

CE NO



Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

Prime Minister

Discuss at the next regular

meeting with the Chancellor?

MUS 22/4

010
I think the reactions to this would be justifiably hostile.
They would also be hostile.
The point is to lobby the PM - come to lobby the PM for married women (don't know) would they object to this? All makers with married women (don't know) would they object to this? All makers with married women (don't know) would they object to this?

PRIME MINISTER

TAXATION OF HUSBAND AND WIFE

1. When we last discussed this subject I think we were all agreed that the present system had serious weaknesses and that all the options for change had their difficulties, but if a change were to be made at all, the best choice would be independent taxation with transferable allowances (ITTA). A number of us felt, however, that before we took this further forward a more detailed paper was needed setting out the effects of ITTA on families; and this is now attached.

2. Of the other options, we saw strong objections to a system of mandatory independent taxation (MIT) which would direct the extra tax savings from cutting the tax threshold for all married couples into more and bigger cash benefits. This is the system favoured for obvious reasons by the Poverty Lobby and, as we thought at the time of our previous discussion, by the Labour Party. In their latest campaign document published last month, however, the Labour Party recognising the large number of "losers" under MIT appear to be drawing back from their earlier commitment and may themselves be shifting towards some form of ITTA.

3. None of this lessens my conviction that we must say something before the Election in response to the Green Paper and the reactions to it - indeed the contrary. The issue is a live one and will not go away - the other political Parties have given their views and will firm them up once an Election is announced. It would, I believe, be indefensible for us alone to remain silent, particularly with the risk that otherwise our position can be misrepresented as the Guardian leak



at the end of last month illustrated. At the same time our response need not and should not be more than indicative of the direction of our thinking - a final decision on any change cannot be taken until 1984 at the earliest.

4. This, as I see it, leaves open two questions. What should the Government's response be and how can it best be presented?

5. On presentation I suggest there are three options (though obviously they are not mutually exclusive):-

- i. a piece in the Party Manifesto;
- ii. a Green Paper to be published ahead of the Manifesto (depending, of course, on the timing of the Election;
- iii. a major speech - perhaps by myself to the Conservative Women's Conference next month - which could then serve as the basis of the policy adopted during the Election campaign.

6. Because the subject needs delicate and careful handling, I incline towards option ii. or iii, but first we need to decide how best the substance of our response can:-

- i. respond to the criticism of the present system;
- ii. mount an effective attack upon MIT with cash benefits; and
- iii. prepare our answer to the crucial question, which I asked in my earlier paper - "Do the advantages of ITTA outweigh the cost?".



Present System

7. We ourselves recognised the faults of the present system when we published the Green Paper:

- by any standard of equity (or international comparisons) it gives too much relief to the husband, when both husband and wife are earning;
- in other cases (mainly in the case of investment income) it imposes a penalty on marriage;
- more generally, it does not recognise women's reasonable demands for independence and equality within a marriage.

8. As I said in my earlier paper, the response to the Green Paper shows virtually everyone united in rejecting the present system. This covers (at one extreme) our political opponents, the Poverty Lobby and the Equal Opportunities Lobby and (at the other extreme) our National Women's Committee, the Chartered Accountants and the Law Society.

9. Before adopting an alternative system we have to satisfy ourselves that the alternative is not only better, but sufficiently better to justify the change. But we cannot argue that the present system is, or is generally accepted as, satisfactory in itself.

Countering MIT

10. The apparent shift in Labour Party thinking does not lessen the need for us to mount our arguments against MIT - it still commands strong and widespread support from some powerful pressure groups.

11. But we should be inviting battle on pretty unfavourable ground, if we mount our counter-attack on MIT simply by comparison with the present system; and if we offer no other alternative. MIT addresses all the



three criticisms in paragraph 4, though in a way we find unacceptable. We cannot hope to win over all those who criticise the present system, because some of them have a view of society which we do not share. Others however include many of our own natural supporters, and at present they are advocating ITTA. Whatever decision we finally make, we need to win their support.

12. As I have said, I see this as the purpose of any public document we issue. We need to demonstrate why MIT is wrong. We need to bring out the full facts about ITTA - its advantages and disadvantages. And we need to establish whether, in the light of this fuller analysis, there would be sufficient public support to justify the Government committing itself either to the change to ITTA, or, though less likely, to a defence of something very close to the present system.

ITTA - the costs

13. The attached factual paper provides further material on the distributional and other implications of ITTA. It might be helpful to pick out the main points.

14. Losers Any serious reform of the present system must end the present anomaly under which a married couple, where both work, can get more than the total of two single allowances. This means that some 5 million or so married couples must under the new tax system get less relief than they would have got under the existing tax system. However, the paper brings out three facts very clearly:

- a. Most of the losers would be couples without young children - ie young couples who had not yet started a family, or those whose children were teenagers or had left home. The great majority of families with young children would not lose, and on a revenue neutral basis would actually gain (see paragraph 15 below).

