



Policy in Practice

The policy and reality of
effective marginal tax rates - is
there a difference?

Mary-Alice Doyle, 10 July 2023

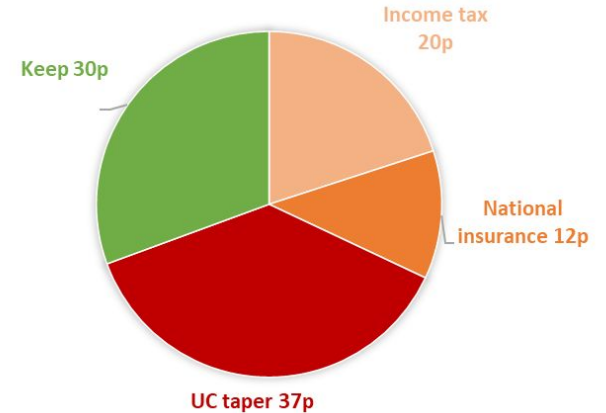
This presentation

1. Background
2. Methods
3. Benefit take-up
4. EMTRs as designed
5. EMTRs in reality
6. Cliff-edges
7. Summing up



If I earn an extra £1, how much do I keep?

- Effective marginal tax rate (EMTR), based on:
 - Income tax
 - National insurance
 - Benefit taper
 - Child benefit
 - Eligibility for passported benefits (e.g. free school meals)
 - Eligibility for social tariffs (i.e. discounted water and broadband)
- E.g. single person earning £20k, claiming UC:
 - EMTR: 70%
 - Average tax rate (incl. UC taper): 40%
- Why do we care?
 - Work incentives
 - Fairness



What do we already know?

EMTRs are really high for some households in the UK: 90% +. This is because of the interaction of taxes, UC taper and child benefit withdrawal that contribute to high rates in the £50-60k/year range

- A 'disincentive desert' (Richardson & Blizzard 2021)

People receiving DWP benefits are '**passported**' to other benefits. These likely increase EMTRs:

- Free school meals
- Healthy Start
- School uniform/transport costs
- Council Tax Support
- Social tariffs for water and internet

A lot of benefits are unclaimed (we estimate £19b/year). That likely decreases EMTRs.

What don't we know?

1. How many households are actually in the 'disincentive desert'?
2. How much do passported benefits affect EMTRs?
3. How much does benefit take-up affect EMTRs?



Methods

Better Off Calculator

Household details Property details Income and earnings Results

To answer these questions, we need:

1. Representative data on the distribution of household income
 - I use 2020/21 FRS data at family/benefit unit level for working-age households

2. Actual benefit receipt vs benefit eligibility
 - I run FRS data through our [benefits calculator](#) API - it's essentially a microsimulation model, with very detailed breakdown of benefit components, UC and legacy benefits, and local benefits.

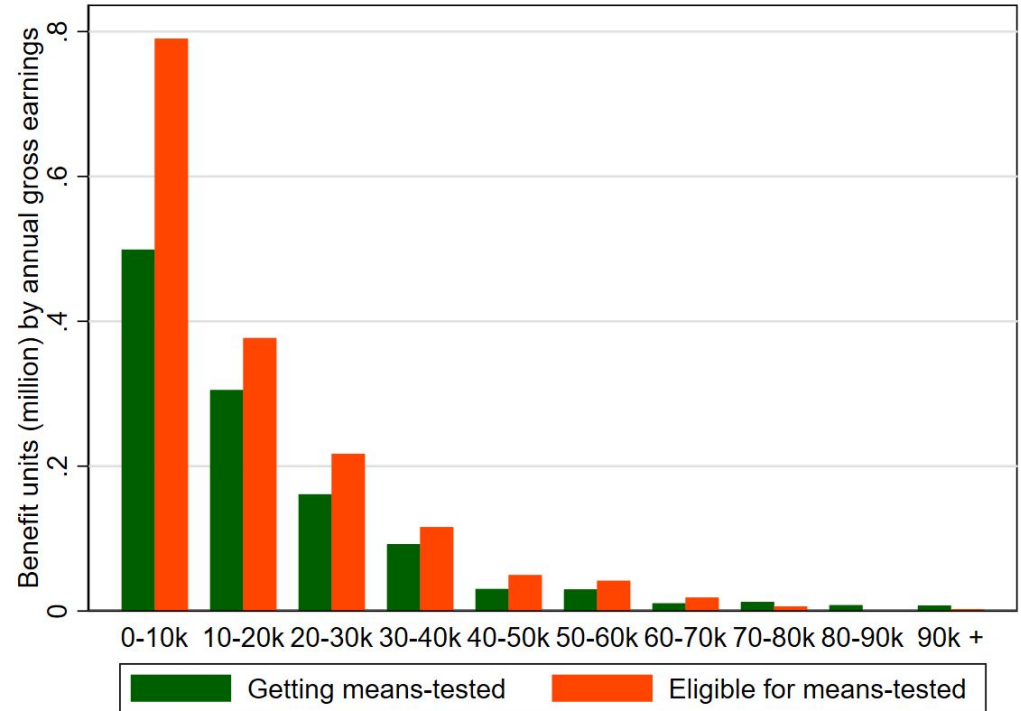
3. Eligibility for **all** benefits - incl passported and local
 - For each family, the API spits out:
 - Tax liability
 - Eligibility for DWP benefits - I assume all claim UC not legacy benefits
 - Eligibility for other benefits

