

Treasury Officers response to questions from Deputy Mahoney and Deputy Kazantseva-Miller

28th October 2024

Deputies Mahoney and Kazantseva-Miller have asked a series of questions originally seeking to compare two different packages:

- 1) An increase in the basic rate of income tax of 2% accompanied by the continued gradual increase in the rate of social security contributions.
- 2) The implementation of the Tax Review package of a 5% GST, restructured social security contributions and a lower rate of income tax.

The Members then requested that a third package be added into the analysis:

- 3) An increase in the basic rate of income tax of 2% accompanied by a restructure of the social security contributions system.

ANALYSIS PROVIDED

Options 1 and 2

NOTE – FOR THE PURPOSE OF THIS ANALYSIS AND COMPARISON, IT IS ASSUMED THAT THE INCOME TAX INCREASE STAYS IN PLACE BEYOND THE PROPOSED DATE OF 31/12/2026.

The Tax Review proposals incorporated the Social Security Contributions (SSCs) within a much broader review and therefore covered both elements of the States' finances, not just General Revenue. The package within the Tax Review includes a significant restructure of contributions (applying an allowance for all contributions and increasing the applied rates) and that is integral to the model.

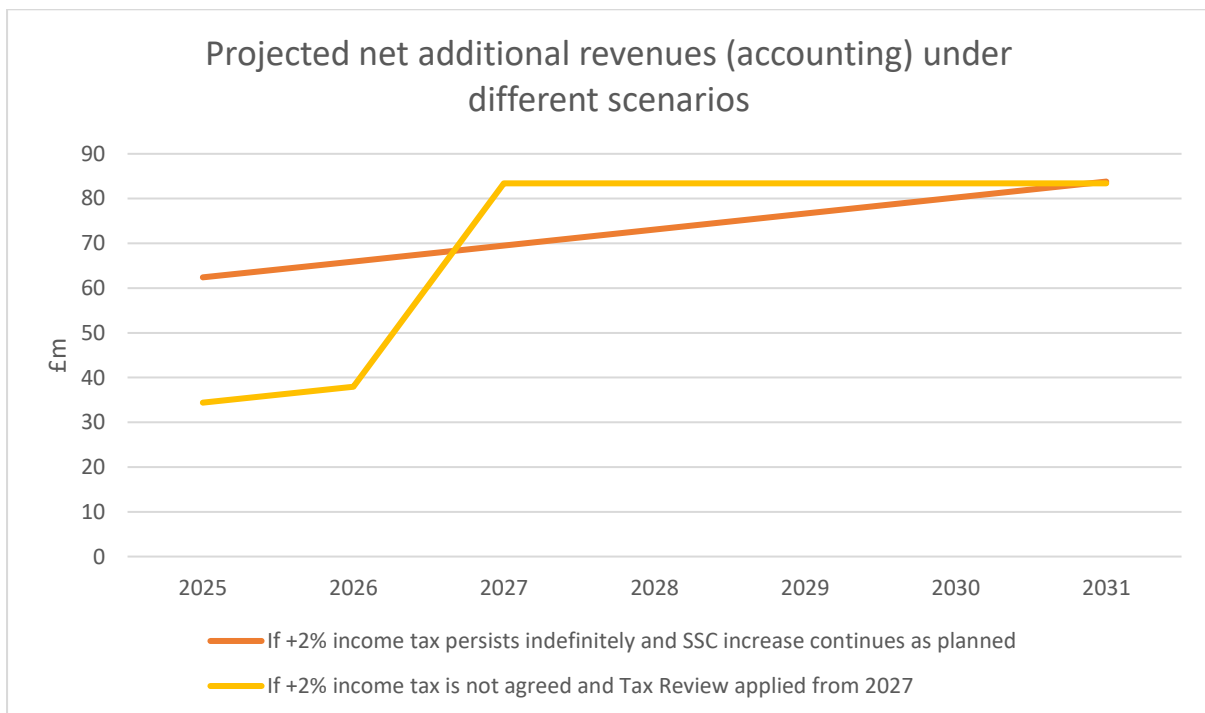
As a result, to make a valid comparison, the 2025 Budget measures must be considered together with the contingency decisions on SSCs made in 2021 to ensure the stability of the Social Security schemes (given the uncertainty of the outcome of the Tax Review) which are now being implemented. The employee rate of contributions is set to increase from 6.6% in 2021 to 8.0% in 2031 (+1.4%) with rates already having increased to 7.2% in 2024. The equivalent employer rate is set to increase from 6.6% in 2021 to 7.6% in 2031 (+1%) having reached 6.9% in 2024.

