Tax & the Family

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Analysis Paper

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Is the Income Tax burden fairly shared in 2022/23?

Analysis That Examines Who Bears The Heaviest Income Tax Burden

Is the Income Tax burden fairly shared in 2022/23?

1. Tax is a key political issue. To get the economy growing do taxes need to be cut? Or do they need to be increased to deal with the hole in the government's finances? This paper examines which households are bearing the heaviest income tax burdens in England, Wales, and Northern Ireland[1] in 2022/23. It updates and extends a similar analysis for 2021/22.

2. Income tax accounts is the biggest tax. It it accounts for 25% of all tax revenue. National insurance contributions, a tax on income by another name accounts, for a further 15%. Taxes on incomes therefore account for 40% of all revenues. It is very important that these taxes in particular are fair. Income tax is overwhelmingly paid by those with the largest incomes. The top 10% of income taxpayers (those earning over £50,000) pay 60% of all income tax. The top 1% (those earning over £160,000) pay a quarter of all income tax[2]. 40% pay no income tax, at all. Does this mean that the tax burden is shared fairly? The answer depends on how income is measured.

How income is measured

3. For income tax purposes, income is measured on an individual basis, For benefits income is measured on a household basis. This is also how successive governments have measured income, when income inequality is measured or when they count the number of children in poverty the answer. The most frequently used measure of poverty is household income below 60% of median. When household income is used, a £50,000 household could well be in the poorer half of the population[3]. They are not "rich" and are unlikely to be in the top 10%. Because Income tax only takes account of individual income, low earnings do not necessarily mean a low standard of living or low household income or high earnings a high standard of living.

4. There are two ways of measuring household income - one is before housing costs (BHC) and the other is after housing costs (AHC). When household income is measured before housing costs benefits are counted as income. The Department of Work and Pension's (DWP) annual survey of household incomes is the foremost source of

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[1] The figures will be different for Scotland . Income tax rates and benefits are different in Scotland.

[2] IFS website

[3] Our modeling suspects that a couple with two children could be in the fourth decile.

information about household income and inequality. It is also the basis of the Institute for Fiscal Studies annual analysis of living standards, poverty, and inequality and the Office of National. Statistics analysis of the household incomes. The latest figures are for the year 2020/21[4]. The results are based on a survey of 19,000 households. The survey captures household net income, disposable income, in other words, the amount of income a household has to live on each week after tax, national insurance, and benefits are taken into account. Because its purpose is to measure living standards it takes account of the number of people in the household and their ages. Household disposable income, adjusted for household size and composition, is taken as a "proxy" for material living standards. Incomes are adjusted to take account of the fact, for example, that a couple with two children will usually have a significantly lower living standard than a single adult with the same income.

5. There was a reduction in median household income between the tax years 2019/20 and 2020 /2021, both before housing costs (BHC) and after housing costs (AHC). The reduction represented a decrease in real terms of 1.7% (BHC) and 1.4% (AHC). The percentage of individuals in relative and absolute low income decreased both before and after housing costs in 2021. The DWP say that none of the changes reported in the headline measures between 2020 and 2021 are statistically significant. Changes in the low income measures are, we are told, subject to more uncertainty in 2021 due to the impact of the coronavirus pandemic on survey data collection. They are however the best available source for household incomes.

6. The DWP uses a modified OECD equivalisation scale when measuring incomes before housing cost (BHC) and a DWP variant of this scale when measuring incomes after housing cost (AHC).[5] The government statisticians work on the basis that a single parent with two children under 14 needs 70% more disposable income an a single adult to have the same standard of living after housing costs are taken into account, a couple with two children to almost two and a half times as much, with three children two and three quarters times as much and with four children more than three times as much. [6]

Before Housing cost incomes

7. The Treasury published along with the 2022 Spring Statement a table showing the gross income five different households needed to be in

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4 Households below Average income for financial years ending 1995 to 2020, published 25 March 2021.

5 For more information on the methodology see Living Standards, poverty, and inequality UK: 2020 Appendix A IFS July 2020.

