Child Benefit for higher rate taxpayers

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Child Benefit is a universal, non-taxable cash payment for families with children. It is currently worth £20.30 a week for the eldest eligible child, and £13.40 for each subsequent child. Around 7.8 million families were paid Child Benefit in 2009-10 at a total cost of just under £12 billion.

The benefit was introduced in 1977 to replace the Family Allowance and Child Tax Allowances. While the commitment of successive governments to universal Child Benefit has at times been questioned, it has survived broadly intact. The last Labour Government significantly increased income-related support for families with children through tax credits but retained Child Benefit, in line with its commitment to "progressive universalism".

The Coalition's June Budget announced that Child Benefit would remain, but that rates would be frozen for the next three years. At the Conservative Party conference on 4 October, the Chancellor said however that from 2013 Child Benefit would be withdrawn from families with a higher rate taxpayer, saving around £1 billion a year. Child Benefit would continue to be paid to all families, but would be clawed back where the recipient, or their partner, paid higher rate tax. The Spending Review on 20 October revised upward the estimated savings to £2.5 billion a year. The Institute for Fiscal Studies estimates that 1.8 million families will be affected.

Commentators have pointed out that, under the proposals, a lone parent or single earner couple earning just above the higher rate threshold (currently £43,875) would lose their Child Benefit, while a dual earner couple both earning just under the threshold would continue to receive it. The reform could also distort incentives for those with incomes around the higher rate tax threshold. Media reports that some in the Treasury believe the policy to be "unenforceable" have been denied by the Government.

Press reports suggest that further Government plans to end Child Benefit for young people aged 16 an over have been shelved.

This note looks at the background to the announcement, and at issues raised by the clawback of Child Benefit from families with a higher rate taxpayer.

Contents

1 Background

1.1 What is Child Benefit?

Child Benefit is a tax-free cash benefit paid to people responsible for children. In the case of couples, it is usually paid to the mother. It is payable in respect of each child or young person who is:

- under 16;
- over 16 and up to age 20, and in non-advanced education or training that qualifies for Child Benefit; or
- 16 or 17, has left education or training that qualifies for Child Benefit and is registered for work, education or training with an approved body

The amount paid depends only on the number of children in the family, with a higher rate for the eldest child (currently £20.30 a week). The rate for each subsequent child is £13.40 a week. Child Benefit is administered by HM Revenue and Customs.

At August 2009 7.8 million families in the United Kingdom received Child Benefit for 13.6 million children.[1] Total expenditure in 2009-10 was £11.9 billion.[2] Take-up of Child Benefit is estimated at 97 per cent.[3]

Child Benefit is not the only source of financial assistance for families with children. **Tax Credits** were introduced by the Labour Government in April 2003 to "tackle child poverty and help to make work pay."[4]

Tax credits comprise:

- **Child Tax Credit**, payable to people with children. Child Tax Credit replaced the child allowances within Income Support and income-based Jobseeker's Allowance, and the increases for child dependants paid with non-means tested benefits such as Incapacity Benefit. The intention was that the Child Tax Credit, along with Child Benefit, would constitute a "single, seamless system of support for families with children, payable irrespective of the work status of the adults in the household."[5] The Government hoped that this would ease the transition from welfare to work for families with children, and create a more inclusive system of support for children that did not stigmatise poorer families.[6]
- **Working Tax Credit**, payable to people in low-paid work, including those without children. Those with children may be able to get help with childcare costs via the "childcare element" of the Working Tax Credit.

People may receive the Child Tax Credit, or the Working Tax Credit, or both. Tax credits are claimed on a family rather than an individual basis, so that for couples the incomes and circumstances of both partners will be taken into account.

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1 HMRC Child Benefit Geographical Statistics
2 *HM Revenue and Customs 2009-10 Accounts*, HC 299 2010-11
3 HMRC Child Benefit, Child Tax Credit and Working Tax Credit Take-up rates 2007-08
4 HM Treasury, *The Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System*, Number 10, April 2002, para 1.2
5 *ibid.* para 2.3
6 *ibid.*

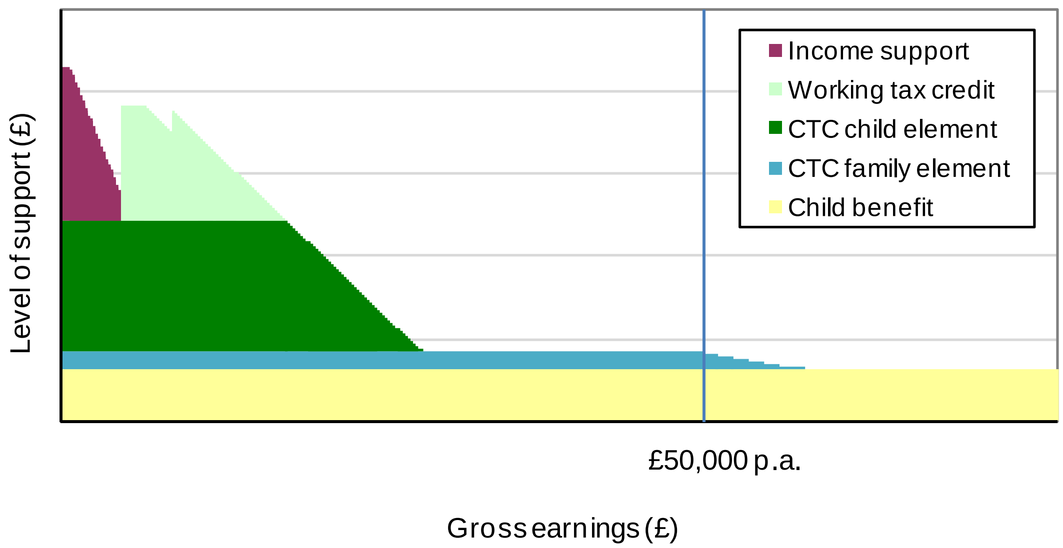
How much a family receives from tax credits will depend on a number of factors including:

- The number and ages of the children, and whether any are disabled
- The number of hours worked by the adults, and whether they are disabled
- Whether the family is incurring childcare costs for eligible childcare
- The family's income from earnings and other sources

Tax credits are means-tested; i.e. the amount received depends on income, so that in general the amount received tapers away as income increases. However, the "family element" of Child Tax Credit (worth £545 for most families) is currently payable in full for families with incomes up to £50,000 a year.

