

Benefit simplification

How, and why, it must be done

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CONTENTS

Summary	
1. Introduction	1
2. The consequences of complexity	7
3. Marginal deduction rates	14
4. An integrated system of means-tested benefits	17
5. Summary of principal benefits	19
6. Creating an integrated system	29
7. Tax and benefits	47
8. Concluding remarks	49
Appendix 1: detailed description of main means-tested benefits	50
Appendix 2: removing overlaps	63
Appendix 3: integrating tax allowances and benefits	65
Bibliography	69

SUMMARY

- The great complexity of the UK benefit system damages both claimants and taxpayers:
 - It reinforces the poverty trap. High marginal withdrawal rates (which can be as high as 95.5%) and uncertainty over the impact on future benefit entitlement means that claimants may feel that it is not worth their while to take a job.
 - It is next to impossible for claimants to know or to calculate accurately their own entitlements.
 - It is inefficient. Claimants can often apply for many different benefits which have different thresholds, rules, payment periods, forms and decision-making processes.
 - It increases the risk of errors, overpayments, and fraud.
 - It deters many claimants from making valid claims while encouraging those who wish to play the system to maximise their income.
 - It puts the decision on benefit levels, and benefit expenditure beyond effective democratic scrutiny.

- Expenditure on the main benefits analysed in this paper is expected to be roughly £150 billion this year (see Table overleaf). This is equivalent to a quarter of total government spending (Total Managed Expenditure).
- The complexity of the current system means that it is next to impossible to control the level of this spending
- An integrated system will allow much of the current complexity to be eliminated – and for the level of spending on the main benefits to be more amenable to democratic control.
- An integrated system would involve creating a single agency to offer a localised and complete service in which many claimants would become personally known. Having a single entry point and point for reporting changes in circumstances would have the following advantages:
 - Increase efficiency. A single agency would make all relevant decisions and it would have the ability to handle cash transfers (e.g. to and from local authorities) or to advise HMRC of appropriate adjustments to PAYE codes to give effect to benefits.
 - Increase transparency.
 - Reduce the scope for fraud.
 - Simplify the rules. A single agency could ensure that all benefits for eligibility conform with one another.
 - Eliminate the overlaps between various benefits.
 - Combine various benefits.

- Features of an integrated benefit system would include:
 - A single form for all benefits.
 - A single website so that claimants could see how their net income would be affected if they took on a job or worked longer hours or accepted a pay rise.
 - A local office at which claimants could settle all benefit claims.
- The advantages of an integrated benefit system would be many:
 - People would be spared much of the time-consuming and energy-sapping effects of the current system.
 - It will reduce the poverty trap.
 - It will be possible for government to increase or cut the overall level of expenditure on benefits with a clearer understanding of the impact such changes would have on households.
 - It will be possible for the overlap of tax, national insurance contributions and benefits to be addressed in a simpler and clear way, further reducing the poverty trap.

EXPENDITURE ON PRINCIPAL BENEFITS

Benefit	Expenditure (£ billions)	Note
Income Support	14.68	(1)
Jobseeker's Allowance	5.86	(2)
Employment Support Allowance	1.14	
Housing Benefit	19.63	
Council Tax Benefit	4.65	
Working Tax Credit	5.92	(3)
Child Tax Credit	15.68	(3)
Retirement Pension	67.2	
Pension Credit	1.38	
Child Benefit	11.8	(4)
Disability Living Allowance	1.39	
Attendance Allowance	5.09	
Carer's Allowance	1.50	
TOTAL	£155.9	

Notes

1. All data are forecasts for 2009/10 and are for England, Scotland and Wales unless otherwise stated.
2. This includes spending on the Minimum Income Guarantee and Pension Credit.
3. Data for 2007/08 and for all UK.
4. Data for all UK.

Note that, according to the 2009 Budget Red Book, total UK spending on all social security payments and tax credits was forecast to be £186.4 billion in 2009/10.

1. INTRODUCTION

The great complexity of the benefits system in the UK is widely acknowledged to be a problem. The House of Commons Work and Pensions Committee published a substantial report in July 2007 emphasising the need for benefits simplification. Many professional bodies and charities, such as the IFS and the Child Poverty Action Group, have contributed to the debate, both before and since then. But still the system remains overly complex.

Given the wide of variety of circumstances in which people can find themselves, and the tendency of these circumstances to keep changing, it is clear that no benefits system which operates in the real world is going to be completely simple. Calculating benefits will never be without difficulties. This paper will argue, however, that the degree of complexity associated with the current system is unreasonable and unjustified. There are practicable solutions to the problem.

Discussion of benefits and their simplification can sometimes be rather abstract. Should there be a single working age benefit or a single working age system of benefits? Should the system be based on “entitlement”?

This paper puts forward a specific picture of what a simplified system might look like. The purpose is to make proposals in sufficient detail that they can be tested for their practical effects. Do proposals for simplification result in too much rough justice? Would they work? Even if a proposal is a good one, is it politically practicable? Are there too many 'winners' and 'losers'?

It might be considered that, even though the proposals may sometimes have merit, they are unrealistically ambitious. But this counsel of despair would condemn claimants, administrators and society at large to carry on living indefinitely with the serious problems of the current system, when this is not necessary.

It might also be questioned whether, in the light of the recent forecasts of public sector borrowing requirements, there are not more important matters than benefits simplification. However, while simplification is important in its own right, it is also essential as a forerunner to any serious attempt to reduce the welfare bill in the future – a bill that the 2009 Budget forecast would total £180 billion in 2009/2010.

The intention here is to help policy makers to choose which direction to take. Standing still should not be an option. Nor is setting off as in a train which carries its own track, laying it in front as the train goes forward, but without anyone on board the train having much idea where the final destination is. This paper identifies the right destination, and explains how to get there from where we are now.

The paper concentrates on means-tested benefits. It will not have much to say about the levels of benefits that should be payable, although some changes necessarily occur as a result of the simplification process. But, as mentioned, a simpler system should enable more clarity to be achieved on who is actually

getting what, so that benefit levels become more amenable to democratic control.

The historical background

The first Poor Law was introduced in 1597, and formed the basis of a relief which was administered at the local parish level until the early 19th century. The New Poor Law of 1834 was harsh by today's standards, and reflected the belief in the merits of thrift, and a reliance on the fear of the work-house. But that century also saw the growth of friendly societies, which provided an insurance-based relief for working men, who had paid their subscriptions, if they fell on hard times.

In 1908, a non-contributory pension was introduced for over 70s "of good character". But in 1911 Asquith introduced flat rate compulsory insurance contributions to protect workers for a period of up to 15 weeks against loss of earnings because of sickness, or being made unemployed. In 1921, with the prospect of large numbers of ex-servicemen who were not covered by the insurance based scheme becoming reliant on the old Poor Law, a new non-contributory benefit was introduced for the unemployed. Surprisingly, this relief could actually be more generous than the insurance based scheme.

In 1945, the Beveridge reforms introduced a new broad and insurance-based scheme. In return for a single flat rate weekly contribution there would be the right to sickness, medical, unemployment, widows, orphans, old-age, maternity and funeral benefits. However two problems should be noted. First, the costs of providing the benefits were greatly in excess of the contributions made. Secondly, it was still necessary to make provision for people who had not paid contributions, and these might still actually be more generous than contribution based benefits. Both these problems remain today.

Between 1957 and 1975, contributions became earnings-related rather than flat rate, and benefits became increasingly means-tested. Both developments flowed from the need to close the gap between the burgeoning costs of the benefits system and the contributions paid. The system became bureaucratised by the desire of Governments to create more and more specific benefits for special circumstances and to target benefits at specific groups. New policy considerations, together with the desire to correct shortcomings where benefits did not work as anticipated, have also led to constant change, refinement and complication.

For example, since 1997 the Government has introduced the Working Families Tax Credit, Disabled Person's Tax Credit, Childcare Tax Credit, Employment Credit, Children's Tax Credit, Baby Tax Credit, Child Tax Credit, Working Tax Credit, and the Employment and Support Allowance. They have abolished the Family Credit and also other benefits that they had themselves introduced – Working Families Tax Credit, Disabled Person's Tax Credit, Children's Tax Credit, Baby Tax Credit and the Employment Credit. They are also in the process of abolishing Incapacity Benefit. And these are only the most recent examples of the constant churning and revision of benefits over many years.

There are now more than 50 benefits, mainly administered by three different agencies – Department of Work and Pensions (DWP), HMRC and local authorities. Other departments are also involved – such as the Department for Children, Schools and Families (DCSF), which pays for free school meals, and the Department of Health, which funds certain health benefits. These less fundamental benefits are given only brief attention in this paper.

The different benefits are complicated. They overlap and they confuse. And there seems to be little regard to the overall framework for the benefits system, and to how the various benefits should interact and fit within that framework.

The extent of complexity

The DWP issues a total of 14 manuals, with a total of 8,690 pages, to its decision makers to help them to apply DWP benefits. A separate set of four volumes totalling over 1,200 pages covers Housing and Council Tax Benefits, which are primarily the responsibility of local authorities. The Tax Credits manual used by HM Revenue and Customs is a further 260 pages, even though it omits details for many relevant tax concepts which are found in other tax manuals. In addition to these encyclopaedic works is a cornucopia of circulars, news releases and guidance notes issued to professionals and claimants. The underlying legal statutes and statutory instruments make up a vast mass of further material.

Complexity also exists because of the number of separate benefits. Take a specific case of a woman with a disabled son. She had to complete ten different application forms, containing over 1,200 questions, to apply for the benefits she needed.

