Putting the 'Universal' into Universal Credit

Broken housing and childcare markets mean higher rate tax paying families may be able to access support

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Executive summary

This report looks at the interaction between taxes and benefits, focusing on two case studies to highlight how Universal Credit supports families.

We look at how their incomes change as their earnings increase, and find that:

Out of work support under Universal Credit is inadequate

For families with two children living in an expensive part of the country, the Benefit Cap leaves them with £18,000 (40%) less than their needs as assessed by the benefit system.

In work support helps more people than you might think

200,000 to 300,000 higher rate taxpayers are potentially eligible for Universal Credit. This is caused largely by the high cost of housing and childcare.

This table shows the maximum a household can earn and still receive support, broken down by the reasons why they have an entitlement to Universal Credit.

Maximum household earnings at which a couple living in London could access Universal Credit	
2+ children, rental and childcare costs	£148,000
2+ children and rental costs	£112,000
2+ children and childcare costs only (e.g. owner-occupier)	£68,000
2+ children, no rental or childcare costs	£42,000
No children, rental or childcare costs	£12,629

This isn't limited to the most expensive parts of the country. A couple with two children renting in Leeds could access support at earnings of up to £96,000.

Higher earners lose out through the interaction of taxes and benefits

The savings limit, which prevents households with capital above £16,000 from accessing Universal Credit, has been unchanged since 1990. This can potentially halve household income, creating a strong disincentive to save.

Under Universal Credit, families with more than two children who rent their home and earn £50,000 or more can be subject to an effective tax rate of over 100%.

The withdrawal of the tax free personal allowance at £100,000 means that dual earner couples, each earning £62,570, are over £14,000 better off after tax than a single earner household earning £125,140. Together, these penalise single earner couples and make the tax system less progressive than it should be.

Our policy recommendations:

- **Invest in out of work support in Universal Credit.** For families with children living in high cost areas, support is clearly inadequate because of the Benefit Cap and the two child limit (which hits families both in and out of work), and because the cost of housing is not fully covered by social security.
- **Remove the savings limit in Universal Credit.** There is no savings limit under Tax Credits or Pension Credit, and savings under Universal Credit are already means-tested by applying a notional income of £4.35 per week for every £250 in savings. Removing the savings limit would bring the needs allowance firmly into the tax system, in particular helping younger families who otherwise feel 'stuck' renting.
- **Ensure effective marginal tax rates are below 80%.** Remove the High Income Child Benefit Charge and the withdrawal of the tax-free personal allowance to remove couple penalties within the system and ensure effective marginal tax rates are progressive rather than punitive.

We also make an important practical recommendation: people in work should check if they are eligible for Universal Credit, and companies should check for eligibility on behalf of their customers. This paper was partly inspired by work for clients in the financial services and utilities sectors who have been surprised at how many of their customers we have been able to help, and by how much.

We estimate that around £19 billion of Universal Credit and other national, local and private sector support goes unclaimed each year. Even if the amount you are eligible for is small, access to Universal Credit can help you to tap into additional support, including this year's £900 cost of living payment, free prescriptions, cheaper broadband and social tariffs.

Policy in Practice runs the Better Off Calculator[1], one of the benefit calculators on GOV.UK, and helps local authorities and corporate sector clients to identify and support customers who are struggling. We believe it should be easy for people to access the support they need. To learn more about how organisations can help their residents or customers tackle the cost of living crisis, please contact hello@policyinpractice.co.uk.

[1] www.betteroffcalculator.co.uk

1. Out of work support under Universal Credit is inadequate

The examples in this report are based on two families each with three children, renting in Hammersmith and Fulham and claiming childcare support for the maximum of two children from April 2023.

In this first example we show how the Benefit Cap, two child limit and high housing costs lead to a significant gap between the households' needs allowance and the support they receive. This gap is £15,230 for the single parent and £17,751 for the couple.

Support elements of Universal Credit for families who are out of work		
Renting with three children	**Single parent**	**Couple**
Standard allowance	£4,425	£6,946
First child (before April 2017)	£3,780	£3,780
Second child	£3,235	£3,235
Third child	£0	£0
Childcare	£0	£0
Housing element	£22,977	£22,977
Universal Credit	**£34,417**	**£36,938**
Child Benefit	£2,902	£2,902
Third child needs	£3,235	£3,235
Out of work needs	**£40,553**	**£43,074**
Benefit Cap / two child limit	-£15,230	-£17,751
Out of work allowance	**£25,323**	**£25,323**

Table 1: Support elements of Universal Credit for families who are out of work

These households would need up to £43,074 annually to meet their housing and living costs based on Universal Credit and support for children, with over half of this going toward the cost of renting. This is despite support being capped at the lowest 30% of rents in the area.