The following chart shows how Child Benefit fits in with the Child and Working Tax Credits, for a single-earner couple with two children.

Level of support (£)
couple with two children, one earner



Child Benefit remains payable at the same rate regardless of family income, as indicated by the horizontal band.

Families and individuals eligible for Working Tax Credit (either on its own, or with CTC) receive the maximum amount of tax credits if their income is below a threshold set at £6,420 for 2009-10 and 2010-11. For those with incomes above this threshold, the maximum award is reduced by 39 pence for every pound of income above the threshold. The WTC is withdrawn first, followed by the per child elements of CTC. The family element is retained is however retained in full until family income reaches £50,000 a year. Beyond this income level, the family element is withdrawn at a rate of £1 for every £15 of income.

At April 2010, 6.3 million families received tax credits, of whom 5.8 million were families with children (containing 10.2 million children). Of those, 1.5 million families contained non-working adults, and 1.7 million were higher income families receiving only the CTC family element or less.[7] Total expenditure on tax credits was £26.8 billion in 2009-10, although this includes Working Tax Credits for people without children.[8]

Various changes to tax credits were announced in the Coalition's June Budget[9] and in the Spending Review on 20 October. As a result of these, overall spending on tax credits will be around £4.4 billion a year lower by 2014-15, but increases in the CTC child element and an increase in the first withdrawal rate will refocus resources on the poorest families. From April 2012 the CTC family element (coloured blue in the chart above) will taper off immediately after the child element(s) and at the same rate, meaning that many middle and higher income families will lose entitlement to tax credits completely.

1.1 The origins of Child Benefit

Child Benefit first became payable in 1977, and was fully phased in by 1979. Prior to this, families with children received financial support through Child Tax Allowances and Family Allowances.

Child Tax Allowances (CTAs) were introduced in 1909. The rationale was that the presence of dependent children lowered the taxable capacity of a worker, when compared with those without children. In other words, CTAs were a means of achieving *horizontal equity in the tax system*.

Family Allowances first became payable in 1946. The Beveridge Report had included a universal system of "children's allowances" as one of the three basic assumptions underpinning the plan for social insurance (the other two being full employment and a national health service).[10] For Beveridge, universal children's allowances would be necessary to *protect the low paid with large families* (he estimated that between one-sixth and one-quarter of cases of "want" were due to "failure to relate income during earning to the size of the family"[11], and to *maintain work incentives* (since families getting insurance or assistance benefits could, with dependency additions, have incomes greater than potential earnings in work. Beveridge also argued that they would help restore the birth rate and act as "a signal of the national interest in children". "Children's allowances", wrote Beveridge, "should be regarded both as a *help to parents in meeting their responsibilities*, and as an acceptance of *new responsibilities by the community*" (emphasis added).[12]

Under the Beveridge proposals, children's allowances would have been set at a rate to cover the full subsistence needs of a child. Payments would however be limited to second and subsequent children, since "very few men's wages are insufficient to cover at least two adults and one child". Moreover, the system should be based on the principle that "the cost of maintaining children should be shared between the parents and the state". To provide

7 HMRC Child and Working Tax Credits Statistics April 2010

8 *HM Revenue and Customs 2009-10 Accounts*, HC 299 2010-11

9 For an analysis see the Citizens Advice briefing, *The Coalition Budget 2010: Key welfare changes and their impact on low income families*, July 2010

10 *Social Insurance and Allied Services*, Cmnd 6404, 1942

11 Cmnd 6404, p7 and paras 411-413

12 *Ibid.* para 413

allowances for all children in a family would be an "unnecessary and undesirable inroad on the responsibilities of parents". [13]

The 1944 White Paper on *Social Insurance*[14] set out the principles upon which the system of Family Allowances was to be based. Rather than a full maintenance payment, the Family Allowance was presented as a "*general contribution to the needs of families with children*", on the grounds that "nothing should be done to remove from parents the responsibility of maintaining their children".[15] The Allowance was limited to second and subsequent children, but set below the subsistence level recommended by Beveridge, although an expansion of benefits in kind for children was also envisaged.[16] It was originally intended that the Family Allowance would be paid to the father, but an amendment to the *Family Allowances Bill* tabled by Eleanor Rathbone provided for payment to be made to the mother.

The combination of Child Tax Allowances and the Family Allowance raised a number of issues. All families paying tax received tax relief for each child, but the CTA was worth more for parents paying tax at higher rates. Families below the tax threshold did not benefit at all from the CTA, although they received the full Family Allowance. However, the Family Allowance on its own provided limited help towards the costs of child-rearing, and was only uprated four times during its existence. Non-taxpaying families with only one child received no help at all.

1.2 Introduction of Child Benefit

The *Child Benefit Bill* was introduced in May 1975 by the Labour Government, with all party support. Introducing the Bill at Second Reading, the then Secretary of State for Social Services, Barbara Castle, said:

> It gives me the greatest pleasure to introduce the Bill, which I am sure will be accepted on all sides of the House. It achieves a long overdue merger between child tax allowances and family allowances into a new universal, non-means tested, tax-free cash benefit for all children, including the first, payable to the mother. In this way it ensures that the nation's provision for family support is concentrated first and foremost where it is needed most on the poorest families; and that it goes to the person responsible for caring for the children and managing the budget for their food, clothing and other necessities.[17]

Later, she said:

> What will the child benefit scheme achieve? First and most important the poorer families who have not been able to take advantage of child tax allowance in full, if at all, because of their low incomes, will in future do so, as the new benefit extends the cash advantage of the allowance to all these families. Those who are dependent on means-tested benefits will receive a larger part of their income from benefits as of right. Secondly, child benefit will be paid for every single child in the family, thus extending the benefit of a payment to the first child in 4 million families drawing family allowance as well as to the 3 million single child families, thus doubling the number of children

13 *Ibid.* para 417
14 Cmnd. 6550
15 *Ibid.* p14
16 In the event these were however never fully developed.
17 HC Deb 13 May 1975 c330

> receiving benefit. Thirdly, once the scheme is operating, we shall have for the first time a single universal system of family support.[18]

Child Benefit was introduced in 1977 (though only after an outcry when it appeared that the Labour Government was planning to abandon it due to financial pressures[19]), and Child Tax Allowances were phased out by 1979.