Complexity also exists by reason of the relationship between different benefits. Consider one small example: how does a claimant qualify for disability premium for Housing Benefit? One might think it depended on whether the claimant is disabled. But the answer to this question may depend on cross-referencing to whether the claimant or the claimant's partner is claiming Income Support or Jobseeker's Allowance, Disability Living Allowance, Incapacity Benefit at the long-term rate (or, in some circumstances, at the short-term rate), Attendance Allowance, or the old age pension. The issue may also be affected by such matters as the overlapping benefit rules. In

some cases it may even be necessary to apply for one benefit knowing it will be refused, since only then can the claimant be entitled to claim another benefit.

It is time to untangle the web.

2. THE CONSEQUENCES OF COMPLEXITY

Lack of transparency

The complexity of the system means that it is difficult to calculate a person's entitlement to benefit. There are several reasons for this.

(a) Varying rules

Under the current system a claimant may need to claim several different benefits, and the rules may differ unnecessarily for each benefit.

Different amounts of income may be disregarded, or different categories of income may be ignored. For example, notional income on capital is calculated according to a standard formula for many DWP benefits, but actual income earned on capital is taken into account for other benefits, such as tax credits.

The thresholds at which benefits are reduced when income exceeds those thresholds vary for different benefits. And the rates for the withdrawal of benefits vary for income exceeding those thresholds. The claimant, such as a childminder working from home, may be treated as working for the purposes of Working Tax Credits, but treated as not working for Income Support purposes. Or a claimant may be refused both Working

Tax Credits (because HMRC, applying their own rules, say that the person is not in work), and also be refused Income Support and Jobseeker's Allowance (because the DWP applying their own rules, say that the person is working). Such inconsistencies can arise where the person is for example on temporary sick leave, studying, working variable periods, (such as term-time working) or taking paid lunch breaks, all because different benefits have different rules.

One further point is that while many benefits are calculated on a weekly basis, other benefits, such as tax credits, are calculated on an annual basis.

The reasons for these differences, to the extent that they exist, are rarely made explicit.

(b) Benefits overlap

Benefits overlap, because different benefits can be affected by the same circumstances. For example the amount of Housing Benefit, Council Tax Benefit and Child Tax Credits, as well as Child Benefit, all depend on the number of children.

There are many special rules where more than one benefit might apply to determine whether both are available at the same time, or whether one takes precedence, or whether the claimant can choose between them. If there is a choice, the claimant may have to make a comparison between the different conditions that need to be complied with to receive the different benefits.

Complicated calculations may also be necessary to decide which one is the most financially advantageous to apply for. These calculations may need to take into account that some "primary" benefits act as a passport to other benefits (eg free school meals). These may not be available if a different primary

benefit is chosen. The choice may be made more complicated if the claimant is deemed to have paid NICs if one benefit is claimed, but not if an alternative benefit is claimed.

(c) Individual complexity

Some benefits – such as tax credits – are extremely complex in their own right. Even where claimants are only entitled to just one benefit, many will be uncertain how much they should receive.

Inefficiency

(a) Multiple form filling

Applying for a number of different benefits often means completing a number of different forms. The forms need to be separately processed, perhaps by different agencies. The questions asked on the forms may seem similar, but subtle distinctions in the wording may create doubts as to whether the answers should be the same. There are different and highly complex rules for such matters as back-dating claims, or making payments pending final resolution of claims, or changes of circumstances (which may involve different agencies).

(b) Different decisions

Different agencies may reach different decisions on the facts – for example whether a couple is cohabiting, or whether a claimant has voluntarily deprived himself of capital. The claimant, caught in the middle of such disputes, suffers the extra anxiety and complication of resolving them between the different agencies.

(c) Delay

The complexity can cause delays in making payments, which can be a significant cause of hardship.

Reinforcing the poverty trap

(a) High withdrawal rates

The first aspect of the poverty trap is a straightforward consequence of the financial calculation. The increase in spending power as earnings increase may be very small as benefits are withdrawn, or there may even be a decrease. This is particularly true if at the same time more income tax and NICs become payable. Currently, for example, a claimant who loses Housing Benefit, Council Tax Benefit, and tax credits for each extra pound of income, at the same time as paying income tax and NICs on that extra income, has an effective marginal rate of 95.5%.

(b) Uncertainty

In practice, complexity also tends to trap claimants in relative poverty. This is because a person entitled to many benefits may succeed in negotiating the system to reach a stable position in which income, even though not very high, is at least known and regularly received. In this case, they may well feel that it is very difficult or impossible to improve their position because any new earnings or changes would precipitate too much uncertainty. For many claimants it is practically impossible to understand how much extra cash they will have in their pockets if their income increases as different benefits are withdrawn and as tax also becomes payable. The position is worse when it is also uncertain how the decision maker will apply the rules. In effect the system has them trapped: they cannot afford to take steps which would risk their benefit position unravelling in ways that cannot be foreseen.

Errors and costs

A complicated system increases the risks of errors and associated costs. For example The House of Commons Public Accounts Committee has described the tax credits system as a

“nightmare” and “frustratingly arcane”. It believes the system may be too complex to implement properly. Overpayments were made to nearly two million families per year and used to amount to approximately £2 billion each year. This has now been alleviated somewhat by basing credits for one year on the income of the previous year while ignoring increases in income of up to an incredible £25,000 a year. At this point it is obvious that many claimants no longer need the benefit, even though they are legitimately entitled to receive it.

Another example is that it is estimated that £400 million a year is overpaid in Housing Benefit, due to official or claimant error.

Creating opportunities for fraud.

Fraud is widespread. Notwithstanding recent improvements this is particularly true of the tax credits system, and, to a lesser extent, Housing Benefit.

The potential for fraud is increased where separate benefit agencies only have a loose grip over the relevant circumstances of claimants. This includes the fundamental issue of whether they exist under the identity supplied. Computerised systems and computerised applications for benefit, with no personal contact, exacerbate the risks.

Lack of integration with income tax

Benefits can be regarded as “negative income tax”. A satisfactory benefits system should operate so that the combined effect of tax and benefits is to produce a sensible and fair result. The large number of separate and complicated benefits means that it is next to impossible to see whether this happens. Tax is often payable at the same time as benefits are received. While this may sometimes be unavoidable, the bureaucratic churning of funds with no net effect may not always be necessary.

The principle of independent taxation now applies so that (although there are some exceptions) a man and a wife are separately taxed without regard to the circumstances of their spouse. It is almost inevitable, however, that means-tested benefits may need to be calculated by reference to the circumstances of a claimant's partner or perhaps other members of the claimant's household. This applies to any benefit which is restricted by reference to income or capital. There is no clear model giving a coherent relationship between tax and benefits for couples.

Benefits depend too much on other benefits

The amount of one benefit (such as Housing Benefit or Council Tax Benefit) can depend on the receipts of other benefits (eg Child Tax Credits). These rules are complex – for example contribution-based Jobseeker's Allowance is taken into account for tax credits, but not income-based Jobseeker's Allowance.

Where the calculation of one benefit depends on the amount of another benefit, the first benefit is uncertain during the period that the amount of the second benefit is under consideration, or is subject to review. This problem is aggravated where the benefits are provided by different agencies.

National insurance contributions

The current system of NICs and contribution-based benefits is also confusing. The rules for calculating income on which NICs are due are made complicated where they unnecessarily differ from the rules for calculating income for tax purposes. The connection between the money raised by Government from NICs and benefits provided has become threadbare. The calculation of contributory benefits is complicated, and they may actually be less generous than corresponding non contributory benefits (an idiosyncrasy that has stayed with us since 1921).

Other impacts on claimants

Some people are reluctant to claim benefits. These are the people who are perhaps most likely to be deterred from claiming by having to face the complexity of benefits, the forms, and the application process. Others, however, may be keen to play the system to their maximum advantage. It is possible that these people may aggressively exploit the opportunities created by a complex system.

3. MARGINAL DEDUCTION RATES

One further problem arising under the current system, is that of marginal deduction rates. This is the combined cost of the withdrawal of benefits and the payment of tax as a claimant earns extra income

Let us consider a simple example of Miss A. Miss A is a single person, aged 30. She satisfies the basic conditions for Income Support (IS), and her applicable amount (broadly her living allowance for IS purposes) is £64.30 a week. Her rent is £100 a week. Her council tax is £15 a week (i.e. £20 a week reduced by 25% for single occupancy).

If she has no income at all, she receives IS equal to her applicable amount of £64.30p. As she is entitled to IS she is automatically entitled to the maximum Housing Benefit (HB) and Council Tax Benefit (CTB), and will have her rent and council tax paid.

If she has some income but it falls below the applicable amount of £64.30, the payment of IS would be reduced from £64.30p by an amount equal to her other income. She therefore has a marginal withdrawal rate of 100% until her income (less a disregard of £5 allowed for IS purposes) reaches the applicable amount.

If she has earnings which exceeds her applicable amount (plus the £5), she now has no entitlement to IS, but her earnings are less than her personal allowance for income tax. She is still entitled to HB and CTB, but these are reduced by 65p and 20p respectively for each extra pound that she earns. Therefore she has a marginal deduction rate of 85%.

If she has earnings which exceed the personal allowance for income tax and NICs but her hours worked are insufficient to claim Working Tax Credits (WTC), then her marginal income tax and NIC rate is 31%. For each extra pound earned she therefore pays 31p tax and NICs. Her after-tax receipt of 69p reduces her HB and CTB by 85% of 69p, or 59p. Her marginal deduction rate is therefore 90% (31% + 59%).

If she works 30 hours per week so that she can claim WTC, then for every extra pound that she earns she pays a further 20p in income tax, 11p in NICs, and loses 39p in WTC, a total of 70p. The extra net income of 30p (after these deductions from the extra pound) reduces her HB/CTB by 85% of 30p, or 25.5p. Her marginal deduction rate now therefore becomes 95.5% (70% + 25.5%).

As Miss A's income increases further, she will lose her entitlement to WTCs, HB and CTB, so that her marginal deduction rate reduces in steps from 95.5% to 31% (the aggregate of income tax and NICs). The exact calculations will depend on the order in which HB, CTB and WTCs cease to be payable as her income increases.

