1. This year's Budget speech contained proposals for a new tax-credit system which would bring together for the first time the systems of personal taxation and social security in this country. We undertook to produce a Green Paper setting out the details of the system and proposed that the scheme as a whole should be referred for consideration by a Parliamentary Select Committee. The Green Paper is annexed in the form in which we propose that it should be published.

TAX-CREDIT SYSTEM

2. The tax-credit system is an entirely new approach to the integration of tax and social security hitherto untried in any other country. It automatically provides, without the need for means-testing, a substantial and comprehensive benefit to many retirement pensioners; an improved system of family support for lower-paid workers; and a greatly simplified tax system for the great majority of the population. It should make for more efficient administration of the tax and social security systems and provide a saving in the long run of between 10,000 and 15,000 civil servants.

THE GREEN PAPER

3. The tax-credit scheme is described in Chapter 2 of the Green Paper. Chapter 3 describes the consequential changes needed in the income tax system and Chapter 5 reviews the social implications of the scheme.

4. The Green Paper raises three important issues which need to be judged in the light of public reaction. These are discussed in Chapter 4. First, there is the question of the proper treatment to be given to married women's earnings, on which the Green Paper concludes in favour of continuing the special wife's earned income relief as a tax allowance within the new scheme. Second, there is the sensitive question as to whom the child credits should normally be paid. The choice here lies between
following the current income tax and national insurance practice of regarding the father as the normal recipient of benefits in respect of the children, or modelling the child credits for children after the first on the payment of family allowances to the mother. The Green Paper argues the case, primarily on economic and administrative grounds, for payment normally to the father, but given the possibility of strong reaction on behalf of the women's organisations to the withdrawal of family allowances from the mother, it reserves the final decision to be taken in the light of the Select Committee's views and of public comment generally. Third, the Green Paper discusses the proposed limitations on coverage of the scheme and sets out the considerations which have led to the exclusion, at least initially, of the self-employed and those outside the field of employment, for whom alternative provision for family support on lines of the present Family Income Supplement would continue to be made.

CONSULTATION

5. The Green Paper has been circulated at the official level to interested Departments and takes account of comments that have been received.

TIMETABLE

6. It is desirable that the Green Paper should be published, if possible, by the end of June. This ought to enable the Select Committee to be appointed in sufficient time to commission evidence from Departments and other interested bodies before the beginning of the summer Recess; the Select Committee could then make an early start to its work in October. This timetable is important if the Select Committee is to report in time for legislation to be possible next year. Without that, it is unlikely that the complex computer system required for the new scheme could be completed in time for the scheme to begin operating in April 1977.

7. Colleagues are invited to approve the Green Paper in the form annexed.

A B
K J

Treasury Chambers

19 June 1972
Proposals for a Tax-Credit System

Presented to Parliament by the Chancellor of the Exchequer
and the Secretary of State for Social Services
by Command of Her Majesty
June 1972
Proposals for a Tax-Credit System

Presented to Parliament by the Chancellor of the Exchequer and the Secretary of State for Social Services by Command of Her Majesty
June 1972

LONDON
HER MAJESTY'S STATIONERY OFFICE
FOREWORD

This year’s Budget Speech contained proposals for a new tax-credit system. This is a radical new approach—in which this country is leading the world—to bringing together the personal taxation and social security systems. It is a development of immense human importance and one which we believe could prove to be, in principle, widely acceptable to the British people. Because it would affect the everyday lives of so many it merits widespread public interest and discussion. The scheme described in this Green Paper is eminently suitable for examination by a Select Committee of the House of Commons.

It is as a practical exercise that this scheme must be judged. No matter how good a scheme is theoretically, it is no use if it will not work. We realise that this scheme does not do everything: it does not cover everybody: it does not solve all the problems. But it does do much that is desirable and it greatly reduces dependence on means-tested benefits. As time goes on it should be possible to extend it and solve some of the remaining problems. First, however, we must decide how best to apply it to the great majority of our people. This is the challenging task we now face.

ANTHONY BARBER

KEITH JOSEPH
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CHAPTER 1
THE PROBLEM

1. A complete merger of income tax and social security—whatever its theoretical attractions—is impracticable both on grounds of cost and administrative considerations. It would not, for example, be possible to merge the administration of supplementary benefit with the income tax machine, since it is not part of the normal administration of income tax to take into account rent and rates and other special needs nor to respond immediately to changes in these factors. Nevertheless, there is undoubtedly a degree of avoidable overlap between the two systems, and as each system, taken by itself, is complex in its operation and expensive to administer, rationalisation and simplification would yield substantial advantages.

2. Quite apart from the elimination of overlap between the two systems, there are complexities in the PAYE system on its own which need to be simplified. This system has operated fairly and well for nearly thirty years. But it is complicated and difficult to understand. It requires the employment of some 35,000 staff in the Inland Revenue and perhaps as many again in industry. It has been found to lack flexibility and governments of both political parties have found it difficult to adapt it to accommodate changes that they have felt desirable. Nor would those handicaps have been removed even if the system had been operated fully by computers. The complexities of PAYE arise partly from the annual coding, and partly from its cumulative basis which requires the tax office to maintain contact with all employees through their employer no matter how frequently they change jobs—and there are about ten million job changes a year. Any major simplification must start by avoiding the need for these features.

3. The overlap between the two systems which exists in the area of cash benefits for families with children and the Inland Revenue's dealings with the same families is a serious problem. The combination of the full tax allowances and family allowances alone results in nine different rates. Nor can it really be said that the differing amounts have a logical connection with one another. As a result, the system of family support is more costly to administer and more difficult to understand than is necessary. People in the tax field can benefit from tax allowances. All families with two or more children can claim family allowances, which are then subject to income tax and to a special tax deduction (the "clawback"). A further set of increases for children is available to national insurance beneficiaries. Low earners with children can claim family income supplement.

4. Between them these systems provide substantial help for those who are bringing up children on low incomes. But because the various allowances are either flat-rate, with entitlement determined by reference to the number of children, or graded and selective by reference to age and income, there is scope for simplification and integration. Moreover, it would be desirable that any
change should be towards a system that was more readily comprehensible than the present arrangements, so that a low income family could understand without difficulty what help they were entitled to, and should also make its provisions available, so far as possible, automatically—without a separate means-test.

5. As things are, a man who is receiving a family income supplement loses 50p in benefit if he increases his earnings by £1, and in some cases he may lose 35p* as well in income tax and national insurance contribution, leaving him only 15p better off. Cases where there is so marked a disincentive effect are of course exceptional, even if the possible loss of other means-tested benefits is taken into account. A comprehensive scheme for cash benefits, however, with a constant tax rate running right through the range of normal earnings, would substantially improve this situation.

6. The pensioners form another large group who in theory come within both the tax and social security systems; however, in practice many of them are well below the tax threshold (i.e. their incomes are too low to give rise to any liability to tax and they therefore get less than the full benefit from their tax allowances). On the social security side the White Paper “Strategy for Pensions” has outlined a plan for the development of national insurance benefits and of occupational pensions which “will provide independence in retirement, without recourse to supplementary benefit, for a steadily increasing proportion of the community”.† But this is a long-term aim. In the meanwhile about two million pensioners receive additional help from the supplementary benefit scheme, and there are also two or three million retirement pensioners, including very many elderly widows, who are not eligible for supplementary benefit, but have incomes only a pound or so above the supplementary benefit level. Many of them are finding it hard to manage on an income which cannot attract the full benefit of the tax allowances under the present system.

7. These problems led the Government to seek a way to simplify and reform the whole system of personal tax collection and, at the same time, to improve the system of income support for poor people. From this study have come the present proposals, which go a long way to meet both sets of problems within a single scheme.

8. In the next chapter the scheme itself is described in some detail (though the Green Paper does not attempt to cover all the matters that will eventually need to be settled, but which will first need to be considered in the light of public discussion). Chapter 3 sets out the simplifications in the income tax system which are inherent in the scheme. Chapter 4 examines three important issues which it raises. Chapter 5 considers its social impact and Chapter 6 its financial and budgetary implications.

* Assuming a basic rate of tax of 30 per cent: this is the basic rate of tax under the unified system provisionally fixed for 1973/74 and it is taken as the basic rate under the tax-credit scheme for illustrative purposes throughout this Green Paper.
† Cmnd 4755, paragraph 16.
CHAPTER 2
THE NEW SYSTEM IN DETAIL
ESSENTIALS OF THE SYSTEM

9. Those who came within the scheme would receive an entirely new form of tax credit for themselves and their families, which would take the place of the main income tax personal allowances and family allowances. These credits would normally be available for those in work and for occupational pensioners through the employer; for people drawing national insurance benefit or otherwise temporarily out of employment they would be available through the Department of Health and Social Security, or the Department of Employment.