*Many of the
mothers go
out to work
part-time.
i.e. up to the
married woman's
earned income relief.*



- b. All but a few of elderly couples over 65 would gain (by contrast with MIT, under which most elderly married couples would lose). A number of couples could lose, when the husband is over 65 but the wife is under 65 (or vice versa). But the transitional arrangements (c. below) would protect them initially, and by the end of the period most of these couples should have become "gainers" because the younger partner would have reached the age of 65.
- c. Transitional arrangements could ensure that no individual taxpayer suffers a withdrawal of tax relief in cash terms, and that a married couple (both working) could actually get increased tax relief in cash terms. This could be done by modifying the normal Rooker-Wise increases in allowances. (The lower the rate of inflation, of course, the longer the transitional period would be, on a revenue neutral basis. If it were wished to shorten the period, the alternatives would be either to put in additional resources or to make some cash reduction in allowances. The pattern of transition and the length of transitional period are questions that - as the paper explains - will need to be decided much nearer the time.) Leaving aside the mechanical details, however, the essential point is that we can hope to avoid the sharp impact on the take home pay of married men of the kind which accompanied the shift from child tax allowances to child benefit, and which affected wage negotiations at the time.
15. By the same token, the savings from ending the present anomaly rising to perhaps £900m on present day values, could on a revenue neutral basis finance higher tax thresholds for taxpayers generally, including the majority of families with young children. Alternatively



the savings could be used to finance improvements especially for families with children or a combination of both. These savings would first begin to emerge at the beginning of the 1990s and, depending on how the transitional arrangements work out, the full amount could be achieved some time around the middle of that decade.

16. Incentive for wives to work The note of our previous meeting recorded scepticism

"about the desirability of altering the tax system to encourage wives to stay at home".

Certainly, I would be against any system that discriminates against wives. (This is the critical objection to ideas of reducing the present allowance for working wives - it would widen the gap between the allowances given to a married man and those received by wives, and would mean that the wife had a smaller tax allowance than anybody else.) The point at issue here, however, is very different. The proposal is to withdraw a selective tax incentive for married women to go out to work, which is given to the husband, not to the wife. This incentive is not available in the case of any single man or woman (and has no precedent in any overseas country). It was universally criticised in the response to the Green Paper.

17. Under ITTA the tax system would neither encourage nor discourage the married woman from going out to work. It would leave the matter to her choice.

18. Effect on husbands and administrative implications

As the factual note explains, we are exploring the possibility of transferring allowances by a system of end-year (not in-year) adjustment. This could have two main advantages. First, it could avoid the situation arising in which a man had his take-home pay cut,



at the point when his wife went out to work. Second, it is already clear that it would significantly simplify the administrative arrangements and cut something like 1,000 off the staff requirements which could - on present estimates - otherwise be of the order of 4,000-4,500 with partial transferability. It is too soon yet to say whether it could open up the possibility of more radical staff saving.

19. Additional requirements on taxpayers As I said in my earlier paper, there is no escaping the fact that there must be some cost, for the Revenue and for taxpayers, in taking on their books up to 12 million married women (though end-year adjustment could minimise this). But "taking on their books" would not mean subjecting them to anything like the "full treatment". For the 5 or 6 million married couples where the wife is at work, there could be little or no change in the present arrangements. For the remainder, we envisage that there might be just one piece of paper, signed by both husband and wife, giving the information which the Revenue would need to transfer the allowance. This would be an additional chore for the majority of men and women, who do not now complete any tax return. But it would be a good deal less formidable and complex than existing tax returns.

ITTA - the advantages

20. As I see it, the advantages of ITTA remain:
- a more coherent and acceptable tax structure No
 - independence where the wife goes out to work or otherwise has her own income
 - fair support where she stays at home to look after the family
 - the recognition that this is her choice, for her to make ?
 - bringing the UK's tax treatment of husband and wife more into line with the best treatment in North America and the rest of Europe.

Are we planning to
have the joint
income - but then
as 2 single incomes?



Conclusion

21. I believe that we should now make a further public statement in response to the 1980 Green Paper on the taxation of Husband and Wife. This would reject MIT with cash benefits and develop fully and sympathetically the implications of ITTA.

22. As I suggested in my earlier paper, any statement of our position should have broad "green edges". I have in mind a very open approach, recognising the attractive features of ITTA, but at the same time emphasising that the Government would not wish to change the system unless there was broad public support for the change, and for the consequent redistribution of the tax burden.

23. As I said at the end of my earlier note, the timetable needs "to give ample time to assess the response to this further consultative document, before we finally commit ourselves to go ahead."

This means that a decision would not need to be, indeed could not be, taken until 1984 at the earliest. But a substantive response in the form of either a consultative document or major speech before the Election might well give us the most defensible basis on which to stand during the campaign.

24. You may wish to discuss.

25. I am copying this minute to Norman Fowler, Patrick Jenkin, Janet Young, Ferdinand Mount and John Sparrow.

A handwritten signature in dark ink, appearing to be 'G.H.'.

(G.H.)

22 April 1983

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FILE

MJ

10 DOWNING STREET

From the Private Secretary

26 April 1983

Dear John,

Taxation of Husband and Wife

The Prime Minister was grateful for the Chancellor's minute of 22 April about the proposal for independent taxation with transferable allowances (ITTA). The Chancellor and the Prime Minister had a word about this at Chequers on Sunday.

The Prime Minister believes that public reaction to this proposal would be hostile, and justifiably so. She also considers that these changes would wholly alter the part-time labour market for married women, and that professional women (teachers, doctors, nurses and so on) would strongly object; so, too, would married women factory staff and the large number of married women working in shops, catering, hotels and so on. The Prime Minister suspects that the response to the Green Paper which showed that virtually everyone was united in rejecting the present system was not a truly representative response. On the assertion (in paragraph 14a) that the great majority of families with young children would not lose, the Prime Minister has commented that many mothers go out to work part-time, up to the married women's earned income relief. On the claim, in paragraph 20, that this change would bring the UK's tax treatment of husband and wife more into line with the best treatment in North America and the rest of Europe, the Prime Minister has asked whether we are planning to halve the joint income and treat it as two single incomes.

