



# A FAIRER SHARE

HOW RETHINKING INCOME  
TAX CAN FREE FAMILIES  
FROM POVERTY

A NEW REPORT FROM  
**CARE FOR SCOTLAND**



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Tax &   
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# **A FAIRER SHARE**

## **HOW RETHINKING INCOME TAX CAN FREE FAMILIES FROM POVERTY**

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# Introduction

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CARE has examined the inequalities of the UK tax system and its impact on families over many years. With certain fiscal powers devolved, it is important to examine how fair and equitable the Scottish tax system is and what can be done to reduce inequality and help families in poverty by reforming the tax system.

Scotland, like the rest of the UK, has inequality built into the very heart of its tax system. Single-earner households shoulder a heavier tax burden than that carried by other householders. In particular, households with children are placed at a disadvantage by the tax system. This is true whether it is a single parent, cohabiting couple or if the couple are married.

Given income tax accounts for more than a quarter of tax revenue, it is vital that we ensure everyone is paying tax in a way that is fair. As a result of tax changes announced this year the tax burden is forecast to rise to its highest level since the 1950s.<sup>1</sup> It is all the more important that people know they are paying a fairer share of the income tax burden.

The central problem is this – the UK tax system is based on the individual and takes no account of the particular circumstances of a household, including the family's ability to pay. This approach to taxation has kept many families in Scotland in poverty and continues to be a barrier preventing them from increasing income and escaping poverty.

It is deeply concerning that any family in poverty pays income tax.

Indeed, it will be a shock to many that today, in Scotland, a couple with two children earning over £30,000 per year could find themselves in poverty. Yet this is one of the consequences of having an income tax system that ignores the family. But it does not have to be this way, there are alternatives to the British individualised tax system. Other countries such as Germany, France and the US take families into consideration and distribute the tax burden more fairly across society. There is no reason why Scotland should not adopt the same approach.

It is incumbent upon the Government to examine ways of rebalancing the income tax system to ensure that the significant income tax burden borne by low income working families with children is reduced. Amidst rising household bills, spiralling fuel costs and an increase in the price of day-to-day essentials, it is difficult to see how we avoid more Scots slipping further into poverty without direct action on the part of the Government.

This is a moment of real opportunity. As we hopefully emerge from the pandemic of the last 18 months, we can begin a process of reimagining how our tax and benefits systems operate to ensure those who need help the most, get it. We have an opportunity to fight to rebalance our tax system to ensure proper account is taken of families with children and not just individuals.

“ We have an opportunity to fight to rebalance our tax system to ensure proper account is taken of families with children and not just individuals.”

It is time to build a benefits and tax system that is fair and equitable for all. It's time for us to imagine a fairer share for Scotland's families.



**STUART WEIR**  
National Director of CARE for Scotland

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<sup>1</sup> Rishi Sunak will have to cut taxes to counter cost of living crisis, says committee head - Business Live (business-live.co.uk)

# The Taxation of Families - A Scottish Perspective

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## Overview

Put simply: the Income Tax system is unfair for households with children. They pay the same or even more tax than households without children who are much better off. Why is this the case?

The answer is not complex: the greater burden of tax is placed on households with children (when compared to other countries) because our tax system focuses on the individual rather than the household circumstances. This individualised tax system makes it difficult to end in-work poverty, especially for households with children.

Income tax, unlike universal credits and tax credits, is based almost entirely on individual income. It does not take account of household income or household size; therefore, it is not based on the "ability to pay". It is not radical to say that larger households face larger day-to-day bills and costs, thus reducing the available disposable income that family can rely upon to live.

According to UK Government statisticians,<sup>1</sup> in order for a couple with two children to enjoy the same standard of living as a single adult without dependants, the family will need almost twice the amount of disposable income as that needed by the single adult. If this couple and the single adult earn the same amount of money, in our individualised tax system they will pay the same amount of tax. The household with children will be significantly less well-off as they face higher costs. It is not a complex calculation: clearly, a household with four people costs more to run than a household with one person.

Unlike other countries, the United Kingdom income tax system takes almost no account of families. There are just two exceptions – the small transferable allowance that married couples and civil partners can claim if only one of them earns above the personal allowance threshold, and the High-Income Child Benefit Charge where it is disadvantageous to have only one income. The failure of the income tax system to take account of the family is one of the reasons why households with children are the poorest in the country.

Scotland has its own income tax rates, as well as the Scottish Child Payment Scheme. This scheme is a weekly payment of £10 (increasing to £20 in April 2022) for every child under 6 years of age. The Scottish Government aims to increase the payment to children under 16 years of age by the end of 2022. It does not affect any other UK or Scottish Government benefit but the payment is only made to people in receipt of Universal Credit or one of the legacy benefits.<sup>2</sup> Given the payment is linked to benefits, not all families who find themselves in poverty get this support.<sup>3</sup>

## Implications for families in Scotland

To help illustrate the implications for taxpayers in Scotland, we have analysed six households. All of our Scottish homes bring in an income of £25,000 per annum.

