

Husband
+ WIFE tax n.

FROM: P J EDWARDS
DATE: 4 OCTOBER 1985

MR SCHOLAR

FAMILY POLICY GROUP

I have managed to find a CU file series on this group which, as you mentioned this morning, seems to have been most active around Sir G Howe's period in office.

2. Attached on file SB-8 part C is George Monger's submission to the Chancellor dated 9 July 1985 on fully transferable allowances. Also attached are the papers outlining the historical background on the taxation of husband and wife which I believe you were recalling this morning;

- (i) Flag A - Sir Geoffrey Howe's paper (FPG(82)3), dated 23 November 1982 - and circulated for discussion at FPG on 30 November .
- (ii) Flag B - The Brief prepared for the meeting. You will see that para (I) section (b) refers to the 12 million wives who would have to take over, from their husbands, responsibility for their own tax affairs .
- (iii) Flag C - Minutes of the meeting produced by Tim Flesher in the Prime Minister's office - see second paragraph of minutes .
- (iv) Flag D - A second paper produced by Sir Geoffrey Howe on 5 January 1983 .
- (v) Flag E - Norman Fowler's response to 5 January letter .
- (vi) Flag F - Patrick Jenkin's response to 5 January letter .

P. J. Edwards
P J EDWARDS

cc CST
FST
EST
MST(C)
MST(R)
Mr Middleton
Mr Moore
Mr Monger
Mr Kemp
Mr Martin
Mr Robson
Mr French

FP6

+ Ireland Revenue PS to Chairman



Handwritten scribbles and initials

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

23 November 1982

Tim Flesher, Esq.,
No.10 Downing Street

Dear Tim,

FAMILY POLICY GROUP

..... I attach a paper prepared by the Chancellor of the Exchequer on the taxation of husband and wife which you agreed should be discussed at the meeting of the Family Policy Group on 30 November.

Copies of this letter and attachments go to John Halliday (Home Office), Imogen Wilde (Department of Education & Science), David Edmonds (Department of the Environment), Jonathan Spencer (Department of Industry), Richard Bird (Department of Transport), Barnaby Shaw (Department of Employment), Alex Galloway (Chancellor of the Duchy of Lancaster's Office), David Clark (Department of Health), Richard Hartfield (Cabinet Office), Gerry Spence (CPRS) and Mr. Mount (No.10). Copies also go for information to C. Evans (Welsh Office) and Muir Russell (Scottish Office).

Yours sincerely,

Jill Rutter

JILL RUTTER

210 23/11

TAXATION OF HUSBAND AND WIFE

Memorandum by the Chancellor of the Exchequer

1. This note considers the case for reforming the present treatment of husband and wife for income tax - which in essence dates from the time when income tax was first introduced in the early days of the 19th century.
2. Our own supporters have been among the foremost pressing for reform. After wide consultation, and after debate at the Annual Women's Conference, our (then) Women's National Advisory Committee published in 1979 a report by a Committee under Miss Shelagh Roberts: "Women and Tax". This spoke of "great resentment building up" and argued for change

"to enable women to be treated as independently as they wish to be treated, but, at the same time to encourage and support the family".
3. In December 1980 we published a Green Paper on the Taxation of Husband and Wife (Cmd 8093). Virtually everyone who has responded to the Green Paper argues that the present system needs to be changed. Those who seek radical reform include our own Conservative Women's National Committee and the professional organisations (such as the Law Society and the Chartered Accountants), as well as a very wide range of social and political commentators.
4. The attached note by officials outlines the tax treatment of husbands and wives as it has developed to date, summarises the criticisms of it, and explains the options for change.

CRITICISMS OF THE PRESENT SYSTEM

5. The basic criticism is that the present tax system reflects a 19th century world, in which the vast majority of married women were legally and financially dependent on their husbands. Today, over 7 million married women contribute to the family income and the vast majority of women go out to work at some point in their married lives. Many of these are, or should be, our natural supporters. But almost as many of them find the present tax concepts anomalous, and sometimes offensive.
6. There are other criticisms. In particular, the present system:
 - gives more than the sum of two single persons' tax allowances to the married couple, if both husband and wife are earning. This is an anomaly dating from 1939-45, specifically introduced to encourage women into war work

- by contrast, imposes a tax penalty on marriage in other respects (mainly in the case of investment income).

7. Finally, there is a body of "advanced" opinion which argues that it is wrong for the tax system to give any recognition to marriage, and in particular to give the married man a bigger tax allowance than the married woman, or the single man or woman.

OBJECTIVES OF REFORM

8. The broad criteria against which to measure options for change of the tax system are those rightly identified by the WNAC in 1979: independent treatment of women and - crucially - support for the family. It may help to set out the objectives in more detail. In my view they are:

- (a) to treat men and women ~~as equal~~ ^{with an even hand} for tax purposes and respond to the reasonable demand for independence and privacy in the tax affairs of partners in a marriage;
- (b) to support the family and avoid a tax penalty on marriage;
- (c) for this purpose to strike an equitable balance in the tax system
 - between the single man or woman and the married couple and
 - between those married couples where both husband and wife go out to work, and those where one (usually the wife) stays at home.

In particular, to continue to take direct account in the tax system of the fact that a married couple, when the wife does not go out to work, has a lower taxable capacity than a single person with the same total income.

- (d) to remove the present tax bias in favour of the married couple where both husband and wife go out to work, as compared with two single people both working, so that a wife's freedom of choice is not distorted by consideration of tax.
- (e) to minimise cost and administrative complexity, for Government and the public;
- (f) to improve - or at least avoid worsening - work incentives and encourage wage moderation (bearing in mind the implications for the poverty and unemployment traps.)
- (g) more generally - to produce a system which ordinary people can understand, and find attractive, as matching the way in which married couples now organise their financial affairs.

9. The relative weight to be attached to these objectives is a matter of judgement. But they provide a series of benchmarks for judging the relative merits of the options for change set out below and - in more detail - in the attached paper by officials.

A LIMITED REFORM

10. As the note by officials explains, successive Governments have so far responded to pressures for reform by ad hoc change. At one time, I saw attraction in a further limited reform - introducing a "right to choose independent taxation" for married women, which would still leave the present basic structure intact. We floated a scheme of this sort in the 1980 Green Paper. The response has made me doubt whether it is the right way forward. It would be widely interpreted as failing to deal with the real problem, and bringing substantial benefit only to wealthy people with investment income. At best, it would get no more than a lukewarm reception from our supporters. And, in practice, I fear that taxpayers would find it complex and difficult to understand.

OPTIONS FOR THOROUGH-GOING REFORM

11. I think it follows that, if we decide to respond positively to the present pressures, we need to consider a more thorough-going reform, reaching to the root of the problem.

12. The response to the Green Paper has identified two main options:

(i) Mandatory independent taxation with cash benefits (MIT)

Under this a husband and wife would be taxed as separate individuals; the present married man's allowance would be abolished and "replaced" by cash benefits for those with children and other dependants.

(ii) Independent taxation with transferable allowance (ITTA)

Under this a husband and wife would again be taxed as separate individuals but if one of the two had too little income to use up their allowance, part or all of the balance could be transferred to the other.

13. Each system has powerful advocates.

14. At present, the pace is being set by advocates of MIT with cash benefits. This is now the official policy of the Labour Party and the SDP. Its supporters include (at one extreme) the Child Poverty Action Group and the National Council for Civil Liberties and (at the other extreme) Mr Sam Brittan in a recent article in the Financial Times.

15. I am convinced that this is the wrong approach. It would take a further large tranche of income from taxpayers, and pay it out as social benefits. By contrast with ITTA (see paragraph 22)

it would reduce the tax threshold for every married man with unwelcome effects on take-home pay and wage claims. It would be difficult to devise a satisfactory benefit alternative which did not either add significantly to public expenditure or result in an unacceptable number of losers or further complication of the social security system.