If the income tax proposal is combined with the phased increase in SSCs, it would raise approximately the same amount as the Tax Review package (suitably adjusted for the impact of inflation since it was first discussed).

However, this means the *total* increase in charges levied against income are generally higher than the +2% increase in income tax presented in the Budget. Comparing against a 2021 baseline (reflecting the beginning of discussions on the Tax Review) the total increase in the marginal percentage rate deducted from employed earnings for a median earner would be 3.4% by 2031, with a further 1% carried by the employer.

The comparable application of the Tax Review package is more complex because in addition to the 5% GST it incorporates substantive structural changes to both the SSC system (to add an allowance for all contributors on all income and introduce higher rates) and the Income Tax system (to apply a 15% lower tax band). For most this means that their direct tax burden will fall although their total marginal rate (income tax + SSCs) may be higher if they earn more than the assumed threshold on the lower rate. Their indirect tax burden will increase. The balance between the two factors is dependent on individual household circumstances.

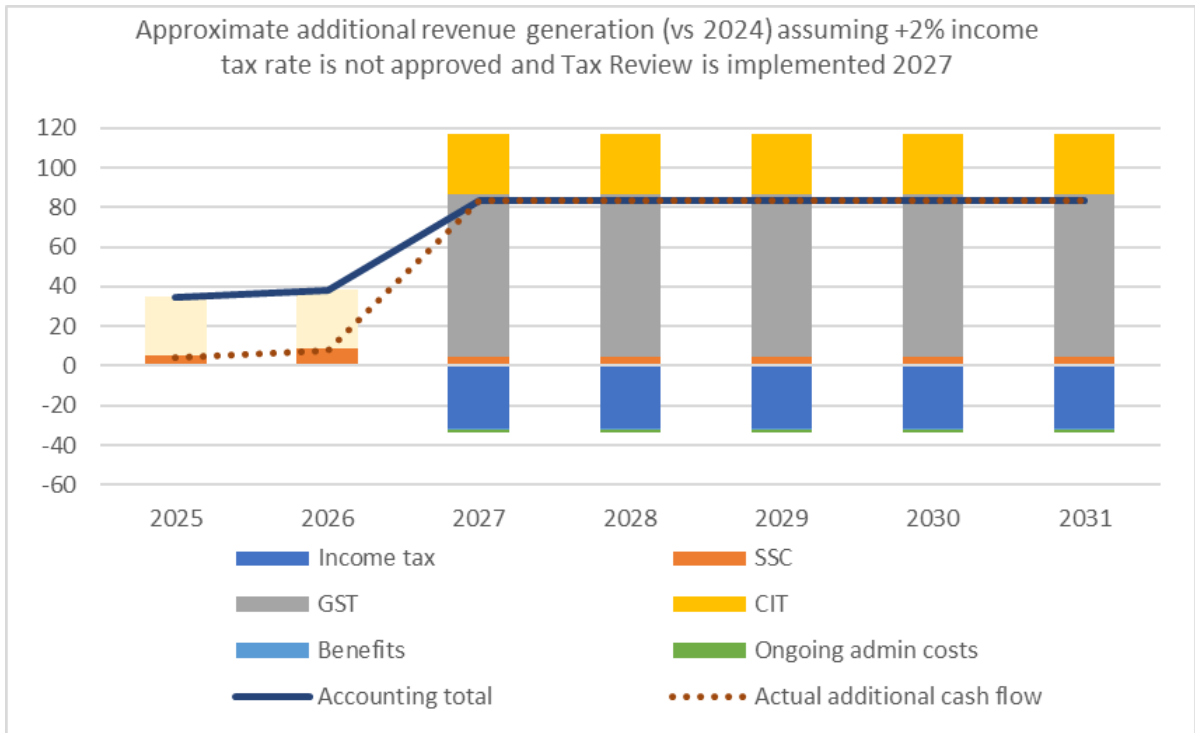
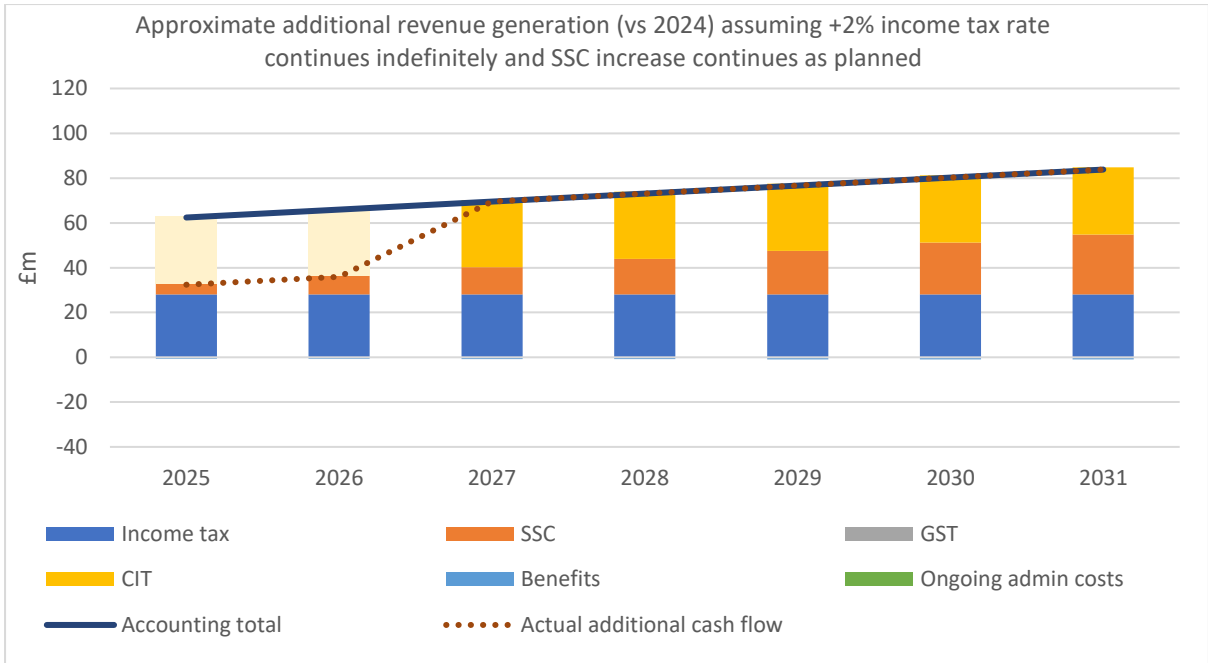
However, while the quantum of income generated is similar, the timing of the income will be different. The graph below shows two possible paths for government revenues.