The different marginal rates that may apply are bewildering. The above example would be even more complicated if Miss A had any children.

Jobcentre Plus staff endeavour to provide “Better Off” calculations to claimants, showing how their net income would change as their gross income increases. As the House of Commons Work and Pensions Committee recognised in a recent report, these are difficult to prepare, and often inaccurate, because the system is so complex.¹

It would be implausible to claim that such a system has been planned in any way. Rather, it is the result of layers of new initiatives being piled on top of each other. Complex rules combine in ways that are difficult to identify in advance.

Simplification, on the other hand, could reduce the number of marginal withdrawal rates. It would also lead to increased transparency, which might increase political pressure to reduce the highest marginal rates.

It ought then also to be practicable to establish a user friendly official website for the public, so they could check their benefit and how it might change as their circumstances change. This would in turn encourage policy makers to create a system where there were clear incentives for those out of work or on low earnings to escape from the poverty trap.

¹ House of Commons Work and Pensions Committee, *Benefits Simplification*, 26 July 2007.

4. AN INTEGRATED SYSTEM OF MEANS-TESTED BENEFITS

Means-tested benefits are, whether we like it or not, here to stay. This is because the alternatives are impractical, being either too expensive (if means-tested benefits are replaced by universal benefits); or because society is unlikely to tolerate total reliance on insurance or other social security contributions, (as this would mean that people who have not paid premiums would have no safety net whatsoever).

One of the most common objections to means-testing is the complexity that results. However, if the complexity can be reduced this objection loses its force.

The fundamental objective of the benefits system is to provide a basic living allowance to those people who are able to work but who are seeking employment; to those who are not able to work for good reason (because they are disabled, for example, or caring for someone else); or to those who have reached pensionable age. The system also needs to top up the incomes of some people in work but who are on low incomes.

These aims can be met by an integrated benefit system administered by one agency. The system would first identify

whether a person qualifies for benefit, which may be for more than one reason. It would then determine the level of any payment according to all the relevant circumstances of the claimant and any partner of the claimant.

The proposal for a single, or integrated, system is not new. In its paper produced for the Mirrlees review, the IFS suggested that IS, Jobseeker's Allowance (JSA), Employment and Support Allowance (ESA), Pension Credit (PC) and tax credits should all be combined into one family benefit.²

This paper takes these ideas forward by setting out in more detail what an integrated system might look like, and how we might progress there from where we are now.

² M Brewer, E Saez and A Shephard, *Means testing and tax rates on earnings*, IFS, 2008.

5. SUMMARY OF PRINCIPAL BENEFITS

It is proposed that the current principal benefits, appropriately modified for the purpose of being integrated together, should form the building blocks of a unified system. There follows a short description of each of these benefits (a fuller description of some of the means-tested benefits is provided in Appendix 1).

Income Support and Jobseeker's Allowance

(a) Income Support (IS)

IS is available to people on low incomes who are either sick or disabled, or have carer or child-caring responsibilities, or are students or in training or who fall into certain other residual categories such as being on jury service, or being on strike. It is administered by the DWP. In 2009/10, spending on IS is forecast to total £14.68 billion with £7.86 billion spent on IS for those under 60, plus another £6.82 billion spent on IS for those over 60 (including the Minimum Income Guarantee and Pension Credit).³

³ Unless otherwise stated, expenditure estimates for all benefits are taken from the DWP, *Benefit Expenditure Tables, Medium-Term Forecast*, uploaded on 30 June 2009. Estimates from this source are for England, Scotland and Wales. See http://research.dwp.gov.uk/asd/asd4/medium_term.asp for full details.

Note that the new Employment and Support Allowance (ESA) is paid to persons unable to work through incapacity, rather than IS.

IS is normally paid tax free.

(b) Jobseeker's Allowance (JSA)

JSA is a benefit available for a claimant who is available for work and is actively seeking work. It is administered by the DWP. It may be income-based or contribution-based. Total spending on JSA in 2009/10 is forecast to be £5.86 billion. Spending on income-based JSA is forecast to be £4.74 billion and on contribution-based JSA another £1.12 billion.

JSA is taxable up to a maximum amount equal to the JSA personal allowance for a person of the claimant's age

(c) IS and JSA rates

The rates are similar for both IS and income-based JSA. An applicable amount is calculated for the claimant. This is the aggregate of a personal allowance, and any premiums and any allowable mortgage interest. The personal allowance depends on the age of the claimant, and whether the claimant is single or has a partner. Premiums may be given if the claimant has carer responsibilities, or is disabled, or is a pensioner.

If the claimant's other relevant income is less than the applicable amount, the IS or JSA paid is equal to the shortfall. No IS or JSA is payable if other income exceeds the applicable amount. The payment is reduced if the claimant has capital in excess of the lower prescribed limit (normally £6,000), and no payment is due at all if the claimant has capital in excess of the upper prescribed limit (normally £16,000).

(d) Contribution-based JSA

If a claimant satisfies certain conditions relating to the payment of NICs in the preceding two years he or she may be entitled to

contribution-based JSA without reference to the above means tests. The claim for contribution-based JSA may still be reduced if the claimant has part-time earnings from working.

Employment and Support Allowance (ESA)

ESA replaced Incapacity Benefit and Income Support on the basis of incapacity for work for new claimants from October 2008. It is administered by the DWP. Spending on ESA in 2009/10 is forecast to be £1.14 billion.

The basic qualification for ESA is that the claimant has limited capability for work. There are two types of ESA – contribution-based and income-related. After an assessment phase of 13 weeks a customer moves into the main phase at which time he is awarded either a work-related activity component or, for those more severely affected by a physical or mental condition, a support component.

The person must not be claiming IS or JSA. He or she must not be entitled to Pension Credit (PC), nor must a partner be entitled to income-related ESA, income-based JSA, IS or PC in his or her own right. The claimant must either satisfy contribution conditions or his or her income must be less than the applicable amount.

The claimant will have an applicable amount for income-related ESA equal to a personal allowance plus any premiums and allowable mortgage interest. The only premiums are for enhanced carer, disability, and pensioner. Similar capital limits apply for income related ESA as apply for IS (see above).

Income-related ESA is tax free, but contribution-based ESA is taxable.

Housing Benefit and Council Tax Benefit

(a) Housing Benefit (HB)

HB is available to help people on low incomes to pay their rent. It is normally administered by local authorities, although the DWP may also be involved. Spending on Housing Benefit in 2009/10 is forecast to be £19.63 billion (excluding discounted housing payment).

There are rules for calculating the amount of rent (“the eligible rent”) which may be reimbursed, which depend on the accommodation which is appropriate to the claimant’s circumstances. Restrictions also apply to exclude any part of the rent which is in substance a payment for other services supplied by the landlord.

HB is tax free.

(b) Council Tax Benefit (CTB)

CTB is also administered by local authorities and is available to help people on low incomes to pay their council tax. Spending on CTB in 2009/10 is forecast to be £4.65 billion (including Community Charge).

In some circumstances, claimants may be better off claiming the second adult rebate as an alternative to CTB, which is not based on the claimant’s own resources but on the circumstances of other adults living in the property.

CTB is tax free.

(c) HB and CTB rates

Being on IS, income-based JSA or ESA, or the guarantee credit of PC is an automatic passport to maximum HB and CTB. Otherwise one calculates the applicable amount in the same way for HB and CTB.

While the calculation of the applicable amount is similar to that for IS/JSA there is an extra personal allowance if the claimant has children under 20. There are also more generous allowances which may be available to claimants over 60. There are extra premiums available for family and for disabled children.

If the claimant's income falls below his or her applicable amount the amount of HB equals the eligible rent. If the claimant's income exceeds the applicable amount the amount of HB is reduced by 65% of the excess.

If income is less than the applicable amount, the maximum CTB is available, but if income exceeds the applicable amount the CTB payable is reduced by 20% of the excess.

Similar capital limits apply for HB and CTB as apply for IS (see above).

Working Tax Credits and Child Tax Credits

Tax credits fall into two categories, Working Tax Credits and Child Tax Credits.

(a) Working Tax Credits (WTCs)

WTCs are administered by HMRC. Spending on WTCs in 2007/08 was estimated to be £5.92 billion.⁴

To qualify for WTCs the claimant must be aged 25 or over and work at least 30 hours a week. But if the claimant or partner has responsibility for a child, or a disability which puts the claimant at a disadvantage in getting a job, or qualifies for a "50 plus element" he or she need work only 16 hours or more per week.

⁴ Source: HMRC, *Child and Working Tax Credits Statistics, Finalised Annual Awards 2007-08, 2009*. Estimates are for the UK as a whole.

The maximum WTC is calculated by adding the elements applicable. There is a separate basic element, lone parent element, couple element, 30 hour element, disability element, severe disability element, 50 plus element and childcare element.

The claimant's relevant income is then calculated. If this is not greater than the income threshold of £6,420 a year, the WTC equals the maximum WTC. If relevant income is higher than the income threshold the WTC is equal to the maximum WTC reduced by 39% of the excess.

(b) Child Tax Credits (CTCs)

CTCs are also administered by HMRC. Spending on CTCs in 2007/08 was estimated to be £15.68 billion.⁵

To qualify for CTCs, the claimant must have responsibility for one or more children who are under 16, or under 20 if they are in full-time non-advanced education or approved training.

The maximum CTC is the child element, plus a disability element, a severe disability element, and the family element

If other relevant income is less than the income threshold figure for the relevant period, the maximum CTC is awarded. If income exceeds the threshold, CTC is the maximum CTC reduced by 39% of the excess. The income threshold is currently £16,040 a year, save that for a person who is also entitled to WTC the income threshold of £6,420 a year is used. The family element of CTC is only abated where income exceeds £50,000 a year.