Benefit take up



Who's missing out?

13% of working age households are eligible for but not claiming means tested benefits



But on average, non-claimants would get lower payments



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| Average monthly value of (potential) UC benefit claim | Children in household | No children in household |
|--|------------------------------|---------------------------------|
| Claiming benefits | £1,534 | £1,333 |

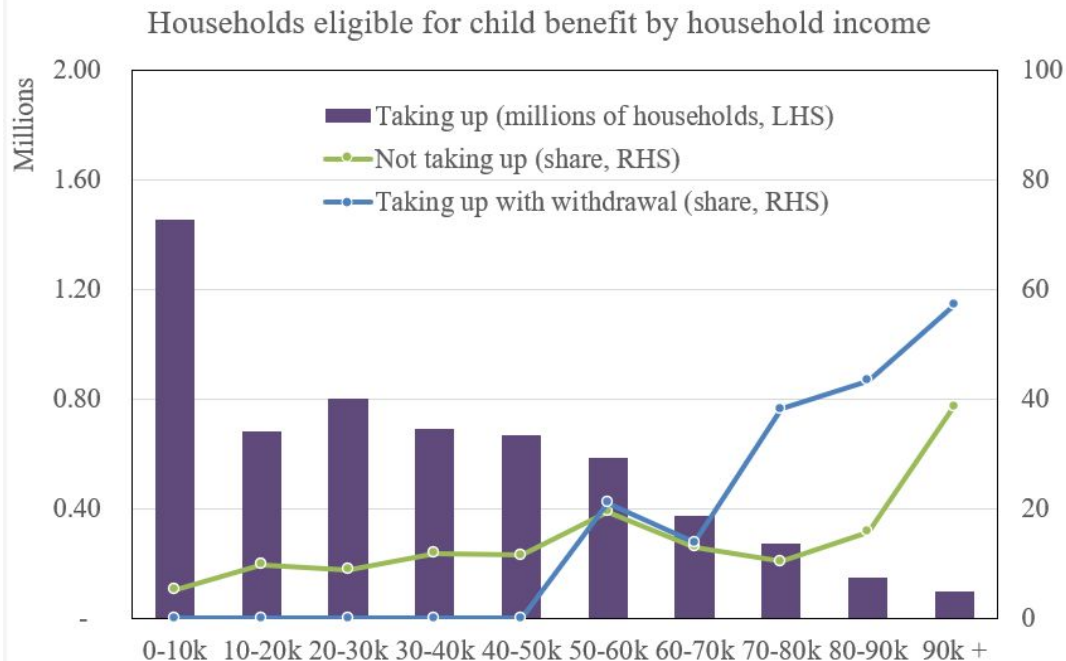


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| Average monthly value of (potential) UC benefit claim | Children in household | No children in household |
|--|------------------------------|---------------------------------|
| Claiming benefits | £1,534 | £1,333 |
| Not claiming but eligible | £860 | £434 |