10. Each individual in the scheme would be issued with a notification informing him of the amount of credit to which he was entitled. He would give this to his employer or make it available to the authority from whom he was receiving a pension, benefit or other relevant payment. In making payment of wages etc the employer or other payer would deduct tax at the rate of 30 per cent. Against this tax the employer would set the amount of credit to which the taxpayer was entitled. If credit exceeded tax, the difference would be paid to the taxpayer; if tax exceeded credit the difference would stand as a tax deduction just like PAYE.

11. The credits would thus perform two distinct functions. In the first place they would, like the present income tax allowances, graduate any income tax due broadly according to family circumstances, by offsetting in part or in whole the tax that would be deducted from earnings, pension or national insurance benefit. Secondly, the credits would do something that the tax allowances do not do. Since they would be payable automatically week by week, they would become a form of additional income to the extent that they exceeded the tax which was currently due. If the credits for the whole tax year exceeded the tax payable for the year they would be a form of social benefit and would provide a new means of income support.

12. In any pay period in which the credit was not fully used by being set against tax the unused credit would be paid out as an addition to the wage or salary; there would therefore never be any need to carry forward unused credits. This differs from the present system. If, under PAYE, a person's earnings in a particular week fall below his tax threshold the part of his tax allowances that is not used may have to be carried forward for use in subsequent weeks, or backward to give a repayment of tax paid in previous weeks. This is because both pay and tax are accumulated through the whole of the tax year. This "cumulation" would no longer be necessary under the tax-credit system.

WHO WOULD BE IN THE SCHEME

13. The scheme would apply to people who regularly work for an employer, to office holders, to retirement pensioners and people in receipt of other national
insurance benefits and to certain people who have retired from employment with an occupational pension before reaching the qualifying age for national insurance retirement pension.

14. For the reasons set out in paragraph 90 it would be necessary to have for employees a minimum qualifying level of earnings for entry to the scheme. The level proposed is that which will bring an employee into liability for earnings-related national insurance contributions as a Class I contributor under the Government’s new pension proposals. The White Paper “Strategy for Pensions”, indicated that the minimum qualifying level for contributions to the new scheme would be set at about one-quarter of average male industrial earnings*: in present terms this would be about £8 a week.

15. The credits would be payable if a person qualified for any of the principal benefits of the national insurance scheme. A number of these benefits which are at present tax free—unemployment, sickness and injury benefit, maternity allowance and invalidity pension—would, as a corollary to their giving title to a tax credit, become subject to tax, as was the original position under the national insurance scheme. This would remove the present anomaly whereby tax-free benefits are paid in place of taxable earnings. Where national insurance benefits were taxed in this way people who qualified for them but who were normally self-employed would, while on benefit, come temporarily within the scheme and receive credits; the tax paid and credits received would then be taken into account in assessing their annual tax liability under Schedule D.

16. It is not proposed to bring within the liability to tax either attendance allowance or the pensions paid on account of war or industrial disablement; at the same time these pensions and allowances would not of themselves give entitlement to credit where (exceptionally) this did not already exist.

17. Child credits would be at a sufficient level to replace the increases of short-term national insurance benefit which are payable for dependent children. But to the extent that the special children’s allowances payable to widows and to invalidity and retirement pensioners were higher than the child credit, the balance would continue to be paid as a taxable benefit within the national insurance scheme.

18. The scheme would also extend to anyone with a flat-rate national insurance retirement pension or widow’s benefit whether this was at the full or a reduced rate and regardless of the class of contribution on which it was based. War widows and women with widows’ benefits under the industrial injuries scheme would also be included. The majority of retirement pensioners and widows do not at present pay income tax because their incomes are below the tax threshold. For them, as for invalidity pensioners, the deduction of tax and the award of the credit would normally result in a significant net increase in their income.

19. There are many people who retire somewhat before the age at which national insurance retirement pension is paid. If they received a pension which took the place of full-time earnings and which was above the qualifying level

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"Cmnd 4755, paragraph 40."
for admission to the scheme, that is, in current terms £8 a week, they would remain within the scheme. Where a person had retired only a few years before becoming entitled to national insurance retirement pension, continuity of credit entitlement would be particularly desirable. It is therefore proposed that a person who had been within the scheme for a substantial period and retired on pension shortly before reaching State retirement age should continue to qualify for tax-credits, even though his pension was below £8 a week. To qualify in these circumstances he would have to have a pension or annuity from approved superannuation arrangements of an amount at least equal to the minimum level of flat rate national insurance retirement pension, currently £1.50 a week. He would not however be eligible to remain within the scheme if he took up self-employment. Since the main purpose would be to bridge only a relatively short gap in membership of the scheme it would seem reasonable to confine it to those who had reached the age of 60.

20. On the basis set out above about 90 per cent of the adult population and their dependants would be in the scheme. For reasons which are discussed in paragraphs 90 to 93, below, the scheme would not—at least at the start—include the self-employed or those outside the field of employment altogether (unless they qualified on other grounds: for example, as national insurance pensioners).

21. The position of working wives needs special consideration. The husband would normally receive the higher rate of credit in just the same way as at present he receives the married tax allowance. The important issue is the future of the wife's earned income relief, which is given in addition to the married allowance. For the reasons set out in paragraphs 74 to 81, below, the relief would continue to be given as a tax allowance against the wife's earnings and would not be converted into a credit. This would mean that in the normal case the married woman at work would not be within the scheme in her own right.

22. The wife's earned income relief would as at present also apply to an occupational pension or to a national insurance benefit earned by the wife's own contributions, but not to a retirement pension based on her husband's contributions.

23. In the very few cases where the husband was not within the scheme and was not self-employed the wife would, exceptionally, be entitled as the family breadwinner to the credits appropriate to the family, if her own circumstances qualified her under the general rules for entry to the scheme.

24. Summary

(1) The following groups would be included:

(a) any employed person normally earning above the qualifying level, in present terms about £8 a week;

(b) all the main national insurance beneficiaries, both long and short term;

(c) most occupational pensioners (subject to the limitations set out in paragraph 19 above).
(2) Married women at work would continue to receive wife's earned income relief as a tax allowance. Where a married woman was the breadwinner she would receive credits for her family if she came within any of the categories in the preceding paragraph.

THE NEW CREDITS

25. There would be only three rates of credit: (1) for a single man or woman, (2) for a married couple, (3) for each dependent child. The credits would be expressed in weekly amounts (converted to monthly amounts for those in monthly paid employment). If a change in personal circumstances occurred, e.g. marriage, or the birth of a child, the revised credit would normally be payable with effect from the week in which the change occurred. Thus for the year in which the child was born the child credit would be due for the appropriate part of the year, i.e. for the period after the date of birth. Similarly in the year of marriage the wife would receive the single credit up to the date of marriage and the wife's earned income relief thereafter (the husband of course would also receive the married credit from the date of marriage). The levels at which credits might be fixed are discussed in paragraphs 94 to 97 below.

26. Credits would be paid for wives and children resident in this country. Under EEC or other international arrangements there could be a commitment to pay credits in respect of dependants in certain countries overseas. Such cases apart, the general position of dependants abroad would require further study, especially as existing family allowances, unlike income tax child allowances, are only given for children in this country.

27. An important feature of the scheme is that a person who had single-handed responsibility for bringing up children would be entitled to the married rate of credit. The income tax system already recognises the special position of the single parent by granting an additional personal allowance for the children and the FIS scheme allows the same scale of benefits whether there are one or two parents in the family. The new credits would provide a valuable source of help for a person bringing up children on his or her own.

28. There would be a single rate of credit for each dependent child, which would not vary with the age of the child, the number of children in the family, or the income of the child. This credit would take the place of family allowances, which would cease on the introduction of the scheme. It is a major attraction of the tax-credit system that the present family support provisions can be simplified. It is an important element in this simplification—for employers, taxpayers and Government alike—that the credit for each child should be at the same rate. To protect the position of families with older children who at present qualify for a higher rate of income tax child allowance, a relatively generous rate of child credit would be needed: its level is considered in paragraph 120.

29. The credit would continue so long as the child was in full-time education. In the normal case in which the child completed his or her education at the end of a summer term the credit would continue up to the ensuing October.
30. The present income tax child allowance is reduced if the child’s own income exceeds a certain amount. Such a restriction in the new scheme would give rise to great administrative problems. The child credit would therefore be paid in full irrespective of the child’s own income. In calculating the tax on the child’s own income however only a reduced personal allowance would be given; the value of this would correspond to the level of income which the child can now receive without affecting the parent’s child allowance. The restriction in the allowance would end in the year in which the parent ceased to receive the child credit.