The two child limit means these households don't receive support for their third child, whilst the Benefit Cap limits the maximum total benefit support that an out of work household living in London can receive up to £25,323. The Benefit Cap lowers support to 37% below the uncapped allowance for the single parent and 41% for the couple.

If these families have to pay rent at the Local Housing Allowance rate of £22,977 per year, they will see 91% of their income going to their landlord, leaving just £2,346 per year for all of their remaining household costs, including food, energy and water bills.

Families in this position would need to apply for discretionary support from their local authority, creating administrative complexity, with councils left to pick up the bill to ensure that the family is not left destitute.

People without housing or childcare costs also do not typically get enough in Universal Credit support to cover basic costs. The standard allowance in Universal Credit is now at its lowest level in real terms (reflecting prices) for nearly 40 years. A recent paper from the Joseph Rowntree Foundation[2] found that the Universal Credit standard allowance for single adults is £35 per week less than the minimum needed to cover essentials, and for couples it is £67 less per week.

Almost half of households in receipt of Universal Credit will see an even greater shortfall between their income and essential costs due to deductions to their Universal Credit.

Typical reasons for deductions include debt repayment, sanctions, or benefit caps.

[2] www.jrf.org.uk/report/guarantee-our-essentials

2. In work support helps more people than you might think

As well as supporting out of work households, Universal Credit is designed to tackle in work poverty and improve living standards for people in work. The results from our Better Off Calculator, and analytics for organisations wanting to better support struggling customers, show that Universal Credit can help households across the income spectrum.

Higher rate taxpayers may be able to access Universal Credit

We find that families with two children can be eligible for Universal Credit even if they earn over £50,270, if they rent and need formal childcare. We estimate that 200,000 to 300,000 households paying the higher rate of tax may potentially be eligible for Universal Credit.

Expanding on our earlier case studies, Table 2 shows that their Universal Credit would no longer be reduced by the Benefit Cap if they were in work, and they would be able to claim up to £1,108 per month in childcare support, with Universal Credit tapered away at 55% of net income.

Table 2 shows the Universal Credit award and take home income for a single-parent who is working full time at different earnings levels ranging from the National Living Wage to £50,270. It also shows the same for a dual-earner couple.

This high notional level of in work support enables these families to live and work in areas with high rents. These households have at least one earner working full time, earning well above the administrative earnings threshold, meaning that Universal Credit claimants would face no further work requirements from the DWP.

Table 2 shows that a family with three children would be able to access Universal Credit of around £29,000 a year because of their rent and childcare costs. This is despite the fact they are only able to access support for two children whether in or out of work. This demonstrates how, despite the perception that UC subsidises employers, it in fact subsidises landlords (and to a lesser extent childcare).

Support elements of Universal Credit for families in work				
Renting with three children	**Single parent**		**Couple**	
Gross earnings	**£18,964**	**£50,270**	**£27,633**	**£50,270**
Net income calculation				
Income tax	£1,279	£7,540	£1,279	£5,026
National Insurance	£766	£4,522	£766	£3,012
Net income	**£16,919**	**£38,208**	**£25,588**	**£42,232**
Universal Credit calculation				
Universal Credit	£34,417	£34,417	£36,938	£36,938
In work UC support for childcare	£13,296	£13,296	£13,296	£13,296
Work allowance	*-£4,548*	*-£4,548*	*-£4,548*	*-£4,548*
Net income assessed for UC	*£12,371*	*£33,660*	*£21,040*	*£37,684*
Universal Credit withdrawn at 55%	-£6,804	-£18,513	-£11,572	-£20,726
In work Universal Credit	**£40,909**	**£29,200**	**£38,662**	**£29,508**
Child Benefit	**£2,902**	**£2,844**	**£2,902**	**£2,902**
Take home income				
Take home income	**£60,730**	**£70,252**	**£67,152**	**£74,642**

Table 2: Support elements of Universal Credit for families in work

The household's Universal Credit support would fall from £29,000 to £16,000 without childcare, or to £6,000 if the household needed childcare but owned their own home. A household with a gross income of £50,270 would not be eligible for Universal Credit support if they are owner-occupiers and do not need formal childcare.