6 The adjustment factors are slightly different when measuring BHC income.

each decile in 2021/22 based on the latest (2019/2020) available figures for household incomes before housing costs. [7] Gross income for this purpose is defined by the Treasury as earnings plus benefits. This showed that a household consisting off 2 adults and two children needed a gross income of £52,200 to be in the fifth decile whereas a single adult with no children would be in the ninth decile (top 20%) Their income tax liabilities could be the same.

8. Using the official DWP adjustment factors the table shows the disposable weekly income six different households will need in the current tax year (2022/23} to be in each decile of the income distribution before housing coats based on the latest available information [8].

Table 1

Weekly earnings of households with median gross income (BHC) in each decile in 2022/23

	1 adult	1 adult 1 child	1 adult 2 children	2 adults	2 adult 1 child	2 adults 2 children
top decile	883	1146	1410	1318	1581	1845
ninth	629	817	1005	939	1127	1315
eight	515	669	822	769	922	1076
seventh	442	574	706	660	729	924
sixth	386	502	617	576	692	807
fifth	337	437	538	503	603	704
fourth	295	383	471	441	529	617
third	255	332	408	381	458	534
second	212	275	338	316	380	443
bottom	141	183	225	211	253	294

9. Using our tax benefit model tables the table below shows the approximate pre-tax incomes (income rounded to the nearest £1000)

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7 Impact on households HM Treasury March 2022

8 The assumptions made are that the couples are entitled to the marriage allowance, universal credit is claimed, and all the children are under 14 and born after 2017. Tables showing the gross incomes with benefits included and the equivalent figures for where the households are paying rent equal to the local housing allowance in Leeds.

six households will need in 2022/23 to be in each decile of the income distribution based on the latest available information [9]. The figures take account of national insurance contributions and benefits.

Table 2

Annual earnings of households with median gross income in each decile in 2022/23

	1 adult	1 adult 1 child	1 adult 2 children	2 adults	2 adults 1 child	2 adults 2 children
top decile	65,000	89,000	115,000	106,000	133,000	157,000
ninth	43,000	59,000	76.000	71,000	87,000	105,000
eight	34,000	45,000	59,000	60,000	69.000	83,000
seventh	27.000	37,000	46,000	49,000	49,000	69,000
sixth	25,000	32,000	40,000	41,000	40,000	58,000
fifth	21,000	28,000	36,000	34,000	34,000	46,000
fourth	17,000	23,000	25,000	29,000	29,000	40,000
third	14,000	14,000	15,000	25,000	17,000	30,000
second	12,000	6,000	6,000	19,000	15,000	14,000
bottom	8,000	1,000	nil	11,000	3,000	1,000

10. It seems that in the current tax year a household consisting of two adults and two children will need to earn £46,000 to be in the fifth decile whereas a single adult without children would need to earn only £21,000 to be in the fifth decile. A single adult with one child would need to earn £28,000 and with two children £36,000. Because tax liabilities are based on individual incomes the tax bills of these six households will vary.

11. For example, in 2022/23 for example 2 adults with two children in the fifth decile and not getting any help with their housing costs an average standard of living will probably be paying £6,444, whereas a single adult would pay £ 2,618, a couple with no children £ 4,035 a

[9] The assumptions made are that the couples are entitled to the marriage allowance, universal credit is claimed, and all the children are under 14 and born after 2017. Tables showing the gross incomes with benefits included and the equivalent figures for where the households are paying rent equal to the local housing allowance in Leeds.

single adult with one child £ 3,086 and with two children £4,692. Income tax liabilities have become detached from well off taxpayers are. This has resulted from the cumulative decisions of successive Chancellors. These figures take account of universal credit where appropriate. For modeling purposes we assumed no housing element.]

After housing cost incomes

12. Most economists believe that AHC figures are better indicators of living standards than BHC figures. BHC income includes housing benefits and universal credit payments, which may cover a substantial part of a household's housing costs. A £10 increase in rent might trigger a £10 increase in BHC income but no increase in the amount the family has to live on -its' disposable income. AHC income is also more appropriate when comparing households that own their home outright with those that do not. AHC is also a better measure when mortgage costs fall. In this paper, all subsequent figures are AHC unless stated otherwise.