16. MIT would also involve the State in the highly objectionable business of discriminating between "deserving" and "Undeserving" or "idle" wives. It would be logically inconsistent with maintaining the present widows' bereavement allowance - let alone improving it (one could hardly say that, for tax, marriage begins with the husband's death). I believe its wider implications for the family are wholly unacceptable.

17. The alternative, independent taxation with transferable allowances (ITTA) is supported, in particular, by the WNAC and by the professional organisations. I believe that this offers in principle a much more coherent and acceptable tax structure than either MIT or the present system. It provides independence, where the wife goes out to work or otherwise has her own income; but it also provides fair support, where she stays at home to look after the family; and it recognises that this is a choice for her to make, not for any Government, whether by arbitrary rule or by still more arbitrary discretion.

18. Under ITTA there is a choice to be made between allowing the partner who stays at home to transfer the whole of his/her allowances to the other partner, or only part of them. We do not need to decide on this now. But, for the reasons given in paragraph 22 of the note by officials I think the balance of argument favours partially transferable allowances, rather than full transferability.

19. ITTA would also bring us much closer to the best practice in other European and North American countries, combining the two WNAC criteria of independence and support for the family. By contrast, no major western country either has anything comparable with our present system or seeks to disregard the reality of marriage, in the way that the advocates of MIT with cash benefits propose.

COSTS OF CHANGE

20. Either MIT with cash benefits or ITTA carries significant costs.

21. First, they both reduce the (now relatively too large) total tax allowances payable to the married couple where both husband and wife are earning. This is the clearest anomaly in the present system, and virtually everyone who responded to the Green Paper accepted that it should be removed. The impact could be eased by transitional arrangements. Nevertheless those who would lose (some 5 million couples) may complain, while the gainers may stay silent.

22. Over time the removal of this anomaly could yield savings (allowing for the cost of disaggregating investment income) approaching £1 billion under ITTA with partially transferable allowances (though with full transferability there would be a net cost). As the savings would not emerge before the end of the decade, it is not necessary to decide now how these should be used - whether to increase tax thresholds or cash benefits for families with children.

23. MIT would go further and use the whole saving from abolishing the married man's allowance to finance a new system of cash benefits. So virtually all married couples would face a higher tax burden.

24. Second, they both involve additional administrative costs, requiring perhaps some thousands of extra staff. Obviously, we should make every effort to reduce additional costs to a minimum. But some significant cost is unavoidable. This is partly because they require the Revenue to take on its books up to 12 million married women, whose tax affairs are now treated virtually as a by-product of their husbands'. In addition, the systems themselves are more complex, requiring (with MIT) the creation of new cash benefits, or (for ITTA) a system to transfer allowances between husband and wife. The planning and introduction of either system would take some years and the introduction of ITTA could not, in any event, be managed before the computerisation of PAYE is complete. There is the risk that - whilst virtually every woman may support the principle of independence - some women may in practice have difficulties when they have for the first time to fill in their tax returns, and become themselves responsible for payment of tax on their income.

THE CHOICE

25. The questions we now have to decide are

- (i) what is the best alternative to the present tax treatment of husband and wife?
- (ii) do the advantages of this alternative outweigh the costs?
- (iii) if so, how far should we commit ourselves to reform at this stage?
- (iv) what would be the timetable for implementation?

26. On the first question, I have no doubt that, if we decide to make a thorough-going reform of the present system, independent taxation with transferable allowance (ITTA) is the only acceptable alternative.

27. The second and third questions are more difficult. For obvious reasons, I am reluctant to make any change which would, in itself, complicate the tax system and add to administrative costs. However, I am not at all sure whether we have the option of staying where we are. We are under pressure for reform from many quarters - both the other main political parties, our own Conservative Women's National Committee, the academic commentators, the political and equal opportunities lobbies, and professional organisations. If we cannot respond positively to these pressures, we risk leaving a clear field to our political opponents, and to a system of mandatory independent taxation with cash benefits, which I believe to be wholly unacceptable.

28. If we decide that there is a sufficient case for reform, the next step might be to prepare a White Paper - though with some pretty broad green edges. I might announce this in the Spring 1983 Budget, and publish perhaps a little later. The paper would need very careful drafting and I would wish to involve my colleagues fully in its preparation. It might indicate more or less firm Government support for the principle of independent taxation with transferable allowances; and then go on to launch the necessary next stage of public consultation on a number of points which have as yet been barely touched on in the public discussion. These include implications for other aspects of the income tax, for the capital taxes, and for social security benefits, in particular for the elderly.

29. The White Paper would also, of course, bring out as clearly as possible the disadvantages of MIT with cash benefits.

TIMETABLE

30. The timetable would be designed to give ample time to assess the response to this further consultative document, before we finally commit ourselves to go ahead. Given where we now stand, legislation would be a matter for the next Parliament. Implementation would be towards the end of the decade, when we have the benefits of a computerised PAYE system.

THE PRESENT SYSTEM OF TAXING HUSBAND AND WIFE

1. The present arrangements basically treat the income of husband and wife as one. The wife's income is taxed as if it was the husband's and he is responsible for his wife's tax affairs as well as his own. The married man is given an allowance which is higher (by 56%) than that of a single person. There is an additional allowance (equal to the single allowance) which is given against the wife's earned income, but does not run against either her investment income or any income of the husband's.

The present structure of personal allowances can thus be summarised

| | <u>£ p.a.</u> | <u>(% of a.)</u> |
|---|---------------|------------------|
| a. Single Person | 1,565 | (100) |
| b. Married Couple, only husband earning | 2,445 | (156) |
| c. Married Couple, husband and wife both earning | 4,010 | (256) |
| d. 2 Single People, both earning (compare with c. above) | 3,130 | (200) |

MEASURES WHICH OFFER MARRIED WOMEN A MEASURE OF INDEPENDENT TREATMENT

2. Over time there have been a number of changes to the basic system, designed to give married women a measure of independent treatment. Thus the normal tax rules can be varied in two ways:-

- a. Separate assessment (introduced in 1914) enabled husband and wife to be responsible for handling their own tax affairs, and for payment of their own share of the tax. It does not alter the total tax payable by the couple; it divides the bill between them according to their share of the joint income. Very few people (about 10,000) take advantage of this election.
- b. Wife's earnings election (introduced by the Conservative Government in 1971) enables a couple to elect for the wife's earnings to be taxed separately. She gets a single allowance against her earnings and the husband gets a single allowance (instead of the married allowance) against the rest of their joint income. The wife's investment income is still taxed as her husband's income and he remains responsible for returns of his wife's income as well as his own. The election is only beneficial for couples where the total income and the wife's

earnings are large enough for the loss of the married allowance to be outweighed by the reduction in their higher rate tax. About 200,000 couples benefit from it at present.

3. In addition, there have been some administrative changes in the last few years to provide more equal treatment for married women in some respects - for example,

repayments of tax on the wife's income are now usually made direct to her;

and

correspondence on the wife's own tax affairs is now normally addressed to her direct.

CRITICISMS OF THE PRESENT SYSTEM

4. The main criticisms of the present system are:-

- a. It treats the married woman as a 'chattel' of her husband (section 37 ICTA - if a married woman is living with her husband her income shall "be deemed for income tax purposes to be his income and not to be her income.").
- b. The married man's allowance gives married men a bigger tax allowance than their wives (and a bigger allowance than single men or women).
- c. It gives more than the sum of two single allowances to a married couple where the wife is working (they get $2\frac{1}{2}$ times the single allowance, while one income couples get $1\frac{1}{2}$ times the single allowance).
- d. (from some critics) it gives any recognition to marriage
- e. (from some critics) it imposes a tax penalty on marriage (mainly in the case of couples where the wife has substantial investment income) so that couples can be better off co-habiting than married.