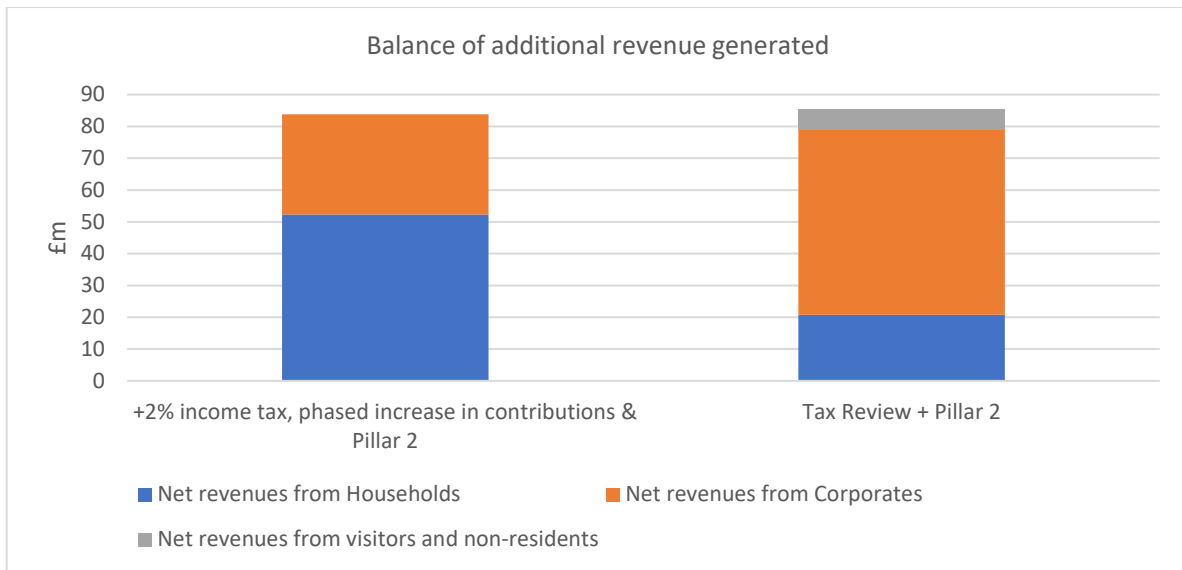
Orange Line: Assumes that the +2% income tax rate is approved for 2025 and 2026 and subsequently made permanent. Once this is combined with the agreed increase in SSCs and the Pillar 2 measures this results in revenue raising of around £60m in 2025, growing steadily to around £80m by 2031 when the phased increase in contributions is completed.

