Title: The Tax Credits (Income Threshold and Determination of Rates) (Amendment) Regulations 2015

Lead department or agency: Her Majesty’s Treasury

Other departments or agencies: Her Majesty’s Revenue and Customs

Summary: Intervention and Options

Cost of Preferred (or more likely) Option

<table>
<thead>
<tr>
<th>Total Net Present Value</th>
<th>Business Net Present Value</th>
<th>Net cost to business per year (EANCB on 2009 prices)</th>
<th>In scope of One-In, Two-Out?</th>
</tr>
</thead>
<tbody>
<tr>
<td>£0m</td>
<td>£0m</td>
<td>£0m</td>
<td>No</td>
</tr>
</tbody>
</table>

What is the problem under consideration? Why is government intervention necessary?
The Government is determined to move from a low wage, high tax and high welfare society to a high wage, lower tax and lower welfare society. Tax credit expenditure more than trebled in real terms between 1999 and 2010; and increased by £9.6 billion a year in real terms between 2004/05 and 2014/15. In 2010 9 in 10 families with children were eligible for tax credits, reduced to 6 in 10 following the government’s reforms in the last Parliament.

What are the policy objectives and the intended effects?
These changes are part of a package of policies announced at the Summer Budget which will provide support to those in work through the tax system and wages, rather than topping up low wages through tax credits. Alongside the new National Living Wage and rises in the income tax personal allowance, changes to tax credits and other benefits will ensure that the welfare system is fair to those who pay for it, as well as those who benefit from it. The objective of the policies set out in this Statutory Instrument is to reform tax credits to make the system fairer and more affordable whilst focusing tax credits spending on those with the lowest incomes.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)
The do nothing option is not sustainable. Spending on tax credits increased by nearly £10 billion in real terms between 2004/05 and 2014/15. These changes are forecast to see expenditure on tax credits return to 2007/08 levels in real terms. From 2016/17, rather than 9 in 10 families with children being eligible for tax credits, as in 2010, this will reduce to 5 in 10.

Will the policy be reviewed? It will not be reviewed. If applicable, set review date: Month/Year

Does implementation go beyond minimum EU requirements? N/A
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.
Micro: No
< 20 No
Small No
Medium No
Large No
What is the CO2 equivalent change in greenhouse gas emissions? (Million tonnes CO2 equivalent) Traded: N/A Non-traded: N/A

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: 12/10/2015
## Summary: Analysis & Evidence

### Description:
**FULL ECONOMIC ASSESSMENT**

<table>
<thead>
<tr>
<th>Price Base Year 2016</th>
<th>PV Base Year 2016</th>
<th>Time Period Years</th>
<th>Net Benefit (Present Value (PV)) (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low: Optional</td>
<td>High: Optional</td>
<td>Best Estimate:</td>
<td></td>
</tr>
</tbody>
</table>

#### COSTS (£m)

<table>
<thead>
<tr>
<th>Description and scale of key monetised costs by ‘main affected groups’</th>
</tr>
</thead>
<tbody>
<tr>
<td>In 2016/17 the savings from increasing the tax credits taper rate from 41 to 48 per cent will be £1,475 million; reducing the tax credits income threshold to £3,850 will be £2,760 million; and reducing the income rise disregard from £5,000 to £2,500 will be £170 million.</td>
</tr>
</tbody>
</table>

#### Other key non-monetised costs by ‘main affected groups’

The assessment is only carried out over the period to 2020/21, costs and benefits will continue to accrue beyond the period. Other reforms announced at Summer Budget 2015 will continue to have an impact in later years, with the National Living Wage rising to over £9 by 2020. The Government has also committed to increasing the personal allowance to £12,500 by the end of the Parliament and ensuring that anyone working 30 hours on the National Minimum Wage will not pay income tax.

#### BENEFITS (£m)

<table>
<thead>
<tr>
<th>Description and scale of key monetised benefits by ‘main affected groups’</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings to the taxpayer of the three measures set out in this Statutory Instrument are estimated to be £4,405 million in cash terms on an annual basis in 2016/17 and £590 million by 2020/21 as tax credit claimants migrate on to Universal Credit. Savings within Universal Credit were also announced at Summer Budget 2015.</td>
</tr>
</tbody>
</table>

#### Other key non-monetised benefits by ‘main affected groups’

It is fairer to the taxpayer to ensure that tax credits are placed on a sustainable footing for the future. These reforms are introduced alongside the new National Living Wage and rises in the income tax personal allowance; Table 1.8 in the Summer Budget sets out the illustrative impact on households from 2010/11 to 2020/21.

#### Key assumptions/sensitivities/risks

A range of factors will determine the precise level of savings from these measures. In particular, the rate of earnings growth amongst tax credit claimants will play a role in determining the number of families who experience changes in income and whether or not those changes are amongst families on the tax credits taper. Key demographic and economic assumptions have been agreed by HMRC with the independent Office for Budget Responsibility. Published costings notes are available at www.gov.uk.

