

Tax credits favour lone parenthood

The UK government has a goal of halving the number of children living in poverty (defined as standard of living below 60% of median household income). This focus has shaped the tax and benefit systems and driven a shift toward tax credits which are calculated according to the household rather than the individual situation. The government has chosen to tackle child poverty by creating incentives for parents to work, even at part-time or minimum wage levels. Because lone parents have a high risk of living in poverty, the government has structured the new tax credit system especially to encourage them to enter work.

The problem with the tax credit system is that it favours children who live with a lone parent rather than with both parents. This occurs because the system expects two adults and a child to live on exactly the same amount of money as one adult and a child. This results in the perverse situation in which a child, both of whose parents work full-time at minimum wage, experiences a higher standard of living if he lives with only one parent rather than both. In fact, each of the individuals in this scenario has a higher standard of living before housing costs if the parents live apart, and the custodial parent has a higher standard of living both before and after housing costs (see Table 1).

Table 1: Financial situation for two adults working 35 hours per week at minimum wage and one 12-year-old child in various household situations

	Case A: Both parents and child living together	Case B: First parent and child living together	Case C: Second parent living separately
Earnings	£16,424	£8,212	£8,212
Disposable income after tax and benefits	£16,791	£12,567	£8,240
Government Subsidy ^a	£367	£4,355	£28
Equivalence scale value (before housing costs)	1.26	.86	.61
Standard of Living ^b Before Housing Costs	£13,432	£14,612	£13,508
Standard of Living After Housing Costs ^c	£10,693	£11,689	£9,818

^a Does not include amount of income tax and national insurance cancelled by tax credits (£1,900.76 in Case A and £950.38 in Cases B and C)

^b Based on McClements Equivalisation Scale as used in Department for Work and Pensions, *Households Below Average Income, 1994/95-2001/02*, CDS, Leeds, 2003.

^c Housing costs based on Department for Work and Pensions, *Tax Benefit Model Tables, April 2003*. Assumes each example is living in local authority housing.

All of the individuals in Case A experience a standard of living similar to a childless couple whose after-tax earnings are £13,432; the individuals in Case B experience a standard of living similar to a childless couple whose after-tax earnings are a bit higher--£14,612; and the individuals in Case C experience a standard of living comparable to that experienced by a childless couple with after-tax earnings of £13,508. The important point is that this child experiences a standard-of-living that is almost 10% higher if he lives with a lone parent rather than with both parents.

To fix the problem, the government would have to increase the couple element of the working tax credit and increase the threshold (the amount of household income above which the tax credits start to be withdrawn) for both the child and working tax credits for couples.

It is true that children living in lone parent households are statistically much more likely to be living in poverty. However, if we look at absolute numbers, we see that more than half of all poor children are actually living with a couple.¹ By targeting lone parent families, the government's policy actually leaves the majority of poor children behind.

¹ Department for Work and Pensions, *Households Below Average Income, 1994/95 – 2001/02*, Leeds: CDS, 2003.