Local authorities can take account of tax credits for HB and CTB benefit purposes, but only to the extent that they are actually claimed and received. There are further disregard rules

⁵ Ibid.

for HB and CTB if some of the specified elements are taken into account for tax credit purposes.

WTC and CTC are not taxable.

Retirement Pension

This is administered by DWP. Spending on retirement pensions in 2009/10 is forecast to be £67.2 billion.

A person qualifies for a Category A retirement pension if he satisfies the contribution conditions on the basis of his own record and is over pensionable age. A divorced person, or widow or widower, can be entitled to a category B pension on the basis of the contribution record of their spouse. The category A pension is £95.25 a week plus a further £57.05 a week for an adult dependant. The category B pension is £57.05 a week. The pension can be deferred and an enhanced pension or a lump sum paid instead at a later date.

The retirement pension is taxable.

Pension Credit (PC)

PC is administered by the DWP. There are two separate categories of PC – the guaranteed credit (the cost of which is included in the IS data above) and the savings credit. Spending on the savings element of the PC in 2009/10 is forecast to be £1.38 billion.

The qualification for guaranteed credit is that the person is 60 or over and has income below the minimum guarantee. The guaranteed credit makes up any shortfall.

The qualification for savings credit is that the person or partner is 65 or over and has qualifying income that exceeds the savings credit threshold but is not too high to produce a nil award.

Savings credit is calculated by taking 60% of the excess of all qualifying income that counts for the savings credit over the applicable savings credit threshold. This is the maximum savings credit, but it is also subject to a cap.

If total income is less than the minimum income guarantee the 60% figure is the amount is the savings credit. Otherwise it is necessary to calculate 40% of total income over the minimum income guarantee, and deduct that figure from the 60% figure to give the amount of savings credit.

CTC does not count as income for PC purposes, but WTC does count as income. A man aged 60-64 can choose between applying for income-based JSA or PC.

PC is not taxable.

Child Benefit (CB)

CB is administered by the HMRC. Spending on CB in 2009/10 is forecast to be £11.8 billion for the UK.⁶

CB is one of the simpler benefits and is paid at the rate of £20.00 a week for the first child and £13.20 a week for each other child for which the claimant is responsible. It is not means tested. All children under 16 are included, together with other children aged 16-19 who satisfy certain qualifying conditions.

CB is not taxable.

Disability Living Allowance (DLA) and Attendance Allowance (AA)

DLA and AA are administered by the DWP. Spending on DLA in 2009/10 is forecast to be £1.39 billion plus a further £5.09 billion on AA.

⁶ Hansard, Written Answer to David Laws MP, 19 May 2009, c1366W. Data for UK.

The DLA mobility component is paid at two rates –the lower rate is £18.65 a week. and the higher rate is £49.10 a week. The DLA care component is paid at three weekly rates – the lowest rate is £18.65, the middle rate is £47.10, and the highest rate is £70.35. These rates depend on the degree of disability.

AA is a benefit for people aged 65 or over who have attention or supervision needs. It is paid at the lower rate of £47.10 a week and the higher rate is £70.35 a week in circumstances similar to the highest and middle rates of the DLA care component.

DLA and AA are ignored in any calculation of IS, income-based JSA HB, CTB or PC. They are also ignored as income in calculating WTCs or CTCs. A disability element is included in CTC for each child who gets DLA. If the child gets the highest rate of DLA care component the claimant may get the severe disability element in CTC. If the claimant or the claimant's partner gets the highest rate of DLA care or the higher rate of AA, a severe disability payment is included in WTC. The old Severe Disablement Allowance has generally been superseded for new claims.

DLA and AA are not taxable.

Carer's Allowance (CA)

CA is administered by the DWP. Spending on CA in 2009/10 is forecast to be £1.50 billion.

It is paid to a person who is caring for someone receiving either the highest or middle rate of the DLA care component, AA, or constant attendance allowance. The claimant must be aged 16 or over, and not gainfully employed or in full-time education. The claimant counts as being gainfully employed if his or her earnings are more than £95 a week. The claimant does not

need to live with the person being cared for, but the care given must be regular and substantial.

The allowance is £53.10 a week plus a further £31.70 a week if the claimant has an adult dependant, and a further £9.20 for a first dependant child and £11.35 for each further dependant child.

If the claimant receives CA the claimant is entitled to a carer's premium to be included in IS, income-based JSA, HB or CTB. However CA is taken into account in calculating these benefits, so the net gain from claiming CA may only equal the carer's premium. If the claimant receives CA the person the claimant cares for loses any entitlement to a severe disability premium or additional amount in his or her IS, income-based JSA, PC, HB or CTB.

CA is taxable, save for any element paid for adult children.

6. CREATING AN INTEGRATED SYSTEM

There should be four stages in creating an integrated system of benefits.⁷ These would be:

1. to identify where the separate pieces of the benefit system might be simplified;
2. to eliminate overlaps between benefits;
3. to combine the pieces together to form an integrated system and to establish a single entry point for claimants into the benefit system;
4. to review and propose reforms to the current system for NICs and the payment of contributory benefits.

Stage one – simplification of different benefits

A huge amount of simplification could be achieved by making all the rules for benefit eligibility conform with one another. The

⁷ These proposals could, if desired, be pursued in steps over a period of time. They are also not intended to be definitive, but to illustrate how the approach might work, and how an integrated system might appear when the task is completed.

preceding pages have demonstrated that there are many rules which are pointlessly different for different benefits.

For example, it is essential that all benefits should be set on the same periodic basis. A weekly period is proposed. CTCs and WTCs should be conformed to this from the current annual basis, which has proved very difficult to administer. Equally, relevant income should be calculated on the same basis for all benefits, and the different disregards which currently apply for different benefits should be aligned. The different personal allowances which apply to claimants and couples with different ages should be aligned for both IS and JSA on the one hand and with HB and CTB on the other hand.

The tax rules should also be aligned. At present IS is not taxable but JSA is taxable up to the amount of the claimant's personal allowance. A claimant who receives JSA for a complete tax year would not actually pay any tax because the annual tax free allowance would exceed the taxable element of the JSA. A JSA claimant who commences employment during the tax year would have any claim to a PAYE refund reduced because of this tax rule. However, the rule taxing part of JSA is not only complex but also removes an incentive to return to paid work.

There is little rationale between the distinct tax treatment of IS and JSA, and the benefit to the exchequer of taxing JSA will be very small. Also the distinction between contribution-based ESA, which is taxable, and income-related ESA, which is not taxable, appears unwarranted. It is suggested that all these benefits should be tax free, so as to reduce complexity and enhance coherence within the benefits system.

The rules should be further examined to see where further simplifications over and above such alignment, are possible. One may find, for example, that detailed rules intended to

provide more certainty actually create doubt and confusion, if they obscure underlying principles. Any attempt to address all possible combinations of circumstances is doomed to failure, but may deny the decision-maker the ability to reach a sensible conclusion where detailed rules apply in ways which were not anticipated.

Stage one need not be completed before stages two and three are implemented although it would be helpful to have carried out substantial work on stage one alignment before moving forward. It is recognised that this kind of incremental simplification can have its own difficulties. There may, for example, be unintended consequences of knock-on effects with other benefits. Nevertheless difficulties may be more acceptable if they are part of the price for achieving major reform in due course, not merely tinkering with the system.

Stage two – eliminating overlaps

In this second stage the intention is to eliminate overlaps between benefits. Thus, for example, only one means-tested benefit should depend on what children the claimant may have. The overlaps between IS, JSA, ESA and PC should be eliminated, so that a claimant is permitted only to claim one of these. The proposals are described in more detail below.

Children

There are several different benefits which depend on whether the claimant has children. These include tax credits, HB, CTB, and CB. CB is not a means-tested benefit although it is assumed that it would continue to be paid by the single agency which is proposed.

While the applicable amount for HB and for CTB purposes depends on the number of children, the applicable amount for IS and JSA purposes does not now depend on the number of

children. This seems to result in unnecessary complication for HB and CTB. If a claimant has children, he or she may need a bigger house than would otherwise be the case, and this means that rent and council tax may be higher than if the claimant had no children. But the amount of HB and of CTB is calculated by reference to that rent and council tax. No other adjustment to HB or to CTB is appropriate to take children into account. The rent or council tax is a fixed cost, and to have HB and CTB vary depending on the number of children creates an unnecessary overlap with other benefits. The shortfall in HB or CTB if children are removed from the calculation could be made good by enhancing CTC (which would be adapted to reflect all benefit claims for children) as suggested in Appendix 2A.

One exception to this principle of eliminating overlapping benefits for children is that childcare costs would be taken into account for calculating WTCs for people who work sufficient hours to claim this benefit.

Removing premiums relating to children from HB and CTB would mean that the applicable amount would be more nearly the same as for IS , income-based JSA and income-based ESA, which would improve transparency, and facilitate building an integrated system.

CB could also be incorporated in the total for CTC, save that the CTC could not then be reduced below the amount of CB by means testing.

Disability

Similar arguments apply to premiums relating to disability. Disability is taken into account for many different benefits, and it impacts on those benefits in very different ways. Thus, for example, premiums for disability are given for IS, JSA, and ESA. These premiums increase the applicable amount of the claimant,

and (broadly speaking) the amount of money gained equals the amount of the disability premium until the claimant's other income reaches the enhanced applicable amount. Premiums for HB and CTB also increase the applicable amount, but they can have the effect of increasing these benefits even where other income exceeds the applicable amount. WTCs include different elements for different degrees of disability. Then DLA may also be due, which is not generally means-tested.

It is suggested that all these factors should be combined into a unified DLA. The basic rates of DLA would be paid irrespective of other income, but increased rates of DLA would be subject to means testing. This would facilitate transparency as to the amount paid by reason of disability, and enable basic amounts to be calculated for all of IS, JSA, ESA, HB and CTB without regard to disability. The high degree of cross referencing currently required to determine how disability recognised for one benefit impacts on another benefit would be removed.