We have compared the following types of household:

- Single adult without children
- Single adult with two children (under 6)
- Single adult with four children (two under 6)
- Single income married couple with no children
- Single income married couple with two children (under 6)
- Single income married couple with four children (two under 6)

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1 Household below income statistics (HBAI) for year ended 2020, published 25 March 2021.

2 We do not know if it affects council tax support payments; council tax support is administered by local authorities.

3 Even with the Scottish Child Benefit Bridging Payments not all families in poverty get support. See: Scottish Child Payment Bridging Payments - mygov.scot

*[Please note: when we speak about married couples we also mean couples in civil partnerships.]*

In making our calculations we have made the following assumptions:

- Unless stated otherwise everyone is living in rented accommodation and paying rent equivalent to the local housing allowance in the Perth and Kinross area<sup>4</sup> where the allowance for a family entitled to a three-bedroom house is £150 per week.<sup>5</sup>
- None of our families have childcare costs.
- Universal Credit is claimed where appropriate.
- Child benefits are claimed (for analytical purposes the High-Income Child Benefit Charge is dealt with by an adjustment to the benefit).

## Households with the same income

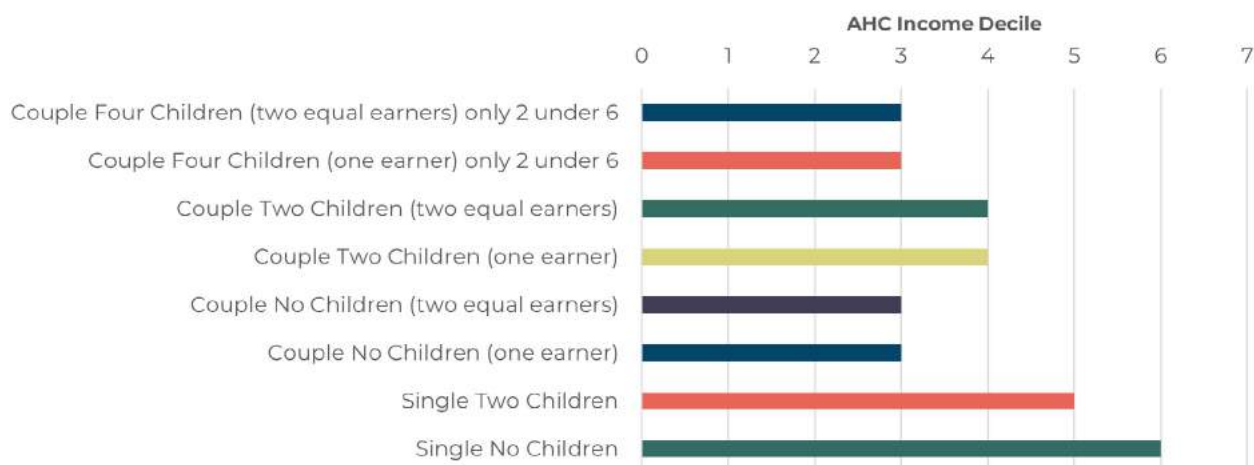
All single income families pay almost the same income tax.<sup>6</sup> Despite paying the same tax, households will not be equally well off.

How well-off a household will be after tax depends on its size (i.e. the number of people who live in the house) and benefits received.

The chart below shows where, in the current tax year, various households all with earnings of £25,000 fit into the UK distribution of incomes. In essence, the chart shows how well off each of our model households are compared with the rest of the UK population.<sup>7</sup>

After housing costs are taken into account, a married couple in Scotland in rented accommodation with 2 children will be in the 4th decile. This means that they are in the poorest 40% of the population. A single adult with the same income is in the 6th decile, placing them comfortably into the top half of the wealthiest in the population. These results are highlighted in the chart below.

**FIGURE 1: WHERE HOUSEHOLDS IN SCOTLAND EARNING £25,000 PER ANNUM FIT INTO THE AHC INCOME DISTRIBUTION IN 2021.**



The picture is different if the children are over the age of 6 or the family is not receiving Universal Credit. Children over the age of 6 do not at present qualify for the Scottish Child Payment Scheme and, unlike renters, owner-occupiers do not get any help with their housing costs through Universal Credit. A

<sup>4</sup> The rents allowance in Perth and Kinross are below the median for Scotland. Highest allowance is Lothian (Including City of Edinburgh, East Lothian and Midlothian) at £253.15, lowest is North Lanarkshire at £113

<sup>5</sup> Local Housing Allowance Rates: 2020-2021 - gov.scot (www.gov.scot)

<sup>6</sup> Families with two incomes pay less tax as both earners enjoy the tax free allowance. If two earners have a combined income of £24,570, which is just below the income of the households we compare in this paper, that household will pay no income tax at all.