### BUSINESS ASSESSMENT (Option 1)

<table>
<thead>
<tr>
<th>Direct impact on business (Equivalent Annual) (£m):</th>
<th>In scope of OITO?</th>
<th>Measure qualifies as</th>
</tr>
</thead>
<tbody>
<tr>
<td>Costs: 0</td>
<td>No</td>
<td>NA</td>
</tr>
<tr>
<td>Benefits: 0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net: 0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Problem and rationale for intervention

1. The Government is determined to move from a low wage, high tax and high welfare society to a high wage, lower tax and lower welfare society. This means providing support to those in work through the tax system and wages, rather than topping up low wages through tax credits.

2. Alongside this, the Government has made clear its objective of tackling the deficit and rebalancing the welfare state. Welfare expenditure is a significant driver of public spending and the Government is committed to delivering a more sustainable welfare system, including changes to tax credits, to put the system on a more sustainable footing.

3. Tax credit expenditure more than trebled in real terms between 1999/00 and 2010/11, with total expenditure in 2014/15 estimated to be around £30 billion – an increase of almost £10 billion in real terms over the last 10 years.

4. Prior to Summer Budget, generous support in tax credits continued to be paid to families high up the income distribution. Families with three children on an income of nearly £40,000 could receive support through tax credits in 2015-16.

5. Summer Budget focuses spending on tax credits on those with the lowest incomes. In 2010 9 in 10 families with children were eligible for tax credits, reducing to 6 in 10 in April 2012.

Policy objective

6. Summer Budget 2015 set out a package of reforms offering a new deal for working people, introducing a new National Living Wage to lift the wages of the lowest paid, while setting out the path to a tax-free National Minimum Wage.

7. The changes in this Statutory Instrument are part of a package of policies announced at the Summer Budget which will deliver a more sustainable welfare system. These changes will reform tax credits to make them fairer and more affordable and will return expenditure on tax credits to 2007/08 levels in real terms. As a result of Summer Budget changes the number of families with children eligible for tax credits will reduce to 5 in 10 by 2016/17.

8. Action taken to date on the income tax personal allowance means that the typical basic rate taxpayer pays £825 less income tax than they were in 2010. The Government has also committed to increasing the personal allowance to £12,500 by the end of the Parliament and ensuring that anyone working 30 hours on the National Minimum Wage will not pay income tax.

Do nothing option

9. The do nothing option is unfair to families who are not eligible for state support and to the taxpayer, and does not return welfare spending to a sustainable level. These changes will ensure that the benefits system is fair to those who pay for it, as well as those who benefit from it, as Britain shifts from lower wage, higher tax and high welfare society to a high wage, lower tax and lower welfare society.

10. Delivering welfare savings is a vital part of the government's deficit reduction plan. Had the Budget not announced significant welfare savings, steeper reductions in public service spending, such as schools or the NHS, would have been required – or higher borrowing and debt, or higher taxes.

11. As public services provide greatest support to those on lowest incomes, greater cuts to public services would have a disproportionate effect on the lowest paid. The distributional analysis that was published alongside Summer Budget 2015 showed that spending on public services disproportionately goes to those on lower incomes: just under half (48%) of public services spending which directly benefits households goes to those in the bottom two fifths of income distribution.
Exchequer and Claimant Impact

12. These changes are part of a package announced at Summer Budget. Overall as a result of policies announced at the Summer Budget 8 out of 10 working households are better off in 2017/18.

13. The impact on individual households from the tax, welfare and National Living Wage changes announced at Summer Budget 2015 will depend on a number of factors, including: existing wage rate and annual income, number of children, whether the household is in receipt of Housing Benefit and migration to Universal Credit system.

14. It is expected that by 2020-21, an illustrative couple with two children, currently in receipt of Housing Benefit, where one partner works 35 hours a week on the NMW will see a cash increase in their annual income of £2,400 compared to today.

15. The changes to tax credits will protect the cash income of those who are out of work: an illustrative couple with one child, currently in receipt of Housing Benefit, where both partners are out of work, will see no fall to their income in cash terms, unless they are affected by the new lower benefit cap.

16. The OBR have indicated that knock-on effects further up the wage distribution could mean a further 3.25 million people also see an increase in wages as a result of the NLW. By the end of the Parliament, an individual aged over 25 working 35 hours a week and previously earning the NMW will see their gross wages increase by around £4,800 a year in cash terms. This is equivalent to an extra £2,000 per year from the premium alone, £4,000 for a couple.

17. There is evidence from previous analysis of increases to the National Minimum Wage that in addition to those directly affected, there is a ripple or spillover effect to wage rates further up the wage distribution. As part of its analysis of the impacts of the NLW, the Office for Budget Responsibility estimated that this spillover effect could extend up to the 25th percentile of the wage distribution, meaning that as well as the 2.5 million workers directed affected, an additional 3.4 million, earning up to around £10.50 per hour in 2020, could benefit indirectly from the policy.

18. In addition, the government is providing additional support for childcare, doubling the current free entitlement offer from 15 hours a week of free childcare for 3 and 4 year olds, to 30 hours a week for working parents, starting from September 2017.