One can also note in passing that the overall approach to disability would match that for children. There would be a guaranteed minimum payment (corresponding to the current CB and DLA respectively) and a means-tested further payment (corresponding to CTC and the proposed enhancement to DLA respectively).

The ways in which DLA might be adjusted to take into account the proposed changes are set out in Appendix 2B.

Carers

The current interaction between CA and other benefits available to the claimant and the person cared for is highly complex. It might be sensible to provide that CA would not be taken into account for the purposes of IS, income-based JSA or ESA, HB or CTB, but carer's premiums would cease to be available for

those benefits. The amount of CA could however be subject to reduction where these other benefits are also claimed.

Housing Benefit

At present mortgage interest can be paid to people on IS and income-related JSA and ESA. It is suggested that such payments should also be integrated within a merged HB and CTB – this would not only be logical, but also practicable if all these issues are handled by a single agency. Mortgage interest would then cease to be allowable as an increase to the applicable amount for IS, JSA and ESA purposes

Pensioner premiums

The pensioner premiums should also be removed from the calculation of IS, income-based JSA, HB and CTB. PC could be increased as appropriate.

Overlaps between JSA, IS, ESA, and PC

At present, many claimants may be entitled at the same time to claim income-based JSA (simply referred to as JSA in this paragraph) or IS. An instance would be that many IS claimants may be deemed available for work for JSA purposes even though they have caring responsibilities.

Complications arise where a claimant can choose to claim more than one benefit. The choice may be difficult. For example there is no risk of getting sanctioned if the person claims IS, whereas the claimant may be sanctioned if claiming JSA and then failing to comply with the necessary requirements about looking for work. However the claimant may be credited with NIC payments if on JSA, but may not be if on IS. These factors may make the decision which to claim very difficult. Similarly, a man aged from 60 to 64 may be entitled to claim either PC or income-based JSA.

These inconsistencies and overlaps are unnecessary. The system would be much clearer if these different benefits were made mutually exclusive, so that a claimant can only qualify to claim one. This would relieve claimants, and their advisers, of the difficult decisions concerning which benefit to claim. It would enable policymakers to be clear about any different financial results that should flow from different entry tickets into the benefit system.

It is suggested that having identified the relevant different categories of claimants for, say, IS, income-related JSA, or income-related ESA or PC, that category would be given the right to claim only that benefit that, by and large, appeared to be to the financial advantage of that category.

The fact that ESA and not IS must now be claimed in cases of incapacity is a major advance which has already been made in reducing overlaps between benefits.

A cascade test

A possible “cascade test” for deciding which of the above basic benefits applies in a given case would be as follows. If the claimant falls within an earlier benefit he or she would not then be able to claim under a later benefit.

First, PC applies to anyone who is no longer expected to work because they have reached pensionable age unless they want to claim income-based JSA and are better off financially doing this.

Secondly, JSA applies to people out of work who are not faced with a recognised obstacle to their taking up full time employment.

Thirdly, ESA applies to anyone out of work who faces either a limited or a more substantive health problem, restricting his or her ability to work in the short or in the long term

Fourthly, IS applies to certain other residual categories of people who are not expected to work, or to work full time, for specified reasons.

A claimant would thus be entitled to only one out of PC, JSA, ESA, or IS. A single agency would apply a common set of rules and decide in borderline cases which benefit applies – with the claimant having a right of appeal of course, if he or she disagrees with the decision.

The classification of claimants into the exclusive categories for IS, JSA, ESA and PC would be done in order to identify any different conditions to which payments would be subject, and, although applicable amounts would normally be the same for IS, JSA and ESA claimants during assessment phase, in order to identify any different payments due to claimants

This system could then be extended to couples, so that the circumstances of the couple do not give rise to a variety of possible entitlements. Many of the necessary rules already exist. For example, there is no entitlement to IS or JSA where a partner is receiving PC. One partner could claim JSA or ESA if the other partner were also claiming JSA or ESA or PC, but the income taken into account for the second partner's benefit would include the amount paid to the first partner.

Other benefits

If the claimant were entitled to any of the above four mentioned benefits, then he would also be entitled to full HB and CTB. Anyone else on a low income would be entitled to HB and CTB. Anyone with children would be entitled to CTC which would

incorporate the existing CB. WTCs would apply to people who are working sufficient hours but who are on low incomes.

Anyone sufficiently disabled, or having a child sufficiently disabled, would be entitled to DLA.

Those with carer responsibilities could claim CA.

This would complete the conceptual framework for an integrated system for individuals.

Stage three – combining benefits together

Having simplified the components and eliminated overlaps as described in steps one and two, the third step is to integrate the system in a way that produces sensible results for both the withdrawal of benefits as other income increases, and for the combined effect of the tax and benefit system.

Marginal deduction rates

At present there is no withdrawal of HB or CTB if income does not exceed the applicable amount. Then, for a claimant receiving both benefits, there is a combined withdrawal rate of 85% for income exceeding the applicable amount. When income reaches a level that such that either HB or CTB is no longer due, the withdrawal rate is 65% or 25%, depending on whether HB or CTB is still being claimed until income exceeds the level at which both benefits cease.

It would be more straightforward if the two benefits were aggregated and then had a combined withdrawal rate of, say, 50%. This would reduce the highest current aggregate withdrawal rate of 85%, which is unacceptably high. This is especially true for claimants who are also subject to income tax and NICs at the same time. The cost to the exchequer would be reduced to some extent since the withdrawal rate of 50% would apply where at present the withdrawal rate is 20% for a person in receipt of CTB

only. Further, the applicable amount would often be lower than at present, because it would depend on the claimant, his age, and whether the claim is for a couple, and not on the host of further factors which may affect the personal allowance or premiums as at present. This would also tend to balance the cost of applying a lower withdrawal rate where income exceeds the applicable amount.

A similar approach could then be applied for CTC and for DLA. For example the amounts of these benefits could be added to the amount of HB and CTB, and the total then made subject to the withdrawal rate of 50% for income exceeding the same applicable amount. The amount of DLA and CTC would not be reduced below the minimum which is not subject to means testing. If, however, this would disadvantage too much families with children on incomes in the region of £15,000 a year the child element of the combined benefit could be maintained at the same level for incomes beyond the applicable amount, and then withdrawn where income exceeds £15,000 a year. At present the family element of the CTC does not get tapered until relevant income is over £50,000 a year. It would be hard to justify replicating this generosity in a simplified system.

When full integration has been achieved each claimant would have an applicable amount and a total benefit amount. For anyone in receipt of income-based JSA, income-based ESA or IS the marginal deduction rate would be 100% until such time as other income equalled the applicable amount. The excess of the total benefit amount over the applicable amount would then be withdrawn at a constant rate of 50% (with a possible plateau where there are children, as mentioned above), as income increased further. Eventually the payment of benefit would be reduced to a minimum amount and not fall below that,

corresponding to the sum of existing benefits such as DLA and CB which are not means tested.

An exception to this basic rule would be made for WTCs. These would be added into the balance of the total benefit amount due at the income level which the claimant has at the point of satisfying the minimum working hours condition for WTCs. This aggregate balance would then be withdrawn at the same constant 50% rate as income increased further. In accordance with existing practice the balance of of CTCs would then be withdrawn after the WTCs had been withdrawn.

So many different considerations apply to pensioners that this paper does not consider in further detail how an integrated system might be extended to them. It would be expected, however, that the broad principles illustrated above would apply so that the main benefits, such as PC, HB, CTC, DLA and CA would be combined together to make a coherent whole.

A single agency

In such a consolidated claims system, the claimant would apply to only one agency, supplying relevant personal and financial information, including information needed to establish any claim for IS, JSA, ESA or PC as the case may be. Further information relating to children, disability, carer responsibilities and in-work claims can be set out. The single agency would be based on the DWP and its existing network of Jobcentre Plus offices, together with its Pension, Disability and Carers Service. Staff and expertise would also be moved in to the DWP from local authorities and HMRC. It is intended, however, that the single agency would develop an even stronger local presence than it has now. It would know its customers better. It would be much better placed to detect possible irregularities than is possible under the current system where, for example, tax credit claims

can be made with minimal personal contact with the officials administering it.

The single agency operating the merged benefit system would implement payments and adjustments required from any change in income in the most efficient and practical manner – for example by giving appropriate notification to the local authority, or notifying and paying a relevant housing association, or by giving appropriate to the tax authority to change the PAYE deduction. A branch office of the single agency would be involved, normally where the claimant is resident, in order to facilitate personal contact where needed.

A single form

It will be noted that under the above approach a single application form will be enough for the great majority of claimants. Information need be set out only once. The single agency will deal with it. The main part of the form would give information concerning the claimant and any partner of the claimant. It would enable the decision maker to decide which category may apply (eg JSA or ESA and so on). and any different conditions to which payment may therefore be subject such as attending job-related interviews or obtaining medical reports.

The form would set out relevant details of financial resources. Separate schedules would provide information relating to particular needs such as housing costs, children, mobility payments etc. In the same way as for the income tax form, if a given schedule to the form was not relevant to a particular claimant, the schedule need not be asked for, nor completed, by the claimant.

The claim for HB and CTB is 31 pages long. The first 20 pages consist of questions concerning the claimant, the claimant's

family and finances. These questions do not relate specifically to HB or CTB. The next five pages relate specifically to HB and CTB. The last six pages relate to the mechanics of payment, signature of the claimant etc. If a single claim form were used the schedule relating to HB and CTB would therefore only be about five pages long.

The claim form for IS is 42 pages long. Most of this material concerns income, children, housing, other benefits and bank account details for the payment of IS. It is duplicated in other claims forms. Similar points apply to income-based JSA and ESA.