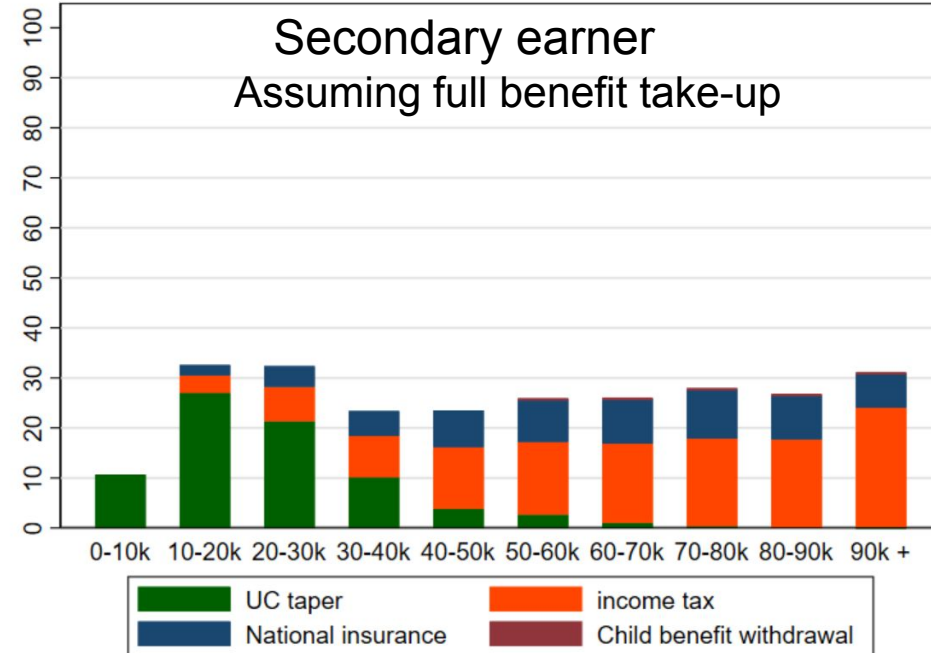
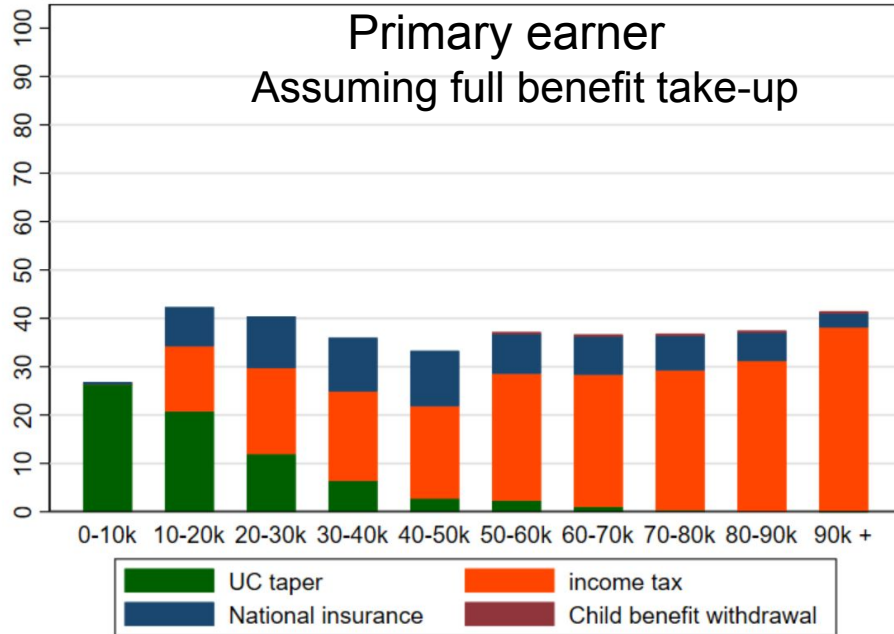
The child benefit withdrawal affects a small number of households