1.3 The Conservative Governments 1979-1997

The incoming Conservative Government retained Child Benefit but rates were frozen for three successive years from 1988. In his Budget Statement in 1991 the then Chancellor, Norman Lamont, announced a new, higher rate of Child Benefit for the first eligible child. He also gave a commitment to increase Child Benefit in line with inflation from 1992.[20]

The "Fowler Reviews" of social security in the mid 1980s looked at the role of Child Benefit within the broader system of financial support for families with children. Various options – including means-testing Child Benefit, taxing Child Benefit, and changing the benefit's structure – were examined but rejected. The 1985 Green Paper, *Reform of Social Security: Programme for Change*, stated:

> The Government's conclusion from their study of the role of Child Benefit was that it had underlined the fact that there are two clear and distinct aims in helping families with the cost of bringing up children. The first is to provide help for families generally while the second is to provide extra help with low income families. It would be a serious mistake to confuse these quite distinct purposes or to seek to restructure a benefit designed to meet one aim in order to meet another aim. Child benefit is designed to meet the needs of families generally. As such, it is... simple, straightforward, well understood and preferred as it is. The case for changing it has not been made out. The Government do not therefore propose to alter its basis or structure.[21]

The Green Paper confirmed that the Government accepted the case for continuing the system of Child Benefit:

> It is right that families with children at all income levels should receive some recognition for the additional costs of bringing up children and that the tax/benefit system should allow for some general redistribution of resources from those without children to those who have responsibility for caring for them. Child benefit is simple, well understood and popular. The system of payment usually to the mother is also well established and appreciated and, although the result is that the value of the benefit as part of general household income is often overlooked, the Government do not wish to change it. Accordingly, child benefit will continue on its present basis as a universal benefit, generally payable to the mother and paid at a flat rate for each child.[22]

The Green Paper did however recommend extra help for low income families via the new systems of Income Support and Family Credit. Family Credit, which replaced Family Income Supplement, was introduced in 1988.

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[18] HC Deb 13 May 1975 c334

[19] See Michael McCarthy, *Campaigning for the Poor: CPAG & the Politics of Welfare*, 1986, Chapter 11

[20] HC Deb 19 March 1991 cc 179-180

[21] Cmnd. 9518, para 4.37

[22] *Ibid.* para 4.44

1.4 The Labour Governments 1997-2010

The incoming Labour Government in 1997 decided – controversially – to proceed with plans originally announced by the Conservative Government to abolish the additional "One Parent Benefit" for lone parents.[23]

In his March 1998 Budget, the then Chancellor, Gordon Brown, announced an additional increase of £2.50 a week in the rate of Child Benefit for the first child, over and above the normal uprating. He also hinted that, were Child Benefit to be raised further, there might be a case for taxing it for higher rate tax payers.[24] In his Statement on the Comprehensive Spending Review on 14 July 1998, Mr Brown also suggested that Child Benefit for the over 16s could be replaced by means-tested education maintenance allowances.[25] However, neither idea was taken forward[26], and the Government subsequently extended eligibility for Child Benefit to cover young people in further education or unwaged training up to the age of 20.[27]

The main development during the Labour Government's period in power was, as noted above, the introduction of tax credits (the Working Families' Tax Credit, later replaced by the Child Tax Credit and Working Tax Credit). When Labour first set out plans for an "Integrated Child Tax Credit" (later to become the Child Tax Credit), concerns were expressed that universal Child Benefit might be allowed to "wither away".[28] However, Government statements emphasised that Child Tax Credit would "build upon" the "foundation of universal Child Benefit".[29] In response to a question from David Laws in 2006 on whether the Government had considered the merits of taxing Child Benefit, the then Paymaster General, Dawn Primarolo, said:

> The Government's system of financial support for families with children is built on the principle of progressive universalism, delivering help for all families and more help for those who need it most. Universal child benefit forms the foundation of this system, recognising the extra costs and responsibilities associated with bringing up a child. The Government believe it is right that society should recognise the importance of family life by providing financial support for every family with a dependent child, and will not tax child benefit. Child benefit is complemented by child tax credit, which delivers greatest support to those who need it most, including families on lower incomes, those with children under one, and parents of disabled children.[30]

1.5 The functions of Child Benefit

As the chronology above indicates, Child Benefit has been said to perform a number of functions, and different functions have been emphasised at different points in time. A March 1999 report by the former Social Security Committee acknowledged the "multi-purpose role" of Child Benefit in-

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23 See Library Research Paper 97/93, *Social Security Bill 1997/98*
24 HC Deb 17 March 1998 cc 1107-1108
25 HC Deb 14 July 1998 c192
26 Announcing the national roll-out of Education Maintenance Allowances in the 2002 Spending Review, the Chancellor said that the scheme would be funded from savings flowing from reducing unemployment and debt (HC Deb 15 July 2002 c29)
27 See Library Research Paper 05/02, *Child Benefit Bill 2004-05*
28 See Social Security Committee, *Integrated Child Credit*, HC 72 2000-01, para 18
29 Budget 2003, HC 500 2002-03, para 5.14
30 HC Deb 12 January 2006 c765w

- Promoting "horizontal" equity between people of similar incomes, with and without children;
- Providing a contribution from society as a whole to the next generation;
- Supplementing parents' earnings, in recognition of the fact that wages do not take into account, and thereby helping to overcome unemployment and poverty traps;
- Giving a stable element at times of financial insecurity caused by, for example, insecure employment or family breakdown; and
- Offering an independent income for women[31]

In a briefing in August 2006, the Child Poverty Action Group summarised the arguments in support of Child Benefit and similar benefits as follows:

- **Horizontal redistribution**. Since those with children have higher costs than those without, they need additional support at whatever level of income they live on, in order to equalise the tax contribution between those with and those without children.
- **Lifecycle redistribution**. Most people have children at some point, and that is a time when needs are higher and income tends to be lower; so child benefit helps to redistribute resources (and the tax contribution) over the lifecycle.
- **Intergenerational redistribution**. Since everyone – childless people, as well as those with children – will benefit in due course from the productivity of children being brought up now, society should share the cost of bringing up those children with their parents, as an investment by us all in the next generation.
- **Value placed on children**. A payment to all children is concrete evidence of the value placed on children and child-rearing by society. In 1999, the Chancellor of the Exchequer described children as 20 per cent of the population but 100 per cent of our future.[32]

A further argument in favour of *universal* Child Benefit has a political dimension. The CPAG briefing noted the "resilience" of Child Benefit over the last 30 years, in contrast with means-tested support for children, which had been reformed several times. It added:

> A benefit which goes to virtually all children is of course expensive. But it can also be argued that it is more likely that such a benefit will have 'substantial and wide-ranging support', and may be difficult to abolish; provision for the poorest children only, whilst cheaper, is often more precarious.[33]

In a recent comment piece, the Labour MP and former Chief Executive of CPAG, Kate Green, said:

> Politicians have all too often seen [Child Benefit] as an easy target, underestimating its importance in protecting families, and just as importantly, its symbolic significance in giving every family a stake in the welfare state. It's often said that it's the sharp elbows of the middle classes that preserve standards and investment in the NHS, or in schools - the same is true of child benefit too. Residualised benefits that go only to low-income

31 HC 114 1998-99
32 Fran Bennett with Paul Dornan, *Child benefit: fit for the future*, CPAG, August 2006, p12
33 *Ibid.* p30

> households quickly become Cinderella benefits, under-invested in and under attack. But of course, that's the underlying philosophy of this government - a residualised benefits system, which insists that claimants face the indignity of difference - at best a patronising, at worst a demonising, approach to the provision of welfare support.[34]

For a further discussion of the functions of Child Benefit, and the arguments for and against it, see also Library Research Paper 98/79.

2 Recouping Child Benefit from higher rate taxpayers

Neither the Conservative nor the Liberal Democrat General Election manifestos mentioned Child Benefit. However, in his speech to the Conservative Party conference on 6 October 2009, the then Shadow Chancellor, George Osborne, had said:

> We will preserve child benefit, winter fuel payments and free TV licenses. They are valued by millions.[35]

At a public meeting on Bolton on 5 March 2010 David Cameron is also reported to have said that he "...wouldn't change Child Benefit".[36]

2.1 Announcement in the June 2010 Budget

In his Budget speech on 22 June 2010, the Chancellor said that the Government had had to take a "difficult decision" about Child Benefit:

> I have received many proposals about this benefit. Some have suggested that we means-test it; others that we tax it. All these proposals involve issues of fairness.
>
> The benefit is usually claimed by the mother. To tax it would mean that working mothers received less than the non-working partner of higher earners. To means-test it, we would have to create a massively complex new system to assess household incomes. I do not propose to do those things. I know that many working people feel that their child benefit is the one thing that they get without asking from the state. So instead, to control costs, we have decided to freeze child benefit for the next three years. This is a tough decision, but I believe that it strikes the right balance between keeping intact this popular universal benefit, while ensuring that everyone across the income scale makes a contribution to helping our country reduce its debts.[37]

The Budget *Red Book* estimated that freezing Child Benefit would save £365 million in 2011-12, £695 million in 2012-13, £940 million in 2013-14 and £975 million in 2014-15.[38]

2.2 Announcement at the Conservative Party conference

In his speech to the Conservative Party conference on 4 October, Mr Osborne announced that Child Benefit would also be withdrawn from higher rate taxpayers:

> We still pay over a billion pounds a year in child benefit to higher rate taxpayers.
>
> Believe me, I understand that most higher rate taxpayers are not the super-rich.

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[34] Kate Green, 'Why we must defend child benefit', *Progressonline*, 5 October 2010
[35] *George Osborne: We will lead the economy out of crisis*
[36] 'Stay-at-home mothers his by benefit cut', *Daily Telegraph*, 4 October 2010
[37] HC Deb 22 June 2010 c173
[38] HC 61 2010-11, Table 2.1

> But a system that taxes working people at high rates only to give it back in child benefit is very difficult to justify at a time like this.
>
> And it's very difficult to justify taxing people on low incomes to pay for the child benefit of those earning so much more than them.
>
> These days we've really got to focus the resources where they are most needed.
>
> We've got to be tough but fair.
>
> That's why we will withdraw child benefit from households with a higher rate taxpayer.[39]

The measure would, it was announced, save an estimated £1 billion a year. In the same speech, the Chancellor also announced a "benefit cap" so that "no family on out of work benefits will get more than the average family gets by going out to work." Further details of both proposals were given in press releases issued by the Conservative Party[40] and by the Treasury.[41] Child Benefit would continue to be paid for all children, but would be clawed back from families containing a higher rate taxpayer from 2013. HM Revenue and Customs would implement the policy "through the existing PAYE and Self-Assessment structures."[42]

The announcement provoked strong reactions in certain sections of the media. Particular attention was focused on the perceived anomaly whereby single earner couples earning just over the higher rate tax threshold would have their Child Benefit clawed back, while dual earner couples each earning just below the threshold would keep the full amount. The *Daily Mail* commented, "...yet again, the political classes are penalising the traditional family unit".[43] The *Daily Telegraph* called the Government's plan "ham fisted", adding that while universal benefits for high earners were hard to justify, "...to use quite such a crude and unfair mechanism to demonstrate the Coalition's willingness to take difficult choices was a mistake."[44]

Subsequent comments by the Prime Minister and others were interpreted as suggesting that the Government might introduce transferable tax allowances to address the single earner/dual earner problem.[45] The Conservative Party had proposed, in the run-up to the General Election, transferable tax allowances for couples and civil partners. However, this would be worth only up to £150 a year and would be limited to basic rate taxpayers, at a total cost around of £550 million a year.[46] The *Financial Times* quoted Mike Brewer of the Institute for Fiscal Studies as saying:

> "There are many ways you could design a transferable allowance for higher-rate taxpayers," he added. "But if you have one in which all the personal allowance is transferred but only for couples with children under 16, it would cost about £1.6bn, which is more than the cut in child benefit saves."[47]

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39 Conservative Party website, *George Osborne: Our tough but fair approach to welfare*, 4 October 2010
40 *Osborne unveils tough but fair approach to welfare*, 4 October 2010
41 HM Treasury press notice 48/10, *Chancellor announces reforms to the welfare system*, 4 October 2010
42 HM Treasury press notice 48/10
43 'Daily Mail comment: an anomaly that hits traditional families', *Daily Mail*, 5 October
44 'Clever politics? No, crass and out of touch', *Daily Telegraph*, 6 October 2010
45 'Cameron looks at steps to ease pain', *Financial Times*, 6 October 2010
46 *Ibid.*
47 *Ibid.*

The Coalition Agreement mentions transferable tax allowances, but only in the context of ensuring that provision is made for Liberal Democrat MPs to abstain on any budget resolutions to introduce such allowances without prejudice to the Agreement.[48]