The claim form for tax credits is only 12 pages long, although the guidance notes to help complete the form are 35 pages long. But almost all of the questions in the form would be duplicated or be unnecessary when it and other forms are combined, particularly because the previous year's income would not be relevant.

Under the above proposals it would follow that where a claimant's circumstances change a single notification to a single agency would suffice to deal with the matter.

A single website

Once all relevant benefits can be administered through a single form, so too could a single website be developed. This is not intended as an alternative to the local offices which are proposed above – the personal contact and knowledge of local benefit officers is an important factor in this system. Rather, the purpose of the single website would be to enable claimants to find out quickly and simply their after tax and benefit income if their working income increased (or decreased). This would remove one of the barriers to escaping the poverty trap: the uncertainty in the current system (see page 9 above).

Stage four – Contribution-based benefits and NICs

The NIC system creates much additional complexity and muddle. It is necessary to review the basics of the system in order to understand this.

Firstly it is a mistake to think that NICs are used only to fund benefits. A proportion of NICs is not paid into the National Insurance Fund but is paid to the NHS. This may seem relatively innocuous, but in substance it results in NICs becoming available for other Government expenditure. The Government could decide, for example, to pay more money for aircraft carriers. This means that it would have less money to pay for hospitals unless it increased the amount deducted from NICs to maintain spending on hospitals. In substance, however, the extra money withdrawn from NICs has in this illustration funded the aircraft carriers. No genuine hypothecation is possible to restrict payments made from NICs to hospitals.

In 2002, the Government stated that the extra 1% NIC contributions that they were then imposing would be paid direct to the NHS. In fact, it deducted an amount equal to 1% of all earnings to pay to the NHS, not just earnings in excess of the £89 threshold on which NICs were due – so that the amount paid into the National Insurance Fund actually fell following that increase in NICs.

Further, since the abolition of earnings-related increases and substitution of cost of living related increases to the old age pension, the National Insurance Fund has accumulated larger and larger surpluses. This is because NICs are due on earnings, and these have increased more rapidly than the cost of living. The National Insurance Fund invests these surpluses in Government stocks, which means, of course, that the Government has the money available for general expenditure.

The Fund's income from NICs paid by employers has also been deliberately and substantially reduced because of green taxes – landfill tax, climate change levy and aggregates levy. Employers who paid these taxes had their NICs reduced – thus the Treasury has kept the proceeds of the new taxes, while the money paid into the Fund has fallen by about £2 billion a year. No wonder the Treasury treats NICs in practice as simply another form of taxation.

Secondly the NIC scheme functions as a tax rather than a normal insurance scheme from the perspective of those paying them. Amounts paid bear very little relation to benefits received. Class 1 employee and employer NICs due for an employee earning, say, £100,000 a year would equal about £15,000 a year. Yet the employee would be entitled to similar benefits as someone who has no liability to NICs because they earn more than the lower earnings limit but less than the payment threshold. Further, when the self-employed pay Class 4 earnings related contributions they are entitled to no more benefits than they obtain by virtue of their flat rate Class 2 contributions. These outcomes are not necessarily wrong, but simply indicate that NICs do not operate as a normal insurance scheme but more like a tax.

From the time that NICs became earnings-related it was clear that they had more in common with income tax than the payment of insurance premiums.

It is also relevant to mention that employed people are potentially entitled to more benefits, but their NICs are greatly in excess of that needed to fund the extra benefits. It is estimated that the employed subsidise the self-employed in this way to the tune of £2.9 billion a year. Sometimes, it is suggested that this difference is justified by the extra risks assumed by the self-employed. Whatever the merits of this argument it has

nothing to do with NICs. If it were valid the difference in treatment should be reflected in the tax system, not in a system for providing social security.

Furthermore, contribution-based benefits obtained through paying NICs can actually be less generous than means-tested benefits. Sometimes the benefit can be topped up to the level of the corresponding means-tested benefit if that is also due; sometimes the contribution-based benefit remains less advantageous. For example, contribution-based JSA or ESA are normally taken into account in the calculation of other means-tested benefits, but income-based JSA or ESA are ignored.

Another reason that NICs function as a tax from the perspective of people paying them is that payment is generally compulsory, unlike most insurance payments.

Thirdly the rules for collecting NICs are needlessly different to the rules for income tax, creating unnecessary complication and confusion. Some benefits are subject to tax but not employee NICs. Earnings periods are defined differently. Separate employments are aggregated for tax purposes but not for NIC purposes. Many other examples could be given of differences in the rules which cause unwarranted complexity.

All in all the system falls well short of the standards that should be expected for transparent taxation and honest government. NICs have become an extra tax, and an insidious stealth tax to boot. This is because, unsurprisingly, the general public does not always understand the extent that it does not function as a true insurance scheme. It is now apparent as NICs have been regularly increased that they are seen as a more politically convenient way for governments to raise revenue than raising income tax. In the past we have had an investment income surcharge on unearned income. Now we just have NICs, which

are a surcharge on earned income, payable at higher rates than ever before. It cannot be right to discriminate in this way against earned income.

Abolition or reform of NICs?

There are two options for NICs: either NICs could be abolished altogether and the shortfall made up for by an increase in income tax. Or the contributory principle should be restored to the system with a far stronger link between contributions made into NICs and eligibility for benefits.

An advantage of the first option would be that it would not only simplify the benefits system but it would also substantially simplify the tax system by eliminating many of the current anomalies referred to above.

A simple payroll tax could be introduced to fund the extra benefits available to the employed compared with the self-employed. A claim for maternity benefits, redundancy benefits, or contribution-based JSA, for example, would then be based simply on periods of employment rather than on the NIC contribution record. The rules for such contribution-based benefits should also be reviewed to see where they should be further aligned with the rules for income-based benefits, to reduce the circumstances in which claimants are better off claiming income-based benefits.

The old age pension would be paid to anyone who had been resident in the UK for a qualifying period, as recommended in the Turner Report, thus eliminating some of the worst complexities of our current system for paying the old age pension. This would much simplify the current position, and help correct many problems arising at present, such as the bias against women who take time off work to raise a family. Since old age pensioners are not liable to NICs their personal tax

allowance would be increased to compensate for the increased basic rate tax charge.

People could also make their own private insurance arrangements as they may choose for their circumstances, if they wished to provide further cover for themselves.

Restoration of NICs?

An alternative to the merging of NICS and income tax would be to recognise the benefits of the contributory principle which originally underpinned the creation of National Insurance.

This would mean restoring the link between an individual's contributions made into the National Insurance Fund and the benefits which can then be paid out of the Fund. This could include providing contributors with more information about the use of the Fund, ring-fencing the Fund and its component parts and providing greater accountability to contributors.

Restoring the link would have many virtues, not least creating a sense of contract between the individual and the State and a balance between responsibilities and rights. It would end the confusion inherent in the current system whereby the majority of the public believes, wrongly, that contributions paid through NICs are ring-fenced to pay for future needs.

The decision as to whether to abolish or reform NICs is ultimately a political one. What is clear is that the current system has little to recommend it.

7. TAX AND BENEFITS

It is unfair to tax people who have an income as low as £6,475 a year. It is also a nonsense to tax people and at the same time pay them benefits, when the same result could be achieved by eliminating the tax and the benefit.

Thus, if the personal allowance for income tax were substantially increased, then benefits could be reduced to a considerable extent. If necessary, the net cost remaining to the Exchequer of increasing the allowance could be recouped by increasing the basic rate of tax.

The proposal was made above for a combined withdrawal rate of 50% for benefits. There would therefore be an aggregate marginal deduction rate of $31\% + (50\% \text{ of } 69\%) = 65.5\%$ for someone liable to tax and NICs at the same time. This would be significantly less than the current highest marginal deduction rates.

However, when deciding on appropriate marginal withdrawal rates, it is also relevant to take into account the level of tax allowances. It may well be appropriate to reduce the rate of benefit withdrawal for income above this threshold. This proposal, even if practicable for single claimants, becomes

more complicated of course for couples. Nevertheless, where both partners have income above the personal allowance, it might be possible to reduce the rate of benefit withdrawal to avoid marginal deduction rates becoming too high.

It is also suggested that the way of calculating tax allowances should be reconfigured. At present the personal allowance is an amount which is deducted from taxable income, and tax is then calculated on the balance. However tax credits and other benefits are a payment due to claimants. In order to marry up the two systems of tax and benefits, it is suggested that income tax allowances should also be quoted in terms of a payment due to taxpayers –i.e. tax is calculated on total income, and the personal allowance is then an amount deducted from the tax so calculated. Benefits due are added to this amount. In this way one can see much more readily the combined effect of the tax and benefit systems (see Appendix 3 for more detail).

Further, if the single agency decided that the best way to effect payment of a benefit was through the claimant's PAYE code the amount of the benefit would simply be added to the claimant's personal tax allowances in order to obtain the desired result. Indeed this approach could be extended to many other matters, such as student loans and maternity pay, which are currently handled by employers as part of their payroll management. A single PAYE code could be calculated to reflect all these amounts. It would be more efficient for Government agencies, with their specialised personnel and computer systems, to assume a larger administrative role. Employers, and especially small employers, would then obtain significant relief from some of the burdens currently imposed on them.

8. CONCLUDING REMARKS

As Frank Field has recently said we need our benefits system to set people free. A simplified system would go a long way to achieving that

The risk, as ever, is too much talk and too little progress..

It is time to take the hard practical decisions so that a new unified and simplified benefits system can emerge. And we need this soon.

APPENDIX 1

DETAILED DESCRIPTION OF PRINCIPAL MEANS-TESTED BENEFITS

Income Support (IS)

Income Support (IS) is administered by the Department of Work and Pensions.