Maximum household earnings at which a couple living in London could access Universal Credit	
2+ children and rental and childcare costs	£148,000
2+ children and rental costs	£112,000
2+ children and childcare costs only (e.g. owner-occupier)	£68,000
2+ children, no rental or childcare costs	£42,000
No children, rental or childcare costs	£12,629

Table 3: Maximum household earnings at which a couple living in London could access Universal Credit

To illustrate the point, Table 3 shows the maximum household earnings at which a household could access Universal Credit. At the current Universal Credit withdrawal rate, the couple in the case study could receive Universal Credit up to earnings of £148,000. Without childcare costs this falls to £112,000. Without housing costs, this falls to £42,000. Without children, housing or childcare costs, this is £12,629.

Lowering the additional rate tax threshold this April means that even an additional rate taxpayer requiring three bedrooms, renting in a high cost part of the country and needing childcare to work may also be able to access Universal Credit. With earnings of £125,140 a household would be eligible for £8,083 of Universal Credit as a single parent and £2,681 as a couple. Although this situation is rare we estimate there are up to 1,500 households in London who meet this criteria.

> “ **As a £90,000 couple with children, we're not sure if we could afford three bedroom rent in certain parts of the city without support.**

In work owner-occupiers with childcare costs may also be able to receive Universal Credit at higher than expected levels of earnings, £68,000 in the example given above. The level of support is considerably lower than for renters as they are unable to claim support for housing.

Although mortgage costs are rising due to high interest rates, these costs don't account for the quality of housing (Universal Credit only covers rents for cheaper properties), or of capital accumulation for the buyer. Owners have more options at their disposal to help them meet their housing costs during times of financial pressure, such as renting out rooms, realising capital, or changing the type or length of their mortgage. Banks carry out affordability checks and may offer forbearance, and the government has recently changed the rules around Support for Mortgage Interest (SMI) to make it available to all Universal Credit claimants from the moment they receive UC.

Though the examples above focus on the most expensive part of the country, housing costs are high everywhere. Table 4 shows indicative gross earnings levels at which different households could potentially access Universal Credit support. For example, a similar household to that provided in the illustration above, living in Leeds, could earn up to £96,000 and be able to access some Universal Credit.

Maximum total household gross earnings up to which a household can access Universal Credit, by region					
	Single over 25	Single over 35	Couple 1 child	Couple 2+ children	Couple 2+ children
Region	One room in shared house	One bedroom	Two bedrooms	Three bedrooms	Four bedrooms
North East	£16k	£20k	£45k	£57k	£66k
North West	£17k	£25k	£50k	£67k	£85k
Yorks & Humber	£16k	£23k	£50k	£63k	£75k
East Midlands	£18k	£24k	£52k	£66k	£74k
West Midlands	£18k	£26k	£54k	£70k	£81k
East of England	£19k	£29k	£60k	£78k	£85k
London	£27k	£49k	£86k	£112k	£143k
South East	£22k	£33k	£67k	£88k	£105k
South West	£21k	£29k	£58k	£73k	£103k
Scotland	£19k	£28k	£57k	£77k	£100k
Wales	£16k	£23k	£50k	£65k	£72k
Northern Ireland	£16k	£20k	£44k	£56k	£61k

Table 4: Maximum total household gross earnings up to which a household can access Universal Credit, by region
Housing costs are based on the highest Local Housing Allowance rates for each region

While the figures in Table 4 are indicative, they generally underestimate the maximum earnings at which a household could earn Universal Credit. Each case study is based on single earner households without childcare costs. Households with childcare costs for one child could add around £20,000 to the amounts above, and £35,000 for two children.

These examples illustrate how much the cost of Universal Credit is driven by the housing market and childcare, as well as other factors outside the control of claimants. The latest DWP statistics show that six in ten Universal Credit households rent, almost half have children, and over one-third both rent and have children. Nine in ten households are in the bottom half of the income distribution. Many of these households will be missing out on support. Any household with savings below £16,000, particularly if they rent and have children, should use a benefit calculator to assess eligibility for Universal Credit and other support.

3. Higher earners lose out through the interaction of taxes and benefits

The original rationale for Universal Credit was the need to eliminate the complexities and unfairness in the legacy benefit system caused by people having to navigate multiple benefits across three separate agencies with their own complex and overlapping rules. These caused barriers to people claiming the support they were eligible for, and sometimes left people worse off in work.

While Universal Credit has simplified the system and has become a platform that helped people to access support during the pandemic, more work is needed to build on this. Council Tax support sits outside of Universal Credit, while passported benefits can create cliff edges and the growing web of discretionary and third party support makes the system difficult to navigate.

Having established that more people need to access Universal Credit because of high and rising housing and childcare costs, we now look at the impact of Universal Credit on higher earning households.