I am sending copies of this letter to Steve Godber (DHSS), Jonathan Spencer (Department of Industry), Mary Brown (Lord Privy Seal's Office), Gerry Spence (CPRS) and Ferdinand Mount.

Yours sincerely,

Michael Scholar

John Kerr Esq
HM Treasury.

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DISTRIBUTIONAL AND PRACTICAL IMPLICATIONS OF ITTA WITH
PARTIALLY TRANSFERABLE ALLOWANCES

1. This note answers the factual questions about the consequences of ITTA raised by colleagues at our 30 November meeting.

DISTRIBUTIONAL CONSEQUENCES

Methods of Analysis

2. There are two broad approaches to analysing the distributional effects of change from the present structure of tax allowances to a system of independent taxation with partially transferable allowances.

3. First, we could assume that the structural change was to be made in one step at the existing level of allowances. On this basis the two-earner married couple would lose. One-income couples and single people would have the same allowances as now. A change on this basis would yield a revenue gain of about £m900.

4. Alternatively, the effects can be analysed on the basis of a revenue neutral change. This was the approach adopted in the December 1980 Green Paper and the explanatory material published with it. The assumption made then, and in the analysis that follows in this note and its annex, are that the £m900 revenue savings from the structural change are used to increase the basic single allowance - with the one-income couple continuing to get 1.56 times the single allowance. On this basis, two-earner couples would lose less than they would otherwise; one-income couples and

single people would gain.

5. I should emphasise that these assumptions are made solely for illustration. In principle, the revenue yield from the structural change in the tax system could be used in many different ways. For example, the savings could be used partly or wholly to increase the transferable proportion of allowances for the one-income married couple: this would reduce or eliminate the increase in the basic single allowance, so that single people would either not gain at all, or not gain so much. Or the savings could be used in other ways, for example to direct extra benefits specifically to families with children eg by child-benefit or to reduce the PSBR.

6. Ways of introducing the change over time are also examined in this note. The transitional patterns chosen to illustrate the possibilities show at the end of the day the same savings of around £m900 in constant price terms as a one-step change at existing allowance levels. The same range of options for using the savings is also available here.

7. Against this background the attached note by officials analyses the distributional consequences of ITTA, compared with the present system. It shows:-

- i. the numbers who would gain and lose if ITTA was introduced in one step on a revenue neutral basis, but (for simplicity) disregarding the effect of transitional measures;
- ii. the types of families who would gain and lose, on the same illustrative basis as;
- iii. how transitional arrangements could ensure that the "losers" were not worse off from the change in cash terms.

8. The main points are as follows:-

a. Numbers of gainers and losers

For illustrative purposes it is assumed that a

change to ITTA with partially transferable allowances were made in one step and on a revenue neutral basis, and ^{that} the fm900 or so revenue yield from reducing the allowances available to two-earner married couples would be used to increase the basic single allowance (under the new system this basic allowance would be available to everyone regardless of sex or marital status). An increase in the basic single allowance also automatically increases the amount that can be transferred to the working spouse by a wife (or husband) who stays at home - so one income couples would also get bigger allowances than they get now. As a result about three-quarters of the tax paying population would gain and a quarter would lose. In broad terms:-

- all the 4½ million couples where the wife stays at home would gain (with people below average earnings and the fairly well-paid gaining rather more than those in between).
- most two-earner married couples would lose (some 5 million out of the 6 million in the group). The loss would fall on the husband because he would lose the present lead of the married man's allowance over the single allowance; the working wife herself would usually gain because of the increase in the basic single allowance. The losses would generally be smaller for those with high joint incomes.
- the majority of elderly couples would gain, and would usually gain substantially. They would get a bigger age allowance each, or a bigger transferable allowance. And they would gain more, as a group, from the disaggregation of investment income than younger people. The minority of losers - some 400,000 out of the 1.3 million total - would usually be couples where one partner is under 65 (and most of these 'loser' couples would have become 'gainers' by the end of the transitional period - see c. below). This

analysis assumes that the increase in the basic single allowance would be carried through into an increase in the age allowance. If this was thought excessive - and it is arguable that it would be too generous - a smaller increase in age allowance would reduce the amount of the gain, though without (probably) much of a reduction in the numbers of elderly couples who would gain.

- all single people would gain - 8 million under 65, 1.3 million elderly.

As I have said, this revenue-neutral illustration assumes that all the £m900 or so saving was spent on increasing the basic single allowance. The pattern of gainers and losers would change if it were spent in different ways - eg if it were spent specifically on families with children. This alternative is dealt with in para 2.12 of the note by officials.

b. Types of family who gain and lose: gains and losses over the life cycle.

Families with children. Section 3 of the note by officials brings out the fact that the main reason why wives stay at home is to look after children - particularly young children. Wives are most likely to be at work if they have not yet started a family or if their children are teenagers or have left home. The broad effects of ITTA on families with children would therefore be:-

- the majority of families with dependent children would gain (because the wife is not working at all, or has only small part-time earnings);
- 40% of families with children have a child under 5. In three-quarters of them the wife is not working; all these couples would gain. Some of the rest would also gain, because the mother would have only small part-time earnings;

- 60% of families with three or more children are one-earner couples who would gain from ITTA. (Again, some of the rest would also gain because the mother had only small part-time earnings.)

