £18,528.04 in 2020. Despite their pay rising by £5,000, this family is just £291.36 better off in 2020 than it was in 2015.

They will be worse off in 2016, in 2017, in 2018 and in 2019 than they are today.

Over the parliament this family, instead of being £6,472.95 better off, will be £2,031.99 worse off.

With the changes to the tax credit threshold and taper						
Single Earner Family with one child, 1 x 35 hours NMW (enhanced NMW from April 2016)						
	April 2015	April 2016	April 2017	April 2018	April 2019	April 2020
Gross Income	£11,830.00	£13,104.00	£14,014.00	£14,742.00	£15,652.00	£16,830.00
Income Tax	-£246.00	-£420.80	-£562.80	-£588.40	-£630.40	-£766.00
National Insurance	-£452.40	-£605.28	-£714.48	-£801.84	-£911.04	-£1,052.40
Child Benefit	£1,076.40	£1,076.40	£1,076.40	£1,076.40	£1,076.40	£1,076.40
Working Tax Credit and Child Tax Credit	£6,028.68	£4,274.60	£3,663.08	£3,226.28	£2,876.84	£2,440.04
Total Income	£18,236.68	£17,428.92	£17,476.20	£17,654.44	£18,063.80	£18,528.04

Any gain the family makes from the enhanced minimum wage and higher personal tax allowances simply goes straight to the Treasury along with another £2,031.99 due the changes to the tax credit threshold and taper.

In the budget speech (8 July 2015) George Osborne said

“Those currently on the minimum wage will see their pay rise by over a third this Parliament, a cash increase for a full time worker of over £5,000.”

What he omitted to say was that if that worker was in receipt of tax credits they would not see a penny of that £5,000 cash increase in pay because the changes to the threshold and taper that he also announced would ensure that it (and more) went straight to the Treasury.

Two Nations

While the Government is picking the pockets of low and middle paid workers, those that earn the most are enjoying a huge windfall.

Each year HMRC publishes the UK Income Tax Liability Statistics.

Table 2.5 provides a breakdown of the income tax liabilities.

The latest statistics were published in May 2015.

They show that in 2013/14 10,000 taxpayers earned between £1,000,000 and £2,000,000

Their total income was £13.8bn (£13,800m)

Each of these people will not pay the additional rate on the first £150,000 of earnings (10,000 x £150,000) £1.5bn (£1,500m)

If the 50p tax rate had not been cut they would pay 50p on £12.3bn (£12,300m)

If the tax rate had remained at 50p they would pay £6.15bn (£6,150m)

As the tax rate has been cut to 45p they pay £5.535bn (£5,535m)

The tax cut for people earning between £1m and £2m is worth £615m

Or to put it another way an average of £61,500 each

They also show that in 2013/14 5,000 taxpayers earned over £2,000,000

Their total income was £25.9bn (£25,900m)

Each of these people will not pay the additional rate on the first £150,000 of earnings (5,000 x £150,000) £0.75bn (£750m)

If the 50p tax rate had not been cut they would pay 50p on £25.15bn (£25,150m)

If the tax rate had remained at 50p they would pay £12.575bn (£12,575m)

As the tax rate has been cut to 45p they pay £11.3175bn (£11,317.5m)

The tax cut for people earning over £2m is worth £1,257.5m

Or to put it another way an average of £251,500 each

Conclusion

This report examines the changes to the tax threshold and taper announced by the Chancellor and shows that they will hit families hard – they will be ‘eye wateringly painful’ to quote Conservative MP Guto Bebb.

HMRC statistics (for April 2015) show that there are 2,718,900 families with 3,471,500 children that will be affected by the change next April.

In addition there are another 558,300 families without children that are affected.

Speaking on the 22 June 2015 in advance of the announcement of those changes David Cameron told the nation

“I said on the steps of Downing Street on May 8 that this would be a ‘one nation’ government, with working people at its heart. In its simplest terms, that means if you want to work hard and get on in life, this government will be on your side.”