RESPONSE TO THE GREEN PAPER

5. The Green Paper, published in 1980 posed two basic questions:

a. should the present system be left unchanged?

- virtually all those who responded said that the present system was unacceptable, and that fundamental changes should be made;

b. if the system was changed, should the tax unit be the family or the individual?

- there was almost no support for moving towards the family

as the basic tax unit (as in France). The virtually unanimous response was that the individual should be the basic tax unit. Discussion centred on the form that a system of independent taxation should take, and in particular how far it is possible - or right - for the tax system to reconcile the principle of independence of the individual as the basic unit for tax with support for the married family.

OPTIONS FOR CHANGE

6. The main options for change canvassed in the Green Paper and subsequently developed in further work, are as follows:-

a. A right under which either husband or wife could choose from year to year

- to remain under the present system: or
- fully independent taxation of both earned and investment income, each with a single person's allowance - and no transfer of allowances between husband and wife.

This would extend the present options for separate assessment and for separate taxation of wife's earnings. A less developed version of the proposal received lukewarm support in response to the Green Paper, and the only as an interim reform before option c. becomes possible.

b. Mandatory independent taxation with cash benefits (MIT):

- i. tax husband and wife as separate individuals, each with a single person's tax allowance
- ii. abolish the married man's allowance, and replace it by
- iii. cash benefits - increased child benefits and other benefits (usually unspecified) for those with dependents.

This is favoured by the poverty lobby, the Equal Opportunities Commission and both the Labour* and Social Democratic parties.

c. Independent taxation with transferable allowances (ITTA)

- i. tax husband and wife as separate individuals
- ii. give each, in the first instance, a single person's allowance
- iii. permit any allowance unused by one partner to be transferred to the other (wholly or partially).

This is favoured by the Women's National Advisory Committee and the professional bodies.

* See extract from 'Labour's Programme 1982' attached

EXCHEQUER IMPLICATIONS

7. Under all three options the investment incomes of husband and wife would be taxed separately, whereas the wife's investment income is now aggregated with that of her husband and taxed at his marginal rate. The Exchequer cost of this at present allowance levels would be £bn0.3 under option a. and some £bn0.5 under MIT and ITTA mainly for the benefit of higher income families. Under both MIT and ITTA - but not option a. - there would be an off-setting gain of up to £bn1.3 from ending the anomaly under which a couple in which both husband and wife are earning get more than two single person's allowances (see paragraph 22. below for the further effect of fully transferable allowances). Under MIT there would also be an increased tax burden on one-income couples, and a further revenue gain on this account of £bn2.2.

STAFFING IMPLICATIONS

8. All three options are more complex than the present system and would involve additional staff costs. Option a. would cost several hundred additional staff. Both under MIT (particularly if we wished to mitigate the impact on minority groups such as the disabled) and under ITTA the costs could perhaps add up to several thousand additional staff; one of the reasons is that the Revenue would require tax returns of some kind from up to 12 million women whose affairs are now handled along with their husbands. The eventual costs will of course depend on the precise form the new system takes and its suitability for computers. This is a most important area for further work.

9. IMPACT ON TAX THRESHOLDS

Option a. would of course leave the present pattern of thresholds unchanged, except for the few hundred thousand couples who might choose independent taxation (where the husband would receive only the single person's allowance). On the existing levels of allowances, MIT would reduce the tax threshold for all married men from £2,445 to £1,565, increasing the tax bill for some 12 million couples; under ITTA the only major group to lose would be 5 million or so two-earner couples - the different effect on one-earner couples of partially or fully transferable allowances is discussed at paragraph 22. below.

Under both MIT and ITTA about $\frac{1}{4}$ million couples where the wife is the sole breadwinner would lose, but more so under MIT.

The impact of either MIT or ITTA on the elderly is more varied and more difficult to estimate, but under MIT almost all the taxpaying elderly would lose (some substantially) and under ITTA about two-thirds would gain and one-third lose.

TIMING

10. Option a. could be introduced quickly: perhaps legislation in 1983 and implementation in 1984. ITTA is not administratively practicable until after PAYE is fully and successfully computerised, at the earliest, by the end of 1987/88; it would in any event be prohibitively expensive of staff without computerisation. In

practice the timescale for any comprehensive MIT system would probably be very similar because it would involve a new range of cash benefits; it could only be implemented much earlier on a crude basis which would disadvantage many one-income couples of the kind which even the advocates of MIT would probably wish to protect.

11. Paragraph 24. below sets out a possible "time path" to reform.

ANALYSIS OF OPTIONS

Option a.: Right to choose independent taxation

12. This would give the wife the right (which she now does not have) to independent taxation; and it could thus be presented as going a long way towards meeting the pressure for change. It avoids the upheaval to the basic system that the other two more radical options entail, and, though costly in staff for the Revenue (some hundreds of extra staff would be needed), it is a good deal less costly than the other options.

13. This has attractions, but also serious disadvantages:

- it depends on a choice - with the attendant complexity and risk of criticism from taxpayers who find the choice difficult - and some of them would inevitably get the choice wrong.
- it retains the married man's allowance for the great majority of families and so does not tackle the anomaly that a two-earner couple can get more than two single allowances.
- if it has to be seen as no more than a first step towards independent taxation with transferable allowances, it implies the disturbance of two major changes in this sensitive area of the tax system within a decade
- it would be strongly opposed - as a step in the wrong direction, by those in the Equal Opportunities Commission, poverty lobby and the Opposition parties who want to abolish the married man's tax allowance in favour of bigger and better social security benefits.
- it would get only a lukewarm welcome from the other critics of the system, as no more than a first step in the right direction - independent taxation with transferable allowances.
- it would (like all moves towards independent taxation of husbands and wives) benefit those with investment income and the first costs might arise in 1984-85. But it would not have the broader (and arguably more "progressive") distributional effects of the more radical options.

Option b.: Mandatory independent taxation with cash benefits

14. This approach has a variety of supporters, not all with the same objective:

- an increase in child benefit would be welcomed by mothers

in particular in low income families;

- increases in child benefit, and consequent possible reduction in means tested benefits, would also be helpful in mitigating both the poverty trap and the unemployment trap for some families with low incomes (though the consequent reduction in tax thresholds would also make the trap worse for some families);
- if financed by a reduction in income tax allowances, it could contribute to a new re-distribution of income more generally from middle and higher income families, in favour of those with low incomes;
- the whole approach would be consistent with a view of society in which marriage is irrelevant*.

15. The first two of these objectives are important, so far as they go. Indeed, they were among the Conservative Government's objectives in the original tax credit scheme of 1971. The question always, is cost; and whether - as is proposed here - the cost is easier to handle if it is wholly financed by increasing the income tax burden on married couples without children below school leaving age. Why income tax? and why married couples?

16. The second two points are not among the Government's objectives. In particular, the present Government have always emphasised the importance of the family, and the fact that the family is based on marriage.

17. Moreover, when one comes to look at this approach more closely it raises some formidable problems:-

- i. it would take a further £3½ billion directly from taxpayers in order to pay it out in social benefit;
- ii. it would inevitably involve a radical review of the way the social security system treats married couples and the family unit;
- iii. as stated above, it would reduce the tax threshold for all married men.
- iv. it is based on the objectionable idea that in dealing with couples where the wife is at home the State should

* eg National Council for Civil Liberties -

"Neither sex nor marital status should result in a different tax burden"

National Labour Women's Commission -

"Men and women should be treated as equal and separate for tax purposes regardless of marital status"

discriminate between 'deserving' and 'undeserving' wives that is, give cash benefits to those who look after children or have other "worthy" reasons for staying at home and deny cash benefits where the wife "simply chooses to stay at home";

- v. even if one accepted the principle of discrimination between 'deserving' and 'undeserving' wives, in practice it would be impossible to devise a sensible cash benefit system and put the dividing line in the 'right' place;
- vi. it would at the same time be logically inconsistent with any special tax relief for widows, such as the Widow's Bereavement Allowance introduced by the Chancellor in 1980;

No other major Western country completely disregards the fact of marriage in the way that the advocates of this system propose.