Other Families. While looking after children is the main reason why the wife stays at home, there are of course other reasons why the wife stays at home rather than working - eg

- older wives who cannot get back into the labour market after having children

(Only 60% of childless women between 50 and 60 have a job, compared with 85% of childless women under 30.)

- younger wives who would like a job and cannot find one
- some wives have to stay at home to look after an elderly relative or because they have a sick husband (this is most likely to be the case if the wife is in her late 40s or 50s than if she is older).

These important - and sensitive - families where the wife is not working would gain from ITTA.

The life cycle. The vast majority of wives work at some stage in their lives. The effect of ITTA will be to redistribute income from the stages in the life cycle at which the wife is working to those where she is not. For most couples this means that they will be worse off as a result of a change to ITTA in their early, childless, married years and in later life when the children become less dependent, but better off than they are now:

- when they have a young family
- when they retire
- and in intervening periods where there are other reasons

(elderly dependants etc) which prevent the wife from going out to work.

Regional Variations. The information on this is limited. In general, the proportions of one-earner and two-earner couples are fairly evenly spread, which implies that the gainers and losers would also be fairly evenly spread. There is a tendency for the proportion of one-income couples to be slightly higher than average in Scotland, Wales and the North (also in East Anglia and the South West) than in the rest of the UK. On the other hand, the regions where the proportions of two-earner couples are higher are also, generally, those (like the South East and Midlands) where incomes are higher and where the losses to two income couples will, on average, be rather lower than in the rest of the UK.

c. Transitional Arrangements

A transitional period would be necessary to mitigate the impact of ITTA on two-earner couples. By definition, of course, the change involves a real reduction in tax allowances for them. So long as inflation persists this can be masked by modifying the Rooker Wise cash increase in allowances that would otherwise be necessary. Perversely, the greater our success against inflation, the more plainly the change will be perceived unless (as is possible) that success itself enables us to raise thresholds in ^{real terms.} /Section 4 of the note by officials shows how it would be possible to manage the transition so that, while these couples would get less tax relief than they would have done if the present system was maintained, nevertheless:

- a. working married couples could get increased tax reliefs between them in cash terms;
- b. no married man would be worse off in cash terms;
- c. one-income couples and single people would get the

and

same in tax reliefs as they would have had under the present system.

The - purely illustrative - examples in the Annex show how this might be done if the annual inflation rate was 10% or 5% (with a transition period of five and nine years respectively). On these particular examples there would be a revenue saving over most of the transition period, with a saving in the last year of around £m900. If this was used to increase tax thresholds generally, one-income couples (and single people) would gain to about the same extent as they would in the - revenue neutral - analysis set out above. Or it could be used in other ways. The precise details of the transition would be a matter of decision at the time, and would depend on the availability of resources, the current level of inflation and the view on how long a transition period would be desirable. In general, the lower the rate of inflation, the longer the transition period at a given revenue yield.

Transitional Arrangements for the elderly. The transitional arrangements for the elderly would be on the same lines as the general transitional arrangements. They would phase in the benefit for those who would gain from ITTA (the majority) and cushion the impact for the minority who did not gain. In practice, the number of elderly couples who would be worse off than under the present system would be very small indeed by the end of the transition period. Most of those who would be 'losers' if the charge to ITTA was made in one step would be couples where only one partner was over 65 (see a. above). By the end of the transition period, most of these under 65 will have reached the age of 65 (and be entitled to age allowance). These couples will therefore gain from ITTA in the same way as other elderly couples.

PRACTICAL EFFECTS OF INTRODUCTION OF ITTA

9. My colleagues may find it useful to have some more detailed information on points about the administrative implications of ITTA - and its impact on the public - which were raised at the 30 November FPG meeting, or are relevant to them.

The effect of bringing 12 million wives into the tax system

10. ITTA would bring some 12 million wives into the tax system, in the sense that they would all formally be responsible for their own tax affairs, instead of being treated as adjuncts of their husbands. This will inevitably involve extra work, and extra staff, for the Revenue. In practice, however, this should not constitute much of an extra burden for the great majority of these 12 million women.

(i) For the majority of working wives (5 million odd in total) there would be no change of substance. Tax is already deducted from their earnings under PAYE and the tax office already writes to them direct about this if correspondence is necessary. In this respect ITTA would make no noticeable difference for most of them. Some of these wives would get annual returns. But the majority would not, because their financial affairs would be pretty straightforward. (And some of their husbands would stop getting annual returns, because once the wife's income was separately taxed his affairs would become straightforward enough for him not to need one.) If the wife received a return, she would have to be given the right to complete it independently if she so wished - many wives would complain if they were not allowed this degree of independence. But there would be no need to insist that the wife should send in a separate return if she does not want to. The wife and husband could be allowed to send in what would in effect be a joint return if they wanted, which would in essence be what happens now.

(ii) Non-working wives, or those with small incomes (7 million or so). Where the wife's income is below the level of the single allowance* (now £1,565), the Revenue would need to know:

* The income level would be higher where the wife is over 65 and gets single age allowance

- whether the husband is claiming the transfer of his wife's allowance
- whether the wife is willing to surrender it
- the amount of the wife's income, so that the Revenue know how much to transfer.

For many taxpayers this will be a new requirement, but it can (and should) be on one piece of paper, and would be much simpler than a normal tax return.

How the Transfer of Allowances would work

11. If one starts from the existing allowance level, partial transferability would mean: £1,565 single allowance; £880 "partially transferable" element (representing the difference between the single and the married man's allowance); £685 the basic or non-transferable element.

