

A research project for the Citizen's Income Trust

The aim of the project: To test whether it is possible to revise the tax and benefits system in such a way as

- 1) to increase employment incentives and make nobody worse off for household gross earnings up to £750 per week for families with children and up to £450 per week for single adults without children;
- 2) to considerably reduce administrative complexity by scrapping Working Tax Credits and Child Tax Credits
- 3) and to do by it making as few other changes as possible to the current system.

The method:

I took three family types:

- a) Single adult, no children, local authority tenant (working 40 hours per week)
- b) Lone parent, two children under 11, local authority tenant (working 16 hours per week)
- c) Couple, with two children under 11, private tenant (working 40 hours per week)

I have used the spreadsheet employed by the Department for Work and Pensions to construct their Tax Benefit Model tables to calculate net incomes after housing costs for gross earnings between £20 and £1,200 per week for a variety of schemes for each of the household types a) to c) and have compared those net incomes with net incomes under the current system.

The scheme which provides the closest fit with the criteria 1) to 3) above is as follows:

I have scrapped Working Tax Credits and Child Tax Credits and replaced them with Citizen's Incomes of £60 pw for each adult and £31.59 pw for each child (in addition to Child Benefit). (A Citizen's Income is an unconditional, nonwithdrawable income paid to each individual as a right of citizenship)

Income tax is collected on all earned income as follows:

From £0 to £20,000 pa, 20%

From £20,000 to £40,000 pa, 35%

Above £40,000 pa, 40%

I have removed the Lower Earnings Limit for National Insurance Contributions, and also the Upper Earnings Limit (but see below)

I have reduced the Housing Benefit taper from 65% to 40%

The graphs show the results. The steeper curve resulting from the revised scheme indicates higher employment incentives, particularly for the couple with children.

(Note that because a National Minimum Wage is paid, the first £232 of the gross earnings range can be ignored in the case of the couple and the single adult and the first £93 for the lone parent.)

All three graphs show net income under the revised system diverging from net income under the current system as gross earnings rise towards the right hand side of each graph. This is because for the purpose of the project I have removed the National Insurance Contribution Upper Earnings Limit so 11% National Insurance Contributions are now paid on all earned income.

A political decision will be required to determine whether and where a new Upper Earnings Limit should be established. If there is no Upper Earnings Limit then the revised scheme will save money. If a low Upper Earnings Limit were to be established then the scheme would cost money. Somewhere along the gross earnings range there will be an Upper Earnings Limit which will enable the revised scheme to break even.

The Chancellor will therefore have available a simple mechanism for regulating the cost of the scheme.