Households with a median income

13. Table 3 below shows the annual earnings the six households appear to need in 2022/23 to have median household income after housing costs are taken into and there is not help for these costs. Housing costs are assumed to be equal to the local housing allowance in Leeds.

Table 3

Households with median income 2022/23 no housing element

Household	Earnings	Income tax
Single no children	£25,289	£2,544
Single two children	£39,944	£ 5,485
Married couple no children (one earner)	£31,286	£3,493
Married couple no children (two equal earners)	£25,759	£124
Married couple two children (one earner)	£59,756	£11,320
Married Couple two children (two equal earners)	£49,744	£2,952

14. Table 4 below shows the same information where the households are paying rent equal to the local housing allowance in Leeds and claiming universal credit

Table 4

Households with median income 2022/23 housing element included

Household	Earnings	Income tax
Single no children	£25,289	£2,544
Single two children	£28,835	£3,253
Married couple no children (one earner)	£31,755	£3,837
Married couple no children (two equal earners)	£35,040	£1,980
Married couple two children (one earner)	£59,584	£11,418
Married Couple two children (two equal earners)	£48,849	£4,942

The same information in charts

Chart 1

Gross incomes required by renting households to have a median income

Income tax payable in 2022/23 by renting households all of whom have a median income

15. Income tax liabilities are unrelated to living standards. Larger households need more disposable income to have the same standards of living than smaller households. They may need to earn more and as a result pay more tax. Income tax takes no account of household size. Universal credit does but even when universal credit is due and rent qualifies for credit a couple household with two children may need to earn more than twice as a much as a single adult without children and as a result pay more than four times as much tax, Even with two equal incomes they will need to earn twice as much although in this case their tax liabilities will be similar.

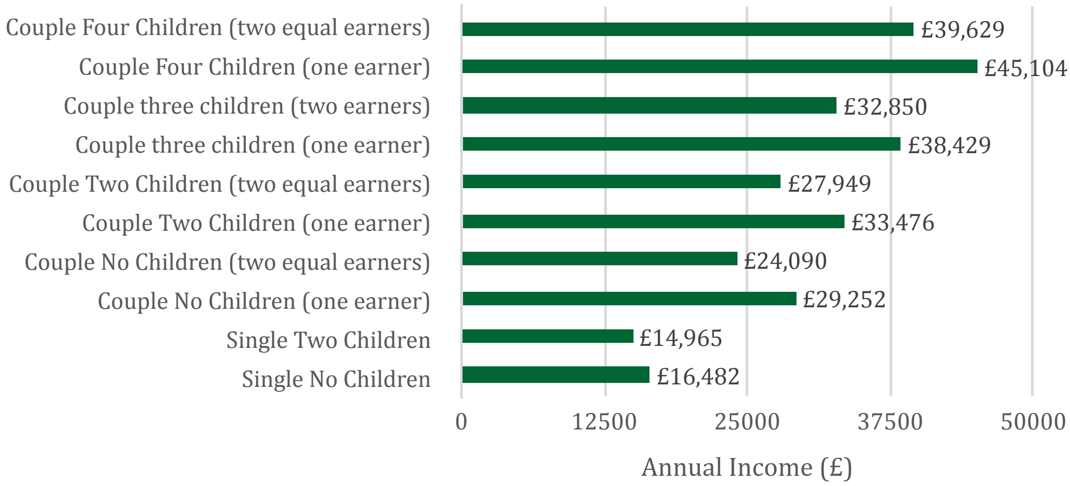
16. Single parents also have to earn more to have the same living standards as a single adult without children and pay more tax. A single parent paying rent equal to the local housing allowance in Leeds could be paying over £5000 in income tax whereas a single adult without children could be paying half this amount.

Households with 60% median household income

17. Chart 2 below shows annual earnings ten households who are owner occupiers appear to need in 2022/23 to have household income after housing costs equal to 60% median. To enable comparisons to be made these examples assume the mortgage interest payments are equal to the local housing allowance in Leeds, which a renting household entitled to universal credit, would get. The allowance for a three-bed house is £161 week. Assuming a 6% mortgage rate this implies a loan of about £140,000.