It is family incomes that are important, not just pay. The Chancellor, Prime Minister and Work and Pensions Secretary and other Ministers cannot be allowed to claim that people will be better off because their pay has been increased when they know full well, that at the same time, another part of their family income – tax credits – are being cut so drastically that they are actually substantially worse off.

Notes

Note 1 Hourly pay increases from £6.50/hour to £7.20/hour so annual pay increases by £1,274.00

Note 2 Higher pay results in higher income tax, the April 2016 figure takes account of the increase in personal tax allowance from £10,600 to £11,000 and the April 2017 figure takes account of the increase to £11,200

Note 3 Higher pay results in higher national insurance contributions (it is assumed that there is no change to the earnings thresholds)

Note 4 Child benefit is frozen - no change

Note 5 Higher (household) pay results in lower tax credits (note the tax credit calculation uses previous year income). Under the current rules the reduction is £41 for every £100 increase in gross pay

Note 6 Tax credits reduce dramatically for three reasons. First the point at which tax credits start to be reduced (the threshold) is reduced from £6,420 to £3,850 from next April. Secondly the rate at which tax credits reduce is increased next April from £41 for every £100 above the threshold to £48 for every £100 above the threshold. Thirdly higher (household) pay results in lower tax credits (note the calculation uses previous year income). Under the new rules the reduction is £48 for every £100 increase in gross (household) pay.

Note 7 Hourly pay under the enhanced minimum wage is assumed to further increase from £7.20/hour to £7.70/hour in April 2017 and annual pay increases by £910 in April 2017.

Note 8 Hourly pay increases from £6.50/hour to £7.20/hour so annual pay increases by £582.40

Note 9 Hourly pay under the enhanced minimum wage is assumed to further increase from £7.20/hour to £7.70/hour in April 2017 and annual pay increases by £416 in April 2017.

Note 10 Gross pay is less than the personal tax allowance so no liability for income tax

Note 11 Gross pay is less than the level at which employee national insurance contributions start to be paid so no liability for national insurance

Note 12 Gross pay is less than the threshold (£6,420) at which tax credits are reduced – so no reduction

Note 13 Assume national minimum wage rises to £7.20/hour in October 2016

Appendix 1 – Tax Credit calculations

Single earner family with one earner (over 25) with one child, 35 hours on national minimum wage

Single Earner Family with one earner (over 25) earning the minimum wage for a 35 hour week with 1 child									
	Without the April 2016 changes to threshold and taper					With the April 2016 changes to threshold and taper			
	ELEMENTS	2015	2016	2017		ELEMENTS	2015	2016	2017
	<i>Working Tax Credit</i>	£	£	£		<i>Working Tax Credit</i>	£	£	£
Step 1 Add together the relevant elements	Basic	£1,960.00	£1,960.00	£1,960.00		Basic	£1,960.00	£1,960.00	£1,960.00
	Couple	£2,010.00	£2,010.00	£2,010.00		Couple	£2,010.00	£2,010.00	£2,010.00
	30 hours	£810.00	£810.00	£810.00		30 hours	£810.00	£810.00	£810.00
	Disability	£0.00	£0.00	£0.00		Disability	£0.00	£0.00	£0.00
	<i>Child Tax Credit</i>					<i>Child Tax Credit</i>			
	Family	£545.00	£545.00	£545.00		Family	£545.00	£545.00	£545.00
	Child	£2,780.00	£2,780.00	£2,780.00		Child	£2,780.00	£2,780.00	£2,780.00
	Maximum Elements	£8,105.00	£8,105.00	£8,105.00		Maximum Elements	£8,105.00	£8,105.00	£8,105.00
Step 2 determine relevant income	'Relevant' Income	£11,484.20	£11,830.00	£13,104.00		'Relevant' Income	£11,484.20	£11,830.00	£13,104.00
	Threshold	£6,420.00	£6,420.00	£6,420.00		Threshold	£6,420.00	£3,850.00	£3,850.00
Step 3 Calculate Excess Income - Relevant income less threshold	Excess Income	£5,064.20	£5,410.00	£6,684.00		Excess Income	£5,064.20	£7,980.00	£9,254.00
	Taper rate	£0.41	£0.41	£0.41		Taper rate	£0.41	£0.48	£0.48
Step 4 apply taper to Excess Income	Taper amount	£2,076.32	£2,218.10	£2,740.44		Taper amount	£2,076.32	£3,830.40	£4,441.92
Step 5 deduct taper amount from maximum award	Tax Credit award	£6,028.68	£5,886.90	£5,364.56		Tax Credit award	£6,028.68	£4,274.60	£3,663.08