PERSONAL ALLOWANCES CORRESPONDING TO THE TAX CREDITS

31. Those who were not within the tax-credit scheme would receive personal tax allowances corresponding in value to the single, married and child credits excluding the standard expenses deduction (see paragraph 59). Where a person was within the scheme for part of the year only (e.g. if he entered or left self-employment) he would receive tax credits for the weeks for which he was within the scheme and corresponding personal allowances for the remaining weeks.

HIGHER RATE TAX

32. For those liable to tax at higher rates under the unified tax system which is to be introduced from 6 April 1973, the main personal tax allowances would continue to be given against higher rate tax, both for those within the tax-credit scheme and those outside it. From 1973 onwards the deduction of tax at higher rates will be merged with the ordinary PAYE system: about 150,000 taxpayers will be affected. Similar unified arrangements would continue under the tax-credit system. The tax deductions would be on a non-cumulative basis; if this resulted in an overpayment of higher rate tax, the matter would be put right in the assessment made at the end of the year, which would also take account of other income.

33. In calculating deductions of higher rate tax the main income tax personal allowances, i.e. the single and married allowance and the child allowance, would be given currently; similarly the other reliefs (including in particular interest on property loans) would be allowed by repayment of tax at the end of the year. If a person liable at higher rates had two or more employments, employers might be asked to make deductions at special rates to approximate as closely as possible to his true liability.

34. A married couple whose earnings jointly took them into liability for higher rate tax but who elected to be taxed separately on their earnings would have tax deducted during the year as if they were two single persons each receiving the single credit against their respective earnings.

35. A system of non-cumulative deductions involving more than one rate of tax tends inevitably to result in some overcollection of tax, particularly where earnings fluctuate above and below the starting point for higher rates, or if earnings for a period move up to a higher rate band. The number of people affected would be relatively small. Nevertheless it would be important to
devise procedures to avoid this where earnings rose exceptionally above the point of higher rate liability in a particular week, e.g. because of a special bonus or a retrospective pay adjustment. There will be consultations to see whether satisfactory and workable rules can be devised.

**ADMINISTRATION OF THE SCHEME**

**How the credits would be paid**

36. A card would be sent to every employed person within the scheme showing his credit entitlement—*i.e.* single, married, or family with one, two, etc children. He would hand the credit card to his employer so that he could be paid the appropriate credits week by week (or month by month in the case of monthly-paid staff) with his pay.

37. PAYE in its present form would go. Employers would deduct tax from pay—generally at the basic rate—on a non-cumulative basis. The new system would work as follows. On making a payment of wages, salary or pension, the employer would look up the tax due at the basic rate and deduct it from the pay. (He would also make any additional deductions that might be required—see paragraphs 32 and 71.) He would add the credit due for the relevant pay period at the rate shown by the employee's credit card. Thus, if the tax was greater than the credit there would be a net deduction from the employee’s pay; if, however, the credit was more than the tax there would be a net addition to the pay. Deductions from pay on account of national insurance contributions would continue to be made separately.

38. Employers would be responsible for paying credits to all employees for whom they held a credit card. When an employer took on a new employee he would normally pay credits from the first pay day; but provision would also be made for him to pay credits which had not been issued for previous weeks—usually because the employee had had a short gap between employments without qualifying for national insurance benefit. Discussions will be held with employers' representatives and with the trade unions to work out these arrangements. Any credits still remaining unpaid would be dealt with after the end of the tax year. When an employee left an employment his employer would hand the credit card back to the employee for use at his next employment. He would at the same time give him a certificate of pay and credits received and income tax and national insurance contributions paid in the employment.

39. A person who had two or more employments concurrently would normally obtain his credits through his main employer by depositing the credit card with him; tax would then be deducted at the full basic rate from the pay from the other employments. If someone was temporarily without his credit card, because he had lost it or failed to obtain it from his previous employer, an emergency procedure would operate on the lines of the PAYE emergency coding; subject to suitable safeguards, this would allow him a single person’s credit while matters were sorted out. This procedure would also cover anyone who entered qualifying employment before being issued with a credit card.

40. Payment of credits would continue during periods of entitlement to national insurance benefit, as explained in paragraph 15. Those getting
unemployment benefit would receive their credits through the employment exchange. If someone who was sick was still receiving pay from his employer he would normally continue to receive his credits from his employer too indeed, it would probably be convenient to make the payment of credits generally an employer's responsibility during the first weeks of sickness. If, however, sickness was prolonged the credits would be made available through the offices of the Department of Health and Social Security. If supplementary benefit was claimed, either in this case or in any other gap in employment, the credit would be fully taken into account as one of the claimant's resources in reckoning his entitlement. Tax at the basic rate would be deducted from unemployment, sickness and invalidity benefit; supplementary benefit would not of course be taxed.

41. The credits for retirement and widow pensioners would be taken into account together with a deduction of income tax at the basic rate in arriving at the amount of their pension to be shown on the pension order book. Since pensioners would receive their credits with their benefit they would not, if they entered employment, have a credit card to give to their employer. In such a case the employer would deduct tax from all the wages paid; this would produce the right result automatically.

42. To avoid problems for someone who was normally within the scheme but whose earnings temporarily fell below the qualifying level, or who was out of employment but could not draw his credits because of ineligibility for either sickness or unemployment benefit, credits would be allowed to continue in any year for up to a total of six weeks in which the qualifying conditions for credit were not met. Thereafter they would continue until the end of the income tax year only so long as the person remained in employment (even though earning less than £8 a week) or, if he was out of a job, only for so long as he was registered for work at the employment exchange. At the end of the year, unless he had meanwhile re-entered employment with earnings above the qualifying level or had become a national insurance beneficiary, he would not be eligible to continue within the scheme and would not be issued with a new credit card until he came within it again.

43. Some people will move between employment and self-employment in the course of a year. For that part of the year for which they were not entitled to credits they would be able to claim personal tax allowances. These could be used against the income tax which they had paid at any time during the year, to the extent that it exceeded the credits that they had actually received. These allowances would be given by repayment of tax by the Inland Revenue after the end of the year. It would be necessary for those concerned and others who had claims to repayment of income tax, to keep their certificates of pay and tax from each employment so that their claims could be dealt with speedily at the end of the year.

Adjustments at the end of the year

44. The great majority of taxpayers within the scheme would need no adjustment of their tax liability at the end of the year and the proposals outlined in this and the next chapter have been specifically designed to achieve this end.
Adjustments would be necessary, however, where for example a person was liable to higher rate tax or to the investment income surcharge, or where he was entitled to reliefs which could not be given through the mechanism of the tax-credit system.

45. Claims to the income tax personal allowances that would remain for some members of the scheme would also be dealt with by repayment after the end of the year. The repayment would be limited to the excess if any of income tax paid over credits received, because only to this extent would there have been any net liability to tax.

Responsibility for running the scheme

46. The way in which the scheme would be administered will be the subject of further detailed study. Computers would be used for the issue of credit entitlements and for such end of year tax adjustments as were still needed, but the aim would be that people could deal with a local office wherever possible. Within the Inland Revenue some PAYE work has had to be moved out of London to the regions because of staffing difficulties and this work would mostly remain where it is; so also would the work that has been centralised in preparation for automation, including that at East Kilbride.

47. The proposals for a tax-credit system as outlined in this Green Paper would enable an eventual saving of some 10,000 to 15,000 civil servants to be made. It is hoped that these reductions in staff could be achieved to a large extent through the process of natural wastage. The Government will be discussing the implications of the scheme with the representatives of the staff who would be affected by it.

Timetable

48. The changeover from our present tax and social security arrangements to the new system of tax credits would be an enormous undertaking requiring most careful planning. This and the necessary preparatory work for a computer system on the scale required must take a considerable time. If the tax-credit scheme on the lines set out in this Green Paper is generally acceptable, the Government would hope to introduce the necessary legislation for it during the course of the present Parliament, but the preparatory work before such a massive change could be made would take a good deal longer. Depending on when the Parliamentary Select Committee reports and the timing of the legislation it is hoped that the scheme could be in operation within five years from now.
CHAPTER 3
OTHER INCOME TAX CHANGES

49. People hutside the scheme would, as explained in paragraph 31 above, receive personal allowances corresponding to the tax credits. For people within the scheme the new credits would take the place of the main income tax personal allowances and PAYE coding would disappear. It would thus no longer be possible to give other tax reliefs, such as that for mortgage interest by adjusting PAYE deductions made from pay. Nor would the PAYE machinery any longer be available to recover through PAYE the tax due on other income—for example, small maintenance payments or investment income received in full. This chapter outlines proposals for dealing with the various reliefs and deductions that are at present given through the PAYE coding and then considers how to deal with the tax on income other than employment income which has hitherto been collected by an adjustment of the PAYE coding.

