The Children's Society

The Future of Family Incomes

How key tax and welfare changes will affect families to 2020

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1. Introduction

The current and previous Government have introduced a wide range of measures which will affect family incomes up to 2020. In some cases (such as the introduction of the National Living Wage and income tax personal allowance) these will increase household incomes. In other cases they will significantly reduce support for families.

Much of the debate around the impact of welfare changes has focussed on the impact of individual reforms. This is important, but will always be a partial account of the impact of changes on individual family types because of the cumulative (and interactive) effect of different measures.

This briefing is intended to start to fill this gap by showing how the overall income of different family types are likely to be affected by key welfare and tax and benefit changes introduced in the coming five years. It does this using case studies comparing overall income for a given household type making a claim for Tax Credits and other benefits in 2015, and the same household type making a new claim for Universal Credit and other benefits in 2020.

The briefing is also intended to give an introductory account of how benefits, tax credits, tax liabilities and earnings interact. Such interactions mean that the overall impact of a combination of different reforms cannot be viewed as equal to their sum, making it all the more important to consider whole case studies.

2. Summary of changes included in this briefing

Over the coming five years the government will introduce a large number of changes affecting benefits, tax credits, income tax liabilities, and earnings. Some of the key changes considered in this report include the following:

- An increase in the income tax personal allowance threshold to £12,500 by 2020
- An increased National Minimum Wage (of £9 per hour) for workers over 25
- The introduction of a 4 year freeze on entitlements to most benefits and tax credits – including Local Housing Allowance rates (affecting HB receipt for families in private rental accommodation)
- A limitation on the receipt of the child element of Child Tax Credit and Universal Credit to the first two children in the household
- The loss of the family element of child tax credit (and equivalent higher rate of first child addition in Universal Credit)
- Reductions in work allowances/ income thresholds in Universal Credit and Tax Credits
- A cut to the disabled child addition within Universal Credit compared to equivalent support available through the Tax Credits system
- A reduced standard allowance for parents aged under 25 within the Universal Credit system.

3. Other assumptions

- Household earnings for tax credit purposes are the same in 2014 as in 2015 – if earnings were lower in 2014 than 2015, then the between year income disregard would mean that in some of the cases 2015 incomes would be higher than stated.
- Gross household earnings increase in line with RPI (except in cases of the National Minimum Wage with a worker over the age of 25 – where it is assumed that earnings increase to £9 per hour by 2020.)
- Overall costs of living for the given household types increase in line with current RPI forecasts. An assumption like this is necessary for simplicity of modelling, but is unlikely to be accurate for two reasons (1) RPI forecasts are only predictive and (2) individual household types will face variations in increases in costs of living depending on the balance of individual household expenditure.
- RPI forecasts are based on the OBR November 2015 forecasts[1].
- Families claim Universal Credit in 2020 rather than make a claim through the current Tax Credits and Benefits system – this is a crucial assumption, since the structure of the new system is different.
- 2020 claimants are new claimants – the Government has promised that "cash losers" affected by the transition onto Universal Credit will receive cash protection of their previous entitlement. This is an important provision (though it has limitations since (1) it is only cash protection (2) it only applies to existing claimants who are transferring across to Universal Credit and (3) it can be lost as a result of changes in household circumstances). This briefing is exploring the long term future of incomes for different household types, and for this reason it is more useful to consider the situation for new claimants entering the system in 2020, rather than existing claimants moving across.

[1] http://budgetresponsibility.org.uk/pubs/Charts_and_tables__November___2015.xls
Table 3.19 – forecasts RPI to quarter 1 of each year (2017-2020) at 2.7%, 3.0%, 3.2% and 3.3% respectively.

Case study 1

Lone parent aged 23, 2 children, £500 pm rent, £15pw council tax. Earning £22000, starting as a primary school teacher

Assuming earnings increase in line with current RPI forecasts, increases in net earnings of £184 per month (including a £19 per month gain from increases in the personal allowance for income tax), mean that this family type is predicted to be better off in cash terms by 2020 by about £25 per month.

However, this cash gain is entirely driven by projected increases in earnings. Benefit and Tax Credit entitlement face considerable cash cuts of around £176 per month. As a result of a four year benefit freeze the real term impact is considerably larger still, with this family type overall being worse off by around £239 per month by 2020.

Current monthly income (and 2020 value)		
Tax credits:	£373	(£421)
Child benefit:	£149	(£168)
Housing benefit:	£34	(£38)
Net earnings	£1,504	(£1,697)
Total income	£2,060	(£2,324)

Actual 2020 income*	
Universal credit	£231
Net earnings (projected)	£1,705
Child benefit	£149
Total income	£2,085

A difference each month of:

-£239
per month

A difference each year of:

-£2,868
per year

*assuming earnings growth in line with rpi projections

Case study 2

Couple (aged over 25) with 3 children, renting in London, rent £800 per month, council tax £20 per week. One working and earning £22000 as a nurse.

