

22 July 2014

## Supplementary forecast information release

### Effect of fiscal drag on numbers of income tax and NICs taxpayers

The OBR are releasing the information below following a request for further detail underlying the July 2014 *Fiscal sustainability report (FSR)*. We will where possible meet requests to release supplementary forecast information, where this will improve the quality of public debate on the public finances. Our full release policy can be found on our website.

Fiscal drag is the process by which the average tax rate rises if allowances and thresholds are indexed to prices rather than earnings, resulting in more taxpayers' income falling into higher tax bands. In our medium-term forecast, unless the Government states otherwise, we assume that it will uprate income tax allowances and thresholds in line with inflation, in line with Government policy. But because earnings are expected to rise more quickly than prices in the long term (due to productivity growth), this would result in the average tax rate rising steadily over time as more income moves into higher tax bands. In the central projections in the *FSR* we assume that allowances and thresholds rise in line with earnings (proxied by nominal GDP) rather than prices beyond the end of the medium-term forecast, effectively switching off fiscal drag. We can use HMRC's Personal Tax Model (PTM) to estimate the effect of this – in the main report we included estimates of the change in tax liabilities associated with fiscal drag, but the PTM can also be used to assess changes in the number of people liable in each tax band, as shown in Table 1.

Table 1 shows that under our central projection the number of people paying income tax is projected to rise from 29.9 million this year to 31.1 million in 2033-34, an increase of 1.2 million. We estimate that an additional 4.3 million people would pay income tax in 2033-34 if allowances and thresholds were uprated with prices rather than earnings. The number of people liable at the basic rate of income tax would be 0.2 million lower, as there are more people moving into the higher rate than there are entering the basic rate. There would be an additional 3.5 million people in the higher rate and a 1.1 million in the additional rate of income tax.

**Table 1: Cumulative effect of fiscal drag on numbers of income tax payers by 2033-34**

	2011-12	2014-15	Effect of fiscal drag by 2033-34		
			CPI indexation	GDP per capita indexation	Difference
<b>Number of liable income taxpayers (million)</b>					
Total	30.8	29.9	35.4	31.1	4.3
of which:					
Basic rate	26.0	24.1	24.6	24.8	-0.2
Higher rate	3.6	4.6	9.2	5.7	3.5
Additional rate	0.3	0.3	1.7	0.6	1.1

Note: 2011-12 is the latest data available from HMRC Survey of Personal Incomes. The projection for 2014-15 is an HMRC estimate consistent with the March 2014 *Economic and fiscal outlook*.

Table 2 shows the effect on National Insurance. In our central projection the numbers liable for National Insurance contributions are set to increase by 2.0 million, from 52.6 million this year to 54.6 million by 2033-34. If thresholds were updated with prices rather than earnings, the numbers liable for NICs would be 3.7 million higher. The effect of fiscal drag on NICs liabilities is much smaller than for income tax, since the marginal rate for employee NICs falls to 2 per cent above the upper earnings limit. Fiscal drag leads to lower receipts from employee NICs, offset by higher employer NICs where there is no upper limit.

**Table 2: Cumulative effect of fiscal drag on numbers of National Insurance payers by 2033-34**

	2011-12	2014-15	Effect of fiscal drag by 2033-34		
			CPI indexation	GDP per capita indexation	Difference
<b>Numbers liable (million)</b>					
Total	52.3	52.6	58.2	54.6	3.7
<i>of which:</i>					
Employee and self-employed	27.0	27.2	30.9	28.9	2.0
Employer	25.3	25.4	27.3	25.7	1.6

The projection for 2014-15 is an HMRC estimate consistent with the March 2014 *Economic and fiscal outlook*.