19. In 2010, 9 in 10 families with children were eligible for tax credits. The Government’s reforms in 2011 reduced this to 6 in 10 in April 2012. Summer Budget policy changes will reduce this to 5 in 10 by 2016/17.

Table 1: Exchequer savings as a result of changes to tax credits

<table>
<thead>
<tr>
<th>£m</th>
<th>2016/17</th>
<th>2017/18</th>
<th>2018/19</th>
<th>2019/20</th>
<th>2020/21</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase tax credit taper rate to 48 per cent</td>
<td>1,475</td>
<td>1,035</td>
<td>600</td>
<td>345</td>
<td>245</td>
</tr>
<tr>
<td>Reduce income threshold in tax credits</td>
<td>2,760</td>
<td>1,835</td>
<td>945</td>
<td>450</td>
<td>235</td>
</tr>
<tr>
<td>Reduce the income rise disregard in tax credits</td>
<td>170</td>
<td>225</td>
<td>250</td>
<td>180</td>
<td>110</td>
</tr>
</tbody>
</table>

Longer term impact

20. The package of policies announced at Summer Budget will continue to have an impact for the longer term. The new National Living Wage will rise to over £9 by 2020 and the Government has committed to increasing the personal allowance to £12,500 by the end of the Parliament and ensuring that anyone working 30 hours on the National Minimum Wage will not pay income tax.
21. The reforms set out in this Statutory Instrument will put tax credits expenditure on a more affordable long term footing. The cost of the tax credit system has already become unsustainable. Tax credit expenditure more than trebled in real terms between 1999/00 and 2010/11, with total expenditure in 2014/15 estimated to be around £30 billion – an increase of almost £10 billion in real terms over the last 10 years. As a result of the Summer Budget changes, the Office for Budget Responsibility forecast that expenditure on tax credits will fall to £25.3 billion by 2016/17. As a whole the package of tax credits changes announced at the Summer Budget will put tax credit spending on a more sustainable footing and reduce it to the same level as in 2007/08 in real terms.

22. The effects of these measures will be phased out over time as claimants are migrated onto Universal Credit.

Behavioural assumptions

23. The primary purpose of the Government’s welfare policies is to help people move into sustained employment, whilst ensuring the system is fair to both recipients and non-recipients.

24. The government wants to move from a low wage, high tax and high welfare society to a high wage, lower tax and lower welfare society. The package of policies announced at Summer Budget will ensure that work will always pay more than a life on benefits. After the reforms announced at Summer Budget claimants will always be better off in work and always better off working more.

Distributional analysis

25. Chart 1 shows the share of total tax credit savings which comes from each income decile of the distribution of tax credits claimants, in 2016/17. This analysis is drawn from HM Treasury’s tax and welfare microsimulation model, which is also used to underpin the distributional analysis which accompanied Summer Budget 2015.¹

26. The 10% of tax credit claimants on the highest incomes are contributing nearly 4 times as much as the poorest tax credit claimants to welfare savings. Average household income in the richest 10% of tax credit claimants is £42,000 per year; significantly above average household income of £25,000 per year. 60% of the tax credit savings come from the half of tax credit claimants with the highest income.

¹ See “Impact on Households: Distributional Analysis to Accompany Summer Budget 2015.”
Chart 1: Share of savings from tax credit changes by income distribution of tax credit claimants, 2016/17 (base: all households which receive tax credits)

Source: HM Treasury

27. In this analysis, the households receiving tax credits—approximately 4.6 million households, are allocated equally across ten income deciles, according to their net household income (which includes income from both earnings and benefits). To control for differences in size and composition within households, a process called equivalisation is used to adjust incomes so that they are all comparable on the same basis. These households’ entitlements to tax credits are then calculated both before and after the Summer Budget policy changes, and the change in household income attributed to households in each decile.

28. At Summer Budget 2010, HM Treasury published analysis showing that even after the fiscal consolidation in both this and the 2010-2015 parliament, public spending disproportionately benefits the poorest households. Chart 2 shows that around half of all spending on welfare and public services is still going to the poorest 40% of households.
Impact on protected groups

29. Households that include someone with a protected characteristic (as defined by the Equality Act 2010) will be affected by this policy if they receive tax credits. Overall those groups who are more likely to be in receipt of tax credits are more likely to be affected by this policy change.

Life Chances

30. The new Life Chances legislation (incorporated into the Welfare Reform and Work Bill) proposes to remove a number of the legal duties and measures set out in the Child Poverty Act 2010 and to place a new duty on the Secretary of State to report annually on children in workless households and the educational attainment of children. This is because evidence shows these to be the two main factors leading to child poverty now and in the future (respectively).

31. Parental worklessness and low earnings are main factors in restricting a child’s future life chances. The package of changes announced at Summer Budget, including the new National Living Wage, increases in the income tax personal allowance and changes to put the tax credits system on a more sustainable footing are designed to ensure that families on low or no income with children will have incentives to progress and that work will always pay more than a life on benefits. This will support improved life chances for children in the longer term.

32. The Government has carefully considered the impact of individual policy changes, including the effect on individuals, in line with its current legal obligations.