The second case study is similar to the first, but is a couple claimant household, and has 3 children rather than 2 and a higher level of rent (as a result of a larger family). In this case, the real term losses are greater because of the impact of the 2 child limit for the child addition within Universal Credit.

As a result of the four year freeze on LHA rates, a higher entitlement to Housing Benefit, also has a significant impact on the overall reduction in income for this household

Current monthly income (and 2020 value)		
Tax credits:	£604	(£681)
Child benefit:	£209	(£236)
Housing benefit:	£447	(£504)
Net earnings	£1,504	(£1,697)
Total income	£2,764	(£3,118)

Actual 2020 income*	
Universal credit	£779
Net earnings (projected)	£1,705
Child benefit	£209
Total income	£2,693

A difference each month of:

-£425
per month

A difference each year of:

-£5,100
per year

Case study 3

Couple with 3 children, rent £800 per month, council tax £20 per week. One working and earning £22000 as a nurse, other working and earning £15,000 per year

Case study 3 is the same as case study 2, but with both partners in work. This makes a significant difference to the overall loss this family incurs between 2015 and 2020, partly because both partners gain from increases in income tax personal allowances, and partly because losses from benefit entitlements are limited as a result of a low 2015 entitlement that is lost in entirety by 2020.

Current monthly income (and 2020 value)		
Tax credits:	£91	(£103)
Child benefit:	£209	(£236)
Housing benefit:	£60	(£68)
Net earnings	£2,611	(£2,945)
Total income	£2,971	(£3,352)

Actual 2020 income*	
Universal credit	£0
Net earnings (projected)	£2,963
Child benefit	£209
Total income	£3,172

A difference each month of:

-£180
per month

A difference each year of:

-£2,160
per year

Case study 4

Lone parent aged 30, 2 children, £500 pm rent, Council Tax £65 pm. Earning National Living Wage (30 hours per week) as a shop assistant

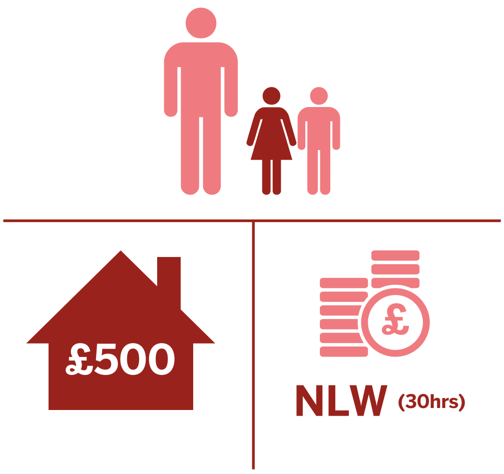
Case Study 4 gives a lower income earner who benefits from the introduction of the National Living Wage, with (as a result) hourly earnings of £6.70 in 2015 but £9 in 2020.

The earnings gain from the introduction of the National Living Wage is significant (the family sees their net earnings increase by £153 per month in real terms by 2020). However, as a result of the 65% withdrawal rate on their Universal Credit entitlement, around £100 of this is lost through reductions in benefit entitlement.

When combined with the four year benefit freeze, reductions in entitlement greatly outweigh gains from increased earnings.

Current monthly income (and 2020 value)		
Tax credits:	£766	(£864)
Child benefit:	£149	(£168)
Housing benefit:	£202	(£228)
Net earnings	£849	(£958)
Total income	£1,966	(£2,218)

Actual 2020 income*	
Universal credit	£693
Net earnings (projected)	£1,097
Child benefit	£149
Total income	£1,939



A difference each month of:

-£279
per month

A difference each year of:

-£3,348
per year

However, were the claimant parent under the age of 25, their situation is considerably worse. This is for two reasons, firstly, they are not entitled to receive the National Living Wage, and secondly because they receive a lower rate of standard allowance as an under 25 (whilst a young single parent within the current benefits system would still receive the over 25 rate).

Notably, of these two factors the bigger is the lower rate of standard allowance - costing them around £66 per month, whilst the reduced rate of minimum wage leaves them around £49 worse off each month.

If 24 (NMW uprated from £6.70 with inflation)	
Universal credit	£717
Net earnings (projected)	£958
Child benefit	£149
Total income	£1,824

A difference each month of:

-£394

per month

A difference each year of:

-£4,728

per year

Case study 5

Lone parent aged 30, 2 children, £500 pm rent, Council Tax £65 pm (not working.)

Case study five gives the circumstances of a non-working single parent with two children. It is notable that whilst in real terms the 2020 household is significantly worse off than the 2015 family, the losses (which come from a combination of the four year benefit freeze and the loss of the oldest child addition in Universal Credit,) are lower than many similar working families. This is because, unlike working families, these family types are not affected by reductions in in work entitlements as well.