THE PRINCIPAL CHANGES

50. First to be considered are three reliefs which are claimed by many millions of taxpayers: the relief for life assurance premiums, the relief for interest paid, and the deduction for expenses of employment. There would be no means of giving these reliefs under the new system as there are under the PAYE machinery; but to allow relief in a form which would require repayment after the end of the year would be so costly in staff as to put at risk the savings which the scheme would otherwise provide. It is essential to find other ways of giving effect to these reliefs and deductions. The proposed solutions are as follows.

Life assurance relief

51. Most of the fourteen million claimants to life assurance relief are now given an allowance in their PAYE coding which automatically gives the appropriate relief. Equivalent relief could be given at source at the time of payment and this is the course proposed under the tax-credit scheme. On payment of a qualifying premium, the policyholder would deduct tax at 15 per cent (the rate at which relief will be given after unification of income tax and surtax). The Life Office would be able to recover from the Revenue the 15 per cent withheld from qualifying premiums.

52. This change in the basis of relief would have two consequences. First, provided the policyholder paid an amount of tax on his income at least equal to the tax withheld from his premiums he would normally receive the correct relief automatically without further adjustments. Virtually all members of the new scheme would be in this position. But some policyholders would have incomes below the tax threshold. Under present arrangements they would not get tax relief in respect of the premiums, but what is proposed would in effect allow them to obtain relief in future.
53. Second, the effect of the change would be to reduce the amount of relief available to taxpayers whose total annual premiums are less than £20 and who, under the unified income tax system, will obtain relief at the basic rate of 30 per cent on £10 or on the amount of the premiums paid, if less. This degree of simplification, like that proposed in paragraphs 58 and 59 on the treatment of tax relief for expenses, would be essential to the operation of the new scheme. The loss in tax relief for someone paying premiums of not more than £20 would be very small, the maximum being £1.50 a year, or 3p per week, this being the difference between relief at 15 per cent and 30 per cent on a premium of £10; these small losses can reasonably be expected to be outweighed by the general improvement in tax relief given by the scheme as a whole. Moreover, the new arrangements would be of particular benefit to those whose incomes are not sufficiently high for them to take advantage of the tax relief at present given on small premiums.

54. Giving the life assurance relief by deduction at source would raise a number of other problems in the application of the law affecting life assurance relief, some of them inevitably somewhat technical, which the Government will wish to discuss with the Life Offices and other institutions concerned. They recognise that there may be certain difficulties, but they are confident that these can be overcome.

Relief for interest paid

55. Relief for interest paid on loans for buying or improving property in the United Kingdom (here referred to as “property loans”) is claimed by over five million taxpayers. Up to 1970 annual interest on loans was paid under deduction of tax at the standard rate unless the interest was payable to a bank, building society, or (in certain circumstances) local authority, in which case it was paid in full. Since 1970 virtually all interest on loans to individuals has been payable in full, and relief to borrowers who are within PAYE is given through an adjustment to their PAYE code number.

56. From the introduction of the new scheme interest on property loans would in general be paid under deduction of tax; on paying interest the borrower would deduct income tax at the basic rate, paying over the net amount in satisfaction of the interest due. This would ensure that all borrowers received the full amount of relief due, generally when the interest was paid. This arrangement would be confined to interest on property loans by bodies which are qualifying bodies for the purpose of the present option mortgage scheme; this would include principally building societies, friendly societies, local authorities and life assurance companies. No steps would be taken to recover tax withheld at source from interest on qualifying loans where the payer’s income was below the tax threshold. The scheme would thus give everyone, irrespective of income, tax relief at the basic rate. It therefore has the important advantage that it would automatically make available assistance equivalent to that provided under the present option mortgage scheme to those who cannot under present arrangements obtain the benefit of full tax relief on the interest that they pay. It would thus be possible to wind up the option mortgage scheme, and to relieve borrowers of the need to make the sometimes awkward decision on whether or not to apply for an option mortgage subsidy.
57. The Government will discuss with the bodies concerned how the scheme would operate and the arrangements to be adopted in respect of loans from qualifying lenders that do not rank for tax relief. Consideration will be given to the method of relieving other interest qualifying for relief.

Expenses

58. An employee may claim a tax deduction for expenses incurred "wholly, exclusively and necessarily" in the performance of his duties. Some eleven million claims to expenses deductions are made each year, of which the large majority are claims to small flat rate allowances for the cost of tools and clothing in particular trades. The relief is given in nearly all cases through the PAYE coding and it would not be possible to give it in this way once the new scheme was in operation. To give relief by repayment at the end of the tax year would be impracticable, given the number of claims involved.

59. Under the new scheme a new standard deduction for expenses would be introduced and this would be taken into account in fixing the amounts of the new credits; this deduction would for the most part replace the separate individual allowances that are now given. It would cover allowances now given for tools, clothing, professional expenses, subscriptions and other small amounts of expenses, but not superannuation contributions, which are considered in the next paragraph. It would be given regardless of the actual expenses incurred. It is proposed that the amount of the standard deduction incorporated in the new credits should in terms of present values be £30. If an employee’s expenses were larger than this sum he could claim for the extra, subject possibly to a de minimis rule. The standard expenses deduction would also be incorporated in the wife’s earned income relief.

60. At present an employee who contributes to a superannuation scheme by regular deductions from his pay obtains tax relief either by an allowance through his PAYE coding or because his employer calculates the income tax on his pay after the contributions have been taken off. Arrangements are now being made whereby all employers will move over to the latter system so that the need to include superannuation contributions in the coding will disappear. No change in the treatment of superannuation contributions would therefore be required on the introduction of the new system.

OTHER CHANGES

61. The foregoing paragraphs have suggested ways of dealing with the three reliefs affecting very large numbers of taxpayers which under the tax-credit system it would not be possible to allow by coding adjustment. While the solutions proposed raise certain technical problems they would not create any complications or difficulties for the great majority of those claiming the reliefs. The remainder of this chapter is concerned with the future of the secondary personal allowances and the treatment of income other than pay or pensions. Relatively few people would be affected by these changes, but it is nevertheless very important that the complications for those affected should be resolved.

SECONDARY PERSONAL SERVICES

62. Under this heading are included the dependent relative allowance, the housekeeper allowance, the additional personal allowance given where a married
man with children has a totally incapacitated wife, the allowance given to a single person who maintains a female relative to look after a younger brother or sister, the relief in respect of daughter's services and the blind person's allowance. The special allowance for the married man with children who has an incapacitated wife and the blind person's allowance rest upon considerations which are not affected by the scheme and these allowances would remain. But so far as the other allowances are concerned the effect of the scheme in most cases would be to give more favourable treatment than is at present available and it would be appropriate as a result to withdraw those allowances.

63. Most of the allowances which would be withdrawn are due in respect of relatives of the taxpayer who are in some degree dependent upon him. Many of these relatives have very little income of their own and thus cannot benefit fully from the income tax personal allowances. Under the new scheme, however, the majority of them would be helped directly by their tax credits; even if the single credit were no higher than the present single personal allowance it would give a net increase of £1.40 a week to the single pensioner with no other income than the basic pension, and with the £4 credit assumed in paragraph 95 the net increase would be £1.98 a week. This compares with the 58p a week which the dependent relative allowance for example is worth at a 30 per cent rate of tax.

64. The scheme would thus give many dependants a measure of financial independence, and it would be wrong to give an income tax relief in respect of them to somebody else in addition to the credit they received themselves. There would be others who could not be brought within the scheme at the start. Many of these will never have qualified for national insurance benefit because of prolonged incapacity. They are already entitled to claim supplementary benefit and it would seem better where help is needed to give it directly to the dependent relative than in the form of tax relief to the person helping to support him.

65. Finally, there would be a small number of dependants outside the scheme with incomes which were above the level at which they could qualify for supplementary benefit, but which were at the same time not large enough to disqualify a relative contributing to their maintenance from the dependent relative allowance. In these as in other cases the contributing relative would still benefit from his own tax credits, or, if he was outside the scheme, in most cases from the corresponding increase in income tax personal allowances.

