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MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

TAXATION OF BENEFITS FOR THE UNEMPLOYED

Memorandum by the Secretary of State for Social Services

1. Our main objective in this area is to bring short term benefits within the tax system, so that the man who is earning his money is not at an unfair disadvantage compared with the man who draws benefit. It would also help to restore the will to work if we could minimise (or even eliminate) the payment of tax refunds during spells on benefit, though in practice the majority of them are paid on return to work. We are also pledged to simplify the social security system, and to protect those in greatest need. I am convinced that we should bring in to tax all the benefit paid to the unemployed - unemployment benefit, earnings-related supplement and supplementary benefit. However, the taxation method we adopt is crucial.
2. Any scheme which taxes all three benefits currently, on the lines of PAYE, will leave significant numbers of beneficiaries and their families below their supplementary benefit levels (ie with incomes insufficient for their assessed needs) during a spell on benefit. This is because 10 per cent-20 per cent of taxpayers have tax codes below the standard rate of unemployment benefit; and because the emergency code used when no P45 is available has the same effect. For example about 90,000 people will be left below the supplementary benefit level by the Chancellor's preferred option - including the new proposal for "taxing" the earnings-related supplement by a flat-rate reduction of benefit in paragraph 15 of the Inland Revenue's note. Under the present law those concerned would have the right to claim additional supplementary benefit to make good part or all the tax deducted. Legislation to remove that right would be highly controversial and might be difficult to get through the House. Even the suspicion that such legislation was in prospect would make the passage of the Social Security Bill much more difficult.
3. Somehow or other we should have to bring those concerned back to their supplementary benefit levels. As the Inland Revenue note points out (para 12) taking benefit away with one hand and returning it with another would create a substantial unproductive work-load and risk discrediting the whole scheme. But it would be harder still to defend bringing people up to a minimum level

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through the social security system, taxing them so that they are pushed back under that level and then leaving them below it. Of those receiving supplementary benefit the unemployed are the least favourably treated and the worst off. Only a very few low earners - mainly those with large families - receive less in work than when they are on benefit. Deducting tax week by week from the benefits paid to the unemployed would bring more people into hardship. So far from simplifying the scheme it would mean more shuffling between unemployment benefit offices and social security offices, so that benefit can be made up to take account of tax deducted.

4. I have had little time to consider the method of taxing earnings-related supplement now proposed. It is attractively simple and economical in staff, but its great defect is that it would "tax" those who have no tax liability. Unless some way of exempting or compensating them can be found the proposal is indistinguishable from a straightforward cut in the benefit. As such, it would fuel anxiety about our intentions towards other benefits and, again, there would be a serious risk of its back-firing into the debates on the Social Security Bill.

5. It seems to me that the way to achieve our objectives and avoid all these difficulties is to tax the three benefits subsequently (Method 1B in the Annex to the Inland Revenue's note). This avoids bringing people below their supplementary benefit levels and produces the highest tax yield. The staff costs, taking the three Departments together, are virtually identical. There would be no need to treat ERS in any separate or special way. This method also helps with incentives by eliminating nearly all tax refunds during unemployment. It would enable us to bring benefits paid to the unemployed into the tax net in a simple and reasonably cheap way without making the social security system any more complicated.

P J

Department of Health and Social Security  
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