

Prime Minister

(1)

17 December 1982

Policy Unit

PRIME MINISTER

Agree / enquire about

X ?

Thu 17/12

- I am very much in favour of (i).

CHILD SUPPORT AND THE POVERTY TRAP

(ii) will be included whenever for the

In our discussions on unemployment, taxation and family policy, we are again and again led back to the same impasse. The plight of the married man with two children on average and below-average earnings is already an embarrassment to us in the House. It will be an embarrassment in a General Election campaign, unless we do something in this Budget.

have rule-down

1. The heavy burden of income tax on poorer working families is a scandal. At times, it leads to marginal tax rates of 100% or more. This is not only a disincentive to work, it is absurd and unjust.
2. This poverty trap affects principally families with children. So does the unemployment trap.
3. Yet at present the only specific way of concentrating help on families with children is via child benefit. But this does not help their income tax position. It is a transfer from earned income to welfare benefit, and thus unappealing to many of our supporters.
4. Increasingly, we regret the abolition of child tax allowances. Without something of the sort, it is hard to see how we shall ever raise the thresholds high enough to be clear of the FIS taper. Of course, those allowances were of extra value to higher-rate taxpayers; but that was not unwelcome to Conservatives, who believe that working for one's children's future is commendable.

With hindsight, the abolition of the lower rates of income tax seems increasingly dubious, too. It has given us the highest starting rates in the world which, combined with the lower thresholds, has a lethal effect.

A married couple start paying income tax

in the UK at	<u>£2,446</u> pa and at 30p in the pound
in France at	<u>£3,480</u> pa and at 7.2p in the pound
In West Germany at	<u>£3,235</u> pa and at 18p in the pound.

The abolition of both the lower rates and the child tax allowances was and is defended largely on the grounds of the Inland Revenue's convenience. The Treasury's line, eg in Tim Flesher's letter to

Squadron-Leader E G Clark of 26 November 1982, is that "Child benefit is not only simpler to administer, but it also helps parents with incomes below the tax threshold who would get no benefit from a tax allowance".

In reality, there are now relatively few parents with incomes below the tax threshold (£50 a week) and they qualify for FIS, in any case. Only unemployed families would get no benefit and, for them, the dependants' allowances plus child benefit are reasonably adequate.

Administrative simplicity is an admirable principle, but it should not be allowed to take precedence over the construction of a rational, internally consistent system of taxation.

5. There would be some embarrassment if we revived child tax allowances - although it was not we who abolished them. But it might be simpler to bring in a family responsibility allowance, payable to all tax-payers who have a child for whom they now receive child benefit.

This would be a relatively cost-effective way of raising thresholds for those families who suffer most from the present system.

6. If, at the same time, we indexed the other personal allowances, there would be no losers in absolute real terms. Families would gain, and the present humiliating gap between our aspiration and our achievement would be largely closed. And family support would come increasingly from earnings and less from benefits.

7. Likely further advantages would be:

- (a) a reduction in recorded public expenditure if we gradually shifted from benefit to tax allowance;
- (b) a reduction in wage demands, since the real family take-home pay tends to be the standard on which wage claims are based.

8. I suggest that the Treasury be asked:

- (i) to review the possibility of introducing an income tax allowance for child support;
- (ii) to review the possibility of reintroducing lower rates of income tax.

Title

Econ Pol
BSG

c. h. Mount

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10 DOWNING STREET

From the Private Secretary

20 December 1982

Dear Jill,

CHILD SUPPORT AND THE POVERTY TRAP

The Prime Minister has seen a note from Ferdinand Mount dated 17 December of which I understand Mr. Mount has sent you a copy.

The Prime Minister would be grateful for a note on the possibility of introducing an income tax allowance for child support, a proposal which she strongly favours; and on the possibility of reintroducing lower rate bands of income tax.

Yours sincerely,

Michael Scholar

Miss Jill Rutter,
H.M. Treasury.

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SRP