COLLECTION OF TAX ON OTHER INCOME

66. In the past it has been convenient that certain kinds of income going to those below the tax threshold could be paid in full: this has avoided the need for a very large number of repayment claims which would have arisen if tax had been deducted at source. However, an increasing proportion of people have, over the years, become liable to tax and it has been a valuable feature of the PAYE scheme that the coding can generally be adjusted so that an employee's PAYE deductions cover the tax due on such income as well as that on his remuneration. Following introduction of the tax-credit scheme there would be very few people indeed who would not pay tax as a counterpart to receiving credits, and since the PAYE coding would have disappeared other ways of collecting the tax would have to be found. These are discussed below.
67. One solution would be that income tax should be deducted at source more widely than it is now. Interest on property and other loans to individuals is mostly paid in full. The normal rule for other interest and dividends is that they are paid under deduction of tax. This applies to most Government stock, local authority loans, company dividends and debenture and other company loan interest; but interest paid on War Loan, dividends on Government stock and bonds held on the National Savings Stock Register, Savings Bank interest, bank deposit interest and interest which is not annual interest is paid without deduction of tax.

68. The interest on 3½ per cent War Loan is payable without deduction of income tax under the original terms of issue, as are the dividends on a number of Government stocks and bonds held on the National Savings Stock Register. In the case of War Loan held on the register of the Bank of England or Bank of Ireland there is already provision* for a holder to apply to the appropriate Bank to have the interest paid in his case under deduction of tax if that is more convenient to him; no doubt once the tax-credit system was operating many more people would wish to avail themselves of this facility rather than meet a separate lump-sum demand for the tax.

69. The question whether arrangements should be made whereby tax is deducted at source on dividends on securities held on the National Savings Stock Register (other than those which are paid without deduction of tax under the terms of the prospectus), or on interest arising on deposits with the National Savings Bank or with a United Kingdom Trustee Savings Bank, will require further consideration. But in any event the introduction of the tax-credit system is not intended to affect the exemption from income tax at present allowed on the first £21 interest on deposits held in an ordinary account with the National Savings Bank or the Ordinary Department of a United Kingdom Trustee Savings Bank and certain other savings banks.

70. It is important to the new scheme that interest paid on other forms of bank deposit should be paid under deduction of tax and the Government will wish to enter into discussions with the banks to see how this might be done.

71. Tax cannot be collected at source from certain kinds of income, for example, earnings from self-employment, income from property and forms of interest which continued to be paid in full. Tax due on such income would normally be collected by direct assessment, as is done in many cases at present. The possibility of self-assessment in these cases is being considered. It may be desirable to arrange in some cases for the collection of directly assessed tax, including tax which has not for some reason been deducted at source from employment income, to be made by special deductions from pay made by employers; recovery of credits which have been overpaid might also be made by deductions from pay.

72. Small maintenance payments. As the law now stands, maintenance payments made under a Court Order have to be made in full without deduction of income tax provided they do not exceed a certain amount. Tax relief is

then given to the payer by adjusting his code number or by a repayment. It would generally be more convenient under the new system if tax were deducted at source from maintenance payments. Where the wife was within the new scheme she would thus bear the right amount of tax without further action; at the same time the husband would automatically obtain the relief to which he was entitled as and when he made payments to his wife. If, however, the wife was outside the new scheme and below the income tax threshold the tax deducted would have to be repaid to her, and to avoid hardship such repayments would need to be made at regular intervals.
CHAPTER 4

SOME QUESTIONS RAISED BY THE SCHEME

73. This chapter considers three important issues raised by the tax-credit scheme:

the treatment of married women’s earnings;
whether the child credits should be payable wholly to the father with his pay or whether they should be paid at least in part direct to the mother;
the limitations on the coverage of the scheme.

MARRIED WOMEN’S EARNINGS

74. The question of the treatment of married women for tax purposes is of crucial importance in relation to the tax-credit system. It has been a lively issue of debate at least since 1920. It is sufficient for the present purpose to say that both for tax and social security purposes a lower level of combined allowance has been considered appropriate for the married couple than for two single persons. The level of tax credits suggested in the next Chapter, namely £6 for the married couple and £4 for the single person, would broadly follow this pattern.

75. An exception to this general rule has since 1920 been the tax treatment of the married woman at work. In such cases an additional allowance—the wife’s earned income relief—can be claimed. Originally this was equal to the difference between the married allowance and two single allowances and it was designed to ensure that where both husband and wife were working they were no worse off so far as the starting point of tax liability was concerned than if they were not married. In 1942 the allowance was increased to the same amount as the single allowance and in 1948 because of the exigencies of PAYE the reduced rate relief was extended to the married woman at work. In 1970, the reduced rate relief was in effect “merged” in the personal allowances and the wife’s earned income relief was similarly increased in line with the increased single allowance.

76. The Royal Commission on the Taxation of Profits and Income, in their Second (Interim) Report in 1954 (Cmd 9105) said that the wife’s earned income relief was based on a mixture of incentive and administrative convenience. They felt that the differential in favour of the married woman at work was too big and they recommended that it should be reduced. Instead the effect of changes in recent years has been to tip the balance even more in favour of the married couple where the wife goes out to work.

77. It can be argued that two people should not be treated differently for tax purposes because they were married. To a degree this argument has been accepted in the 1971 Finance Act which allows a married couple to opt to be
treated as two separate individuals for tax purposes in respect of their earned income. In the context of a tax-credit system, this argument would point to fixing the married credit at twice the single credit. It would follow from this that the wife's earned income relief would disappear: if in effect the wife enjoyed the same credit as a single woman, there would be no case for giving her an additional allowance as well if she went out to work. The real problem, however, is that such a change would result in a dramatic change in the relative position of the married couple where the wife was working as compared with the married couple where the wife was at home. The former might not in fact lose; indeed, under the illustrative figures used in the Green Paper, a working couple where the wife earned enough to use the whole of the present wife's earned income relief would just about break even. But as against this the married couple where the wife was at home would show a large relative gain.

78. Whatever the theoretical arguments in favour of treating the married couple as equal to two single individuals and apart from any question of cost, the Government doubt whether such a radical reassessment of the relative position of married couples where the wife was working as compared with married couples where the wife was at home would be acceptable to public opinion. Nevertheless there is a strong case for saying that the balance has been tipped too much against the married couple where the wife is at home. The constraints under the present PAYE system which compel the wife's earned income relief to be fixed at the same figure as the single allowance would no longer exist under the tax-credit system. It would be possible, therefore, for the amount of the allowance to be determined on its merits rather than by reference to other factors.

79. Apart from the limitations imposed by a desire not to upset existing relativities too drastically there are two arguments in favour of the retention of some kind of wife's earned income relief. First, incentive: the needs of the economy require the continued employment of large numbers of married women and the system must be such that they feel it is worth their while going to work. Second, the additional expenses involved: where both husband and wife work additional expense is often incurred, e.g. on domestic duties otherwise undertaken by the wife, and it is fair to regard their taxable capacity as being less than that of the couple with the same total income which is earned entirely by the husband.

80. The proposals put forward in the next Chapter, for a married credit of £6 compared with a single credit of £4 with the retention of some form of wife's earned income relief, would enable a reasonable balance to be struck. As compared with the present system, the married credit represents an improvement for the married couple in relation to the single person. This improvement would go to the married couple both of whom are working as well as to the married couple where the wife is at home. The retention in principle of wife's earned income relief would recognise both the incentive argument and the additional expenses. There remains the question of the amount of the relief.

81. The more favourable the treatment of the working wife, the greater the burden that must fall on other taxpayers, including married couples where the wife is unable to work because there are young children. These tend to be less
affluent than married couples both of whom are able to work. Taking all these factors into account, the fairest course would seem to be to keep the wife’s earned income relief at its present level. This would mean that married couples both of whom were working would enjoy precisely the same extra benefit from the scheme—namely the increased value of the married credit in relation to the present tax allowances—as the married couple where the wife was at home: but not a second and additional benefit which would come if the wife’s earned income relief were increased in line with the single credit.

82. The question whether in the ordinary case of a two-parent family the child credits should be paid to the father or to the mother is one of the most important issues raised by the scheme. This involves major considerations, not only of administration but also of social and economic policy. The advice of the Select Committee will be of very great importance.

PAYMENT OF CHILD CREDITS TO FATHER OR MOTHER?

83. It has been assumed so far in this Green Paper that the recipient of tax credits would be the father. He would receive them either through his paypacket—as an offset against the tax deducted by his employer—or, if he were unemployed or sick, together with his national insurance or any supplementary benefit. These benefits are already payable to the father of a family, whose entitlement includes sums in respect of his wife and children. A similar arrangement for paying all the family’s tax credits to the father would be in line with this; it would reduce the cost of administering the scheme.