IS is available to people on low incomes who are either (a) sick or disabled, or (b) have carer or child caring responsibilities, or (c) are students or in training or (d) who fall into certain other residual categories such as doing jury service, or being on strike. ESA now applies to the exclusion of IS where a claimant is prevented from working by reason of incapacity. The rules set out below also reflect the relationship of IS with Incapacity Benefit (IB), which continues to be relevant for many current claimants.

Sick or disabled

This means the claimant must be incapable of work due to illness or disability and:

- either be entitled to statutory sick pay, or satisfy the “own occupation test” or the “personal capability assessment”, or treated as incapable of work by a decision maker, or treated as capable of work for IB purposes because of misconduct or failure to accept treatment; or,
- appealing against a decision that the claimant is not entitled to benefit (eg IS or IB) because the claimant is not treated as incapable of work under the own occupation test or the personal capability assessment; or,
- the claimant is mentally or physically disabled and as a consequence the claimant’s earnings or hours worked are reduced to 75% or less of that of a person without disability doing the same or comparable job; or,
- the claimant is registered blind (if sight is regained entitlement continues for a further 28 weeks); or,
- the claimant counts as not in full time work whilst living in a care home, Abbeyfield home or independent hospital.

A claim for IS on or after 27 October 2008 on the grounds of disability is treated as a claim for ESA unless certain exceptions apply.

People with child-care responsibilities and carers

The categories are:

- lone parent responsible for a child under 12 who lives in the household (may be reduced to age 7 by 2010); or,
- entitled to and on “parental leave” from work under the Maternity and Parental Leave etc Regulations 1999, and not entitled to any payment from the claimant’s employer, with child(ren) living in the same household, and entitled to either

WTC, CTC payable at a higher rate than the family element, HB or CTB on the day before the parental leave began; or,

- entitled to and on paternity leave, and either not entitled to statutory paternity pay or any payment from the employer or entitled to either WTC, CTC payable at a higher rate than the family element, HB or CTB on the day before the paternity leave began; or,
- fostering a child under 16 through a local authority or voluntary organisation, and not a member of a couple; or,
- looking after a child under 16 because its parent or the person who usually looks after him is temporarily away or ill; or,
- responsible for a child under 16 who lives in the claimant's household and the claimant's partner is temporarily outside the UK; or,
- the claimant is pregnant, and either incapable of work because of the pregnancy or the baby is due in less than 11 weeks; or,
- the claimant had a baby not more than 15 weeks previously, or,
- looking after a partner or a child who is temporarily ill; or,
- the claimant is a carer, and either receives carer's allowance (or would receive it but for a benefit offence), or the person for whom the claimant cares has claimed AA or DLA, or receives (or been awarded) AA or the highest or middle care component of DLA. The claimant must be regularly and substantially engaged in providing care, but this could be less than 35 hours per week.

Pupils, students, and people on training courses

The categories are

- the claimant is a person in relevant education who can qualify for IS, or
- the claimant is a student who can qualify for IS, or
- the claimant is aged 16-24 on a training course being provided by the Learning and Skills Council (or Welsh or Scottish equivalent). This does not apply if the claimant is a child for child benefit purposes, or if the claimant is training as an employee in full-time paid work.

Others

The categories are:

- the claimant has to go to court as a JP, juror, witness or party to the proceedings; or,
- the claimant is in custody pending trial or sentence (in which case IS is available for housing costs); or,
- the claimant was accepted as a refugee before 15th June 2007, or the claimant is a refugee on a training course to learn English, or the claimant is a person subject to immigration control; or,
- the claimant is not treated as in full time work because the claimant qualifies for mortgage interest run on; or,
- the claimant is involved in a trade dispute, or has been back at work for 15 days or less following a trade dispute.

Further conditions

There is no entitlement to IS for a person in one of the above groups if:

- the claimant or the claimant's partner is in full time work. In the case of the claimant this means 16 hours or more per week, for the partner this means 24 hours or more per week. However a person can be deemed to be in full time work if they are not, and vice versa. A person normally in full time work but who is on maternity, paternity or adoption leave is deemed not be in full time work (and may also qualify for WTC). If the claimant or the claimant's partner has just taken up full time work the claimant may be able to claim IS for housing costs for the first four weeks (mortgage interest run on); or,
- the claimant's partner is entitled to pension credit; or,
- the claimant is entitled to contribution-based JSA, or the claimant or the claimant's partner is entitled to income-based JSA; or,
- income exceeds the applicable amount; or,
- capital exceeds £16,000.

The amount of IS is calculated by working out the claimant's applicable amount. This is the total of a personal allowance, premiums and certain housing costs such as mortgage interest.

The personal allowance depends on whether the claimant is single or not, whether aged under 18 or under 25, or whether a lone parent. Any applicable premiums, which are available to carers, claimants having varying degrees of disability and certain pensioners are added on.

If the claimant's other income is below the applicable amount IS will be paid to make up the balance. The claimant is deemed to have notional income earned on capital in excess of a lower limit, which is normally £6,000.

Jobseeker's allowance (JSA)

Jobseeker's Allowance is available if the following conditions for the claimant are satisfied:

- must not be in full time work nor (for income-based JSA) must a partner be in full time work
- must not be in relevant education
- must be available for work, actively seeking work and have a current jobseekers agreement
- must be capable of work
- must be below pensionable age

For contribution-based JSA, it is necessary to satisfy the contribution conditions. (There are two contribution conditions, one of which relates to the minimum NICs which must actually have been paid in a prior year, the other of which relates to the minimum NICs which must either have been actually paid or credited in the two preceding tax years.) Further, the claimant must not have earnings above a specified amount (the prescribed amount).

To qualify for income-based JSA, the claimant's income must be below the applicable amount and capital must be less than £16,000. Neither the claimant nor the claimant's partner can be entitled to pension credit. If not a joint claim couple, the partner should not be claiming and entitled to either IS or income-

based JSA. If a joint claim couple, neither the claimant nor partner must be claiming and entitled to IS.

Certain groups qualify for IS as well, eg a carer, a person incapable of work because of illness or disability (under the old rules), a person treated as not being in full time work whilst at a care home, a disabled student, a person who is registered blind, pregnant, or aged 60 or over etc. The person can choose which of IS or JSA to claim.

The amount of benefit for contribution-based JSA is £64.30 a week (reduced if aged under 25). For income-based JSA the amount equals the top up to the applicable amount. The applicable amount is the same as for IS.

JSA is taxable upto a maximum amount equal to the JSA personal allowance for a person of the claimant's age. Benefits are calculated in the same way for IS and for income-based JSA. Current figures are set out below.

Personal Allowances	£ /week
Single under 25	50.95
Single 25 or over	64.30
Lone parent under 18	50.95
Lone parent 18 or over	64.30
Couple both under 18	50.95
Couple one under 18, one 18-24	50.95
Couple one under 18, one 25 or over	64.30
Couple both 18 or over	100.95
Premiums	
Carer	29.50
Disability single	27.50
Disability couple	19.30
Enhanced disability single	13.40
Enhanced disability couple	19.30
Severe disability one qualify	52.85
Severe disability two qualify	105.70
Pensioner single (JSA only)	63.55
Pensioner couple	97.50

In addition to the personal allowance and any premiums, mortgage interest on a loan of not more than £200,000 may also be payable under IS.

Housing benefit (HB)

The basic qualification for HB is that the claimant has a low income. Being on IS, income-based JSA or ESA or the guarantee credit of PC is an automatic passport to maximum HB. Otherwise it is necessary to calculate the appropriate amount for the claimant.

The maximum amount of benefit is the “eligible rent”, but if after-tax income is greater than the applicable amount the payment is reduced by 65% of the excess. Only “eligible rent” qualifies, which excludes for example any payment to the landlord for extra services. There are also rules for excluding rent to the extent that it is unjustifiably high.

If capital exceeds £16,000 there is no HB unless person or partner is getting the guaranteed credit of the pension credit. There is a deduction from the eligible rent for non-dependants living in the property. The applicable amount is made up of the personal allowance, as for income support above, save for a further £56.11 a week for each child under 20, plus premiums as described below.

The rules for people aged 60 or over who are not (and whose partners are not) eligible for IS or income-based JSA are different and more generous. As mentioned above the capital limit is ignored for those getting the guarantee credit of PC. If the claimant is on the savings credit but not the guarantee credit the local authority use the DWP assessment of capital and income, although the amount of PC is taken into account in the calculation of HB. Personal allowances are also more generous for this age group.

Council Tax Benefit (CTB)

The basic qualification for CTB is that the claimant has a low income. But CTB is not available if capital exceeds £16,000, unless the person or partner is getting the guaranteed credit of the pension credit or if the person is a student (with certain limited exceptions).

The amount of benefit depends on the person's applicable amount, and the claimant's income or capital. Being on income support, income-based JSA allowance or the guarantee credit of pension credit is an automatic passport to maximum CTB. Otherwise, if income is less than the applicable amount, the maximum CTB is still available, but if income exceeds the applicable amount CTB equals the maximum CTB minus 20% of the excess of income over the applicable amount.

The second adult rebate is available if a second adult resides in the property, who is not liable to council tax or liable to pay the person rent

CTB is not taxable

The applicable amount is computed as follows for both HB and CTB.

Personal allowances	£
Single under 25	50.95
Single 25 or over	64.30
Lone parent under 18	50.95
Lone parent 18 or over	64.30
Couple both under 18	76.90
Couple one or both over 18	100.95
Children under 20	56.11
Pensioner single under 65	130.00
Pensioner single 65 or over	150.40
Pensioner couple both under 65	198.45
Pensioner couple one or both 65 or over	225.50
Premiums	
Carer	29.50
Disability single	27.50
Disability couple	39.15
Disabled child	51.24
Enhanced disability single	13.40
Enhanced disability couple	19.30
Enhanced disability child	20.65
Severe disability one qualify	52.85
Severe disability two qualify	105.70
Family ordinary rate	17.30
Family some lone parents	22.20
Family baby addition	10.50

Employment and Support Allowance (ESA)

ESA replaced incapacity benefit and IS on the basis of incapacity for work for new claimants from 27 October 2008.