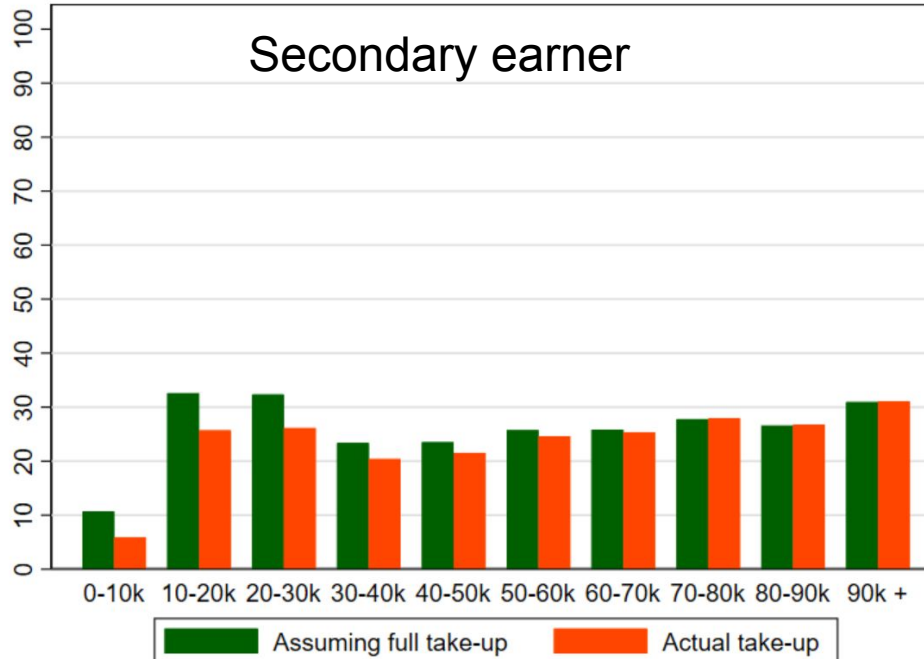
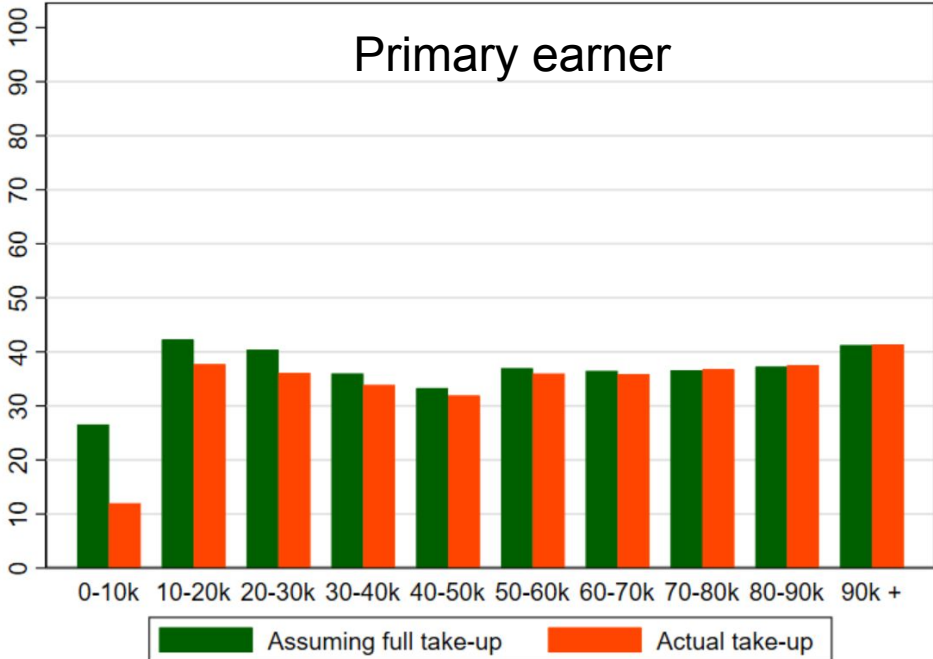
EMTR estimates



On average, EMTRs are not that high



Actual EMTRs are even lower - especially for households earning under £10k/year



Which households face very high actual EMTRs?

Characteristics of working-age households, by effective marginal tax rate

| | 0 to 40% | 40 to 60% | 60 to 80% | 80%+ |
|-------------------------------------|-----------------|------------------|------------------|-------------|
| Total number of households | 18,200,000 | 6,046,728 | 728,264 | 951,814 |
| Number of children | 0.40 | 0.75 | 1.47 | 1.50 |
| Household gross earnings | £26,299.88 | £73,310.35 | £32,805.23 | £24,152.50 |
| Receiving means-tested benefits (%) | 11% | 34% | 100% | 100% |
| Receiving child benefit (%) | 20% | 21% | 74% | 70% |
| Receiving free school meals (%) | 5% | 1% | 0% | 0% |
| Receiving healthy start (%) | 2% | 0% | 0% | 0% |