<sup>7</sup> The figures take account of the recently announced changes to Universal Credit. The income distribution figures are the latest available UK figures. We are not aware of comparable Scottish figures.

married couple with 2 children under 6 (born after 2017) would, when their children cease to qualify for the payment, be in the 3rd decile – i.e. the poorest 30% of the population.<sup>8</sup>

A married couple with two children, that do not pay rent, but have the same housing costs, pay the same in tax, but will get no help with their housing costs. This family will be in the 2nd decile, that is the bottom 20% of the population. This family will be officially recorded as living in poverty.

For an owner-occupier family to get themselves out of poverty, they would need to increase their income to £29,000. If they have three children, they would need to earn £38,000 and will pay £4,900 in income tax. Because they own their own home they will not be entitled to the Scottish Child Payment scheme and their income will be too high to receive Universal Credit. It is clear that an adjustment in the level of income tax paid by this household, could help the family start to move out of poverty.



## Children in poverty

The usual definition of a family in poverty is one which has a household income below 60% of the median income after tax, benefits and housing costs, i.e. for a single adult and two children disposable income of less than £14,042 and for a couple with two children less than £20,060. With the tax threshold at £12,570, many families in poverty will be liable to pay income tax. Research published by the TUC in July 2021 found that there are over 165,000 children living in poverty in Scotland where at least one parent is in work.<sup>9 10</sup>

It is an arresting statistic that over 40% of children living in poverty in Scotland currently reside in households with incomes greater than £30,000 per year. How can we best help these families move out of poverty? If a single income family in Scotland earning £35,000 is paying £4,000 in income tax, it is clear adjusting the tax paid, to allow them to keep more of their earnings, will help move some of these households out of poverty and provide better outcomes for the future of children in Scotland.

For many it will be a shock to learn that a family in Scotland could be in poverty and yet have an annual income of over £30,000. But that is the reality for many. A single parent needs 70% more disposable income than a single adult with no children to be above the poverty line. A couple with two children needs almost two and a half times more than a single adult to to enjoy the same standard of living.<sup>11 12</sup>

We need a tax system that helps people pay a fairer share.

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<sup>8</sup> The government have announced that the payment will be extended to over 6s by the end of 2022.

<sup>9</sup> Households below average income: an analysis of the income distribution FYE 1995 to FYE 2020 - GOV.UK ([www.gov.uk](http://www.gov.uk))

<sup>10</sup> One million children in key worker households live in poverty | TUC

<sup>11</sup> Office of National statistics figures.

<sup>12</sup> As already noted owner-occupier couple with two children and housing costs of £150 per week would have household income of less than 60% median up to £32,954. With 4 children they would need to be earning £41,000. Earning £3000 more they would be paying higher rate tax.

## Households with an average standard of living

A recent government breakdown of UK household incomes reveals that to enjoy the national average standard of living; a single adult without any dependants needs to have (after tax, benefits and after housing costs) £13,900, a couple with no children £23,900, and a couple with two children £33,400. This means that in Scotland a single adult (depending on the level of rent they pay) needs to have gross (pre-tax) earnings of £23,500, a couple without children £38,000, and a couple with one income and two children needs to earn £61,000, just to be at the national average.

The single adult in Scotland pays £2,150 tax, a married couple with one income and no children pays £5,000, and a married couple with one income and two children pay a tax bill of almost £14,000. It is difficult to justify such big differences in income tax when the families are supposedly equally well off. The married couple with two children is liable to higher rate tax and does not get child benefit.

This chart shows the income tax which households with an average standard of living are paying.

**FIGURE 2: ANNUAL INCOME TAX HOUSEHOLDS WITH MEDIAN INCOME 2021/22**



The tax system has become less progressive under successive UK governments, impoverishing those who can least afford it. Our analysis shows that households with children, on average or low incomes, suffer disproportionately compared to those households without children.

The failure of the UK tax system to take account of household circumstances is resulting in:

- Families paying a lot more tax than taxpayers without children who have the same household income/living standard
- Families paying more tax than taxpayers without children who have a higher household income/living standard
- Some families with income below the poverty line paying income tax
- Many working families paying income tax and needing to claim Universal Credit which results in their having an effective marginal rate even after the change to the Universal Credit taper rate of 69% – i.e. the government took back 69% (70% in April) of any new income, far more than the tax rate that applies to the highest earnings
- Families in the least well-off half of the population paying higher rate tax and losing their child benefits
- Families in poverty paying income tax.