Yellow Line: Shows the alternative path if the +2% income tax rate is not approved but the Tax Review measures are approved and are implemented in 2027. The Tax Review package incorporates a restructure of SSCs, which would replace the phased increase in SSCs at the point of implementation. Incorporating Pillar 2, this results in lower revenues in 2025 and 2026 but brings forward the point at which the full revenue potential is reached to 2027 (assuming a decision to proceed is made this side of the election).

The following two graphs provide more detail on how this additional revenue is distributed over different forms of tax. They also highlight the difference between the accounting revenue for 2025 and 2026 and the expected additional cash flow given that the expectation is that the initial receipt of payment from Pillar 2 will not be remitted until 2027.



It should be noted that one of the reasons the impact on households looks quite different between an income tax/SSC package and the GST package, is because the revenue is being raised from different sources, with the GST package less focussed on individuals as illustrated in the following chart:



Addition of Option 3

The below analysis provides a comparison of the Tax Review package (amended to reflect the impact of inflation since it was put together), with a combination of a sustained increase in the income tax rate by 2%, and a restructured SSCs system based on the work done to date as part of the Tax Review process and through further development of the idea with the Committee for Employment & Social Security (CfESS) as a stand-alone proposition.

Note:

- While CfESS is expected to come back to the States with proposals on this before the end of this term, there is no formal proposal or decision on the implementation of a restructure of SCCs at this time.
- The implementation of a restructure of this nature is estimated to take at least two years to complete and is therefore unlikely to be in place until 2027.
- The model used in the below analysis is that under discussion with CfESS and is designed to generate the same amount of revenue as the existing resolution to apply a phased increase in SSCs between 2021 and 2031 so that it is internally self-funding. As such the allowance applied to SSCs is lower than the equivalent allowance on SSCs applied in the tax review model.
- All three models (+2% income tax and phased SSC's; +2% income tax and restructured SSCs; and the Tax Review package) raise approximately the same amount of revenue (after costs) but do so in different ways.

The table below compares the details applied to the Tax Review proposals and an income tax increase combined with a restructure of contributions.

| | Budget 2025 + phased increase SSC | Adapted Tax Review Proposals | Budget 2025 + restructured SSC |
|-------------------------------|---|--|--|
| Income taxes | | | |
| Personal income tax allowance | £15,000 | £15,200 ¹ | £15,000 |
| PITA withdrawal threshold | £82,500 | £82,500 ² | £82,500 |
| Tax rate 1 | 22% | 15% | 22% |
| Tax rate 2 threshold | N/A | £32,400 ³ | N/A |
| Tax rate 2 | N/A | 20% | N/A |
| Social Security | | | |
| Headline rates | 8.0% employee 7.5% employer | 8.5% employee 8.0% employer +2.5% above UEL for employers ⁴ | 8.9% employee 8.0% employer +2.5% above UEL for employers ⁴ |
| Basis of assessment | Earned income only for employees and self-employed, all income for non-employed and pensioners | All income for all contributions | All income for all contributions |
| SSC allowances and thresholds | £10,674 ⁵ allowance for non-employed & pensioners only Lower earnings limit: £9,568 Upper earnings limit: £188,640 Lower income limit (non-employed & pensioners only): £23,920 | £15,200 available to all individuals ⁶ Lower earnings limit: N/A Upper earnings limit: £188,640 Lower income limit (non-employed & pensioners only): £23,920 | £10,674 available to all individuals ⁶ Lower earnings limit: N/A Upper earnings limit: £188,640 Lower income limit (non-employed & pensioners only): £23,920 |
| GST | | | |
| Headline rate | N/A | 5% | N/A |
| Basis of charge | N/A | Broad base, minimal exemptions and zero rating | N/A |

¹ Represents £600 increases above the level of personal allowance propose if the 2% increase in income tax is not approved.

² Aligned with 2025 budget proposals.

³ Increased in line with inflation between 2022 and 2025.

⁴ This was 2% in the original Tax Review presentation but has been aligned with the 2.5% to align with the application in Jersey.

