

# Universal Credit Policy Briefing Note 5

## Second Earners

### 1. Core Objectives

- a) The Universal Credit has been designed to simplify the benefit system. A key aspect of the Universal Credit is that it should mimic work and receipt of a salary. In order to help households understand what money they receive and how choices over work affect it, the Universal Credit will be simpler and will work on a single system of disregards and one taper.
- b) Universal Credit is therefore designed to help improve work incentives for a household, particularly for the first earner to help break cycles of worklessness. It supports work incentives directly by ensuring that individuals can keep more of their income from work but also by simplifying the system and providing more certainty about what people will receive in work – a benefit which all will see.

### 2. Impact of Universal Credit on second earner incentives

- a) Given constraints on the affordability of the system, incentives for first earners have been given priority over second earners, for example by investing in higher disregards for many working households, rather than creating a specific earnings disregard for second earners. The aim of Universal Credit is to ensure that as many households as possible have at least someone in work and that work will pay for that household.
- b) The majority of existing or potential second earners do not see their work incentives affected by the Universal Credit because their household is already earning too much to be eligible for income related support under UC. For example, only 25% of existing second earners would see their incentive to remain in work affected by the reform and only 6% would see a change in their incentive to work a little more. Potential second earners are more likely to be affected but even so, almost 54% of them would see no change in their incentive to enter work.
- c) Where second earners are eligible for income related support the impact of the reform on work incentives could be positive or negative, depending on their current benefit combination. Table 1 below shows the marginal deduction rates (MDRs) for a second earner in the current system and under Universal Credit depending on their combination of benefits and whether or not they earn enough to pay tax and national insurance.

**Table 1: Illustrative MDR for first and second earners**

	Example combinations of benefits and tax credits received today	MDR in current system	MDR in Universal Credit – no earnings disregard	MDR in Universal Credit – some earnings disregard remaining
Below Tax/NI Threshold	Tax Credits, HB and CTB	91%	65%	0%
	Tax Credits and HB	79%	65%	0%
	<b>Tax Credits only</b>	<b>41%</b>	<b>65%</b>	<b>0%</b>
Above Tax/NI Threshold	Tax Credits, HB and CTB	96%	76%	32%**
	Tax Credits and HB	91%	76%	32%**
	<b>Tax Credits only</b>	<b>73%</b>	<b>76%</b>	32%

\*Note MDRs have been rounded to the nearest percentage point

\*\*Likely to be very few households in this position

### Participation Tax Rates – Incentives to Work at all

- a) The Participation Tax Rate (PTR) measures the incentive for someone to enter work. At a given level of gross earnings it tells you the proportion of those earnings that are withdrawn in tax/national insurance contributions and reduced benefit payments. Therefore, the lower the PTR the higher the incentive to work and vice versa. Take for example an individual who earns £75 before tax and would receive £100 in total in work (adding in any in work benefits and taking off any tax/NI). The same individual would receive £50 in benefit if they weren't working. In this example, the individual has earned an extra £75 but only kept £50 – they have lost £25 in tax and benefit withdrawal so their PTR is £25/£75 - 33%.

### Potential second earners

- b) Analysis of those non-working individuals in households where the partner is already in work (potential second earners), suggests that some 300,000 would see a lower PTR with the introduction of Universal Credit should they consider work at 10 hours at the national minimum wage. Around 900,000 potential second earners would face an increased PTR (those affected see their mean PTR increase from 35% to 65%), and over 1.3 million would be unaffected by the reform.
- c) It is important to note that for 83% of the potential second earners where the PTR has increased the household is receiving more support under Universal Credit than in the current system. In the majority of cases the work incentives for the primary earner have also been strengthened.

### Existing second earners

- d) We can also consider the PTR for second earners currently in work. Analysis shows that over 5 million existing second earners see no

difference in their PTR as they would not be entitled to any support under either system even if they moved out of work.

- e) There are just under 1.5 million existing second earners who will see their PTR increase under Universal Credit and here the increase in PTR may reduce the incentive for some existing second earners to work. However the mean PTR for this group rises from 30% to 45% - this is much lower than for many first earners and shows that there will still be considerable gains from work for most second earners..

### **Marginal Deduction Rates (MDRs) – Incentives to Work A Little More**

- a) The marginal deduction rate (MDR) calculates how much of a small increase in earnings is lost through benefit withdrawal and taxation and provides an indication of the incentive to increase earnings once an individual is in work.
- b) Amongst existing second earners the vast majority, over 6 million, will be unaffected because their household earns too much to qualify for income related support in either the current system or under Universal Credit.
- c) For existing second earners who do receive income related support, approximately 100,000 will see their MDR decrease, primarily those who will no longer be entitled to any support under Universal Credit, and approximately 300,000 will see their MDR increase, primarily those who were previously eligible for tax credits only and those who become newly entitled to means tested support under Universal Credit.

### **3. Further Work**

- a) We are aware that childcare costs are a substantial consideration for parents considering employment. Childcare costs have been excluded from this initial analysis but as we develop the detail of the childcare element in Universal Credit work incentives for second earners will be considered further.
- b) We intend to publish a revised Impact Assessment and Equality Impact Assessment when the Bill goes into the Lords stage, to incorporate the impact of the recent policy announcements

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