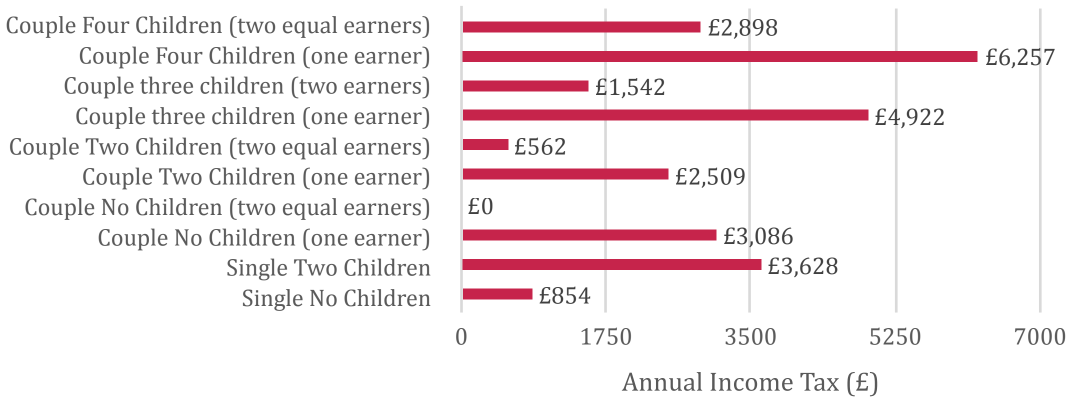
CHART 2

Gross income required in 2022/23 by households with a mortgage to have 60% median income



18. **CHART 3** shows the income tax these households which are regarded as being on the poverty line would pay.

Income tax paid income in 2022/23 by households with a mortgage to have 60% median income



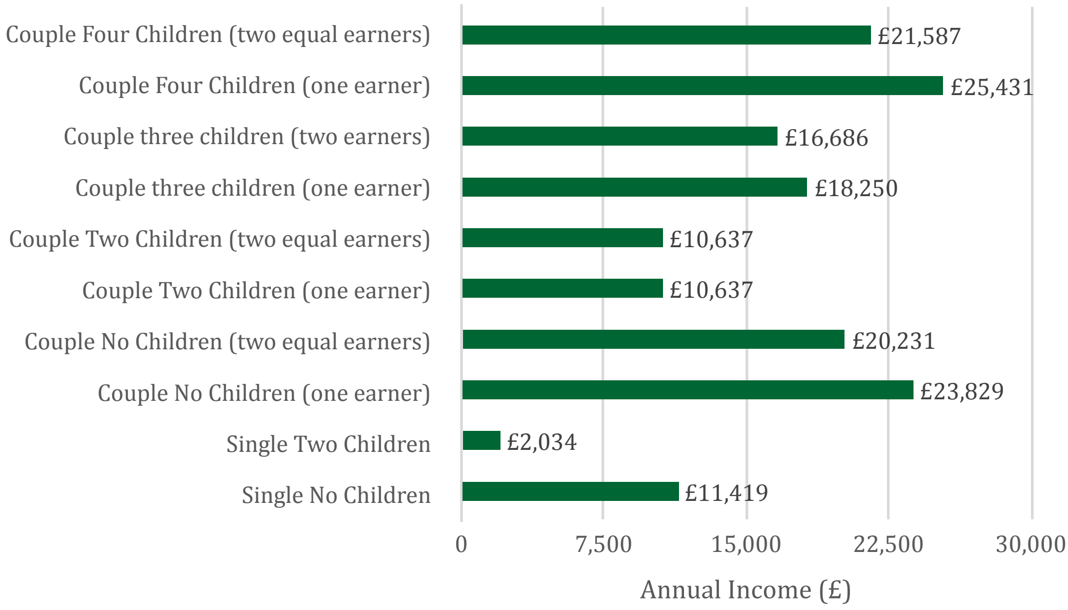
19. The pre tax required to be above the "poverty line" vary considerably. A one-earner couple with four children needs to earn over £45,000, with three children over £38,000 and with two children over £29,000 with the result that their income tax payments also vary. The couple with four children pay over £6,000, with three children almost £5,000 two children £2,500. A single parent with two children and a mortgage could be paying £3,600.