⁵ As recommended in the 2025 contributory benefits uprating report

⁶ Matched to the tax allowance.

| Other taxes | | | |
|-------------|--|--|--|
| | As 2025 budget; incl of Pillar 2 implementation on CIT | As 2025 budget; incl of Pillar 2 implementation on CIT | As 2025 budget; incl of Pillar 2 implementation on CIT |

| Revenues raised | Budget 2025 + phased increase SSC | Adapted Tax Review Proposals | Budget 2025 + restructured SSC |
|--------------------------------|--|--|---|
| | Income tax = +£24.6 ⁷ m Social Security = +£26.8m Corporate tax = +£30m Income support and other benefit costs = (£1.0m) ⁸ Ongoing admin cost = Minimal Net revenue = £80.5m | Income tax = (£35.8m) ⁹ Social Security = +£4.5m GST (household) = +£63.5m GST (business & visitors) = +£18.9m Corporate tax = +£30m Income support and other benefit costs = (£0.5m) Ongoing admin cost = (£1.5m) Net revenue = £79.0m | Income tax = +£24.6 ⁷ m Social Security = +£24.3m Corporate tax = +£30m Income support and other benefit costs = (£0m) ¹⁰ Ongoing admin cost = (£0.5m) Net revenue = £78.4m |
| Attribution of revenues raised | Households- £40m Businesses- £41m Other- £ - | Households- £ 20m Businesses- £ 53m Other- £ 6m | Households- £31m Businesses- £47m Other- £ - |

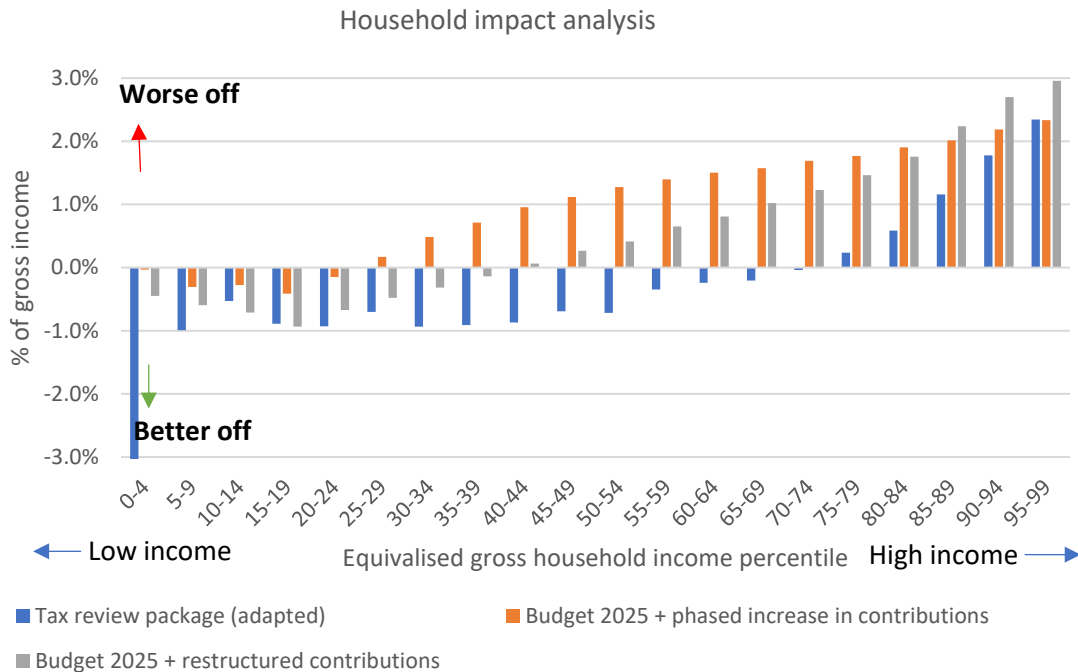
⁷ All three packages incorporate £4m nominal cost of maintaining the real value of the tax allowance and increasing the tax allowance to £14,600 to match the States' Pension. The net gain from the 2pp increase in the personal income tax rate and the further increase in the tax allowance to £15,000 is approximately £28m.

⁸ Incorporates the net cost to income support of compensating reduced net incomes for claimants.