The basic qualification is limited capability for work. The claimant must not be claiming IS or JSA. He must either satisfy the contribution conditions or his income must be less than applicable amount and his capital below £16,000. He must not be entitled to PC, nor must his partner be entitled to income-related ESA, income-based JSA, IS or PC in his or her own right.

The claimant will have an applicable amount of a personal allowance and any premiums and housing costs. The only premiums are for enhanced disability, carer and pensioner.

The ESA rates are computed as follows:

Personal allowances	£/week
Single under 25	50.95 (main phase £64.30p)
Single 25 or over	64.30
Lone parent under 18	50.95 (main phase £64.30p)
Lone parent 18 or over	64.30
Couple both under 18	79.60 (main phase £100.95p)
Couple one 18 or over	100.95
Premiums	
Carer	29.50
Enhanced disability single	13.40
Enhanced disability couple	19.30
Severe disability single	52.85
Severe disability couple one qualify	52.85
Severe disability couple two qualify	105.70
Components	
Work related	25.50
Support	30.85
Pensioner	
Single, assessment phase	65.70
Work related	40.20
Support	34.85
Couple assessment phase	97.50
work related	72.00
support	66.65

Tax Credits

The maximum WTC is calculated by adding the elements applicable. These are the basic element of £1,890, the lone parent element of £1,860, the couple element of £1,860, the 30 hour element of £775, the disability element of £2,530, the severe disability element of £1,075, the 50 plus element (£1,300 or £1,935 for 16 to 29 hours and 30+ hours respectively) and the childcare element. The latter is calculated from a maximum

eligible cost of £300 per week for two or more children, £175 per week for one child, where 80% of eligible costs are covered. Relevant income is then compared with the income threshold of £6,420. If relevant income is lower, WTC equals maximum WTC. If relevant income is higher WTC is maximum WTC reduced by 39% of the excess.

To qualify for CTCs the claimant must have responsibility for one or more children who are under 16, or under 20 in full-time non-advanced education or approved training. The maximum CTC is the child element (£2,235 for each child) plus a disability element (£2,670 for each child that qualifies), a severe disability element (£1,020 for each child that qualifies) and the family element (£1,090 including the baby element, £545 if not). It is necessary to compare relevant income with the income threshold figure for the relevant period, currently £16,040. For a person entitled to WTC the income threshold of £6,420 is used. If income is less than the income threshold maximum CTC equals maximum CTC. If income exceeds the threshold, CTC is the maximum CTC reduced by 39% of the excess. The family element is only abated where income exceeds £50,000.

Local authorities can take account of tax credits for HB and CTB benefit purposes only to the extent that they are actually claimed and received. If the claimant award of tax credits includes the 30 hour or 50 plus elements of WTC (or would include the 50 plus element if the claimant applied for it), or the disability or severe disability element of WTC, £16.05p of earnings is disregarded when calculating HB or CTB.

Getting certain non means-tested benefits can help the claimant qualify for, or increase an award of, WTC or CTC.

Pension credit

The qualification for guaranteed credit is that the person is 60 or over and has income below the minimum guarantee. The qualification for savings credit is that the person or partner is 65 or over and has qualifying income that exceeds the savings credit threshold (£96.00 for a single person, and £153.40 for a couple) but is not too high to produce a nil award.

The standard minimum guarantee credit is £130.00 a week for a single person and £198.45 a week for a couple. There are further additions for severe disability and for a carer. Savings credit is calculated by taking 60% of the excess of all qualifying income that counts for the savings credit over the applicable savings credit threshold. (Qualifying income is all income that counts for guarantee credit except working tax credit, IB, contribution-based JSA, severe disablement allowance, maternity allowance or maintenance payments). This is the maximum savings credit but is also subject to a cap for a single person of £20.40 a week and for a couple of £27.03 a week. If total income is less than the minimum income guarantee this 60% figure is the amount is the savings credit. Otherwise it is necessary to calculate 40% of total income over the minimum income guarantee, and deduct that figure from the 60% figure to give the amount of savings credit.

The right to PC is reduced where capital exceeds £6,000, or £10,000 with effect from November 2009.

PC is not taxable.

PC acts as a passport for tax credits, although it is necessary to make a separate claim. CTC does not count as income for PC purposes, but WTC does count as income. A man aged 60-64 can choose between applying for income base JSA or PC.

APPENDIX 2

REMOVING OVERLAPS

Children

HB and CTB have additional personal allowances for children under 20, and a family premium with a possible additional premium for a baby. These have the effect of increasing the applicable amount for claimants below which full HB and CTB is due. They will also increase the amount of HB and CTB payable to claimants who still qualify even though they have income in excess of the applicable amount. These allowances and premiums should be abolished. The cost saved by local authorities should be used to increase the child tax credit by an aggregate amount equal to the amount by which aggregate HB and CTB is reduced, and/or to help reduce marginal deduction rates as suggested in Stage three of Chapter 6. When doing this it seems appropriate to reduce the CTC threshold, without affecting the total amount paid to all claimants, so as to compensate those on lowest incomes who would tend to lose most by removing child allowances from CTB and HB.

Disability

It is proposed that premiums relating to disability should be removed from all of IS, income-based JSA and ESA, and HB and CTB. There should be a corresponding aggregate increase in DLA equal to the aggregate reduction in the amount paid for these other benefits, and/or the cost saving should be used to help reduce marginal deduction rates as suggested in Stage three of Chapter 6. The increased amount of DLA should be means tested. The disability elements for WTCs should also be reflected in the proposed comprehensive DLA. (Whilst the overlap with WTCs and DLA would therefore remain, it is proposed that the disability factor should be dealt with within DLA as part of a common procedure for assessing and dealing with disability).

APPENDIX 3

INTEGRATING TAX ALLOWANCES AND BENEFITS

It is proposed that the single agency responsible for benefits should be able to direct that these benefits should be paid through the PAYE system where this is considered appropriate and convenient. At present the systems for operating tax and tax credits and other benefits are not well integrated which means that the combined effect of these on a person's net disposable income is not easy to identify.

An obstacle to the integration of tax and benefits is that personal allowances for tax purposes are given by way of deduction against total income. Tax is then calculated on the net taxable income. Tax credits are however given by way of a tax repayment, or "negative tax" payment. Other benefits are also calculated as an amount payable.

It seems worth considering whether these different mechanisms could be usefully aligned. At present the personal tax allowance

is £6,475, the next £37,400 of taxable income is charged at the rate of 20%, and income in excess of £43,875 ($=£6,475 + £37,400$) is charged at the rate of 40%. (Special rates for dividends and savings are addressed below). The 50% tax rate announced in the 2009 budget will apply to incomes over £150,000. It will not take effect until April 2010, but this change will not impact on the principle of what is described below.

The personal allowance would be converted from operating as a deduction from total income to become a tax deduction after tax on income has been calculated. The tax liability of an individual would first be calculated at 20% on the first £43,875 of income and at 40% on any income over that. Everyone would have a personal allowance of £1,295 ($=£6,475 @ 20%$) which would then be set off against that liability. One can see that ultimate tax liabilities would be unaffected by this change. For example someone earning £15,000 p.a. would, on the existing system, have taxable income of £8,525 ($=£15,000 - £6,475$) on which tax @ 20% would be £1,705. Under the suggested new system he would have a tax liability of £15,000 @ 20%, = £3,000, less the revised "personal allowance" of £1,295, = £1,705.. Someone earning £50,000 however, would have taxable income under the existing system of £43,525 ($=£50,000 - £6,475$) of which £37,400 is taxed at 20% ($=£7,480$) and £6,125 is taxed at 40% ($=£2,450$), a total of £9,930. Under the suggested new system he would have a tax liability of £43,875 @ 20% ($=£8,775$) plus £6,125 @ 40% ($=£2,450$), a total of £11,225, less the revised "personal allowance" of £1,295 = £9,930.

Of course, under this modified system, if the personal allowance is increased in the Finance Act for any year it would also be necessary to increase the 40% threshold to maintain the current relative positions of basic and higher rate taxpayers.

The potential advantage of restating the personal allowance in this way is that it can then be simply added to the tax credit or any other benefit which is directed to be made available through the tax system to give a person's aggregate entitlement. It should be noted that, because the personal tax allowance does not give rise to an entitlement to a tax refund if income falls below the level of the allowance, the aggregate entitlement would only be refundable up to a maximum of the tax credit and any other benefit. This would not be an issue in relation to anyone receiving working tax credits, since anyone earning at least the minimum wage and working for at least 16 hours per week will earn more than the current personal tax allowance, but it could be relevant in many cases where only child tax credits would be combined with personal allowances.

Other allowances, such as the age allowances (currently complex to calculate) would be revised and simplified, and restated as a tax deduction rather than a deduction from total income.

Tax on dividends would (as at present) need to be computed separately unless the tax credit on dividends were restored to correspond to the basic rate of tax.. The tax credits on dividends would then be aggregated with the "personal allowance" to be deducted when calculating the individual's tax liability. Some matters, such as pension tax relief, would still be given by way of deduction against total income.

Each individual would then be given a combined "code" reflecting his personal allowances and the combined tax credits and other relevant benefits which are directed to be dealt with under the PAYE system under the proposals in this paper. Given this combination, it should be easier for the individual to understand his own position. It should also be easier for policy makers, who need to take into account the combined effect of tax and benefits and the effective marginal rates of tax

applicable, to decide on the quantum and interaction of the two forms of relief. Further, because the tax, tax credit and benefit systems would be combined (at least to the extent that the single agency decided to make use of the PAYE system to make benefits available to a particular employee), the proposal should help reduce fraudulent benefit claims from people whose tax affairs are not “married up” with their benefit claims.

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