20. Three of the households are entitled to universal if they qualify, for example if they have no savings A Single parent with two children gets £5899, a one earner married couple with two children £1134 and with two equal incomes £1127. The single earner couple with income below the "poverty line" pays more in tax than they receive in universal credit. Seven of the 10 households modeled are not paying tax and getting universal credit. For households with children universal credit phases out between £30,000 and £40.000. Households paying income tax and nick as well as getting universal credit have an effective marginal tax rate of 69%.

21. Chart 4 below shows the gross incomes these 10 households appear to need in 2022/23 to be above the "poverty line" if they are renting and entitled to the local housing allowance in Leeds.

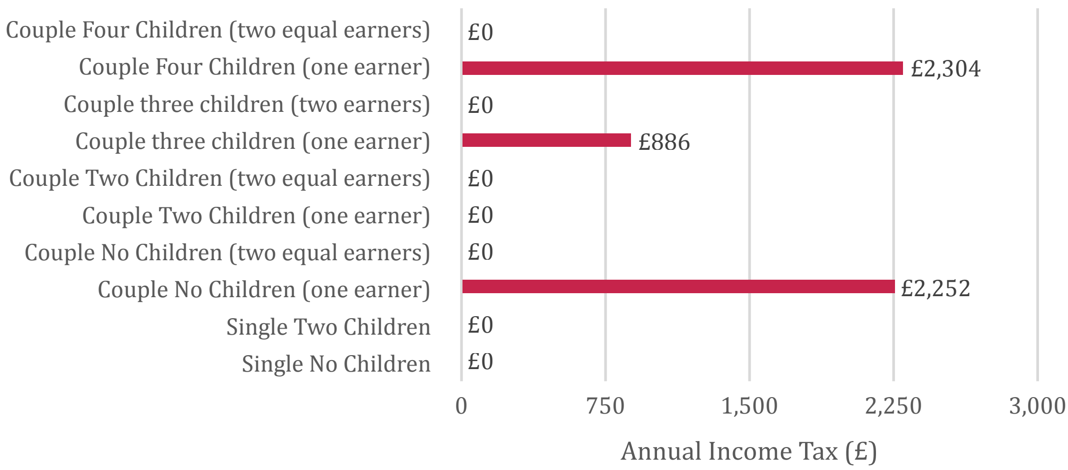
Chart 4

Gross income required in 2022/23 by households paying rent a



22. Chart 5 shows the tax they are likely to be paying

Chart 5
Income tax paid income in 2022/23 by households paying rent and a 60% median income



23. The pre tax required to be above the "poverty line" is lower for renters than mortgagees and as a result their income liabilities are lower. . Un A one-earner couple with four children needs to earn just £25,000 whereas with the same housing they need £45,000. They are probably paying only £2,300 in tax compared to £6000 with three children over £38,000 and with two children over £29,000. With three children they

pay less than £1000 and with two children no income at all, Neither would a single parent with two children.

24. Income tax cannot be looked at on in isolation. In considering the tax burden universal credit and the legacy benefits must be taken into account. Tax and the Family does not have a view as to whether the treatment of housing costs within universal credit is right, many will argue that the last thing the country needs is a further inventive for house purchases.