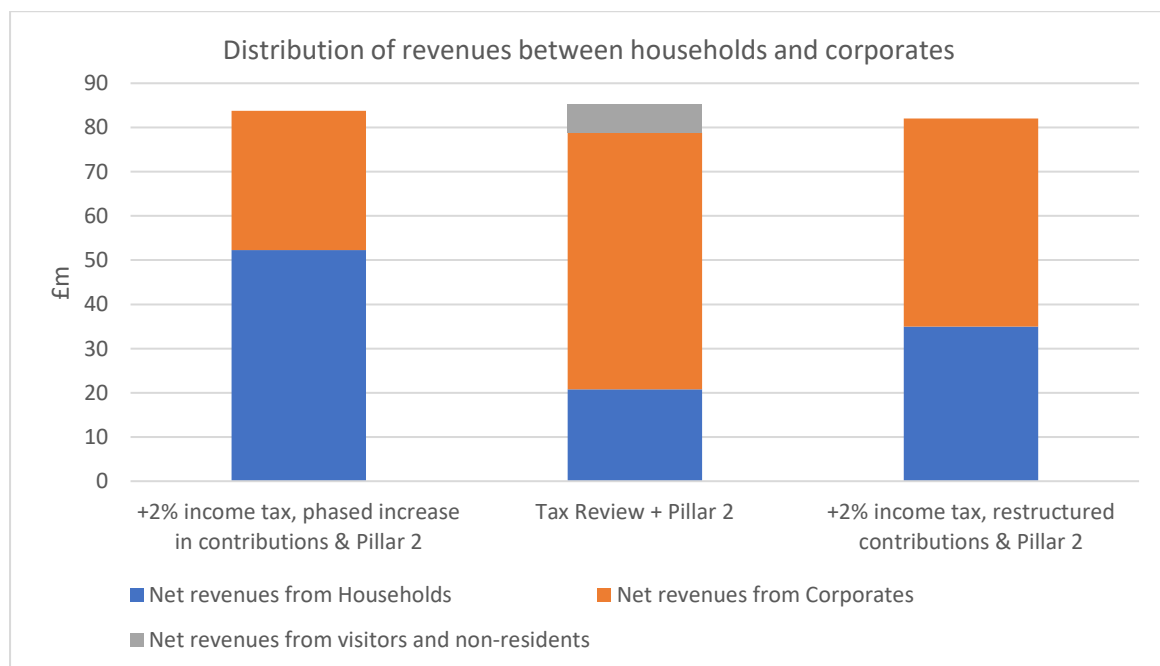
⁹ See note 7. Net cost of additional income tax allowances and the 15% rate total an estimated £31.5m

¹⁰ Modelling suggests minimal impact on income support.

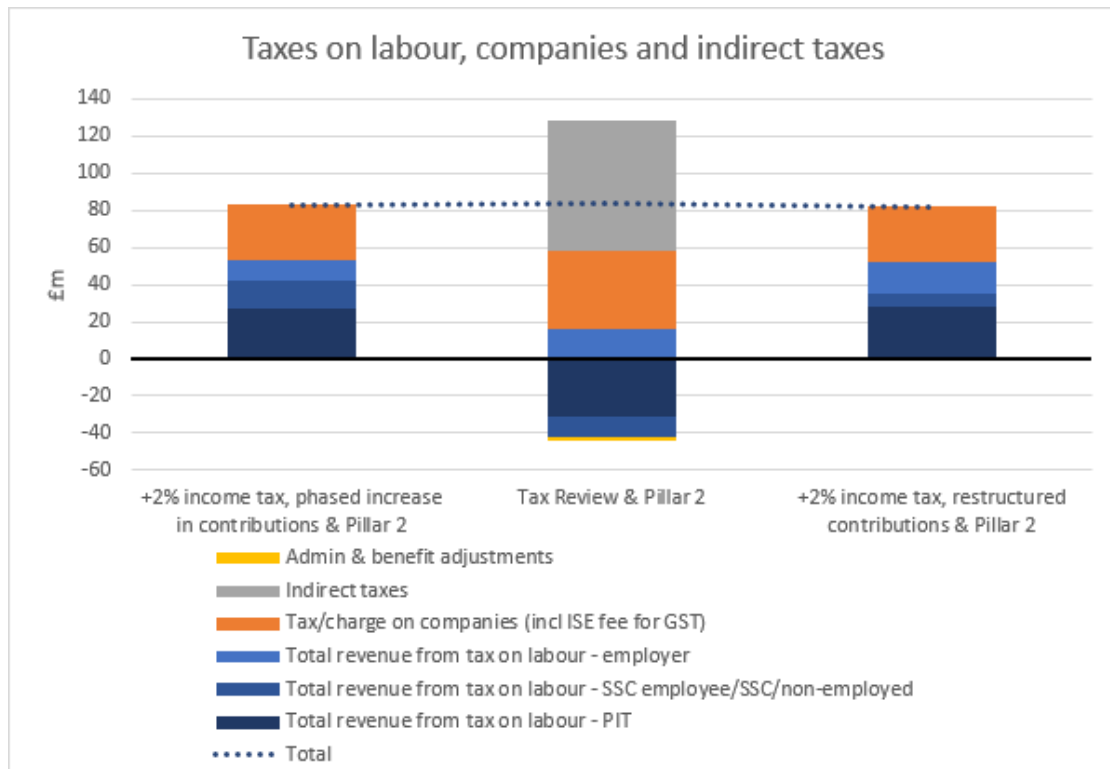
The graph below illustrates the average impact profile of these three scenarios on households once the measures are implemented in full (which is assumed to be 2027 for the Tax Review package and a stand alone reform of SSCs if decisions are made before the election but 2031 for the phased increase in SSCs).