The basic or non-transferable element (£685) would be used first. Thus:

- if the wife has an income of £685 or less, she can transfer the whole £880 to her husband; and the husband has total allowances of £2,445 (£1,565 plus £880), equal to the present married man's allowance;
- if the wife has an income of more than £685 but less than £1,565, she can transfer the balance of her personal allowance to her husband: so that, for example, if her income is £1,000, she can transfer £565 to her husband;
- if her income is £1,565 or more, she herself uses the whole of her personal allowance, and she has nothing left to transfer to her husband.

It follows that the wife can go out and earn up to £685 a year (or less if she has investment income) without affecting her husband's take-home pay. To the extent that she earns more

than £685 a year, she uses more of her own tax allowances against her own income, and has correspondingly less (or nothing) to transfer to her husband.

The impact of this on the husband's tax position when the wife went back to work (or stopped) would depend on the administrative arrangements for handling transferability.

12. The Revenue are considering the possibility of dealing with transferable allowances by way of end-year adjustment, instead of an in-year adjustment on the present PAYE pattern. There are various ways in which this could be done. Basically it would mean that transferable allowances would be given at the end of the year, instead of at the beginning, and any transferable allowance due would be given to the husband - as a tax repayment - at the end of the year. Something on these lines would have two big advantages:-

- a. it would greatly simplify the administration of ITTA and could reduce the staff requirement (4,000 - 4,500 on present estimates) by 1,000 or more;
- b. it would make the operation of transferable allowances considerably easier for taxpayers to understand particularly for those who find the amount of the transfer varying from year to year (and this is the area of ITTA which the public will find most difficult).
- c. it would reduce any disincentive to the wife going back to work (because the husband's allowances would not be changed till the end of the year, instead of changing as soon as she went back to work).

The Revenue are studying all this as part of their work on minimising the staff costs of ITTA, and taking the maximum advantage of the opportunities offered by computerisation of PAYE to simplify the administration of the system.

INDEPENDENT TAXATION WITH TRANSFERABLE ALLOWANCES

NOTE BY OFFICIALS

Introduction

1. This note discusses:

- i. The distributional effects of a change to a system of independent taxation with transferable allowance (ITTA), concentrating on the variant with partial transferability. This analysis is in terms of a revenue neutral change made in one step: that is, one that maintains the same overall yield of tax before and after the change.
- ii. The characteristics of the groups of one-earner and two-earner married couples who would be chiefly affected by such a revenue neutral change.
- iii. A possible method of transition to ITTA starting from existing levels of allowances, which avoids reducing the allowance available to a married man in cash terms.

Distributional effects of ITTA

- 2.1 For the purposes of illustration we have analysed the distributional effects of a move to independent taxation with transferable allowances (ITTA) on the basis of a revenue neutral change made in one step - though in practice the transition would almost certainly be made over a number of years in a way that avoided (or went some way towards avoiding) reducing allowances in cash terms - see para 4.1 below.
- 2.2 Because ITTA with partial transferability at existing allowance levels would produce tax savings from cutting the allowances available to the two-earner couple, the assumption of revenue neutrality means that the £m900 or so tax savings could be used to finance an increase in the level of the single allowance which would become the basic allowance for everybody. This would benefit both single taxpayers and one-income couples and reduce the loss for two-earner couples, thus mitigating the adverse effect of the change-over. This is illustrated in the following table:-

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Partial Transferability

	Existing Regime	ITTA with existing allowance levels	Revenue-neutral ITTA
Singles	1565	1565	1655
One-income couples	2445	2445	2585
Two-earner couples	4010	3130	3310

2.3 An alternative approach would be to direct part or all of the £m900 saving specifically to families with children, instead of using it to raise the basic tax allowance for everybody. The effects of this alternative are dealt with in paragraph 2.12 below. For simplicity, the rest of this analysis assumes that all the saving is used to increase the basic allowance.

2.4 The distributional effects of a revenue-neutral change to ITTA with partially transferable allowances are shown in detail in the table following this section. The numbers of gainers and losers, and the percentage change in income after tax, compared with the existing regime (at 1982-83 levels of income, tax allowances etc), are shown for the following groups:

Under 65: Single
One-earner married couples, by level of total income

Two-earner married couples, by level of total income

Over 65: Single
Married couples, by level of total income

- 2.5 Overall, about three-quarters of the current taxpaying population gain from the change. The effect on each of the above groups is summarised in the following paragraphs.
- 2.6 Single people (elderly and non-elderly) are affected only because of the adjustment in the level of the basic allowance required to maintain revenue-neutrality. Under the partially transferable system, the allowance would rise by £90 (£110 for the elderly), so all single taxpayers would benefit. The gain for a basic rate payer would be £27 a year (or £33 for an elderly person).
- 2.7 One-earner married couples all gain; most of the gain (an overall 1% in net income) stems from the general increase in allowance levels, and this is proportionately more important at lower income levels. Couples with wife's investment income will additionally benefit from disaggregation, particularly those at higher income levels. The increase in net income therefore falls from about 1½% at the bottom income range to ¾%, then rises to just over 1% for those on incomes of £12,000 or more.
- 2.8 Two-earner married couples: the majority of couples in this category (and all 'breadwinner wives', who are included in this group) lose; only 0.9 million out of 6.2 million gain. The fall in net income for the group as a whole is 1.7%. The loss generally falls as income rises, both because the cash decrease in the husband's allowance becomes less significant and because couples at higher levels of income are more likely to have offsetting gains from the disaggregation of investment income.