Family with two children both adults working 35 hours/week on the national minimum wage⁷

Family with 2 children and both adults (over 25) working 35 hours a week on the national minimum wage									
	Without the April 2016 changes to threshold and taper					With the April 2016 changes to threshold and taper			
	ELEMENTS	2015	2016	2017		ELEMENTS	2015	2016	2017
	<i>Working Tax Credit</i>	£	£	£		<i>Working Tax Credit</i>	£	£	£
Step 1 Add together the relevant elements	Basic	£1,960.00	£1,960.00	£1,960.00		Basic	£1,960.00	£1,960.00	£1,960.00
	Couple	£2,010.00	£2,010.00	£2,010.00		Couple	£2,010.00	£2,010.00	£2,010.00
	30 hours	£810.00	£810.00	£810.00		30 hours	£810.00	£810.00	£810.00
	Disability	£0.00	£0.00	£0.00		Disability	£0.00	£0.00	£0.00
	<i>Child Tax Credit</i>					<i>Child Tax Credit</i>			
	Family	£545.00	£545.00	£545.00		Family	£545.00	£545.00	£545.00
	Child	£2,780.00	£2,780.00	£2,780.00		Child	£2,780.00	£2,780.00	£2,780.00
	Second Child	£2,780.00	£2,780.00	£2,780.00		Second Child	£2,780.00	£2,780.00	£2,780.00
	Maximum Elements	£10,885.00	£10,885.00	£10,885.00		Maximum Elements	£10,885.00	£10,885.00	£10,885.00
Step 2 determine relevant income	;'Relevant' Income	£22,968.40	£23,708.00	£26,208.00		;'Relevant' Income	£22,968.40	£23,708.00	£26,208.00
	Threshold	£6,420.00	£6,420.00	£6,420.00		Threshold	£6,420.00	£3,850.00	£3,850.00
Step 3 Calculate Excess Income - Relevant income less threshold	Excess Income	£16,548.40	£17,288.00	£19,788.00		Excess Income	£16,548.40	£19,858.00	£22,358.00
	Taper rate	0.41	0.41	0.41		Taper rate	0.41	0.48	0.48
Step 4 apply taper to Excess Income	Taper amount	£6,784.84	£7,088.08	£8,113.08		Taper amount	£6,784.84	£9,531.84	£10,731.84
Step 5 deduct taper amount from maximum award	Tax Credit award	£4,100.16	£3,796.92	£2,771.92		Tax Credit award	£4,100.16	£1,353.16	£153.16

⁷ The relevant income in 2016 uses previous year income £23660 (2 x £11,830) and includes £48 from 2016 pay because the increase is £2,548 which is £48 more than the income rise disregard.

Lone parent (over 25) with 2 children working 16 hours a week on the national minimum wage