Current monthly income (and 2020 value)		
JSA	£318	(£359)
Tax credits	£508	(£573)
Housing benefit	£500	(£564)
Council Tax reduction	£65	(£73)
Child benefit	£149	(£168)
Total income	£1,540	(£1,737)

Actual 2020 income*	
Universal credit	£1,281
Council Tax reduction	£73
Child benefit	£149
Total income	£1,503

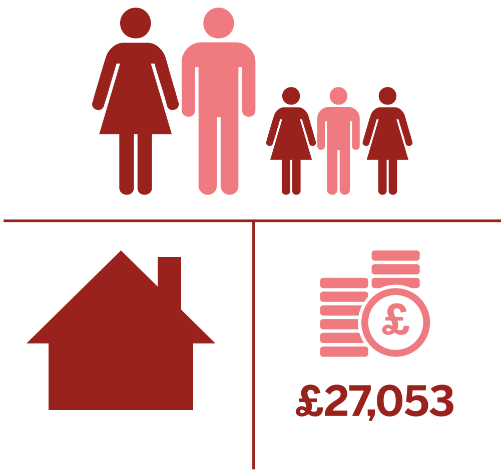
A difference each month of:

-£234
per month

A difference each year of:

-£2,808
per year

Case study 6



Couple 3 children, one disabled in receipt of low rate DLA care component. Own their own home, mortgage £600 per month. One partner working, as army corporal earning £27,053

In this case, net earnings increase by around £9 per month in real terms as a result of planned increases in personal allowances for income tax. However, this is overwhelmed by overall losses. As can be seen, current Tax Credit entitlements have a 2020 value of around £780 per month. This is nearly eliminated in entirety by 2020 with a Universal Credit entitlement by that point of just £28 per month.

This is the result of a combination of factors affecting benefit provision for this group:

- Since they have three children they lose a child element from their maximum entitlement – this is a loss of £2780 per year from their maximum Tax Credit entitlement.
- Since one of their children is disabled but not in receipt of the high rate care component, the value of the disability addition within their Tax Credits/Universal Credit entitlement is reduced by half through the introduction of Universal Credit.
- They are heavily affected by reductions in rates of work allowances and tapers within Universal Credit introduced between now and 2020.
- They lose around 12% of the value of their current means tested benefit receipt as a result of the four year benefit freeze (this also affects their child benefit entitlement but not DLA).

Current monthly income (and 2020 value)		
Tax credits	£692	(£781)
Child benefit	£209	(£236)
DLA	£95	(£107)
Net earnings	£1,790	(£2,019)
Total income	£2,786	(£3,143)

Actual 2020 income*	
Universal credit	£28
Net earnings (projected)	£2,028
Child benefit	£209
DLA	£107
Total income	£2,372

A difference each month of:

-£771
per month

A difference each year of:

- £9,252
per year

Conclusion

For many families with children, incomes will change significantly over the coming years. The extent to which they do (and whether for better or worse) will depend on the individual family type, their personal circumstances, rates of inflation, and the circumstances in which they make any claim for benefit (for example, whether they claim in the current benefits system or Universal Credit, and whether they are an existing or new claimant.)

However, there are some notable trends which are illustrated by the case studies above:

1. Families in receipt of benefits or tax credits are likely to be significantly affected by the overall benefit freeze. The extent to which this is the case depends on the size of their benefit receipt as a proportion of their overall household income and the rate at which prices increase in coming years. Based on the most recent data on Tax Credit claimants, we estimate that around 4 million families, with 7.5 million children, will be affected by the 4 year benefit freeze (excluding those affected by a freeze on Child Benefit entitlement only). Nearly two thirds of these families - 2.6 million families with 4.9 million children – will be in work. Those affected would be expected lose up to around 12% of the value of their current means tested benefit receipt.
2. For many families the introduction of the National Living Wage will not provide sufficient protection from cuts in support through the benefits system – particularly since for families in receipt of Universal Credit up to 65% of any gain from higher wages, will be lost through reductions in Universal Credit entitlement.
3. Young parents are likely to lose out as a result of a number of different measures – most notably the combination of reductions in the standard allowance for Universal Credit, and exclusion from the National Living Wage.
4. Many families with disabled children are likely to be heavily affected by the lower rate of the disabled child addition within Universal Credit, compared to the comparative supplement in Child Tax Credit.
5. Being in work will not prevent income reductions so long as claimants receive some level of in work benefit receipt – in many cases working families may lose out more than other households as a result of cuts to in work support. Higher earning households (with low levels of current benefit entitlement) are likely to lose out less.
6. Combinations of a number of different circumstances can lead to exceptionally large overall impacts – as shown in our final case in which overall 2020 income for a new Universal Credit claimant is down nearly £9000 per year compared to 2015.

It is a painful fact that many children and young people in Britain today are still suffering extreme hardship, abuse and neglect.

Too often their problems are ignored and their voices unheard. Now it is time to listen and to act.

The Children's Society is a national charity that campaigns for changes to laws affecting children and young people, to stop the mistakes of the past being repeated in the future.

We also run local services, helping children and young people when they are at their most vulnerable, and have nowhere left to turn.

The Children's Society

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Names used in this report have been changed to maintain anonymity. All photographs posed by models.

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