2.9 Elderly married couples: 0.9 million of the 1.3 million couples currently paying tax would gain, and 0.4 million (mostly couples where one spouse is under 65) would lose. The net increase in income after tax for the whole group is some 3½%; the gain is fairly constant at just under 3% at income levels up to £12,000, and rather higher, over 5%, for the few couples with incomes above this level, probably because they benefit from the disaggregation of investment income.

2.10 Elderly couples both over 65 would gain more as a group than younger people for a variety of reasons. They would often get more age allowance between them than now (because they would each be entitled to single age allowance, with a separate income limit). They would benefit more from the disaggregation of investment income than younger people: partly because more of the elderly have investment income and it is a bigger proportion of their income; partly because the wife's own tax allowance would be available against the category B pension (paid in respect of the husband's contributions) instead of being aggregated with the husband's income as it is now. Couples where one partner is under 65 would be more likely to lose because the partner under 65 would not get age allowance, whereas married age allowance now goes to couples where only one partner is over 65 (though by the end of the transitional period many of these under 65s would have reached 65, so that the couple would ultimately gain in the same way as other elderly couples).

2.11 Leaving aside single people. The effect of partial transferability on married couples can be summarised as follows:

	Existing married couple taxpayers	of whom:		Couples brought into tax	Total married couple losers
		gainers	losers		
Partial transferability	12.0	6.3	5.7	0.1	5.8

e, Family atus, and nge of tal income	Number of taxpayers under current scheme (1)	Of those - numbers		Percentage gain or loss (-) in income net of tax for whole group
		gaining (2)	losing (3)	
DER 65:-				
ngle	8.0	8.0	-	+0.6
ried, wife ot working:				
,000 - £4,999	0.8	0.8	-	+1.6
,000 - £7,999	1.8	1.8	-	+1.0
,000 - £11,999	1.3	1.3	-	+0.7
2,000 and over	0.7	0.7	-	+1.1
tal	4.6	4.6	-	+1.0
ried, wife orking:				
,000 - £4,999	0.3	0.1	0.2	-2.3
,000 - £7,999	1.2	0.3	0.9	-2.3
,000 - £11,999	2.6	0.2	2.4	-2.1
2,000 and over	2.1	0.3	1.8	-1.1
tal	6.2	0.9	5.3	-1.7
ER 65:-				
ngle	1.3	1.3	-	+0.7
ried:				
,000 - £4,999	0.5	0.3	0.2	+2.7
,000 - £7,999	0.4	0.2	0.2	+2.8
,000 - £11,999	0.2	0.2	neg	+2.9
2,000 and over	0.2	0.2	neg	+5.2
tal	1.3	0.9	0.4	+3.4
LL TAXPAYERS	21.4	15.7	5.7	-

1) Counting married couples as one

2) Included in these numbers are 0.5m cases taken out of tax

3) In addition, some 0.1m cases are brought into tax

eg : negligible

- : zero

Numbers have been rounded independently and may not add to totals.

12 As we have said, this analysis assumes that all the £m900 saving from cutting the allowances for two-earner couples would be channelled into an increase in the basic tax allowance. There are other ways in which the money could be used. Part or all of it could for example be channelled into child benefit. If part of the £m900 saving were channelled into child benefit, one-income couples with children would gain more, and two-earner couples with children would lose less, but other one-income couples, and childless single people, would have a smaller gain and childless two earner couples would have a greater loss. If all the £m900 saving were spent on increasing child benefit, this would give an extra £1.65 for each child. On this basis:

- one income couples with children would gain more than if the saving was channelled into an increase in the basic tax allowance. (A two-child family, for example, would gain about £170 a year instead of £42, and a three-child family would gain about £260 instead of £42).
- two-earner couples with children would lose a smaller amount than if the saving was channelled into an increase in the basic allowance. A two child family would lose about £90 a year instead of £210. A three child family would lose £ 7, instead of £210, and a four child family would be better off.

This improvement would be at the expense of single people and childless couples (including the elderly)

- childless single people would be in the same position as now, instead of gaining (because their tax allowances would be unchanged instead of increasing)
- childless one-income couples would be in the same position as now instead of gaining (for the same reason)
- childless two-income couples would experience a greater loss (because they would lose the full value of the married man's allowance, without any compensating increase in the value of the basic allowance)

Characteristics of one-earner and two-earner couples

3.1 This section examines the characteristics of the groups of non-elderly one-earner couples (who would all gain from a revenue-neutral change to independent taxation with partially transferable allowances) and non-elderly two-earner couples (who mostly lose). The information comes from a variety of sources (General Household Survey 1981; Labour Force Survey 1981; and Women and Employment Survey 1980), and cannot be linked very closely to the data on which the effects of the taxation change are calculated. In particular, some women who are classified as working in these surveys may have part time earnings so low that they are not reported for tax purposes; a couple in this position would be classified as 'one-earner' in our tax calculations. An instance where this may have an effect on the overall picture is pointed out in paragraph 3.5.