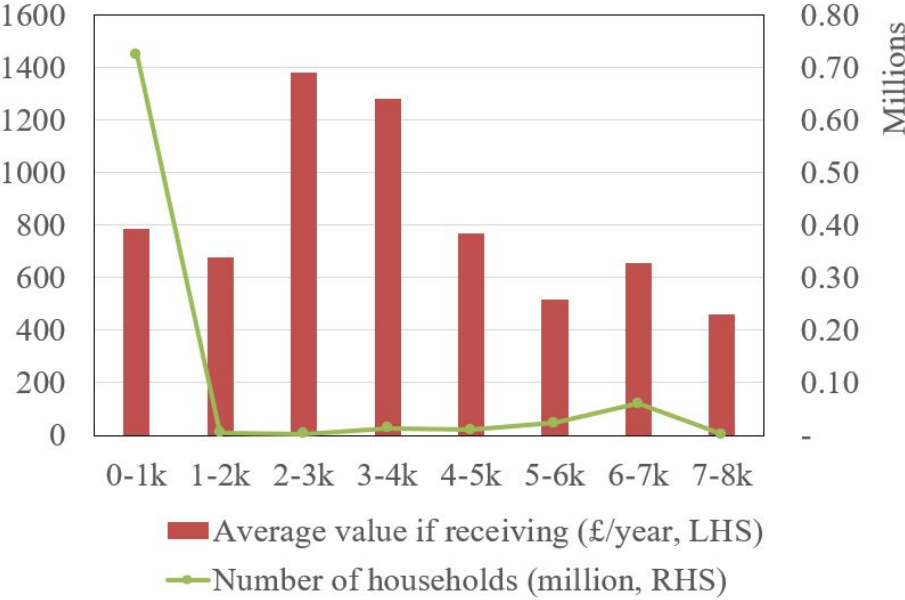


Cliff edges

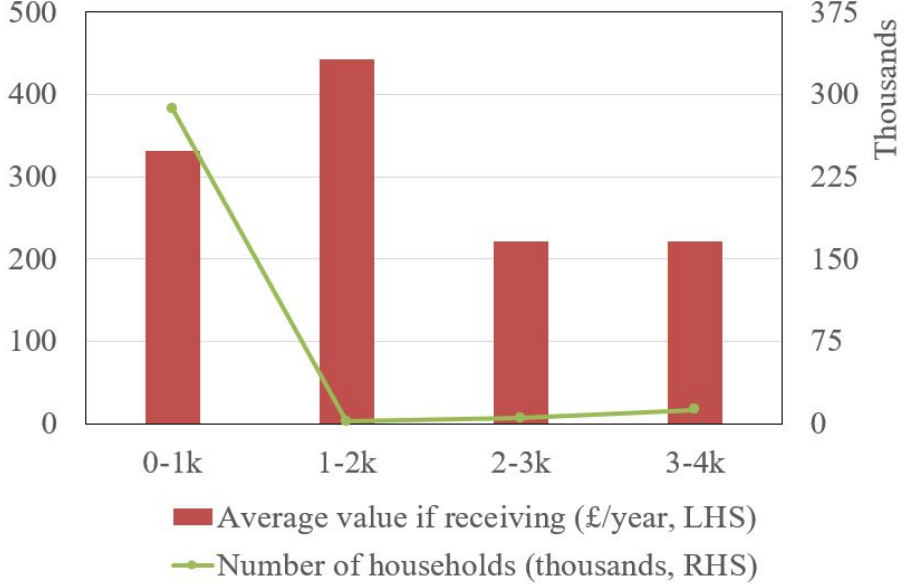


BUT... low-income households face cliff edges

Free school meals



Healthy Start



And cliff-edges interact with EMTRS

- e.g. Free School Meals

- Free school meals are worth around £460/year per child ([IFS](#), 2023). For 2 children, that would be £920/year
- A parent moving from out of work into 2 days/week at minimum wage of work would lose eligibility for free school meals
- They would need to earn an extra £2,200/year to regain that value
- This is because the UC taper and lost eligibility for Council Tax Support mean that even though the household pays no tax or NI, they keep only 42% of their earnings
- This is equivalent to working an extra extra half-day/week at minimum wage



Summing up



What have we learned?

- In practice, average EMTRs aren't as high as we might expect
- But they are high for some households - EMTRs are over 80% for 950,000 households. These are largely households with children, earning median income, and receiving means-tested benefits
- Millions of households are not taking up benefits that they could, though with a lower average claim value than those who are taking them up
- Incomplete benefit take-up reduces EMTRs, mainly at the lower end of the income distribution
- For households with lower incomes, cliff-edges in support interact with EMTRs, meaning they lose £'000s from working more
 - This comes through non-DWP benefits: e.g. Free School Meals
 - Transitional protection has shielded many households, but this will end in 2025



Limitations and next steps

Limitations:

- Assumes static income
- Some non-claiming households have no recourse to public funds

Next steps

- Estimate participation tax rates as well as EMTRs
- Include local benefits (CTR) and social tariffs
- Simulations for each household earning an extra £100/year, £500/year, £1,000/year, etc
- Simulations for changes in policy - e.g. removal of child benefit withdrawal, lower UC taper rate

This is a work in progress. Feedback welcome!!



Thank you

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