Press Release

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Conservatives to recognise one third of marriages in the tax system

The Conservative Party has announced how it intends to recognise marriage and civil partnerships in the tax system if it forms the next government. It plans to make up to £750 of the income tax personal allowance transferable between adults who are married or in a civil partnership, so long as the higher-income member of the couple is a basic-rate taxpayer.

We estimate that the proposed policy would cost around £550m in 2011–12. The Conservatives say that this would be covered by the proceeds of a levy on banks that they estimate would raise at least £1 billion a year, with the surplus revenue being used to reduce government borrowing.

How would it work?

Under the Conservative Party's new proposal, if one adult in a couple is not using all of their personal income tax allowance (because their income is less than the personal allowance, which is projected to be £6,555 per year in 2011–12), then they can transfer up to £750 of this unused allowance to their spouse. This transferred allowance will then lower the spouse's tax bill by up to £150 (the tax that would be paid on £750 of income at the basic rate of 20%). However, this transferred allowance will be tapered away from individuals whose income exceeds £42,455, at a rate of 50p for every £1 by which their income exceeds £42,455. This means that no-one with an income above the threshold of £43,955 at which the higher 40% income tax rate applies would benefit.[1]

A married individual with an income of *less than £5,805* per year will therefore be able to transfer £750 of their personal allowance to their spouse, so long as their spouse's income is less than £42,455, increasing the couple's net income by £150 a year. Married individuals with incomes of *between £5,805 and £6,555* will be able to transfer the unused portion of their personal allowance to their spouse, increasing the couple's net income by less than £150, but again subject to this being tapered away when their spouse's income exceeds £42,455.

Who gains and who does not?

The families that would gain from this policy are couples in marriages or civil partnerships where only one member of the couple pays income tax and where the personal income of the taxpayer is less than £43,955. In total, we estimate that about 4.0 million out of 12.3 million married couples will gain from the policy, at a cost to the exchequer of about £550 million. This includes 2.5 million of the 8.7 million married couples with someone in work. The remaining 1.5 million gainers are mostly married pensioners. The policy is not, therefore, a general recognition of marriage in the tax system, as it affects only 32% of married couples and 29% of non-pensioner married couples.

[1] The Conservative press release describing the policy has rounded all income figures and thresholds to the nearest £100.

Embargo

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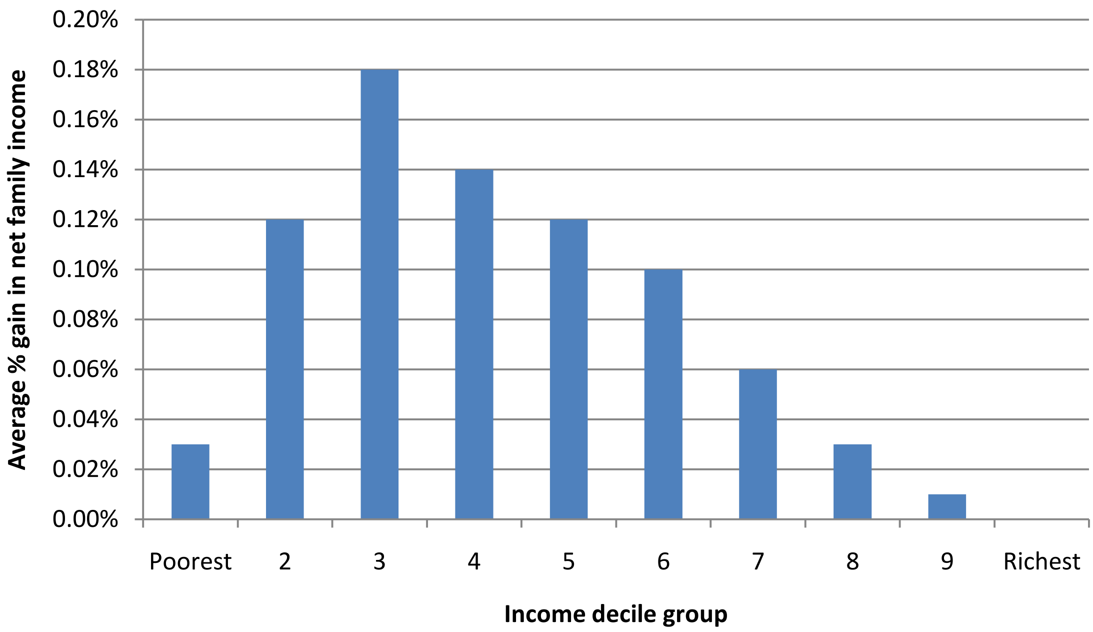
Three sorts of married couples will not benefit from this policy:

- First, those couples where both adults each have an income greater than £6,555 and where there is therefore no unused allowance to transfer.
- Second, those couples where one adult has an income below £6,555, but their spouse pays income tax at the 40% rate or higher.
- Third, those couples where both have an income below £6,555, because such families would pay no tax in the absence of the policy and so neither partner can benefit from a higher tax allowance.