84. At present the only relief available for a one-child family is the income tax child allowance, which operates through the father’s take-home pay and which is worth between £1.15 and £1.53 a week to a standard rate taxpayer, depending on the age of his child. Where, however, there are two or more children in the family entitlement exists both to income tax child allowances (received by the father) and family allowances (normally drawn by the mother). Family allowances are payable at 90p for the second child and £1 for each subsequent one; these sums, which are available to the mother, are somewhat higher than the financial help which the father can receive in respect of the same children since he has to pay the tax on the family allowances and on the “claw-back”. Assuming that he is liable to standard rate tax his weekly net tax relief will vary between 53p and 88p for each child, depending on the ages of the children and the numbers in the family. But the total effect is that in a two-child family, for example, he will still receive nearly three-quarters of the combined benefit of the two allowances.

85. Thus the proportion of existing family support payments which are available to a mother to draw in cash is relatively small; however, it may be argued that this degree of direct payment to her represents a valuable feature of the present arrangements which ought not to be disturbed. In order to reproduce the present position as closely as possible it would be necessary for the father to receive the tax credit for the first child and for the remainder
to be divided more or less equally between him and his wife. But it would make little sense to set up machinery within a single scheme to make separate payments to two parents in respect of the same child. If, therefore, any scheme involving payment to the mother were to be considered, an arrangement whereby the credit for the first child (or for the first two children) was paid to the father and the rest were paid to the mother would seem the best available.

86. The main justification for this compromise would be to preserve the status quo; in principle there is no reason why the credit for the second child should go to a different parent from the first. And in practice even this compromise would not be free from difficulty. The benefit of the child tax allowances for second and subsequent children would, in effect, be transferred to the mother. This would involve some fathers in paying more tax than they do at present. Taxpayers would also find it hard to understand that child credits paid to a wife would be different from her present family allowances, because they would have to be regarded as tax relief already received if any adjustment of the tax liability had to be made at the end of the year; that is, they would be treated as reducing the amount of tax which her husband had paid. In many cases this would lessen the amount of any tax rebate which he was able to claim.

87. A further drawback is that whereas, as explained in Chapter 6, an increase in the value of credits could be put into effect within a few weeks if payment were made through employers, it would not be possible to adjust so quickly the millions of instruments of payment which had been issued to wives. Finally, payment to the mother would mean retaining similar arrangements to those used for paying family allowances and for encashing them at the post office; this in turn would mean foregoing administrative savings of some £8 to £10 million a year. The sole purpose of this heavy cost would be to divert from one person and to pay to another in the same household sums which were intended for the support of the family as a whole.

88. Taking all these considerations together, the balance of advantage favours the payment of tax credits for the family with the father's earnings or benefit, and this has been assumed in the description of the scheme given in this Green Paper. But there are some cases in which serious problems might arise because a wife already has difficulty in obtaining an adequate housekeeping allowance from her husband. Even though her existing family allowances are far from sufficient by themselves to enable her to manage, their disappearance would make her more dependent on her husband—and would increase her difficulties if he was unwilling to make better provision for her and the children out of his increased take-home pay.

89. The need to protect a minority of women in this situation would hardly of itself justify the adoption for every family with two or more children of a costly method of paying credits. There would therefore need to be other convincing arguments that on balance this was the right course to adopt, particularly as in any event there would have to be arrangements to safeguard the position of the husband or wife who, though not in the ordinary way entitled to the child credits, effectively had care of the children. How best to
secure this result, taking account of other arrangements for maintenance, which are currently under review as part of the task of the Finer Committee on Single Parent Families, will require detailed consideration.

**LIMITATIONS ON COVERAGE**

90. On the basis of the coverage outlined in paragraphs 13 to 24 the tax-credit scheme would apply to nine out of every ten people in the country. The new arrangements are not intended, however, to extend to people (other than pensioners) who are right outside the field of employment or whose earnings are regularly below the qualifying level at which the new system will operate. Tax credits have not been designed with the intention of guaranteeing in every case that a family with no further help from the State would have enough to live on. To achieve that would put the cost of a practical scheme far beyond what is supportable. It would require a very substantial increase in tax rates to finance it. In any case, for those in greatest need help must be related to the particular circumstances of each individual family, its needs and its resources, and the system must be capable of responding quickly and effectively to changing requirements. Help of this kind cannot be given satisfactorily on a universal basis. If, therefore, the family breadwinner is neither eligible for a national insurance benefit or occupational pension nor able to command regular earnings of at least a minimum amount—which it is suggested might be £8 a week in current terms—it would be no solution to meet only part of the family’s needs through the tax-credit system, when help can be more satisfactorily provided through the machinery for payment of supplementary benefit.

91. Different considerations apply in the case of the self-employed. The essence of the tax-credit system is that the individual should be able to set his tax credits week by week against the income tax payable on his earnings or his pension, with only the balance of his credits being given as an addition to his pay. A person who derives his income from self-employment, on the other hand, is not taxed currently but pays income tax on his profits in half yearly instalments some considerable time after the profits have arisen. Credits could not be set regularly against a weekly tax liability and to pay them in full nonetheless would simply result in an increase in the tax that he would be called upon to pay when his profits eventually came to be assessed. Far from simplifying the present arrangements, this would be a further complication and would add to the work of the Inland Revenue in assessing and collecting tax from people engaged in business. This would be an unwelcome result and would be contrary to the aim of simplification which the new system seeks to secure.

92. However, since the value of the income tax personal allowances for those outside the tax-credit system would be made to correspond with the value of the tax credits, both the self-employed and people outside the employment field would share in the general reductions in personal taxation that could be expected to accompany the introduction of the scheme. For those who had dependent children and whose incomes were below the tax threshold, the Government’s intention would be that a system of family support on the lines of the present
family income supplement scheme should be available on a scale comparable to the benefits provided under the tax-credit system.

93. If the tax-credit system receives general approval, it would be the Government's intention to keep under review the categories excluded from it, in the hope that ways might be found eventually of associating some of them more closely with the new arrangements.
CHAPTER 5
SOCIAL IMPACT OF THE SCHEME

LEVELS OF CREDIT

94. The tax credit rates set out in the following paragraphs are purely illustrative. Nevertheless they have been chosen as figures which, at 1972 levels, would achieve the main objectives of the scheme—that is, they would allow for the replacement of the main personal tax allowances, family allowances, family income supplement, and the children’s increases payable with short-term national insurance benefits.

95. The single person’s credit would have to be set at £3.43 a week if it was to replace exactly the corresponding income tax allowance. An increase to £3.60 would be necessary in order to cover the £30 expenses allowance which would be incorporated in the single and married credit. If the figure was raised to £4 this increase would have important social advantages, as it would make the tax credits more effective as a means of improving the position of people of limited means and in particular of reducing the dependence of pensioners on supplementary benefit.

96. The child credit has to take the place of child tax allowances and family allowances which, if both are available at their maximum rate in respect of any child, are together worth £1.88 a week to a standard rate taxpayer. (This figure takes account of the taxation of family allowances and of “clawback.”) A child credit of £2 would provide some margin over this, and over the increases for children paid with the main national insurance benefits: these now stand at £1.85 a week*. Increases for the children of widows and invalidity pensioners, which are currently payable at the rate of £2.95 a week, would be only partially replaced by the child credit. The balance would be given as a taxable benefit under the national insurance scheme. Similarly, the age-related rates for children would remain under the supplementary benefit scheme.

97. If the single rate of credit is taken as £4, £6 would become the minimum level for the married credit. Together with child credits of £2, the figure of £6 would provide at least as much as the present family income supplement (FIS) scheme at every point on the income scale (and would provide substantially more than FIS for the majority of claimants)†. There would therefore be no

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* These allowances are scheduled to go up to £2.10 per child (including family allowances) in October, and that would then become the minimum level at which the tax credit for a child could be set.

† This comparison can be seen most clearly in the case of the one-child family, who can receive the maximum (£5 a week) rate of FIS on top of earnings of up to £10. At the £10 level, earnings plus FIS provide a total income of £15. Under the tax-credit scheme earnings of £10 would mean payment of £3 tax, but the addition of £8 credits (£6 “family” credit, plus £2 for the child) would produce the same net income of £15. But where the family had more than one child the tax-credit scheme would provide an extra £2 per child, which is higher than the addition now available under FAM and FIS together.
need to continue FIS except for the self-employed and others who, for one reason or another, were outside the tax-credit scheme.