18. It may help to illustrate the practical points at iv. and v. above.

- The most important case is also the simplest; replacing the married man's tax allowance by an increase in child benefit payable to the mother. It is thought there was some effect on wage claims when child tax allowances were abolished and child benefit first introduced between 1977 and 1979; the transfer from wallet to purse with MIT would of course be much larger.

But there is an almost infinite variety of other situations, where a wife has a commitment which prevents her from going out to earn her living in the market place, and where we could not possibly justify withdrawing tax relief on any grounds of "equity". For example:

- There may be a dependent parent or other relative; sometimes may be someone living with the family, and so infirm that they cannot be left for any length of time; at the other extreme, it may be an elderly or infirm person living nearby who does not need full time care, but who cannot be left to fend for himself or herself day in and day out. In either event, the wife may be unable to commit herself to a regular job.

- Again, the husband may be disabled, or in such "uncertain health" that the wife cannot commit herself to employment.

- The wife herself may be disabled etc.

- The wife may have stayed at home to look after her children. When they leave home, she is in her forties or fifties - when she finds it most difficult to go out and resume a career. Child benefit has ceased, and the proposed new system would

give the family no marriage allowance to take its place.

- The husband may have work in an area of high unemployment - or where there are few if any businesses employing women but the wife (unlike a single woman) is not free to leave home and look for a job elsewhere.
- The couple may be elderly and retired; the adverse effect virtually all elderly couples would be severe and difficult remedy, at least without further action that could be either anomalous or costly, or both.

19. In these cases, and many others, withdrawal of relief would be wholly unjustified on its merits. No-one has yet suggested a scheme of cash benefits which would cater for all these situations of all their variety - and which would not cost far more to pay, and administer than the present system.

Option c.: Independent taxation with transferable allowances

20. As a long term objective, this would in principle provide a coherent and rational alternative to the present sex discrimination system. It meets the legitimate pressure for more independence and equality under the tax regime, but it still pays proper regard to the reality of marriage. In particular

- it would treat husband and wife equally;
- it would end the anomaly under which the two earner couple gets more than two single allowances;
- the UK system would be in line with tax systems abroad in recognising marriage (as now) but not (as now) give more than the sum of two single allowances;
- it would give relief to wives as of right with no invidious discrimination between the 'deserving' and 'idle'.

21. At the same time, it would be a pretty radical change, with broader implications and some substantial costs. In particular

- the change in the tax treatment of two earner couples would - for better or worse - reduce the present incentive for married women to go out to work;
- it would in consequence reduce the tax threshold for 5 million married men (those where the wife is earning more than about £13 per week); and there would probably need to be transitional arrangements to soften the impact;
- the transferability of allowances would be complex and cost a lot of staff - up to 6,000 depending on the degree of transferability (see paragraph 22. below) and the precise form of administration chosen;

- up to 12 million wives would have to take over from their husbands responsibility for their own tax affairs;
- it would raise difficult questions about consequential changes elsewhere in the income tax system - such as whether a married couple should qualify for two separate mortgage interest ceilings: some of these could be to the benefit of the taxpayer; others could be his disadvantage;
- measures would be needed (as its advocates freely accept) to control avoidance through transfers of income between husband and wife;
- changes would need to be considered in the present taxation of capital transfers between husband and wife.

22. Within an ITTA system, there would also be a choice to be made between wholly and partially transferable allowances - that is, whether a spouse with insufficient income to use up his or her own single allowance should be able to transfer to the other the whole or only part of the unused allowance. Both versions would provide equal and independent treatment where the wife has sufficient income of her own, whether earned or not, to use up her single allowance, and both would reduce the allowances available to the two-income couple from $2\frac{1}{2}$ to 2 times a single allowance. Full transfer would however increase the allowances to the one-income couple from $1\frac{1}{2}$ to 2 times the single allowance, whereas partial would maintain the present relativity of $1\frac{1}{2}$. At existing levels of allowances, the net exchequer gain of £0.8 billion from a partial scheme would be converted into a net loss of £0.3 billion if full transfer were allowed; this means that if the change were made on a revenue-neutral basis, the single allowance would have to be cut and all single taxpayers would lose. The staffing costs of up to perhaps 5,000 for partial transfer, (though it might be significantly less, depending on the form of administration) would be increased by at least 1,000 for full transfer. The choice is not one that has to be made yet, but for these and other reasons the balance of arguments points at present very strongly towards a system of partial transfer.

23. Comparison with other countries. Under ITTA the UK tax system would be broadly similar to that of most other Western countries, in that it would continue to recognise the position of one-income married couples in the tax system but give the working couple only twice the single allowance (the present advantage for two earner couples is a peculiarity of the British system). ITTA would however give more independence and privacy than in many other countries. Some have joint taxation of investment income, though earnings are separately taxed. Others have a joint taxation system, with 'income-splitting'. Under this approach a married couple's income is added together and divided by two, with a single allowance and set of rate bands being set against each half of the couple's total income. This approach would give a bigger benefit than ITTA to wealthy one-income couples. It would also be more complex than ITTA - particularly if it was necessary (as in the USA) to add in an option for independent treatment of husband and wife, because of the restrictions on privacy in the basic income splitting approach. Variants of this joint taxation approach were floated in the Green Paper, but attracted very little interest.

SUMMARY

24. Option a. - the right to choose independence - has attractions but it would be complex and difficult for taxpayers, involve significant revenue and staffing costs, and would still be seen at best as only a modest step in the right direction. For the reasons set out above and summarised in the Chancellor's paper, MIT is open to very strong objections. ITTA has significant costs in terms of administrative complexity, major extra staff requirements, redistributive effects and the wider implications for other areas of the tax system and for social security. On the other hand, it seems to go nearest to achieving the right balance between independent tax treatment, support for the family and individual choice.

TIMETABLE

25. If Ministers conclude that a sufficient case has been made for radical change on the lines of ITTA, a possible timetable for action following the publication of a White Paper next Spring might involve:-

- a period of between 1 and 2 years for people to digest the broader implications of major reform and for consultations;
- draft clauses and legislation early in the life of the new Parliament - eg 1985/86;
- a further period for consultation on detailed regulations, administrative instruction to employers, training, publicity and so forth (experience suggests that, even leaving aside the need to wait until the Revenue's computers come on stream, employers also will need at least 2 clear years to implement a change of this kind);
- final instructions to employers, issue of tax returns, coding notices etc - followed by implementation towards the end of the decade.

priority, however, is a significant real increase in tax thresholds.

The income tax age allowances will be kept under review to ensure that those elderly taxpayers with little or no income above the present basic state pension are kept out of the tax net, and we will consider aligning the age allowance with pension age.

At the other end of the scale, Labour will act to bring down the starting point of the higher rates of tax. In order that those with higher earnings pay their full share of National Insurance contributions we shall act to remove the ceiling on contributions or levy a higher rate of tax above the ceiling.

Tax reliefs and perks

Even with the existing rates and allowances, the income tax system could be much more redistributive. The steady erosion of the tax base, by a range of special reliefs of which the wealthiest taxpayers are best placed to take advantage, greatly increases inequality.

These special reliefs include those available on life assurance premiums, and for self-employed annuities for company directors and others not covered by pension schemes. All such reliefs have some justification, and none is used exclusively by the rich. Labour does not seek a total withdrawal of the reliefs. We shall, however, act to limit the open-ended nature of tax reliefs so that the better-off no longer benefit disproportionately.