The figure below illustrates the average percentage increase in net family income as a result of the policy, for each income decile group (the 1st income decile group contains the poorest 10% of the population, and the 10th decile group contains the richest 10%). No one with a personal income above £43,955 can benefit from this policy due to the tapering, and so the largest average gains are towards the bottom of the income distribution, although not at the *very* bottom, since there are significantly fewer married couples amongst the very poorest families, and many of them do not pay income tax in any case. The average gains are small because the policy affects only a small subset of families.

Distributional impact of Conservative Party's proposed transferable personal allowance for married couples



Source: Authors' calculations using 2006/07 Family Resources Survey

How does the policy affect work incentives?

The proposal would increase the incentive to work at all for the *first* potential earner in married couples (provided that, upon entering the labour market, they would pay income tax and their personal income would be less than £43,955), since they would pay less tax on their earned income when moving into work.

But it would also reduce the incentive to work at all for some actual or potential second earners in married couples (in particular, for those whose spouse's income is less than £43,955, and whose own income in work would exceed £5,805). This is because increases in that individual's income above £5,805 would result in a reduced personal income tax allowance for their working partner. Essentially, as the policy benefits some one-earner couples but no two-earner couples, it must reduce the financial reward from becoming a two-earner couple.

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Tapering of the transferred personal allowance between £42,455 and £43,955 means that workers with an income in this range who are benefitting from a transferred personal allowance would have a weaker incentive to increase their earnings slightly. If such individuals increased their earnings by £1, they would lose 50p of the transferable allowance, and therefore would have to pay an extra 10p (20% of 50p) in income tax. The marginal income tax rate for such individuals would therefore rise from its current 20% to 30% between £42,455 and £43,955 before rising to 40% when they reached the higher-rate threshold.

Will it encourage more marriages or discourage divorces?

A policy that benefits only married couples will increase the financial benefits of being married compared with being an unmarried couple. However, the extent to which marriage decisions respond to financial incentives is not known with any confidence; many couples would not benefit from the policy even if they were married; and the incentives to marry (or not to divorce) provided by a policy whose maximum benefit is £150 a year must surely be weak relative to the other costs and benefits involved.

The policy will also increase the financial benefits of being married compared with not having a partner at all. For some beneficiaries, the proposed policy will reduce the so-called 'couple penalty' that is said to exist in the tax and benefit system by up to £150 a year. For a small number of beneficiaries, the proposed policy would lead to a so-called 'couple premium', where the state collects less tax from the couple when they are married than if they were to divorce. IFS research to be published shortly will document the size of the existing couple penalties and premiums, and how these have changed in recent years.[2]

A bigger question is why any government would want to encourage more couples to get married, or provide greater support to married couples than unmarried ones. Research by the Centre for Social Justice shows that children born to parents who are married do better on a wide range of outcomes than children born to cohabiting couples (and indeed to lone parents), but it is not clear that this relationship between marriage and better child outcomes is a causal one. IFS research to be published shortly will look at these issues in more detail.[3]

If encouraging marriage is seen as desirable primarily for the impact that it has on child development, it is not clear that a policy where pensioner families make up more than a third of the beneficiaries and receive 31% of the gains is well targeted. In fact, only 35% of the families who gain from the policy have children, and only 17% have children under 5.

What does it do to the income tax system?

The most striking feature of the policy is that it significantly complicates the income tax system, introducing new marginal rate bands into already increasingly byzantine tax schedules. Simpler ways to provide support to low- to middle-income married couples would include introducing a married couples' 'premium' into working tax credit and pension credit. A transferable personal allowance, restricted to married couples, capped at £750 and tapered away above £42,455 will surely be complicated to understand, and costly to administer, and this cost must be considered in addition to the direct cost of the policy. The policy represents yet another use of a tapered personal allowance, which is a complicated, confusing and untransparent way of simply increasing an individual's marginal income tax rate over a small band of income.

[2] http://www.ifs.org.uk/projects/17/320
[3] http://www.ifs.org.uk/projects/318

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2. IFS election analysis is being supported by the Nuffield Foundation (grant number OPD/36607). Ongoing financial support from the ESRC Centre for the Microeconomic Analysis of Public Policy at IFS (grant number RES-544-28-5001) financed research upon which much of this analysis is based.

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