98. Tax credits of this order have important implications for the social effects of the scheme, and for its total cost. The following paragraphs discuss and give some examples of the social effects—further examples are in the Appendix. The cost is examined in the next chapter.

EXAMPLES OF INCOME SUPPORT

(1) Low Earners with Families

99. The proposals would be of particular help to low earners with family responsibilities, including not only those who at present pay no tax (and who are in general eligible for FIS) but also people with earnings some way above the present tax thresholds. Thus a married man with three children earning £20 a week would pay £6 tax on his £20 but would qualify for £12 in credits: his income after tax would therefore become £26. At present he pays no tax; there are family allowances of £1·90 and FIS entitlement of about another £1. The family’s position would therefore improve, under the tax-credit scheme, by about £3 a week. Moreover the improvement would be automatic and would not require, as does FIS, an application for benefit under a special scheme. There would thus be no problem of take up. Moreover, as compared with FIS, the wage earner would retain 70 per cent as against 50 per cent of any increased earnings.

(2) Families with Average Earnings and Above

100. If, in the example given above, earnings were £30 a week the £12 credit for a three-child family would still exceed the £9 tax which would be payable, giving income after tax of £33. At present a family with earnings at this level is not eligible for FIS: they would receive the family allowance of £1·90 but, as against that, there would be a tax liability of just over £2 a week. The tax-credit scheme would thus increase their income after tax from around £30 to £33 a week—again a net improvement of about £3 a week. At earnings of £40 a week the credits for a three-child family would exactly equal their tax liability. At present the corresponding break-even point (where the tax payable by the father of such a family exactly equals their family allowance entitlement of £1·90 a week) comes at a much lower earnings level—a little over £29 a week*. Further examples of break-even points under the present scheme and under the new proposals are given in the appendix to this Green Paper. Above the break-even point the family would be net taxpayers and the effect of the new scheme would be that of a straightforward increase in tax allowances.

(3) Unemployment and Sickness Beneficiaries

101. The new scheme would alter the position of people qualifying for national insurance unemployment or sickness benefit in that they would qualify for tax credits whether they were at work or on benefit, and their benefits would

* This example assumes that one of the children is aged 11 to 16 and the other two are younger.
no longer be free of tax. This would substantially reduce the anomalies which

102. The tax-credits payable during the first fortnight of unemployment or

sickness would generally be substantially higher than the tax deducted from

flat rate national insurance benefit: this would offer particular help to those

people who do not qualify for occupational sick pay and have to rely on the

benefit alone. Where a family breadwinner had been unemployed or sick for

more than a fortnight and was receiving an earnings-related supplement as well

as flat-rate national insurance benefit the deduction of tax and the award of

credit would still result in an improvement in his income if his previous earnings,

and therefore his benefit, were relatively low. Thus a married man, whose

earnings had averaged £20 a week during the relevant income tax year, would, as

from October, draw benefit of £14.85 a week for himself and his wife. Tax at

30 per cent on this benefit would amount to £4.45, but this would be offset by

the £6 married credit, giving him a net addition of just over £1.50 a week from

the new arrangements while he was on benefit. The person whose previous

earnings were higher would not benefit to the same extent; if his previous

earnings had been £30 a week or more he would more or less break even, as

with benefit of £17.90 a week the £6 married credit would leave only a small

margin over the tax of £5.37 which would be payable on his benefit. Since

any child credits for which he qualified would be at broadly the same level as

the combination of national insurance dependency increases and family

allowances which they were replacing, the net result would be to leave his weekly

income at close to its present level. But to the extent that his tax credits were

already in use to offset the tax payable on some other source of income (for

example, the continuing earnings which might be available under a sick pay

scheme) they would not also be available against the tax on the national

insurance benefit.

103. The increases in current income which people in receipt of benefit

derived from the tax-credit scheme would represent permanent additional help

for those among them who had incomes below the tax threshold. Those who

were net taxpayers, on the other hand, would lose their entitlement to the tax

rebates which they can obtain at present as a by-product of their national

insurance benefits being free of tax. Once a recipient of unemployment or

sickness benefit ceases to receive taxable earnings which absorb his tax

allowances, the present cumulative PAYE system permits these allowances to

run against the tax which he has paid earlier in the financial year, with the

result that some or all of this tax becomes repayable. Because of the way the

PAYE system works, these refunds vary according to the incidence of unemploy­

ment or sickness during the financial year, producing haphazard results in terms

of family support. Under the tax-credit system the continuance of both tax

liability and entitlement to tax credits during a spell of unemployment or

sickness would end this situation.
104. If unemployment or sickness is prolonged, entitlement to earnings-related supplement ends after six months and benefit continues at a flat rate. Sickness benefit is converted to invalidity pension and (again, apart from cases where there is other taxable income) the income from benefit and tax credit combined would generally produce a more favourable situation than at present. Similarly the tax credit available to a person receiving flat-rate unemployment benefit would substantially outweigh the tax payable on his benefit, and his financial position would be improved.

(4) National Insurance Pensioners

105. Credits at the levels proposed in this Green Paper would significantly improve the position of people drawing long-term national insurance benefits as invalidity, retirement or widow pensioners. A single pensioner whose only income was the new standard rate pension of £6.75 a week would pay £2.02 tax on this, but would have this tax offset by a credit of £4. The net result would be to increase his income by £1.98, so that the amount paid to him each week would be £8.73. The married rate of £10.90 would, after the operation of tax and credits, become £13.63. A widow with two children, whose combined national insurance and family allowance entitlement, from October onwards, will be £13.35, would receive a net income of £16.55 from the combined effect of benefit, tax and credits. These improvements would be of particular value to that group of pensioners and widows (estimated at about a third of the total) who at present neither pay tax nor are eligible for supplementary benefit. Among those who at present receive supplementary benefit, the effect in some cases would be to replace part of the means-tested benefit by contractual ones, but in others dependence on the supplementary benefit scheme would be ended entirely.

(5) Single Parent Families

106. It is proposed that a parent who has single-handed responsibility for a child and who is within the scheme should receive the same rate of credit as a married couple with the same family responsibilities. This arrangement would be particularly helpful to women who go out to work to support themselves and their children. Thus a woman with three children who was in this situation would qualify for a credit of £12 a week; the effect of this, less the 30 per cent tax which she would pay on her earnings, would be to raise her income by £8.40 if her weekly earnings were £12, or by £7.50 if she were earning £15. (At present her earnings would be supplemented by family allowances of £1.90 a week and she would also be entitled to FIS of £5 in the first case or £3.55 in the second.) Such increased help would be available to many, although not all, of the people whose circumstances are being considered by the Finer Committee on One Parent Families.

REDUCED NEED FOR SUPPLEMENTARY BENEFIT

107. One of the objects of the Government's pension proposals, as set out in the White Paper "Strategy for Pensions", is to reduce the numbers of retirement pensioners who have to rely upon supplementary benefit. The
improvement of the financial position of pensioners with low incomes is an objective common to all political parties. There is general agreement also that the number of people dependent on the supplementary benefit scheme should be reduced rather than increased. If the tax-credit scheme were to remove a substantial number of people from dependence upon supplementary benefit this would not only be widely welcomed in itself, but would also ease the present pressure on the scheme and create opportunities for improving the service provided for those who remain within it and for whom it can best cater.

108. It is not now possible however to predict what effect the tax-credit scheme might have in reducing the numbers on supplementary benefit. Much depends not only on the movement in supplementary benefit rates between now and the inception of the tax-credit scheme, and on the levels of credits which are then selected, but also on other factors, such as changes in rents in particular. However, it can be estimated that if the scheme were introduced now with credits at the illustrative levels given in this Green Paper and in conjunction with the supplementary benefit levels which are to operate from October, something like three-quarters of a million national insurance beneficiaries, most of them retirement pensioners, might have their incomes raised above supplementary benefit levels. This would reduce the numbers drawing a supplementary pension by over a third.

109. These figures show the position as it might be at one point of time, but cannot fully reflect the reduction which might be achieved over a period in the numbers of people needing to claim supplementary benefits. Many such claims are for quite short periods; and the fact that they were no longer needed could both save the people concerned from going through the relatively complicated procedures for establishing title to a means-tested benefit and would mean a corresponding reduction in the work of administering the scheme.