Lone Parent (over 25) with 2 children working 16 hours a week on the national minimum wage									
	Without the April 2016 changes to threshold and taper					With the April 2016 changes to threshold and taper			
	ELEMENTS	2015	2016	2017		ELEMENTS	2015	2016	2017
	<i>Working Tax Credit</i>	£	£	£		<i>Working Tax Credit</i>	£	£	£
Step 1 Add together the relevant elements	Basic	£1,960.00	£1,960.00	£1,960.00		Basic	£1,960.00	£1,960.00	£1,960.00
	Couple	£2,010.00	£2,010.00	£2,010.00		Couple	£2,010.00	£2,010.00	£2,010.00
	30 hours	£0.00	£0.00	£0.00		30 hours	£0.00	£0.00	£0.00
	Disability	£0.00	£0.00	£0.00		Disability	£0.00	£0.00	£0.00
	<i>Child Tax Credit</i>					<i>Child Tax Credit</i>			
	Family	£545.00	£545.00	£545.00		Family	£545.00	£545.00	£545.00
	Child	£2,780.00	£2,780.00	£2,780.00		Child	£2,780.00	£2,780.00	£2,780.00
	Second Child	£2,780.00	£2,780.00	£2,780.00		Second Child	£2,780.00	£2,780.00	£2,780.00
	Maximum Elements	£10,075.00	£10,075.00	£10,075.00		Maximum Elements	£10,075.00	£10,075.00	£10,075.00
Step 2 determine relevant income	'Relevant' Income	£5,249.92	£5,408.00	£5,990.40		'Relevant' Income	£5,249.92	£5,408.00	£5,990.40
	Threshold	£6,420.00	£6,420.00	£6,420.00		Threshold	£6,420.00	£3,850.00	£3,850.00
Step 3 Calculate Excess Income - Relevant income less threshold	Excess Income	£0.00	£0.00	£0.00		Excess Income	£0.00	£1,558.00	£2,140.40
	Taper rate	£0.41	£0.41	£0.41		Taper rate	£0.41	£0.48	£0.48
Step 4 apply taper to Excess Income	Taper amount	£0.00	£0.00	£0.00		Taper amount	£0.00	£747.84	£1,027.39
Step 5 deduct taper amount from maximum award	Tax Credit award	£10,075.00	£10,075.00	£10,075.00		Tax Credit award	£10,075.00	£9,327.16	£9,047.61

Single earner family with one earner (under 25) with one child, 35 hours on national minimum wage

Single Earner Family with one earner (under 25) earning the minimum wage for a 35 hour week with 1 child									
	Without the April 2016 changes to threshold and taper					With the April 2016 changes to threshold and taper			
	ELEMENTS	2015	2016	2017		ELEMENTS	2015	2016	2017
	<i>Working Tax Credit</i>	£	£	£		<i>Working Tax Credit</i>	£	£	£
Step 1 Add together the relevant elements	Basic	£1,960.00	£1,960.00	£1,960.00		Basic	£1,960.00	£1,960.00	£1,960.00
	Couple	£2,010.00	£2,010.00	£2,010.00		Couple	£2,010.00	£2,010.00	£2,010.00
	30 hours	£810.00	£810.00	£810.00		30 hours	£810.00	£810.00	£810.00
	Disability	£0.00	£0.00	£0.00		Disability	£0.00	£0.00	£0.00
	<i>Child Tax Credit</i>					<i>Child Tax Credit</i>			
	Family	£545.00	£545.00	£545.00		Family	£545.00	£545.00	£545.00
	Child	£2,780.00	£2,780.00	£2,780.00		Child	£2,780.00	£2,780.00	£2,780.00
	Maximum Elements	£8,105.00	£8,105.00	£8,105.00		Maximum Elements	£8,105.00	£8,105.00	£8,105.00
Step 2 determine relevant income	'Relevant' Income	£11,484.20	£11,830.00	£12,194.00		'Relevant' Income	£11,484.20	£11,830.00	£12,194.00
	Threshold	£6,420.00	£6,420.00	£6,420.00		Threshold	£6,420.00	£3,850.00	£3,850.00
Step 3 Calculate Excess Income - Relevant income less threshold	Excess Income	£5,064.20	£5,410.00	£5,774.00		Excess Income	£5,064.20	£7,980.00	£8,344.00
	Taper rate	£0.41	£0.41	£0.41		Taper rate	£0.41	£0.48	£0.48
Step 4 apply taper to Excess Income	Taper amount	£2,076.32	£2,218.10	£2,367.34		Taper amount	£2,076.32	£3,830.40	£4,005.12
Step 5 deduct taper amount from maximum award	Tax Credit award	£6,028.68	£5,886.90	£5,737.66		Tax Credit award	£6,028.68	£4,274.60	£4,099.88