The following graph illustrates the difference in how this income is distributed between households and corporate entities.



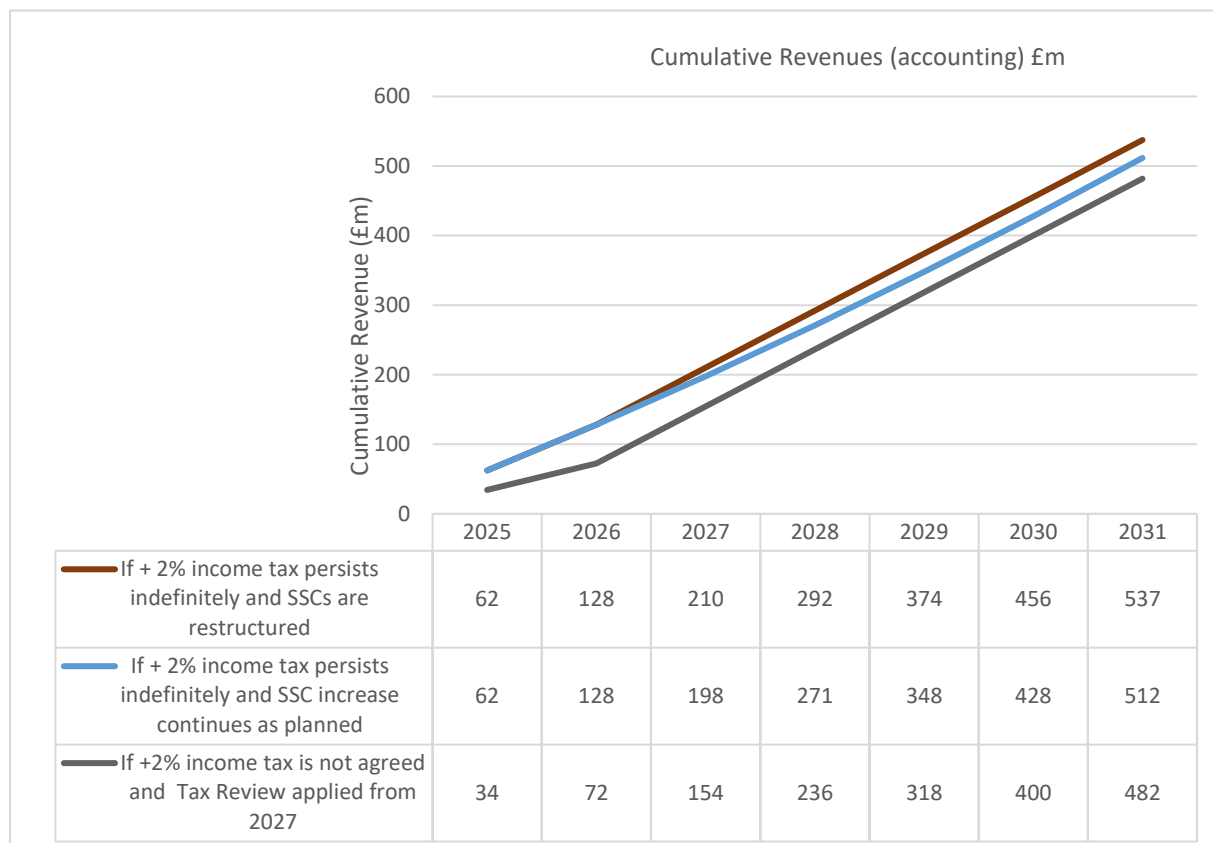
This is broken down further below to show graphically and in tabular form, the revenue generation from each scenario derived from different sources:



| Revenue (£m) | +2% income tax, phased increase in SSC & Pillar 2 | Tax Review & Pillar 2 | +2% income tax, restructured SSC & Pillar 2 |
|-------------------------|---|-----------------------|---|
| Admin & benefit adj. | (1) | (2) | (1) |
| Indirect taxes | - | 70 | - |
| Tax/charge on companies | 30 | 42 | 30 |
| Labour – employer | 11 | 16 | 17 |
| Labour – SSC | 16 | (11) | 7 |
| Labour – PIT | 27 | (32) | 28 |
| Total | 83 | 83 | 82 |

ADDITIONAL ANALYSIS

The difference in revenue generation of the packages to 2031 between 1) income tax increase for 2025 and 2026 only with phased increase in SSC; 2) 2% increase in income tax remaining in place beyond 2026 with the phased increase in SSC; and 3) the GST package implemented from 2027.