Labour will also make a determined attack upon the great array of tax-free perks made available by companies to their employees. We shall ensure that employees are taxed on the full personal benefit of company cars over and above their use for genuine business purposes. The new tax treatment for company cars will, however, be phased in over a period having regard to any possible adverse effects on the British motor industry.

Tight restrictions on the availability of special reliefs and perks will provide the extra revenue to make possible higher personal allowances for all taxpayers.

Some perks directly undermine the public services by artificially encouraging private provision. As a matter of priority, Labour will act to remove all the tax privileges of the independent schools, and the income tax relief on school fees; and will tax employer-funded private health insurance at its full value to the employee.

Sex discrimination in tax

For income tax purposes, married women are treated as wholly dependent on their husbands. Married men receive a differential income tax allowance, and are taxed on the joint income of husband and wife, with the option for separate taxation of earned income only. There must be a fundamental change in the tax treatment of married women, to end the indefensible discrimination of the present system.

Labour will phase out, over a period of three years at most, the married

those with responsibility for dependants through enhanced child benefit rates, and an extension of the Invalid Care Allowance.

Completely independent taxation, with the ending of aggregation between husband and wife, is the only option which would end discrimination according to marital status and ensure that married women can have privacy in their financial affairs. There are other options which could remove direct discrimination between the sexes, but without allowing privacy and independence. We favour the principle of total disaggregation, but recognise that this could cause some problems. By itself, disaggregation would reduce tax revenue and would favour couples with high incomes from investments. It could, however, be acceptable within the context of a total package of tax changes which significantly reduced inequality overall. We are currently consulting within the party on this issue.

Indirect taxation

Labour's commitments for the public and social services will require a strong base of indirect as well as direct taxation. However, Labour vigorously opposed the Tories' heavy switch from direct to indirect taxation in 1979. A reduction in the rate of Value Added Tax (VAT), appropriately timed, could play an important part in Labour's strategy against inflation. Labour will also take action to ensure that the benefit of any reduction in indirect tax rates is passed on to consumers.

Labour will be ready to make changes in indirect taxes, as well as income tax, to move in the direction of greater social equality. One such change would be the introduction of differential rates of VAT, so that the less essential goods and services were taxed at a higher rate than everyday living costs. Labour will ensure that such essential items as food, fuel, children's clothing and public transport, remain fully relieved of VAT through zero-rating. It will add sanitary protection, for example, to this list while making private hospitals liable for higher rates of VAT.

In the longer term Labour intends to remove the complex VAT system and replace it with alternative taxes on goods and services which will place less of a burden of paperwork on businesses, and will also require less public administration. For consumer goods, this alternative would involve a single-stage tax like the former purchase tax, levied on wholesale prices and capable of being levied at a number of different rates with essentials exempted.

Taxing wealth

Taxes on income and expenditure alone can never go very far to change the extremely unequal distribution of wealth in Britain today. It is essential to act directly on inherited wealth, which is by far the greatest source of the inequality. The taxation of capital at present is on an extremely small scale, accounting for only 2% per cent of total tax revenue in the current year, compared with 5% per cent ten years ago.

SECRET



10 DOWNING STREET

From the Private Secretary

1 December 1982

REQUER
 = 2 DEC 1982
 MR ISAAC - IR
 FST, MSTCR), CST,
 MR MOORE, MR KEMP
 MR BLYTHE - TR
 MR SPENCE - IR
 MR FRENCH

Dear Jim,

FAMILY POLICY GROUP

The Prime Minister took a meeting of the Group yesterday to discuss papers prepared for it by the Chancellor of the Exchequer and by the CPRS. The Chancellor of the Exchequer, the Secretaries of State for Education and Science, the Environment, Industry, Transport, Health and Social Security and Employment, the Lord Privy Seal, the Chancellor of the Duchy of Lancaster, Mr. Raison, Mr. Sparrow, Mr. Wasserman and Mr. Mount were present.

Opening the discussion of his paper on husband and wife taxation, the Chancellor of the Exchequer said that the present position was coming increasingly under attack. Features which attracted particular criticism were the assumption that a husband was responsible for his wife's tax affairs and the bias in the system in favour of couples in which both partners were working. Both the SDP and the Labour Party had produced plans for thorough-going reforms and there was a considerable body of opinion within the Conservative Party in favour of change. In considering the options, he had three objectives: first, to treat men and women in an even-handed way; second, adequately to recognise the fact of marriage; and third, to remove the bias in favour of the working wife in the present system. There were three possible options to achieve these objectives:

- (i) the right to choose independent taxation;
- (ii) mandatory independent taxation with cash benefits (MIT);
- (iii) independent taxation with transferable allowances (ITTA).

Option (i) had been canvassed in the Government's Green Paper and had received little support. Its effect would be limited to the disaggregation of investment income and as such would cost £300 million a year. This would be seen as designed to benefit the upper income group. To adopt this option would be seen as an inadequate response to the problem. Option (ii), which would involve taxing husband and wife as separate individuals, abolishing the married man's allowance and replacing it by cash benefits was the one favoured by the Labour and Social Democratic Parties. It was, however, quite unacceptable to the Government since it would continue the trend towards increasing the dependence of the individual on state handouts.

/In the view of

7/12

In the view of the Chancellor option (iii), ITTA, under which husband and wife would be taxed as separate individuals with a single person's allowance which was partially transferable to the other partner was the only practical and politically acceptable alternative to the present arrangements. It had the advantages of treating husband and wife equally; of removing the disincentive for wives to stay at home and therefore enabling them to make a real choice; that if allowances were partially transferable a wife returning to work would not be taxed until she had earned the amount of her allowance; that there would be a £1 billion net gain to the Exchequer as a result of abolishing the married man's allowance which could be used, for example, to raise thresholds; and that the benefit of husbands and wives allowances would accrue to the family unit as a whole. There were objections to ITTA, a number of which were pointed out in discussion. There were, for example, five million couples in which both partners were working who would lose money through the loss of the married man's tax allowance. ITTA would also bring an additional twelve million people into the tax system and given its complexity, would require considerable additional administrative effort. Indeed, it would only be possible when computerisation of the Inland Revenue had proceeded further. There were also doubts about its social consequences; the decision by a wife to go out to work, for example, would automatically reduce her husband's income. Scepticism was also expressed about the desirability of altering the tax system to encourage wives to stay at home.

In further discussion an alternative approach was canvassed. Either there might be a household allowance or the tax system should explicitly recognise family obligations by increasing the married man's tax allowance and decreasing or holding constant the married woman's earned income relief. There were nevertheless a number of objections to this approach; to increase the married man's tax allowance would be contrary to the view widely held in the Conservative Party as well as the other Parties that that allowance was anomalous. It would, moreover, be politically very difficult to discriminate between women on the basis of their marital status.

In further discussion it was argued that the prime objective should be to improve the position of families with children. There was a case for increasing child benefits or reintroducing the child tax allowance. The case against increasing child benefit was that a further move in the direction of a high tax, high benefit society should be resisted. This argued, perhaps, for the reintroduction of child tax allowances: but there would be formidable political difficulties in this course. The real problem was to reduce the overall burden of taxation and Government policy should continue to be directed towards that objective. The Group noted, however, the scale of reductions in expenditure which would be required to enable substantial reductions in the standard rate of income tax or increases in tax thresholds. In these circumstances ITTA offered a way of meeting justified complaints about the present system while in itself being revenue-neutral.

