

Higher rate taxpayer numbers

Synopsis: The Institute for Fiscal Studies has carried out some more number crunching on the growth in higher rate (and above) taxpayers.

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Shortly after the March Budget, the projections for higher rate taxpayer numbers were made by the Office for Budget Responsibility (OBR). The Institute for Fiscal Studies (IFS) has now produced its own assessment of the spread of above-basic rate taxpayers, drawing on HMRC personal income data.

In its report, 'A deepening freeze: more adults than ever are paying higher rate tax', the IFS highlights four main findings...

1. The share of adults paying higher rates has increased 'enormously' in recent decades. In 1991/92 only a mere 3.5% of UK adults paid the 40% higher rate of income tax (the then top rate, which had been introduced by Nigel Lawson in 1988). By 2022/23 11% were paying higher rates, a figure set to hit 14% by 2027/28. Of that 14%, 3.1% of adults will face marginal tax rates of either 45% or 60% (due to personal allowance taper) – only slightly below the share who paid the 40% higher rate at the start of the 1990s.

2. By 2027/28, more than one in eight nurses and one in four teachers – both groups currently involved in industrial action over pay – are set to be higher rate taxpayers. In the 1990s, essentially, no nurses and just 5–6% of teachers paid higher rate tax. However, as a result of income tax thresholds failing to keep up with average wages, both groups are now being dragged into 40% tax.

3. The freeze on income tax thresholds will ultimately represent the single most significant tax increase since Geoffrey Howe increased VAT to 15% in 1979. The IFS blames the sharp rise in the number of higher rate taxpayers over the next five years on the Government's freeze of income tax thresholds. Inflation has turned what was projected to be a relatively modest tax increase, when Rishi Sunak announced his four-year freeze in March 2021, into a massive – and stealthy – revenue raiser.

4. Real household disposable income will be 1.4% lower by 2027/28 thanks to the tax freezes. Viewed another way, the IFS calculates that real household disposable income (RHDI) would be about 1.4% higher by 2027/28 had the personal allowance and higher rate threshold had been increased in line with inflation instead of frozen. The IFS reckons the freeze wipes out around a third of the growth in RHDI that households would otherwise have seen over the period of the freeze.

It is worth giving the report's conclusion in full...

'In the space of 40 years, higher rates of income tax will have gone from a feature of the tax system reserved only for the top few percent, to one that impacts a far more substantial proportion of the population, drawing in a sizeable fraction of

people working in jobs not typically thought of as very highly paid – such as nurses, teachers and electricians.

Increasing the scope of higher tax rates to encompass a larger share of the population is not necessarily undesirable – choices in this area reflect the government’s priorities around work incentives and redistribution.

However, freezing thresholds and allowing the tax system to be arbitrarily shaped by the vagaries of inflation rate fluctuations is not a sensible way to make tax policy.

Moreover, the fourfold increase in the share of adults facing a 60% marginal tax rate between 2010/11 and 2023/24 (with further increases forecast) is part of an unwelcome proliferation in marginal income tax rate ‘spikes’ for those with high incomes that has occurred over the last decade.

The withdrawal of child benefit for those earning above £50,000 and of the free childcare entitlement for those earning above £100,000 (to give just two examples) both create marginal tax rates well in excess of 40% for those affected and risk generating distortions and inefficiencies in taxpayer behaviour.’

Comment

If you are wondering why you thought that the proportion of taxpayers would be about one in five, your imagination is not playing tricks on you. The 20% figure relates to the proportion of taxpayers, whereas the numbers above are all measures against the number of adults.

However, just to muddy the waters further, the number of taxpayers is also rising over the coming years due to the frozen personal allowance. By 2027/28 it will be 38.2m (67% of adults) against a current 35.8m.

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