On 6 October, reported comments from the Secretary of State for Work and Pensions, Iain Duncan Smith, which were interpreted as suggesting that some of the anomalies in the Child Benefit plan could be "rectified" by the proposed Universal Credit by 2017:

> The work and pensions secretary said the benefit would be absorbed into a new universal credit by 2017, dealing with problems raised by George Osborne's controversial announcement.
>
> Duncan Smith also suggested that if the credit were based on household income rather than individual income, it would tackle anomalies in Osborne's plan.
>
> [..]
>
> Speaking at an Observer fringe event, Duncan Smith said there would be measures to "rectify" the effect of the cut.
>
> He said: "We have identified that there is a problem here ... Come the spending review this will be brought into context.
>
> "We're bringing in a thing called the universal credit, which will actually be a device which brings together all this stuff and we'll be able ... to rectify and ameliorate some of these points because of the way it tapers and all that. That is what the prime minister was talking about. This is only one element of a larger package."[49]

The same article quoted Mike Brewer of the IFS:

> "It seems Iain Duncan Smith is saying child benefit will be included in the universal credit, and only disability living allowance will be excluded. Since this credit will be based on household and not individual income, some of the worst anomalies can be addressed. It should also be possible to construct a taper that does not lead to the disincentives introduced by Osborne's scheme."[50]

However, in response to a question from Kate Green following his Statement to the House on Welfare Reform on 11 October, Mr Duncan Smith denied that the Government planned to subsume Child Benefit into the proposed Universal Credit:

> The hon. Lady is right that child benefit has been and will continue to be a very effective mechanism to get money to the poorest families. We are not eradicating the universal benefit in the case of child benefit. We are capping it off at the higher rate. The rest- *[Interruption.]* Well, 85% of the public will get their child benefit. The hon. Lady asked specifically about the universal credit. I did not say that it would subsume child benefit. I said that as we reform the benefit system, and as the PAYE system is reformed, we should be able to look at these things long after the spending review and look for ways of getting rid of anomalies. Right now, in the spending review, there are no plans to make any such changes. We will do exactly as I said. Child benefit will be removed from families where there is at least one earner above the threshold.[51]

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48 *The Coalition: our programme for government*, p30

49 'Child benefit will be means tested, says Iain Duncan Smith', *The Guardian*, 6 October 2010

50 *Ibid.*

51 HC Deb 11 October 2010 c40

Following the same Statement in the Lords, the Minister for Welfare Reform, Lord Freud, said:

> I was asked whether there is a plan to roll child benefit in with universal credit. At the moment, there is no such plan. Within this spending review, the child benefit change will be introduced in the way described using the tax system as a measure. It is clear that beyond this spending review, once universal credit is in place, there can be decisions to use that, but at the moment there is no such decision.[52]

2.3 2010 Comprehensive Spending Review

The Spending Review published on 20 October 2010 confirmed that Child Benefit would be withdrawn from families with at least one adult paying higher rate income tax, from January 2013.[53] No mention was made of transferable tax allowances, or of any other measures to address possible anomalies created by the change.

In his Statement to the House, the Chancellor said:

> I have taken the difficult decision to remove child benefit from families with a higher rate taxpayer. I wish it were otherwise, but I simply cannot ask those watching this earning just £15,000 or £30,000 a year to go on paying the child benefit of those earning £50,000 or £100,000 a year. The debts of the last Labour Government, and the need to ensure that the better-off in society also make a fair contribution, make this choice unavoidable. It also means that no further changes to child benefit are required. Child benefit will continue to be paid in the normal way to the great majority of the population from birth until a child leaves full-time education at the age of 18 or even 19.[54]

Following the announcement at the Conservative Party conference on 4 October, there had been reports in the press that the Government was close to agreeing plans to remove Child Benefit for young people over 16.[55] While no such measure was announced, the Spending Review did announce that Education Maintenance Allowances (EMAs) are to be abolished and replaced with “locally managed discretionary funds” to target support on the “most disadvantaged children”. Savings of around £0.5 billion are envisaged.[56]

The Spending Review estimates that the clawback of Child Benefit from higher rate taxpayers will yield savings of £2.5 billion a year by 2014-15 – considerably more than the previously announced figure of £1 billion. The latest estimate takes into account losses due to “possible tax planning” and “non-compliance”, estimated at £280 million a year and £60 million respectively for the first full year (2013-14).[57]

There has been no public statement by the Government on the reasons for the discrepancy between the initial estimate of £1 billion savings and the figure of £2.5 billion in the Spending Review. The *Financial Times* reported however:

> The chancellor’s aides insisted the discrepancy over child benefit was a technical glitch, partly caused by a last-minute decision to abandon plans to end child benefit for 16- to 19-year-olds.

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[52] HL Deb 11 October 2010 c372
[53] Cm 7942, Box 2.6
[54] HC Deb 20 October 2010 c959
[55] ‘Osborne to take another bite out of child benefit’, *Daily Telegraph*, 7 October 2010
[56] Cm 7942, Box 1.3 and para 2.8
[57] *Spending Review 2010 policy costings*, p14

> However, the mistakes, which were identified by the Office for Budget Responsibility, will be an embarrassment to Mr Osborne. He had faced a barrage of criticism after scrapping the universality of child benefit in his keynote speech to conference.
>
> Treasury officials said there were several reasons for the gap in estimates. First, the impact on higher-rate taxpayers had been modelled on the assumption that payments to over-16s had been ended.
>
> Second, compliance rates had been underestimated. The final issue was the recategorisation of the move as a spending cut rather than a tax. The result is that it appears in the Treasury books sooner than it would otherwise have done.[58]

3 Wall Street Journal blog

In his On Politics blog, Iain Martin of the *Wall Street Journal* reported on 28 October that the Government was "struggling" to make the Child Benefit plans work.[59] He said that, according to Treasury sources, the policy was "unenforceable" and that it was "panic stations" at the Treasury. The central problem was that the unit of taxation in the United Kingdom is the individual rather than the household, and recipients of Child Benefit are under no obligation to tell their partners that they receive it. Potentially, this called into question the whole policy, or made it "prohibit prohibitively expensive and complicated to implement." He went on:

> How can the government easily prove the connection between mothers who pay no tax or earn less than £44,000 and the higher rate taxpayer she might live with? And then keep tabs on the situation on a monthly basis for almost two decades — with millions of taxpayers involved (moving in and out of work, having new children, some separating, getting divorced, finding new partners who may or may not be higher rate taxpayers, etc).