/Summing up the

SECRET

- 3 -

Summing up the discussion, the Prime Minister said that while ITTA was preferable to the other options outlined in the Chancellor's paper, it was nevertheless objectionable in a number of ways. She was not convinced that to retain the status quo would be politically difficult; the fact that ten million people or more would lose under the schemes proposed by Labour and the SDP was a powerful argument. Before the matter could be considered further, a paper should be prepared by the Treasury setting out the effects of ITTA on families at various stages of their lives and in particular an analysis by geography and status of those families that would lose as a result of its introduction.

In a brief discussion of the paper by the CPRS on the Group's priorities it was agreed that it was not possible to take up all the themes identified in the paper. It was noted, however, that a paper on the elderly was in preparation which might usefully be taken at the next meeting, together with the paper on housing for the elderly promised by the Secretary of State for the Environment. The broad outline for the programme for the next few meetings proposed by the paper was agreed; particular points on responsibilities for papers should be resolved between those immediately involved.

I am sending a copy of this to the Private Secretaries to those present at the meeting as well as to John Halliday (Home Office) and Richard Hatfield (Cabinet Office). I should be grateful if further circulation could be limited to those specifically authorised by their Ministers.

Yours ever,

Tim Dun.

Miss Jill Rutter,
HM Treasury.

29 November 1982

Policy Unit

PRIME MINISTER

BRIEF FOR FAMILY POLICY GROUP

5pm TUESDAY, 30 NOVEMBER 1982

I. TAXATION OF HUSBAND AND WIFE

The Chancellor's memorandum explores the historical background. His officials' note outlines the present system and summarises the options for change.

If the Group wants to go ahead with reform, then the Chancellor's preferred option - Independent Taxation with Transferable Allowances (ITTA) - is clearly the only sensible alternative to the status quo. Clearly too, the allowances should be partially transferable. If they were fully transferable, that would err too much in the opposite direction and be unfair to the couple where both husband and wife are earning. The Group will want to consider:

- (a) whether it is worth changing at all; and
- (b) the risks and drawbacks of change.

(a) Is it worth changing?

The economic and social grounds for change are strong. The present system is bizarre, unfair and illogical. Page 1 of the officials' note shows how it favours the working wife over both the working unmarried woman and the non-working wife.

Combined with the present high taxation on lower incomes, it puts strong pressure on young mothers to go out to work; it is thus an anti-family system for poorer families, because they cannot afford to employ child-minders or au pairs.

At the margin, it must also add to the numbers of women seeking jobs (sometimes reluctantly) at a time when we would prefer, if anything, to shrink the labour market. It is a system designed for the war years when the munitions factories were short-handed, not for 1982. Not for nothing was Britain probably the most highly mobilised nation fighting in World War Two.

No doubt the high participation of working wives in the labour force in Britain - as opposed to, say, in Mediterranean countries - is partly due to national tradition and personal preference. But the bias of the tax system is much more marked here than anywhere else.

To introduce a system which would be genuinely neutral as between working and non-working wives would be both equitable and timely. It would offer working-class wives more choice between full-time work, part-time work and staying at home. It would also be possible, at no Exchequer cost, to make some impact upon the numbers seeking work as recorded on the employment register - which, as we have seen, is highly sensitive to people's perceptions of whether it is worthwhile registering (in the light of the economic situation, the wages likely to be available and the tax system).

(b) The risks and drawbacks of change

The Chancellor's paper (page 8) lists the following disadvantages:

- The change would reduce the present incentive for wives to go out to work. But we might not object to that, so long as the change does not penalise the working wife as against other categories, and it does not.
- It would, in consequence, reduce the tax threshold for 5 million married men. There would need to be transitional cushioning. The potential loss to the two-income family is the greatest political problem. It could be minimised by enveloping the transition in a Budget which reduced income tax overall, thus making most of the disadvantage relative not absolute. A gradual increase in VAT rates, coupled with a parallel rise in income tax thresholds, is in any case the best way to phase out the poverty trap. ?!
- Transferability would be complex and demand extra staff (5-6,000). Some of this cost would be merely transitional if the Inland Revenue showed ingenuity. ?
- ? | Up to 12 million wives would have to take over from their husbands responsibility for their own tax affairs. But if a joint declaration form could be evolved, this might be both less costly and less unpopular than we may now imagine. After all, one of the criticisms of the present system is that it

Yes, but....

treats wives as appendages. Is this appropriate to the age of the joint bank account?

- There would be certain consequential problems, eg on Capital Transfer Tax. But these seem minor and capable of resolution. After all, other countries manage ITTA-type systems easily enough.

The next steps

The timetable laid out in the Chancellor's memo (paragraph 28) suggests a White Paper with Green edges after the 1983 Budget.

If the Group agrees to this, we might suggest that, provided the White Paper is well received, we should include in the Manifesto a general commitment to the introduction of ITTA in the next Parliament.

II. PROGRAMME OF WORK

You are invited to approve the programme outlined in the CPRS paper. Some of the work is already under way. Colleagues are preparing papers on the key topics which I have asterisked. I have also picked out some other important topics which urgently need attention.

It is important that you should endorse, with some emphasis, those pieces of work which you do want followed up in a positive spirit. Otherwise, departments will lapse back into the defensive apathy from which we have just begun to rouse them.

A. Personal Taxation and Benefits

The taxation of husband and wife is only one half of the low-income family's tax problem.

The Treasury has already submitted a note on the unemployment trap and the poverty trap. We might invite the DHSS to submit a full-scale paper when they have completed their follow-up work on the unemployment reports.

B. The Elderly

* Norman Fowler's paper on the general situation of the elderly is likely to be ready in time for the next meeting. ✓

- * The Department of the Environment is also ready to offer a paper on housing for the elderly.

C. Encouraging Self-Reliance

I think we need to commission a paper from the Treasury on all the methods of encouraging personal wealth-creation: profit-sharing, personal investment in equities, personal pension funds and so on. There is considerable opposition to this both from the Treasury itself which is worried about loopholes, and the City which would rather deal with large funds. But we must press on if we are serious about a capital-owning democracy.

Not submitted

Not the same: for his other book

D. Children and Schools

- i. Wider parental choice is already being discussed separately.
- * ii. Keith Joseph has already circulated a paper on Preparation for Parenthood which could be discussed at the next meeting.
- iii. We might also welcome a paper from Keith on Maintaining Discipline and Authority - particularly on the crucial question of the headmaster's power to hire and fire teachers.

E. Voluntary Action

- * (a) and (b) Tim Raison is discussing with other departments what changes in the tax system might encourage greater generosity among individuals.
- * (c) The DoE will be putting in a Business-in-the-Community paper on how public and private initiatives can be married to encourage local enterprise and involvement.
- * (d) The DoE is working up a paper which will cover not only the use of school and other local authority facilities out of school hours, but also the use of facilities owned by the nationalised industries and the private sector.

With what results?

F. Housing

The DoE intends to offer two papers:

- * i. Furthering the sale of council houses.
- * ii. Recent developments in the management of council estates.

G. The Face of Government

The CPRS proposes to work on this in collaboration with the MPO and a number of departments which serve the public directly. If you are content that they should go ahead, you might emphasise that they should set out to produce specific recommendations for action.

H. Professionals and the Individual

Again, specific recommendations for action would be welcome. I think it is important that the CPRS should bear in mind the sensitivities of the professions involved - whether they be architects or probation officers - and should be certain of its ground before making recommendations. ✓

J. Reducing Crime

- * The Home Office is circulating a paper which summarises recent research into the causes and cures of crime. The main conclusion is negative - that the criminal justice system by itself is unlikely to reduce crime much - but it does contain some useful practical suggestions on crime prevention which might be worth discussing: vandal-proof design, more caretakers, better architects etc.

K. Racial Equality

We have nothing to offer here at the moment. The Group might like to discuss what initiative the Government could take which would stop us being pressed back onto the defensive and being carried down the road to ethnic monitoring and positive discrimination which may inflame as much resentment as it soothes. Would you like me to do a paper?