Age and children

3.2 Non-working wives (and presumably their husbands too) tend to be younger than two-earner couples:

Age of wife	Percentage of one-earner couples	Percentage of two-earner couples
16-34	47	31
35-59	53	69
	<hr/> 100	<hr/> 100

However, this is largely if not wholly accounted for by the presence of dependent children; younger women tend to be at home because they are more likely to be looking after children. The presence of dependent children is the single most important determinant of whether a wife is working, and in particular the age of the youngest child:

	Percentage of one-earner couples	Percentage of two-earner couples
Wife 16-34, dependent children	43	18
Wife 16-34, no dependent children	4	13
Wife 35-59, dependent children	28	35
Wife 35-59, no dependent children	25	34
	<u>100</u>	<u>100</u>
All wives without dependent children	29	47
All wives with dependent children	71	53
of which, youngest child age: 0-4	41	10
5-9	16	16
10 or more	14	27
All wives with dependent children	71	53
of which, number of children: 1	24	21
2	31	24
3	11	6
4 or more	5	2

3.3 The main conclusions to be drawn from this table are:

Of one-earner couples, who all gain from ITTA:

- around 70% have dependent children
- around 40% have at least one child under 5
- just under half have two or more children.

Of two-earner couples, who mostly lose:

- just over half have dependent children
- only 10% have a child under 5
- about a third have two or more children.

3.4 The data can also be analysed in another way to assess the probability of sensitive groups gaining or losing. The results can be summarised as follows:

- half of all families with dependent children have mothers who work, half are one-earner
- three-quarters of families with at least one child under 5 have non-earning wives, and must therefore gain from ITTA
- 60% of families with three or more children are one-earner couples.

3.5 A gloss on these results is that some 70% of working mothers with dependent children work only part-time (and the greater the number of children, and the younger their ages, the greater the incidence of part-time work). Some of these, with very low part-time earnings, will be amongst the minority of two-earner couples who gain from ITTA. Hence families, and particularly larger families with young children, are even more likely to be amongst those gaining.

3.6 There are also suggestions that, for a variety of possible reasons, there is a stronger than average likelihood that, if the husband is unemployed, the wife will also not be economically active. Couples in this position would be kept out of tax by ITTA, whilst under a scheme of independent taxation with child benefits, the husband would be liable to tax if he had only a small amount of income in addition to his unemployment benefit.

Regional variation

3.7 Unpublished figures from the 1981 Labour Force Survey, covering married women of all ages, show some, but by no means large, regional variation in the proportion in employment:

	Number of married females, all ages, ⁺ in the region (millions)	Percentage in employment
Great Britain	13.5	46.0%
Scotland	1.2	45.2
Wales	0.7	41.3
Northern Yorkshire & Humberside	0.8	43.6
North West	1.2	46.3
West Midlands	1.6	48.4
East Midlands	1.3	46.1
South East	1.0	47.4
East Anglia	4.2	47.0
South West	0.5	44.1
	1.1	43.2

It is difficult to assess the extent to which these variations are associated with regional differences in (eg) demographic characteristics; for instance, a lower than average proportion of the total population is of working age in East Anglia and the South West, and this may account for the lower than average percentage of two-earner couples in those two regions. Differential unemployment rates would clearly be another important factor. It has not been possible within the time and resources available to explore all the causes that could underlie these regional differences, even to the extent that the information to do so exists.

Changes in the position of couples over the life-cycle

3.8 The results discussed above are all based on cross-sectional data, which shows the proportion of women who are working or not working at any one point in time. A different perspective is afforded by the use of longitudinal data which has recently become available from a survey on Women and Employment carried out in 1980. (These results are preliminary, and the report will not be published until mid-1983).

⁺ ie some 12m of these are members of married couples who pay tax; 1½m are not.

3.9 The results of this survey confirm that the presence of children, and particularly the age of the youngest child are the most important determinants of whether a wife is working. Those two variables, together with age, have been combined into a complete life cycle variable, and the following table shows how the proportion of married women working varies at different life cycle stages.

Life stage	Proportion of wives in employment
	Per Cent
Under 30, childless	84
30 and over, childless	77
Youngest child aged 0-4	25
Youngest child aged 5-10	64
Youngest child aged 11-15	77
Children 16 + aged 30-49	78
No child under 16, aged 50-59	59
All married women aged 16-59 excluding students	60

3.10 As looking after children is the primary reason for not working it follows that most women are absent from the labour market only temporarily, and the longitudinal data confirms this. It is difficult to give concise information about this because the proportion of her potential working life a woman has spent at work will depend not only on the stage of the life cycle reached but also on her date of birth. The earlier the generation, the longer spent away from the labour market; nevertheless, even the oldest women in the survey, those aged 55-59, had on average spent 60 per cent of their total possible working lives in work. An indication that this proportion is likely to rise for successive generations is that women aged 35-39 had already spent a similar proportion of their possible working life to date in work; as most of this group will be reaching the end of the child-rearing and caring stage and tending to return to work, this cohort will by the end of their working lives have spent substantially more than 60 per cent of their time in employment.

3.11 However, the survey also suggests that older, non-working women are more likely than their younger counterparts to be affected by ill-health, to be caring for elderly or disabled dependants or to face difficulties in returning to work after a long absence from the labour market. This effect is obviously connected with age rather than the cohort the women belong to, and so is likely to be a persistent factor in depressing the activity rate of older women. ITTA (in contrast to MIT) will preserve the position of couples where the wife is not working for reasons such as these:

3.12 The conclusion to be drawn from this is that the vast majority of couples will at some stage of their lives be one-earners, and at others two-earners. The redistribution from the latter to the former that would result from ITTA should therefore not be viewed as benefitting one fixed group of couples at the expense of another. Rather, it redistributes income from one stage of the life cycle to another for nearly all couples - making them better off during the child-rearing period (when the family income tends to be lowest) at the expense of their early, childless, married life and later life when children become less dependent. (However, it may be difficult for couples already part of the way through their married life at the time^{of} the changeover to view the impact in this way.)