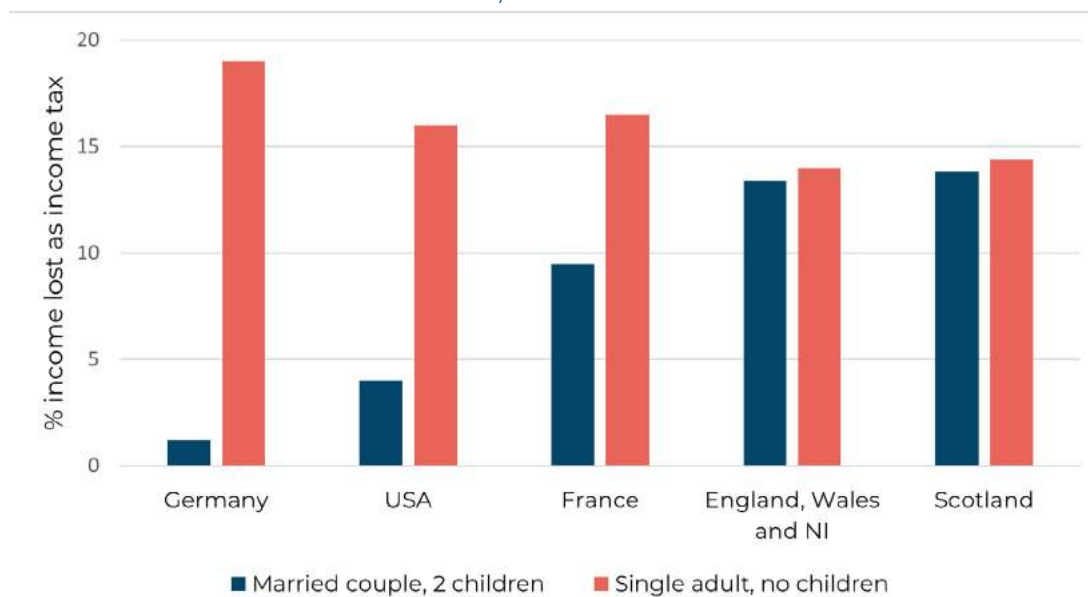
Increasing the personal allowance is not the answer. Recent increases have mainly benefited taxpayers who are in the better-off half of the population. While the Chancellor of the Exchequer has frozen any further increases for the next three years, an increase in the allowance is not the best way of dealing with the problems families face. When the allowance can be increased it should be one which focusses on lifting the tax burden on families with children, many of whom are in poverty but are bearing a bigger share of the tax burden than other taxpayers. There is also a need to reconsider the higher rate threshold which in Scotland can apply to families who are in the least well off 40% of the population.

## International comparisons

International comparison shows us that there are alternatives to the UK system that can help families. The UK income tax system is unusual. Most systems around the world recognise the simple fact that households with children will cost more to run. They build this logical fact into the system and recognise the ability to pay.

The chart below compares the income tax paid by married couples with two children with that paid by single adults without children in Germany, France, the USA, and the UK, all of whom are earning the relevant average wage for the country in question, as measured by OECD in 2020 (latest available figures).<sup>13</sup> This is similar to the ONS figure for mean full-time earnings.

**FIGURE 3: INCOME TAX AS A PERCENTAGE PAID OF AVERAGE WAGE IN 2021 IN GERMANY, FRANCE, THE US AND UK**



13 OECD 'Taxing Wages 2021'



## Conclusion: Does this Matter?

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Ending inequality matters. Ensuring people are treated fairly should be everyone's concern.

Financial struggles can have a detrimental effect on the future of children living in low-income homes. Children are not immune to the pressures of financial struggle. If we want our children to succeed, we should not have a tax system that is a barrier to success.

Put simply: our tax system is an obstacle to people getting out of poverty.

If we want to reduce inequality, we must get back to first principles and ensure that income tax is linked, however loosely, to the ability to pay. Those who are the least well-off must not be left bearing the heaviest income tax burdens.

### What the Scottish Government can do to help:

It is welcome that the Scottish Government has announced that the Scottish Child Payment will double from £10 to £20 in April 2022. They could go further by increasing the payment further and extending it beyond families on benefits.

The Scottish Government has also announced that the Scottish Child Payment will be extended to under 16s before the end of 2022. This should be brought forward to April next year to help families now.

### The Scottish Government should also seek to persuade the UK Government to:

Reform income tax to address the current unfairness of individualism in the system;

Work to unfreeze the personal allowance for those with children; and

Increase the tax relief for married couples and civil partners.

Ultimately, the wellbeing of future generations depends on supporting families and children to ensure that they have the best educational and societal advantages. The tax system, as currently designed, disadvantages households with children and does not provide the best start for families. This is something both the Scottish and UK Governments must work to address together if they are serious about ending poverty.





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