110. The need for supplementary benefit would continue under the new arrangements if, because of a high rent or other special circumstances, a family were unable to meet their assessed needs from the combination of national insurance benefits and tax credits. At present, however, if the level at which a family's needs are assessed is relatively high as compared with the father's previous take-home pay, their supplementary benefit will be restricted to the level of his previous income from full-time work, under the rule known as the "Wage Stop". The improvement which the tax-credit scheme would make in the take-home pay of low earners means that this rule would need to be invoked more rarely. The FIS scheme has already resulted in an appreciable fall in the number of wage stop cases. Tax credits would take this process further.

OTHER MEANS-TESTED BENEFITS

111. For members of the tax-credit scheme the need for family income supplement would disappear. And by increasing their incomes the scheme would reduce the numbers needing means-tested benefits of other kinds. It would not be possible—at least at the outset—to try to integrate these benefits, which are intended for many different purposes, into the tax-credit scheme.
Nor would it be practicable to set the level of the new credits so high that these benefits became unnecessary: to do so would mean paying to taxpayers, at all income levels, credits which were prohibitively costly. Moreover, the poorest families would get only limited value from such higher credits because they would replace existing sources of help, yet better-off taxpayers would get the full benefit from the increases.

112. These other social benefits would therefore continue as separate forms of income support alongside the tax-credit scheme. However the general improvement in income levels which tax credits would bring about should mean some lessening in the use made of them. And since the net benefit which a family derived from the tax-credit scheme would be reduced by only 30p for any extra £ of earnings (as compared with 50p under the FIS scheme, or 80p in the rare case where FIS entitlement and current tax liability overlap) a larger proportion of increased earnings would be retained than is sometimes the case at present.

SUMMARY

113. To sum up, the tax-credit scheme does not offer a complete solution to all the problems of poverty. But to those within it, and this includes the great majority of people at work and everyone in receipt of the main national insurance benefits, it offers the prospect of a system of family support which would be easier to understand than the present one, which would provide its benefit largely automatically and which, being integrated with the tax system, would extend the benefit of tax allowances to people who have insufficient income to pay tax. By doing so it would relieve hundreds of thousands of pensioners from the need to claim supplementary benefit and would bring significant increases in income to many poor people who at present have little or no tax liability, including a further three or four million pensioners in this position. Some means-testing—and the flexibility which only means-testing can secure—would remain, but its role in the social services as a whole would be reduced. These are substantial gains, for which the Government hope the tax-credit scheme will be widely seen as a welcome new departure.
CHAPTER 6
FINANCIAL EFFECTS

COST OF INTRODUCING THE SCHEME

114. The cost of a scheme on the lines outlined in this Green Paper contains three elements. There is first the cost of raising the level of provision for all children to the highest of the present levels, including the provision of an element for family allowance for the first child. Second, there is the cost of fixing the level of the credits so that the general tax threshold is raised. Third, there is the cost of the additions to income for people who would be below the new tax threshold.

115. The exact cost of the system would depend, in the final analysis, on the level at which the credits were set. On the basis of the rates of credit of £4, £6 and £2, to introduce the system would cost in the region of £1,000 million in relation to present circumstances. The illustrative rates used in the Green Paper are based of course on present-day considerations, including the present levels of incomes, personal tax allowances, social security benefits and so forth. By the time the scheme could be implemented all the figures will have changed and the levels of credit would also require revision.

116. Clearly at this date no Government could commit itself to the precise level of credits to come into operation some years ahead. To this extent any figures must be regarded as hypothetical. But this does not affect the basic considerations or the principles on which the scheme is built. It follows that it will only be possible to introduce the scheme at a substantial cost. But with the growth of the national income, more resources will become available to devote to the task of eliminating poverty: the Government consider that, taking all factors into account, and given the right order of priorities, the cost of the scheme would be a manageable one.

UPRATING OF TAX CREDITS

117. A system of tax credits would interact closely with the systems of national insurance and supplementary benefits because it would cover recipients of national insurance benefits as well as the employed population. The scheme would serve as a major new means of family support. But, if it is to succeed in that, the benefits it provides could not be allowed to fall far behind those of the social security schemes. This means that the annual review of national insurance and supplementary benefit levels which the Government now undertakes would have to be matched by regular re-appraisals of tax credit levels.

118. As with changes in the income tax changes in the rates of credit would be a matter for the Budget. An increase in credits should be easier to put into effect than changes in tax allowances. For those in employment it should be
possible to implement new rates of credit within a few weeks of their announce-
ment, but if some of the child credits were paid to the mother it would take
longer. For pensioners and others who receive their credits through an order
book along with a national insurance benefit it would also take longer to give
effect to the new rates.
CHAPTER 7

THE DECISION

119. The time has come to reshape the income tax and social security systems where they at present overlap. The present relationship between the two systems is unsatisfactory. The principles on which each separately rests are different, and the results are not always consistent. The system for collecting tax through PAYE has grown too complicated; it absorbs very large numbers of staff in industry and in the civil service, and is in urgent need of simplification.

120. The tax system deals fairly with the taxpayer. But it can make no contribution, or very little, to helping those in the most hard-pressed sections of the community—namely the low paid with children and the elderly. For these groups there are family allowances, national insurance benefits and different kinds of means-tested provision. Yet here again there are problems: of inadequate take-up, of dislike of means-testing, of overlapping benefits and of disincentives, and finally of complaints that the Government gives with one hand and takes with the other.

121. The tax-credit system described in Chapters 2 to 4 would not do everything: it would not cover everyone. But it would enable us to take an important step forward and would undoubtedly provide a sound basis for further advance in the future. A system of tax credits would simplify the tax system and its administration, saving many thousands of civil service posts. It would increase the incomes of many who are hard-pressed. It would do so without the need for a means test. It would rationalise the system of family support. It would reduce reliance on supplementary benefit and would largely remove the need for a FIS scheme. And, given the will, it could achieve this at a cost that could be managed. The Government therefore commend the proposals as being the best approach to a solution of the problems of the tax and social security systems.
## APPENDIX

### ILLUSTRATIVE EXAMPLES OF THE OPERATION OF THE TAX-CREDIT SYSTEM

#### PERSONS IN EMPLOYMENT

<table>
<thead>
<tr>
<th>Weekly pay</th>
<th>Present net income of family</th>
<th>Weekly pay</th>
<th>Less tax at 30%</th>
<th>Pay after tax and credits</th>
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<td>80·48</td>
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32
UNEMPLOYED OR SICK PERSON QUALIFYING FOR FLAT-RATE BENEFIT AND EARNINGS-RELATED SUPPLEMENT

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<th>Position from October 1972</th>
<th>Position under the tax-credit system</th>
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<tr>
<td></td>
<td>NI benefit</td>
<td>FAM</td>
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<td>(a) Previous earnings £20 a week and</td>
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<td>Single</td>
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<tr>
<td>Married</td>
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<td>With 2 children</td>
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<td>With 4 children</td>
<td>17.85</td>
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<td>With 4 children</td>
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PERSON WITH RETIREMENT PENSION OR OTHER STANDARD FLAT-RATE BENEFIT

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WIDOWED MOTHER

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<td>With 1 child</td>
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<tr>
<td>2 children</td>
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<td>0.90</td>
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### PERSONS IN EMPLOYMENT

#### COMPARISON OF CROSS-OVER POINTS UNDER THE UNIFIED SYSTEM OF PERSONAL TAXATION AND UNDER THE TAX-CREDIT SCHEME

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<tr>
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<th>Under unified tax system</th>
<th>Under tax-credit scheme</th>
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<tr>
<td></td>
<td>Weekly pay</td>
<td>Present net income of family</td>
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<td>11.44</td>
<td>11.44</td>
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<td>Married without children</td>
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<tr>
<td>Married, 2 children under 11</td>
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<tr>
<td>Married, 3 children, 2 under 11, 11-16</td>
<td>29.24</td>
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<td>Married, 4 children, 2 under 11, 11-16</td>
<td>34.94</td>
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</tbody>
</table>

**Notes**

1. Represents weekly net income of family after income tax, family allowance and (where appropriate) FIS. The figures assume current rates of family allowance and FIS. Income tax has been calculated on the basis of the provisional unified allowances and basic rate operative from 6 April 1973.

2. National insurance contributions have been ignored.

3. Benefit is restricted by the rule limiting the payment of earnings-related supplement where total national insurance benefit would otherwise exceed a figure of, broadly speaking, 85 per cent of previous earnings.

4. Assuming that the recipient has no other income no tax is payable at these levels of benefit.

5. It is proposed that, on the introduction of the tax-credit scheme, the child credit should be set at least as high as the national insurance dependency increase which it was replacing. In these illustrations, however, the £2 child credit has not been adjusted so as to match the £2.10 rate of national insurance increase which will operate from October.
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