According to the blog, Ministers were considering a "new government database" to try to match up mothers with their partners, which in theory would enable "cross-checking of the child benefit claims of mothers with the national insurance numbers, tax codes and addresses of fathers/husbands/partners." It was believed that the Government was considering an "honest box" on male self-assessment forms so that fathers could declare that their partner was in receipt of Child Benefit, but-

> ...again, the mother is under no legal obligation to tell the father. The father can simply say he doesn't know and that his wife/partner won't tell him. Is there a way round this? Not easily. Does the coalition have plans to legislate to force husbands, wives and partners to know each other's finances inside out and tell the truth about them at all times. If so, good luck with that.

The blog concluded that the Government's options included scrapping the policy, sticking with the policy but quietly ditching it at some future date, proceeding with a "vast new database" in the hope that it would be "cheap to build and police", or abolishing Child Benefit immediately and replacing it with a combination of tax credits (or bolting it on to the proposed Universal Credit) and transferable tax allowances. The final option would however be difficult, since the Prime Minister had "expressly committed himself to Child Benefit."

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58 'Child benefit error admitted', *Financial Times*, 21 October 2010

59 'Child Benefit Cut 'Unenforceable,' Treasury in a Flap', Iain Martin On Politics, *WSJ Blogs*, 28 October 2010, 09.22

3.1 Responses to the blog

Pressed by Angela Eagle about the *Wall Street Journal* blog in the debate on the Comprehensive Spending Review on 28 October, the Chief Secretary to the Treasury, Danny Alexander, said:

> The story that the measure is unenforceable is nonsense; it will be introduced as planned. The savings were signed off by the Office for Budget Responsibility, which considered the compliance risk involved as well. Higher-rate taxpayers are of course required to disclose all relevant information.[60]

Subsequent media reports gave further information on the Government's proposed approach to clawing back Child Benefit. No official statement has been made, but according to the reports higher rate taxpayers may face fines for failure to disclose that their household receives Child Benefit.[61] The *Financial Times* stated:

> From 2013, higher-rate taxpayers in the self-assessment system will be required to tick a box declaring that their household claims child benefit. They will then pay a higher rate of tax corresponding to the level of benefit, which is worth £1,700 to a couple with two children.
>
> Those on the pay-as-you-earn tax system will be asked in a letter to disclose if their household claims the benefit – a declaration that will put them into a different tax code. The benefit would then be deducted in the next tax year, in an "end-year adjustment" similar to that in the tax credit system.
>
> Legislation to implement the changes will include laws setting out what will happen to the benefit if parents split up, remarry or share custody.[62]

It is not clear how a system based on "end-year adjustment" would cope with in-year changes in circumstances such as the birth of a child, a partner moving out, or a new partner moving in. It is also unclear what a "household" would constitute for these purposes. These and other issues are considered in section 4 below.

According to *The Times*, legislation spelling out how the system would be monitored and enforced is to be introduced "in due course", giving two years before the introduction of the scheme to work on the details.[63] The same report states that the Shadow Chancellor, Alan Johnson, has pledged that Labour would oppose in Parliament any legislation needed to implement the enforcement regime.

4 Implications of withdrawing Child Benefit from higher rate taxpayers

In brief, the Government's plans involve:

- Continuing to pay Child Benefit for all eligible children and young people.

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[60] HC Deb 28 October 2010 c508

[61] See for example 'Osborne and Alexander face grilling over child benefit plan', *The Guardian*, 30 October 2010; 'High-earners face fine if wives fail to tell them of child benefit claim', *Financial Times*, 29 October 2010; 'Fine threats over child benefit', *BBC News*, 29 October 2010

[62] 'High-earners face fine if wives fail to tell them of child benefit claim', *Financial Times*, 29 October 2010

[63] 'Osborne insists 'unenforceable' child benefit cuts are workable', *The Times, 30 October 2010*

- Clawing back an amount equivalent to the amount of Child Benefit paid, from families where there is at least one adult with an income above the higher rate threshold.

The policy is to be implemented by HM Revenue and Customs using existing PAYE and Self-Assessment structures.

Some issues raised by the proposals are discussed below.

4.1 Equity

The most frequent criticism about the Child Benefit plans concerns the treatment of single earner versus dual earner couples (although lone parents may also be disadvantaged in relation to dual earner couples[64]). Mike Brewer and James Browne of the IFS commented:

> ...some may think the proposed scheme is unfair because child benefit is withdrawn where an individual in a couple is a higher-rate taxpayer, regardless of the joint income of the couple. To give an extreme example, the Government's proposed reform implies that a one-earner couple with an income of £45,000 would lose all their child benefit, but a much better-off couple where each has an income of £40,000 would keep all their child benefit.[65]

The only way to avoid such anomalies would have been to base entitlement on household rather than individual income. However, in his Budget Statement in June the Chancellor explicitly ruled out introducing a new means-test, because the Government "would have to create a massively complex new system".[66]

In their initial response to the announcement at the Conservative Party conference, Mike Brewer and James Browne of the IFS suggested an alternative approach (at least as a stop-gap until the introduction of the Universal Credit) would be to use the existing tax credit system:

> The Government might argue that using the income tax system to means-test child benefit is cheaper for it to administer than devising a brand-new means-test, and can be done more quickly. But there is already a system of means-testing support for families with children through the tax credit system, and the Government could have straightforwardly reduced spending on child benefit by combining it with the child tax credit in some way. Using the means-test in tax credits could be considered fairer to single earner couples, and would not distort incentives so dramatically.[67]

However, as noted in section 1.1 above, as a result of changes announced in the June Budget, from 2012 many middle and higher income families will lose entitlement to tax credits completely.