III. NEXT MEETING

It would be helpful to maintain the momentum which we have just established, if the Group could meet again fairly soon - say, in mid-January, and thereafter at monthly intervals.

No date fixed

FM

FERDINAND MOUNT



mp

cc CST
FST
EST
MST(R)
MST(C)
Mr Middleton
Mr Moore
Mr Robson
Mr French

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

5 January 1983

The Rt. Hon. Norman Fowler MP
Secretary of State for Social Services

Dear Norman

cc

THH

cc *(FPG)*

TAXATION OF HUSBAND AND WIFE

When the Family Policy Group discussed this subject on 30 November, our colleagues agreed that ITTA was preferable to the other options for reform, but asked for more information about the mechanics and the distributional consequences of independent taxation, before any firm decision.

... We had, of course, done a good deal of work on these aspects, before formulating my original paper. The results of this work are summarised in the attached "factual" paper, with a more detailed note by officials on the distributional and transitional aspects. I had it in mind to circulate this further paper to the Family Policy Group, together with a second brief paper, of which ... I also attach a copy. This tries to draw together the policy implications of our discussions so far.

I hope that the factual paper, in particular, covers adequately the questions raised on 30 November. However, I should be grateful to know whether you yourself would like any point to be covered more fully, and whether you agree generally with the line which I have in mind to take.

I am sending copies of this letter to Patrick Jenkin, Janet Young, John Sparrow and Ferdinand Mount.

Geoffrey Howe

GEOFFREY HOWE

TAXATION OF HUSBAND AND WIFE

(Memorandum by Chancellor of the Exchequer)

1. We were generally agreed at our meeting on 30 November on four main points.

- the present system has serious weaknesses;
- we should reject the option of mandatory independent taxation with cash benefits;
- if a change is to be made at all, the best option is independent taxation with transferable allowances;
- but we need more facts on the costs and broad implications of independent taxation, before taking any decision for or against reform.

2. I am circulating separately a note, covering a note by officials, which seeks to answer the factual questions raised at our earlier meeting.

Objectives

3. In this note I consider how we might best

- i. respond to the criticism of the present system;
- ii. mount an effective attack upon MIT/cash benefits, whose advocates now hold the floor; and
- iii. prepare our answer to the crucial question, which I asked in my earlier paper

"Do the advantages of ITTA (independent taxation with transferable allowances) outweigh the cost?".

Present system

4. 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.

5. 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 own National Women's Committee, the Chartered Accountants and the Law Society.

6. 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.

MIT or ITTA

7. By the same token, we shall invite 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. 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.

8. As I have said, I see this as the purpose of the proposed White or Green Paper. 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 much less likely to a defence of something very close to the present system.

ITTA - the costs

9. My accompanying factual paper provides further material on the distributional and other implications of ITTA, requested in our earlier discussion. In this paper, I just note the main points.

10. 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 factual papers bring 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 older and 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 11 below).
- (b) All but a few of elderly couples over 65 would gain (by contrast with MIT, under which most elderly married couple 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) can 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 is something which (as the background note 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 that time.

11. By the same token, the savings from ending the present anomaly rising to perhaps £m900 on present day values, as the transitional arrangements work out, 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 specifically 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 the transitional arrangements, the full amount could be achieved some time around the middle of that decade.

12. Incentive for wives to work: The note of our 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, of a kind which is not available in the case of any single man or woman (and which has no precedent in any overseas country). It was universally criticised in the response to the Green Paper. And it is of course given to the man, not to his wife.

13. 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.

14. Effect on husbands and administrative implications:

As the factual note explains, we are exploring the possibility of giving the relief by a system of end-year (not in-year) adjustment. This could have two main advantages. First, it could again 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.

15. 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

16. The advantages of ITTA remain those which I discussed in my earlier note

- a more coherent and acceptable tax structure
- 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.

Conclusion

17. I invite my colleagues to agree that

- i. we should publish a further consultative document on the taxation of husband and wife at some convenient time after the 1983 Budget.
- ii. it should reject MIT with cash benefits.
- iii. it should develop fully and sympathetically the implications of ITTA.

18. In my earlier paper, I suggested that this consultative paper might be a "White Paper with broad Green edges". In practice this might take either of two forms

- i. a more or less firm decision of principle that ITTA is preferable to the present system, but reserving a final decision to implement ITTA until people ^{have} had a chance to think further about it and assess its detailed implications, or
- ii. a still more 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.

I shall be glad to have my colleagues' views as between these two possible approaches.

18. 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 it might well give us the most defensible basis on which to stand during any election campaign that might intervene.

DISTRIBUTIONAL AND PRACTICAL IMPLICATIONS OF ITTA WITH
PARTIALLY TRANSFERABLE ALLOWANCES

Memorandum by the Chancellor of the Exchequer

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 increase child benefits 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 £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 a.;
- 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

If for illustrative purposes we assumed that a

change to ITTA with partially transferable allowances were made in one step and on a revenue neutral basis, the £m900 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). Thi

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 (though, as explained above, this would only happen if the £m900 or so saving was spent on increasing the basic single allowance, instead of being spent in other ways).
- 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 couple 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 allowance for them. So long as inflation persists this can be masked 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 / 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;
- and
- c. one-income couples and single people would get the

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

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:-

Partial Transferability

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

2.3 A system with full transferability at existing allowance 1 would produce the same tax savings from two-earner couples as partial transfer but the savings would be more than absorbed because full transfer would give more allowances couples with only one income than at present (ie they would get double the single allowance instead of the present 1.5). It follows that in terms of a revenue neutral change the single allowance would have to be reduced, with the results shown in the following table:-

Full Transferability

| | Existing Regime | ITTA with existing allowance levels | Revenue-neutr ITTA |
|------------|--------------------|---|-----------------------|
| Single | 1565 | 1565 | 1535 |
| One-income | 2445 | 3130 | 3070 |
| Two-earner | 4010 | 3130 | 3070 |

2.4 The distributional effects of a revenue-neutral change to ITTA with partially transferable allowances are shown in the first of the tables 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 partial 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 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 The second table gives the same information for a system of ITTA with full transferability. The main difference, compared with partial transferability, is that the level of allowance has to be decreased slightly to achieve revenue neutrality, so all single people lose; and considering the taxpaying population as a whole about 70% lose.
- 2.12 Leaving aside single people, the effect of the two schemes on married couples can be summarised as follows:-

Millions

| Age, family status and range of total 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) | |
| UNDER 65:- | | | | |
| Single | 8.0 | 8.0 | - | +0.6 |
| Married, wife not working: | | | | |
| £2,000 - £4,999 | 0.8 | 0.8 | - | +1.6 |
| £5,000 - £7,999 | 1.8 | 1.8 | - | +1.0 |
| £8,000 - £11,999 | 1.3 | 1.3 | - | +0.7 |
| £12,000 and over | 0.7 | 0.7 | - | +1.1 |
| Total | 4.6 | 4.6 | - | +1.0 |
| Married, wife working: | | | | |
| £2,000 - £4,999 | 0.3 | 0.1 | 0.2 | -2.3 |
| £5,000 - £7,999 | 1.2 | 0.3 | 0.9 | -2.3 |
| £8,000 - £11,999 | 2.6 | 0.2 | 2.4 | -2.1 |
| £12,000 and over | 2.1 | 0.3 | 1.8 | -1.1 |
| Total | 6.2 | 0.9 | 5.3 | -1.7 |
| OVER 65:- | | | | |
| Single | 1.3 | 1.3 | - | +0.7 |
| Married: | | | | |
| £2,000 - £4,999 | 0.5 | 0.3 | 0.2 | +2.7 |
| £5,000 - £7,999 | 0.4 | 0.2 | 0.2 | +2.8 |
| £8,000 - £11,999 | 0.2 | 0.2 | neg | +2.9 |
| £12,000 and over | 0.2 | 0.2 | neg | +5.2 |
| Total | 1.3 | 0.9 | 0.4 | +3.4 |
| ALL 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