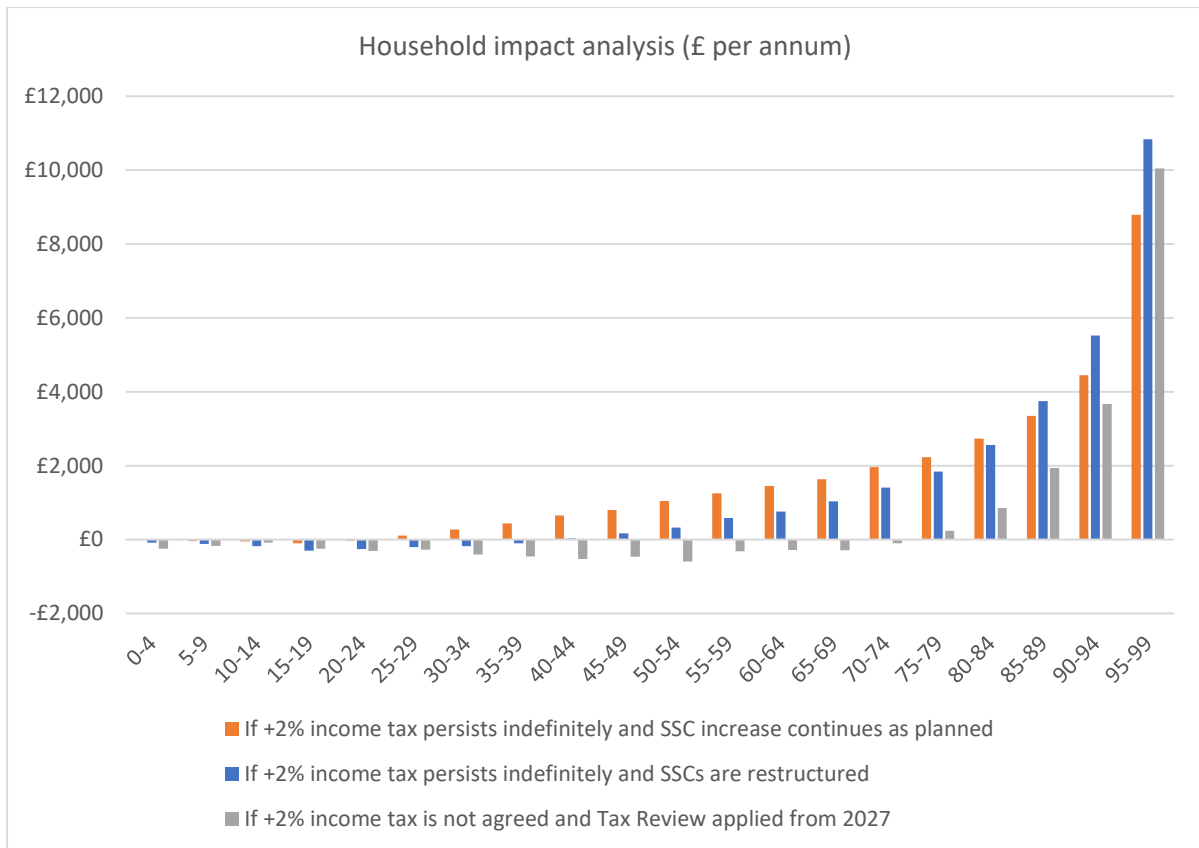


What level of Income tax would be required from 2027 to make up for the delta in revenue generation with the GST package?

As per the chart above in Q2 a 2% increase in income tax alongside the planned increase in SSCs would generate c£30m more than the cumulative revenues generated by the Tax Review package up to 2031. Therefore, an increase of less than 2% would be required from 2027 to make up the delta in that time period, though further modelling would be required to determine the actual % increase required.

What is the cash rather than Percentage impact on households?

This chart uses the same data as previously used to compare the impact of the three different scenarios on households but shows the monetary impact rather than percentages.



Note: it is not possible to prepare this chart with income thresholds in monetary terms on the x-axis owing to the number of variables considered in calculating equivalised household income (such as number of children per household). As per the Budget Report examples of the household income at different percentiles:

Lower income Households (25th Percentile)

- Couple with no children with a household income of £40k or
- Couple with 2 children with a household income of £57k.

“Average” household income (50th Percentile)

- Couple with no children with a household income of £68k
- Couple with 2 children with a household income in the region of £95-100k

Higher Income Households (75th Percentile)

- Couple with no children with a household income of £100k
- Couple with 2 children with a household income of £145k

Higher Income Households (90th Percentile)

- Couple with no children with a household income of £150k
- Couple with 2 children with a household income of £210k.