4.2 Number of families affected

Estimates of the number of families who may be affected by the clawback of Child Benefit vary. The original estimate following the announcement at the Conservative Party conference was that 1.2 million families would be affected, but it appears this was based on the assumption that Child Benefit would also be abolished for young people aged 16 and

[64] See Gingerbread press release, *Child benefit cuts unfair on single parents*, 5 October 2010

[65] *Child benefit withdrawal will mean some worse off after a pay rise*, IFS Observations, October 2010

[66] HC Deb 22 June 2010 c173

[67] *Child benefit withdrawal will mean some worse off after a pay rise*, IFS Observations, October 2010

over (see above). Press reports following the Spending Review suggested 1.5 million families might be affected[68], but the Institute for Fiscal Studies puts the figure at 1.8 million.[69]

There has been some uncertainty about possible future changes to the higher rate tax threshold and the knock-on effect that would have in the number of families affected by the Child Benefit clawback. The June Budget confirmed the Coalition Government's "long term objective to raise the personal allowance to £10,000 with real terms progress towards that goal every year".[70] The personal allowance is to increase by £1,000 in 2011-12, matched by a decrease in the higher rate threshold to ensure that basic rate taxpayers only benefit from the measure. The exact amount by which the higher rate threshold is to be reduced has not yet been announced (an announcement is expected this autumn), but the Budget report estimated that, based on RPI forecasts, it could be in the region of £1,650.[71]

Separately, the June Budget confirmed that the higher rate tax threshold would be frozen in 2012-13, as the Labour Government had proposed in the 2009 *Pre-Budget Report*.[72]

Some organisations have speculated that further increases in the personal allowance, if matched by compensating reductions in the higher rate tax threshold following the approach adopted in the June 2010 Budget, could significantly increase the number of families affected by the Child Benefit clawback.[73] However, on 7 October the *Daily Mail* quoted a Treasury source as saying that there were no plans for further changes to the higher rate threshold beyond 2011-12 and that suggestions that the threshold might fall to as low as £38,600 were "completely hypothetical and without foundation".[74]

4.3 Defining a 'household'

Under the proposals, higher rate taxpayers would be required to declare whether anyone in their household is in receipt of Child Benefit. It will therefore be necessary to determine when adults are to be regarded as living in the same household. It seems likely that the test used would be similar to the "living together as husband and wife" test which applies to claims for means-tested benefits and tax credits.[75] Under this test, couples "living together as husband and wife" are treated in exactly the same way as married couples. Same-sex couples in civil partnerships, and cohabiting same-sex couples not in a civil partnership but living together as civil partners, are also now treated as a single "unit" for means-tested benefit and tax credits purposes.

In deciding whether, for benefits purposes, two people are living together as husband and wife (or, in the case of two people of the same sex, living together as civil partners), the DWP should take into account a range of factors. Volume 3, Chapter 11 of the DWP *Decision Makers' Guide* contains the current guidance on decisions about whether two people are living together as husband and wife or as civil partners.

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68 See for example 'A million face loss of sickness benefits', *The Times*, 21 October 2010; '2010 Comprehensive spending review: Welfare: Child benefit 300,000 more families hit', *The Guardian*, 21 October 2010

69 Mike Brewer, *Cuts to welfare spending, take 2*, IFS Spending Review briefing, 21 October 2010

70 HC 61 2010-11, para 1.93

71 *Ibid.*

72 *Ibid.* para 2.120

73 See '3 million homes may lose family payment', *Daily Telegraph*, 6 October 2010

74 'Now 230,000 MORE families will be hit by child benefit axe', *Daily Mail*, 7 October 2010

75 Alan Johnson has however written to the Chancellor seeking clarification about whether "household" for Child Benefit purposes is to be defined more broadly to include other adults, e.g. grandparents or sisters/brothers; see 'Alan Johnson Demands Answers From George Osborne on Child Benefit Cut', Iain Martin On Politics, *WSJ Blogs*, 29 October 2010, 14.37

The term 'living together as husband and wife (or as civil partners)' is not defined further in social security legislation. Social security case law does however point towards certain factors which may be taken into account when decisions on individual claims are made. In addition, administrative guidance produced for benefit staff has been described as providing "signposts' to assist those making decisions. Factors which may be taken into account include:

- Whether both persons are actually living together in the same household
- Duration and stability of the relationship
- Financial arrangements
- Sexual relationship (although a person should not be asked about this)
- Whether there are children
- How other people see the relationship

As this indicates, a number of factors should be taken into account when it is being determined whether or not two people are living together. No single factor should be conclusive; nor does the list constitute a "score card" to enable the authorities to come to a conclusion. It is the "general relationship" of the two people that is important. However, it is a necessary condition that the two people are actually members of the same household.

The "living together as husband and wife" test is a well-established feature of the social security system, but its extension to the tax system raises a range of issues and could lead to complaints about intrusiveness.

4.4 Incentives and behavioural responses

A number of organisations have pointed out that the Child Benefit proposal creates incentives for taxpayers at or around the higher rate tax threshold to reduce their taxable incomes, to avoid the clawback. In their initial response to the Chancellor's announcement at the Conservative Party conference, Mike Brewer and James Browne of the IFS commented:

> [An] implication, and the most serious from an economic point of view, is that this reform seriously distorts incentives for some families with children. In particular, adults with children whose income places them below the higher-rate income tax threshold might be find themselves considerably worse off from a small rise in income. This is because such a family would effectively lose all their child benefit as soon as the adult's income rose just above the higher-rate income tax threshold.
>
> A family with two children currently receives £1,750 a year in child benefit, so a one-earner couple with two children with a gross income between £43,876 and £46,850 would be worse off than if their income were £43,875. Equivalently, a one-earner couple with an income of £43,875 would need a pay rise of £2,975 or more to ensure they were no worse off after paying income tax and national insurance and losing child benefit.[76]

[76] *Child benefit withdrawal will mean some worse off after a pay rise*, IFS Observations, October 2010

In its statement certifying the Spending Review policy costings, the Office for Budget Responsibility states that there is “particular uncertainty” surrounding estimates of the exchequer effects of the Child Benefit clawback:

> **Withdrawal of Child Benefit from higher rate taxpayer families:** the costing in Chapter 2 includes a behavioural effect for taxpayers near the higher-rate threshold reducing their taxable income. Taxpayers with children and incomes just above the higher-rate threshold have an incentive to reduce their hours worked or find other ways of reducing their taxable income, such as increasing pension contributions, taking part in salary sacrifice schemes or making donations subject to Gift Aid. The ability of such taxpayers to forecast their income and adjust their behaviour accordingly is highly uncertain. There are also uncertainties around the delivery model which could affect the costing[77]

The OBR note also states there could be “potentially significant indirect effects”:

> ...as set out above, taxpayers just above the higher-rate threshold who have children have an incentive to reduce their taxable income. One mechanism to achieve this is to work shorter hours, for example by reducing overtime. This would affect the total number of hours worked in the labour market. Other behavioural changes, such as couples altering the split of hours worked between them so as to both fall under the higher-rate threshold, may also have indirect effects on the economy forecast. In the opposite direction, the withdrawal of Child Benefit could have the effect of increasing labour supply for taxpayers above the threshold who choose to offset the reduction in their income by increasing their hours worked[78]

4.5 Ending Child Benefit claims ‘voluntarily’

Under the Government’s proposals, Child Benefit would continue to be paid to all households, but withdrawn from higher rate taxpayers through the tax system. For single earner couples where the partner claiming Child Benefit is not the higher rate taxpayer, the state would therefore in effect simply be transferring money from one partner to the other (although it is not clear whether this would happen in the same period). At the household level, this may be regarded as unnecessary “churning”, since overall they would be no better or no worse off.