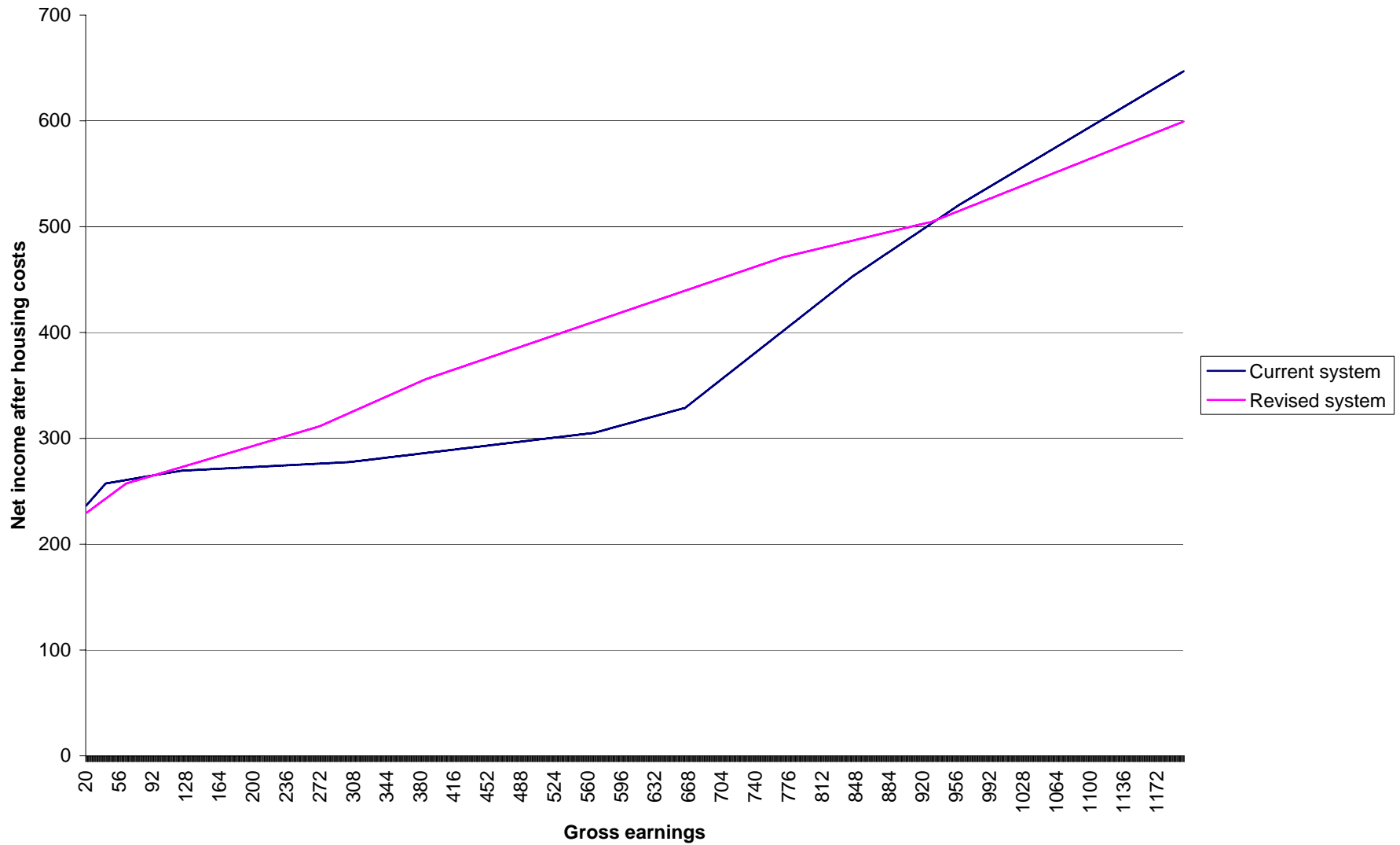
Conclusion

By replacing tax credits with a Citizen's Income, and by making a few other minor changes, the tax and benefits system can be amended to increase employment incentives across substantial earnings ranges for a variety of household types.

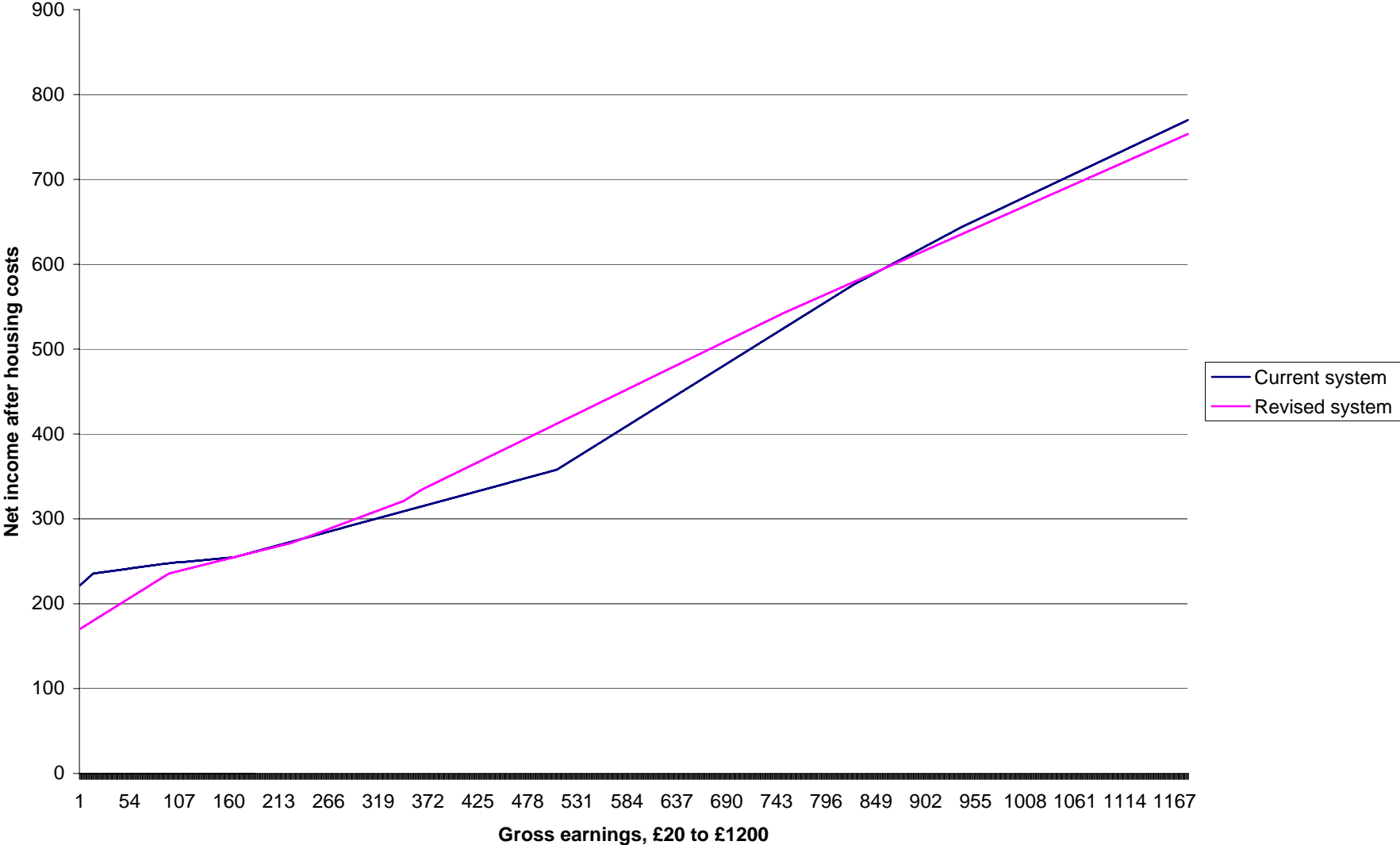
Malcolm Torry, January 2010

I am grateful to the Department for Work and Pensions for providing me with the spreadsheet which they use to calculate their Tax Benefit Model tables.

Couple, 2 children, private tenant



Lone parent, 2 children, LA tenant



Single adult, no children, LA tenant

