

Tax Credits: Why the household income test

New tax credits have a number of objectives:

- Supporting children;
- Increasing the gains to work and ensuring that work pays more than benefit;
- Tackling in-work poverty and low income.

Supporting children - the integrated child credit

Both parents in a couple have responsibility for bringing up their children. Even if one is working while the other cares for the children at home, the job of parenthood is shared. The payment of the integrated child credit on the basis of a couple's joint circumstances reflects this; though the payment will be directed towards the main carer in recognition of their role.

Making work pay – the employment tax credit and the childcare tax credit

People's decisions on whether and how much to work are both personal, reflecting their own skills and motivation, and dependent on their wider circumstances, such as the total income of the household they live in.

Likewise the Government's objectives for the labour market relate both to households and to individuals. The Government's overarching aim is to raise the rate of employment – the proportion of people of working age who have a job. But another important target is to reduce the number of workless households. In the UK one in six households of working age has no-one in employment.

The employment tax credit is specifically targeted on making work pay for those in low-paid or part-time jobs. It is available to households with a total working income of no more than £14,000 a year. For some people low-paid or part-time work is the best route into the labour market, and for some it is the right long-term option. For example, a low-paid job may be the right first step after a spell of unemployment and part-time work may be appropriate for parents with young children, or for people with family members with a disability.

Without tax credits, such jobs are not always financially worthwhile compared to remaining on benefit. The level of out-of-work benefits reflects the household's overall circumstances – for example benefits pay more for a couple than for a single person, and awards are set on the basis of a household means-test. Because tax credits aim to tackle the unemployment trap, they follow the same approach. They are based on a household means-test. Single people receive a lower rate except where there are children; and extra help is available through the childcare tax credit for those with eligible childcare costs.

This household-based system of tax credits is complemented by a comprehensive programme of support for individuals in the labour market. Measures introduced or announced so far include:

- A national minimum wage - set at £4.10 from October 2001 – to ensure fair rates of pay for everyone in the workplace;
- Better rights for employees in the workplace including a minimum of four weeks paid holiday, plus support for family-friendly working, including new rights to parental leave and better maternity pay;
- Cuts in tax and national insurance, which were particularly targeted on the low-paid. The Government remains committed to the principle of independent taxation whereby every individual has the right to their own personal tax allowance;
- Support through the New Deal for those most excluded from the labour market, to help people overcome their own personal barriers to work;
- Provision for training and lifelong learning, to enable people to improve their skills and progress in their job.

Tackling poverty and boosting low working incomes

The employment tax credit and the integrated child credit also both aim to reduce poverty. The integrated child credit guarantees a secure income for the poorest families with children, in and out of work. The employment tax credit boosts low working incomes, a significant cause of poverty for people without and without children.

Poverty is of most concern when it affects the quality of people's lives – for example their health and ability to participate in society. Research shows that people in poor households are more likely to suffer these problems than poor individuals in wealthier households.

A household income test is, therefore, much better targeted on core poverty than simply looking at the income of the individual. Because it is better targeted, it allows more to be given to those most in need, whatever the overall level of resources that is available.