Media reports suggest that the Government believes that some of the problems inherent in clawing back Child Benefit from higher rate taxpayers could be avoided if families stopped claiming Child Benefit voluntarily.[79] In practice, some non-working working mothers may face pressure from their partners to give up their Child Benefit, given the prospect of the clawback. However, this could raise concerns about the impact on women and on children. Proponents of universal Child Benefit point towards studies emphasising its importance in tackling the uneven distribution of resources within families by giving women an independent income. Evidence also suggests that Child Benefit, paid to the mother, is more likely to be seen as labelled for children and spent accordingly.[80]

Voluntarily giving up Child Benefit could also affect future entitlement to State pensions (see below).

77 *Spending Review 2010 policy costings*, p28
78 *Ibid.* p29
79 See ‘Cameron predicts ‘no problems’ with child benefit cuts’, BBC News, 29 October 2010
80 See CPAG, *Child benefit: fit for the future*, August 2006, pp18-19

4.6 Transferring the Child Benefit claim to others

The general situation is that a person may be entitled to Child Benefit for a child if they are responsible for him or her. A person is treated as "responsible" for a child if the child lives with them, or if they are contributing towards the maintenance of the child at a rate of at least the amount of Child Benefit.[81]

A household facing a clawback of Child Benefit could potentially avoid it by transferring the claim to another person (e.g. a grandparent) who is not a member of that household and who is not a higher rate taxpayer. It is not clear how the Government's proposals would deal with situations such as this.

4.7 Administrative issues

Commentators have highlighted a number of potential administrative problems associated with the Child Benefit proposals. In an article on the BBC website, Robin Williamson of the Low Incomes Tax Reform Group notes the single earner/dual earner anomaly. The article continues:

> **People or households?**
>
> *"At the root of this apparent unfairness is a crucial and often irreconcilable difference between the tax and benefits systems."*
>
> Tax liability is assessed on the individual, while benefits entitlement is assessed on joint income and circumstances of the couple, or household.
>
> It will be necessary to define the 'household' whose income is to be taken into account when deciding which families lose their benefit, and which keep it.
>
> The government's plan is fraught with difficulty, suggests Robin Williamson. At present there are no definitions of 'household' in either tax or child benefit law.
>
> And where the claiming unit is a couple, as in benefits and tax credits, defining who is a couple is no straightforward matter, particularly if separations take place gradually.
>
> **Splitting up**
>
> Take, for example, a couple who split up.
>
> He may be a higher-rate taxpayer while she is carer of the children.
>
> When they part, she claims child benefit as she has little other income.
>
> But if the rules treated them as still part of the same household - perhaps they are not sufficiently permanently separated to satisfy the rules - she could lose her child benefit, or even have to pay back whatever she has received.
>
> Even more careful thought will be needed to decide on claims where a household is constituted some other way - for example, by a single mother and her mother.
>
> **Pitfalls**
>
> The 4 October Treasury press release said glibly: "HMRC will implement this policy [withdrawing child benefit from households with a higher rate taxpayer] through the existing PAYE and Self-Assessment structures."

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81 Section 143(1) *Social Security Contributions and Benefits Act 1992*

And what will the consequences be for individuals?

Let us consider some scenarios.

After the year-end, an earner is awarded a bonus which turns them, retrospectively, into a higher rate taxpayer.

How will the child benefit that has been paid to the household throughout the year be recovered?

Or a self-employed person does their accounts nine months after the year-end, and it transpires that they became a higher-rate taxpayer during that year.

By that time they will have received nearly two years' worth of child benefit to which they now find they were not entitled. How do they pay it back?

There are compatibility issues between the computer systems administering child benefit, PAYE and self-assessment.

This will make it virtually impossible for HMRC to collate the necessary information, particularly if the higher-rate taxpayer in a household is not the same person as the benefit recipient.[82]

4.8 A 'couple penalty'?

In a letter to the Chancellor of the Exchequer seeking clarification about the Government's proposals for Child Benefit, the Shadow Chancellor, Alan Johnson, has raised the issue about incentives for couples to live apart:

Earlier this year, David Cameron said: "I want the next Government to be the most family friendly Government we've ever had in this country." Can you explain how this proposal supports the government's stated policy of encouraging families to stay together?

You have talked at great length about the so called "couples' penalty." Given your previous concern to ensure that there are no incentives in the tax and benefits system for families to live apart, I would also appreciate clarification on whether the new proposals would mean a difference in the amount of child benefit for parents who live together and parents who live apart where the mother pays basic rate tax and the father pays higher rate tax?[83]

4.9 National insurance credits

Concerns have been voiced about the potential impact on State Pension entitlement for people affected by the Child Benefit clawback. At present, people who are not in work and who receive Child Benefit for a child under 12 receive National Insurance credits to enable them to build up entitlement to State Pensions.[84]

The Government has however given an assurance that no-one will miss out as a result of the Child Benefit changes:

Teresa Pearce: To ask the Secretary of State for Work and Pensions what assessment he has made of the effects of the proposal to withdraw child benefit from

[82] *Child benefit changes - can the government's plan work? Money Talk by Robin Williamson*, 12 October 2010

[83] 'Alan Johnson Demands Answers From George Osborne on Child Benefit Cut', Iain Martin On Politics, *WSJ Blogs*, 29 October 2010, 14.37

[84] See HMRC website, *How claiming Child Benefit can protect your State Pension*

households where a parent earns over £44,000 per year on women who look after children full-time and receive national insurance credits towards their state pension through child benefit. [18091]

Steve Webb: We are considering the details of the changes announced to child benefit. We will be assessing this in the coming weeks to ensure that no-one misses out on national insurance credits towards their state pension.[85]

[85] HC Deb 19 October 2010 c643w