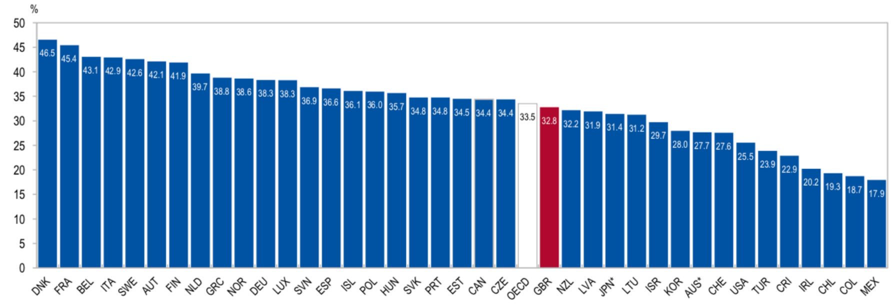
25. However, it is essential to recognise that households with quite high incomes may be below the poverty line or close to it. A married couple with four children and a mortgage earning £50,000 could be in the lease well off 40% not far above the poverty line. They are close to becoming higher rate taxpayers, in Scotland they will be, and liable to the high-income child benefit charge. Paying rent they will be much better off if claiming universal credit but they would have an effective marginal tax rate of 69%. When rent is included Universal credit does appears not run out for a one-earner couple family with two children until their earnings reach £56,000. A further problem, which is almost invariably ignored, is that families claiming universal credit get only half the benefit from income tax cuts although of course they are to same extent protected from increases in income tax. Income tax and universal credit need to be considered together.

Overall tax burden

26. Under current government plans, tax revenue is forecast to rise to 35.0% of **GDP** by 2025–26. If this happens, it will represent the highest sustained level of tax seen in the UK since the aftermath of the Second World War (tax revenue reached 35.1% of **GDP** for a single year in 1969–70 but fell sharply to 33.7% in 1970–71). While 35% of **GDP** would be high by historical standards, the UK would continue to have middling levels of taxation by international standards.[10] See OECD chart below

[10] IFS website November 2022

Tax to GDP ratio 2019



* Australia and Japan are unable to provide provisional 2020 data, therefore their latest 2019 data are presented within this country note.

The differences between tax-to-GDP ratios shown may not sum correctly due to rounding

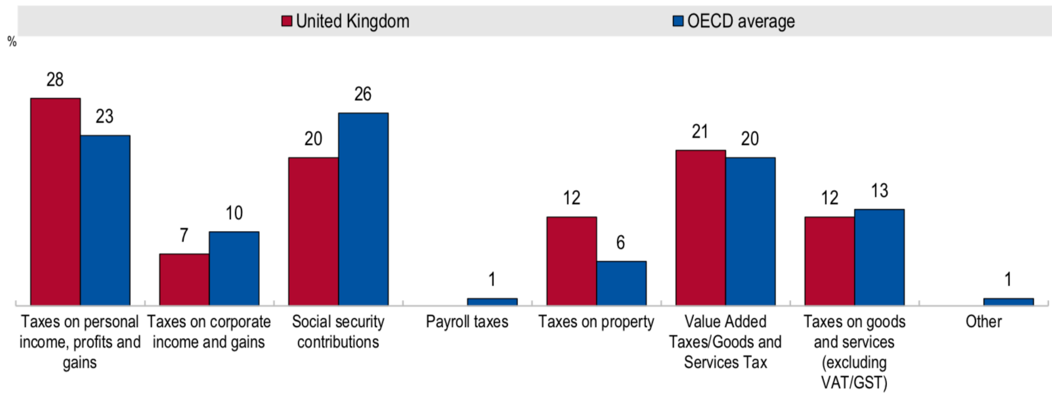
In the OECD classification the term "taxes" is confined to compulsory unrequited payments to general government or to a supranational authority. Taxes are unrequited in the sense that benefits provided by government to taxpayers are not normally in proportion to their payments.

27. Tax revenues are closely related to economic activity, rising during periods of faster economic growth and declining during recessions. As a percentage, tax revenues generally rise and fall faster than GDP, but the ratio tends to stay relatively consistent barring extreme swings in growth. It is difficult to make an argument for tax cuts on the grounds that the tax burden in the UK is significantly higher than in other comparable countries. There are however significant differences.

28. First in this country taxes on personal incomes form a bigger share of tax revenue than they do in other OECD countries. Income tax inequities are therefore important and need to be addressed. Social security contributions are lower. See the following chart.

Tax structure compared to the OECD average, 2019

The structure of tax receipts in the United Kingdom compared with the OECD average is shown in the figure below.



Relative to the OECD average, the tax structure in the United Kingdom is characterised by:

» Higher revenues from taxes on personal income, profits & gains; property taxes; and value-added taxes.