Transitional arrangements

4.1 It is of the essence of the change to independent taxation with partially transferable allowances that the two-earner couple - specifically the husband - will get smaller allowances than they would have enjoyed (other things being equal) under the present system.⁽¹⁾ This is the necessary consequence of abolishing the married man's allowance, as such. There is no escaping that effect, and merely transitional arrangements cannot reverse it. However, they can phase in the changes relatively gradually - and therefore less painfully - over a period of years. For example, they offer the possibility of using the effects of revalorisation (in line with inflation) to "float off" the present married man's allowance - so that, though the total tax reliefs available to a married man are lower in real terms than they would have been otherwise, they are never actually reduced in cash terms.

4.2 One basic possibility might be to

- a. revalorise the single person's allowance in line with inflation in the usual way;
- b. "freeze" the married man's allowance at its present cash level, until it is overtaken by the revalorised single person's allowance - at which point it is subsumed in the single person's allowance and the transition is complete;
- c. phase in the transferable allowance year by year - representing the difference (under a scheme of partially transferable allowances) between 1.56 of the single person's allowance at a. above and the present

(1) With fully transferable allowances the basic allowance would, on a revenue neutral basis, be lower than the current single allowance; so wives of two-earner couples would also lose, as would single people.

- 4.3 This can be illustrated as follows, starting from existing, 1982/83, levels of allowances assuming inflation rates of 10% and 5% per annum with transitional periods of 5 and 9 years respectively.

Transition over 5 years with 10% inflation

	Present rates	Year Y	Y+1	Y+2	Y+3	Y+4	Y+4 under current system*
<u>Single person</u>	1565	1720	1890	2080	2290	2520	2520
<u>Married man (wife not earning)</u>							
"frozen" MAA	2445	2445	2445	2445	2445	2520	
additional transferable allowance	-	245	515	810	1135	1420	
<u>Total of i. and ii. above</u>	2445	2690	2960	3255	3580	3940	3940
<u>Two-earner couple</u>							
husband	2445	2445	2445	2445	2445	2520	
wife	1565	1720	1890	2080	2290	2520	
<u>Total of i. and ii. above</u>	4010	4165	4335	4525	4735	5040	6460

*For comparison with the preceding column, this column shows the level of allowances which would prevail at the end of the transition period if the existing tax régime continued with revalorisation of allowances by the appropriate percentage each year. The figures shown represent, respectively, the single person's allowance; the married man's plus wife's earned income allowance; and the married man's allowance.

4.4 On the assumption of 5% inflation the pattern would be basically the same, with smaller changes in the allowance levels each year:-

Transition over 9 years with 5% inflation

	Present rates	Year Y	Y+1	Y+2 Y+8	Y+8 under current system*
<u>single person</u>	1565	1645	1725	1815	2445	2445
<u>married man (wife not earning)</u>						
"frozen" MMA	2445	2445	2445	2445	2445	
i. additional transferable allowance	-	120	245	385	1370	
<u>Total of i. and ii. above</u>	2445	2565	2690	2830	3815	3815
<u>Two-earner couple</u>						
i. husband	2445	2445	2445	2445	2445	
ii. wife	1565	1645	1725	1815	2445	
<u>Total of i. and ii. above</u>	4010	4090	4170	4260	4890	6260

(The slightly lower allowance levels in the final year here than appear in the previous table arise simply because for consistency a 10% inflation increase was assumed for the final year even though this took the single allowance above the level of the "frozen" MMA.)

* See footnote on previous page.

4.5 It will be seen that .

- the single person's allowance increases in line with inflation
- the total allowances available to the one-earner couple - that is the "frozen" MMA plus the transferable allowance - increase in line with inflation, and remain at 1.56 times the single person's allowance
- the total allowances available to the two-earner couple increase every year in cash terms - though by less than enough to compensate for the full effect of inflation
- at no. point is there any reduction in the cash value of the allowances given to the married man - either in the one-earner couple or in the two-earner couple.

4.6 The transitional arrangements would be broadly similar for elderly couples (though the amounts would be different, to take account of age allowance). Special arrangements would also be needed to avoid a loss in cash terms for the relatively few "bread winner wives".

4.7 Because of the real reduction in allowances for the two-earner couple, a scheme of this kind, would begin to throw up a net saving (after the second year) and this would rise to approximately £m900 per annum by the final year. This saving would be available, if desired, to finance an increase in the basic personal allowance - and therefore a somewhat more generous transition. Alternatively part or all of it could be used to finance (eg) higher child benefit.

4.8 These two tables are purely illustrative. Similar schemes would be possible for different levels of inflation, and different lengths of transitional period. Generally

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speaking, the lower the rate of inflation the longer the period of transition, and the less the revenue savings (or the greater the cost). The precise path and speed of the transition would be for the Chancellor of the day to determine in the light of circumstances at that time. Budgetary considerations might make it possible to put in additional resources to speed the transition or make it more generous. Alternatively it might be impossible to afford full revalorisation, in which case a slower or perhaps a more painful transition would be necessary.

- 4.9 For present purposes it is sufficient to note that there is scope for transitional arrangements which neither cut the cash value of any taxpayer's allowances nor necessarily involve a net cost to the Exchequer.

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