neg : negligible

- : zero

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

GAINS AND LOSSES UNDER REVENUE - NEUTRAL SCHEME WITH
FULLY TRANSFERABLE ALLOWANCES

Millions

| Age, family status, and range of total income | Number of taxpayers under current scheme (1) | Of those - numbers | | Percentage gain or loss (-) in income net of for whole group |
|---|--|--------------------|-------------|--|
| | | gaining (2) | losing (3) | |
| UNDER 65:- | | | | |
| Single | 8.0 | - | 8.0 | -0.2 |
| Married, wife not working: | | | | |
| £2,000 - £4,999 | 0.8 | 0.8 | - | +4.8 |
| £5,000 - £7,999 | 1.8 | 1.8 | - | +3.6 |
| £8,000 - £11,999 | 1.3 | 1.3 | - | +2.6 |
| £12,000 and over | 0.7 | 0.7 | - | +2.0 |
| Total | 4.6 | 4.6 | - | +2.9 |
| Married, wife working: | | | | |
| £2,000 - £4,999 | 0.3 | 0.1 | 0.2 | -2.4 |
| £5,000 - £7,999 | 1.2 | 0.2 | 1.0 | -3.0 |
| £8,000 - £11,999 | 2.6 | 0.2 | 2.4 | -2.9 |
| £12,000 and over | 2.1 | 0.1 | 2.0 | -1.6 |
| Total | 6.2 | 0.6 | 5.6 | -2.3 |
| OVER 65:- | | | | |
| Single | 1.3 | - | 1.3 | -0.3 |
| Married: | | | | |
| £2,000 - £4,999 | 0.5 | 0.4 | 0.1 | +2.2 |
| £5,000 - £7,999 | 0.4 | 0.3 | 0.1 | +1.3 |
| £8,000 - £11,999 | 0.2 | 0.2 | neg | +1.7 |
| £12,000 and over | 0.2 | 0.2 | neg | +4.5 |
| Total | 1.3 | 1.1 | 0.2 | +2.5 |
| ALL TAXPAYERS | 21.4 | 6.2 | 15.2 | - |

(1) Counting married couples as one

(2) Included in these numbers are 0.4m cases taken out of tax

(3) In addition, some 0.2m cases are brought into tax

neg : negligible

- : zero

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

| | Existing married couple taxpayers | of whom: | | Couples brought into tax | Total married couple losers |
|---------------------------------|--|----------|--------|--------------------------------|--------------------------------------|
| | | gainers | losers | | |
| Partial transfer- ability | 12.0 | 6.3 | 5.7 | 0.1 | 5.8 |
| Full transfer- ability | 12.0 | 6.2 | 5.8 | 0.2 | 6.0 |

2.13 From this it can be seen that the proportion of couples who gain is not markedly different between the two schemes; just over half gain in either case, the gainers consisting of all one-earner couples and a minority of two-earner couples. Under partial transferability, most one-earner couples benefit only from the small increase in allowance levels; those who gain under full transferability gain more; and those who lose lose more - as compared with partial transferability.

2.14 Finally, there is nothing much to choose between full and partial transferability, so far as vertical redistribution of the tax burden between different income levels is concerned.

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 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 3.1

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 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:

CONFIDENTIAL

Number of married
females, all ages,⁺
in the region
(millions)

Percentage 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 | 0.8 | 43.6 |
| Yorkshire & Humberside | 1.2 | 46.3 |
| North West | 1.6 | 48.4 |
| West Midlands | 1.3 | 46.1 |
| East Midlands | 1.0 | 47.4 |
| South East | 4.2 | 47.0 |
| East Anglia | 0.5 | 44.1 |
| South West | 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 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 work 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. ITI (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 major 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 redistribute income from one stage of the life cycle to another for near 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 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 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 partial 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 syst |
|---------------------------------------|---------------|--------|------|------|------|------|------------------------|
| <u>Single person</u> | 1565 | 1720 | 1890 | 2080 | 2290 | 2520 | 2520 |
| <u>Married man (wife not earning)</u> | | | | | | | |
| i. "frozen MAA | 2445 | 2445 | 2445 | 2445 | 2445 | 2520 | |
| ii. additional transferable allowance | - | 245 | 515 | 810 | 1135 | 1420 | |
| Total of i. and ii. above | 2445 | 2690 | 2960 | 3255 | 3580 | 3940 | 3940 |
| <u>Two-earner couple</u> | | | | | | | |
| i. husband | 2445 | 2445 | 2445 | 2445 | 2445 | 2520 | |
| ii. wife | 1565 | 1720 | 1890 | 2080 | 2290 | 2520 | |
| Total of i. and ii. above | 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> | | | | | | |
| i. "frozen" MMA | 2445 | 2445 | 2445 | 2445 | 2445 | |
| ii. additional transferable allowance | - | 120 | 245 | 385 | 1370 | |
| Total of i. and ii. above | 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 | |
| Total of i. and ii. above | 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

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.

INLAND REVENUE
December 1982



TXH
cc (FPG) ←

DEPARTMENT OF HEALTH & SOCIAL SECURITY
Alexander Fleming House, Elephant & Castle, London SE1 6BY
Telephone 01-407 5522
From the Secretary of State for Social Services

EX-CHEQUER
20 JAN 1983
PS/IR

CONFIDENTIAL

CST, FST, EST, MST(R)
MST(C) Mr Middleton
Mr Moore Mr Robson
Mr French

The Rt Hon Sir Geoffrey Howe QC MP
Treasury Chambers
Parliament Street
London
SW1P 3AG

20 January 1983

Dear Geoff

TAXATION OF HUSBAND AND WIFE

Thank you for your letter of 5 January enclosing the draft of a memorandum from you to the Family Policy Group on this subject and supporting papers.

I am content with the general lines of the Memorandum, and would only at this stage record my view that we should in any eventual White/Green Paper do better to go for the more cautious of the two options which you put forward in your Conclusions, namely that which would recognize the attractive features of Independent Taxation with Transferable Allowances, but at the same time emphasize that we would not wish to change the present system unless there was broad public support for such a change and for its tax redistribution consequences.

On detail, my officials have already been in touch with the Inland Revenue ones concerned and have suggested some amendments to the various texts. We will of course be very ready to join in the further stages of work which will be needed if the decision is to go ahead with the publication of White/Green Paper after the Budget.

Copies of this letter go to Patrick Jenkin, Janet Young, John Sparrow and Ferdinand Mount.

Yours sincerely

NORMAN FOWLER

CONFIDENTIAL

CONFIDENTIAL

TXH
cc (FPG) E



JF2552
Secretary of State for Industry

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

31 January 1983

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

RECORDED
-2 FEB 1983/2
PS/IR

CST, FCT, EST, NST, D
NSTCJ Mr Middleton
Mr Moore Mr Robns
Mr French

Dear Geoffrey,

TAXATION OF HUSBAND AND WIFE

Thank you for copying to me your letter dated 5 January to Norman Fowler together with the papers by yourself and officials.

2 I am broadly content with the balance of the arguments and the suggested course of action to be put to colleagues. One point, however, which I would like to emphasise is that in advocating rejection of "MIT plus cash benefits" it is the mandatory independent taxation with zero transferability which is being rejected: as you know my preference lies towards ITTA with "savings" allocated to increased child benefits.

3 I am copying this letter to Norman Fowler, Janet Young, John Sparrow and Ferdinand Mount.

Yours
Patel

03. XII 1912