» A lower proportion of revenues from taxes on corporate income & gains; social security contributions; and goods & services taxes (excluding VAT/GST).

29. Whilst the combined burden of income tax and social security contributions may not be very different in the UK from the OECD average this does not appear to be the case for all households. The report on the taxation of families in 2021 compared the "average tax rates" (income tax, plus employee social security contributions less

cash benefits). For a single person without children the combined burden was at all income points just below the OECD average (see Table 4.1) and broadly the same for a one-earner married couple without children (Table 4.1). For both a single person with two children and a married couple with two children the burden was higher (Table 4.4). For a married couple earning an average wage the two taxes reduced their income by 18.3% in the UK, the OECD average was 13.3%. The international case for reducing the tax burden on households with children is strong even when social security contributions are included.

30. It is even more so when income taxes are looked at on their own. The Report on the Taxation of Families in 2021 compares the income tax burdens (see Chapter 3). For both single parents with two children and one-earner married couples with two children the tax burden is significantly higher than the OECD average and much higher than in France, Germany and the US. At 75% of the average wage (in the UK £31,355) the couple family would not be paying any income tax in Germany and the US,. In the UK they paid 11.2%.

Looking ahead

Tax system

31. Both the income tax and higher rate thresholds are frozen for four years. These freezes are forecast to raise £30 billion and reduce household income on average by an average of £1250. [11] This is more than twice the amount of the gain that households would have had if both the cut in the basic rate and the reduction in national insurance contributions had gone ahead.

32. As a result of these stealth tax increases a million more people will be paying income tax and 1.6 million more will be paying income tax. By 2025-26 3% of adults will have some of their personal allowances withdrawn and 760,000 will pay additional rate (45%) tax. The IFS say this is triple the equivalent number in 2010 when the relevant thresholds were introduced.

33. The £50,000 High Income Child Benefit threshold has also been frozen. The IFS say 26% of families with children (2 million) are now loosing some or all of their child benefit – double the proportion when the charge was introduced. This number is set to rise to 3.1 million in 2025-6Millions more are set to be paying higher tax rates The higher rate threshold in England, Wales and Northern Ireland is currently £50,270 and in Scotland £43,622. As the analysis above shows a married couple with two children will only just be in the better off half of the population and in Scotland they will be in the least well off half.

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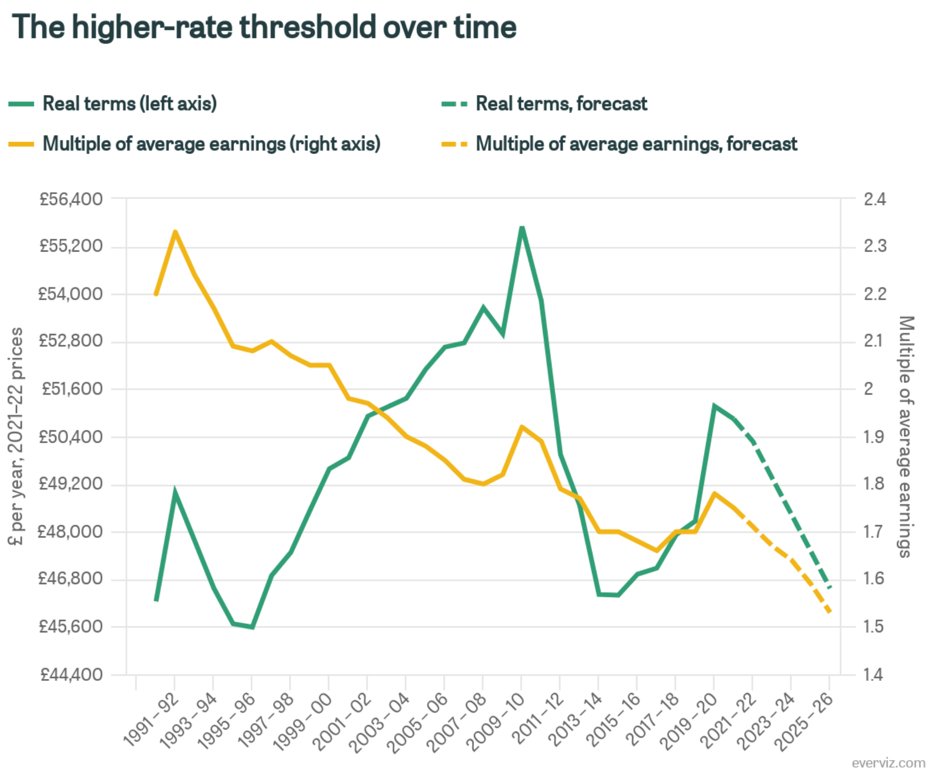
11 IFS Reforms, rollouts and freezes October 2020

Families who not well off are paying higher rate tax and may in addition be subject to the High Income Child Benefit Charge than the government could have expected when income tax thresholds were frozen in Aril 2021.

34. The the chart below which has been obtained from the House of Commons Library shows the real level value of the higher rate threshold has varied over time and is considerably lower than it was when independent taxation was introduced. The House of Commons library was saying even in January that this would result in an extra 1.2 million people will be paying higher rate tax than if the threshold had been raised to £56,270 in line with the then inflation forecast.[12]



Benefit system

35. The tax and benefit system are linked although politicians often talk as if they are completely separate. For the increasing number of working families who both pay tax and are entitled to universal credit (or the legacy benefits) what matters is their disposable income i.e. what they have to live on after tax and benefits are taken into account.

36. Cuts in tax or nic contributions result in a loss of universal credit. Because of the overlap these families have an effective marginal rate of 69% - far higher than that applying to the highest earners. A non-earner going into paid work has an effective tax rate of 55% even if

12 Telegraph Twitter thread.

they earn less than the income tax and nic threshold. For those who know the figures there is little incentive for a non-working partner to move into paid work even before childcare costs are taken into account. With an effective tax rate of 69% it is very difficult, if not impossible, for families to do anything about their finances by earning more.

37. Universal credit does not just apply to households with very low incomes. Even when there is no housing element universal credit phases out at £36,500 for a one-earner couple with two children. If a housing element is involved credit may run up to £56,000.[13]

38. On current plans the UC rollout will be finished by the end of 2024 at which point it will be received by 7 million families[14] There will be both winners and losers. The DWP has estimated that 600,000 families will receive transitional payments. A family in receipt of tax credits gets extra benefit (currently worth £2,935 per year). The great majority of families do not get this benefit for a third or subsequent child born on or after 6 April 2017. When fully rolled out in the mid 2030s this restriction will affect 750,000 households each losing £3,600 per year.[15]

39. The family premium is also being phased out. In the past recipients of tax credits and universal credit received A £545 annual premium. This is now only available to families where the oldest child was born before 6th April 2017

Conclusion

40. The tax burden is rising to an historic high. Family finances are already under severe pressure. As recent events have shown unfunded tax cuts are an unreasonable expectation. This is all the more reason for ensuring that we share the tax burden between ourselves as fairly as possible, that people with th broadest shoulders do bear the heaviest burdens.

41. The figures in this paper show that families, that is households with children bear, by some margin, the heaviest burden. To take just one example a family with two children and an average standard of living is likely this year to be paying over £6000 in income tax whereas a household without children could be paying less than £3000 (see paragraph 11 above).

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13 Assuming a local housing allowance of £161 per week – allowance for a three bedroom house in Leeds.

14 Op cit.

15 Op cit.

42. Taxes on income – income tax and national insurance contributions – account for almost a half of all tax. If these taxes do not take account of how well off taxpayers are there is very little chance of ensuring that the least well off households do not end up bearing the heaviest burdens.

43. National insurance contributions are not going to change although many economists have argued for this tax to be aligned with income tax. Income tax is therefore the only option if we want to ensure that those least able to do so carry the lightest burden. It will be too difficult to base income tax on household income but when it does become possible to cut income tax the cut should be targeted at the type of households who are currently bearing the heaviest burdens. This would not be inconsistent with independent taxation. It is essential that this should take priority over a cut in the basic rate or an increase in the threshold both of which would benefit mainly households who have relatively light burden given their household size.

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