The drivers behind higher earners being able to claim Universal Credit are:

- **The high cost of childcare and housing, particularly in London and the South East.** While benefits are rising by 10.1% in April, this only enables benefit recipients to keep up with inflation. Benefits remain 7.5% less generous in real terms than they were a decade ago. The bulk of money paid to families that rent and need support for childcare goes to the landlord or childcare providers.
- **A lower withdrawal rate in Universal Credit**. People on UC keep more of what they earn than under the legacy system, particularly since the Universal Credit 'taper rate' was lowered from 63% to 55% of net income in October 2021 to help tackle in work poverty. This also means that higher earners who rent and need childcare may be able to access support if they need it. However, even at the previous Universal Credit withdrawal rate of 63%, the single-parent household earning £50,270 in our case study would have been able to access Universal Credit of £26,507.

For higher earners and families in particular, the anomalies of the tax system are exacerbated as they interact with Universal Credit. The impacts of each of these policies are very real. Three clear examples are the savings penalty in Universal Credit, the High Income Child Benefit Charge (HICBC) and the withdrawal of the tax free allowance for earnings above £100,000.

The savings penalty in Universal Credit

Households with capital above £16,000 are not eligible for Universal Credit. These payments are a lifeline for families in work, helping to tackle in work poverty for those on low incomes. However, the savings limit in Universal Credit makes it difficult for people with savings to access Universal Credit. It also discourages people on Universal Credit from saving for a deposit.

This savings limit has been unchanged since 1990. A more reasonable approach would be to remove the savings limit and treat working-age Universal Credit households in a similar manner to pension age households. The mechanism within Universal Credit for taking account of savings could be retained, thereby reducing awards for those with higher savings. Universal Credit treats savings over £6,000 as income. For each £250 in savings UC is reduced by £4.35 per month.

The savings limit does not work alongside the Help to Save scheme which was introduced by the Government to help low-income households. Households that do manage to save whilst receiving Universal Credit lose their eligibility to benefit support once their savings rise above £16,000. This causes a cliff-edge drop in their living standards. The graph below shows how an additional £2 in savings could cause household income to be halved.

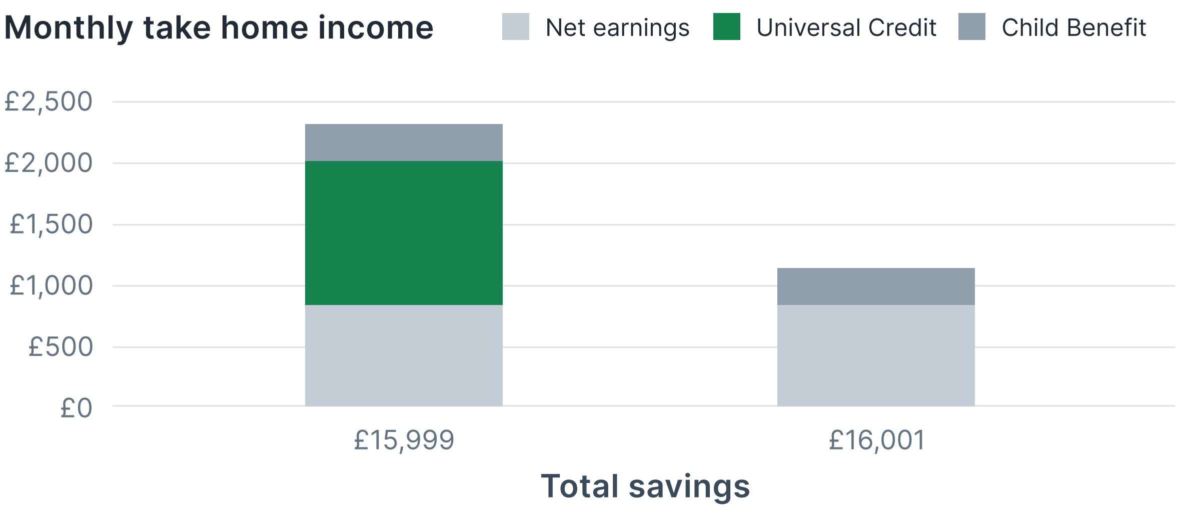

Chart 1: Monthly take home income

The two higher earning households in our case study stand to lose access to £29,000 in Universal Credit support if they have savings over £16,000. If they became unemployed and had savings above this threshold, they would only be able to access contributory benefits, which do not include the child and housing elements of Universal Credit.

> “ **If we weren’t saving for a deposit, we could get Universal Credit of £700 a month.**

Removing the savings limit in Universal Credit would bring the ‘needs based’ principles of additional support at times of need into the wider tax system, whether or not people have savings.

People on UC still face among the highest marginal tax rates

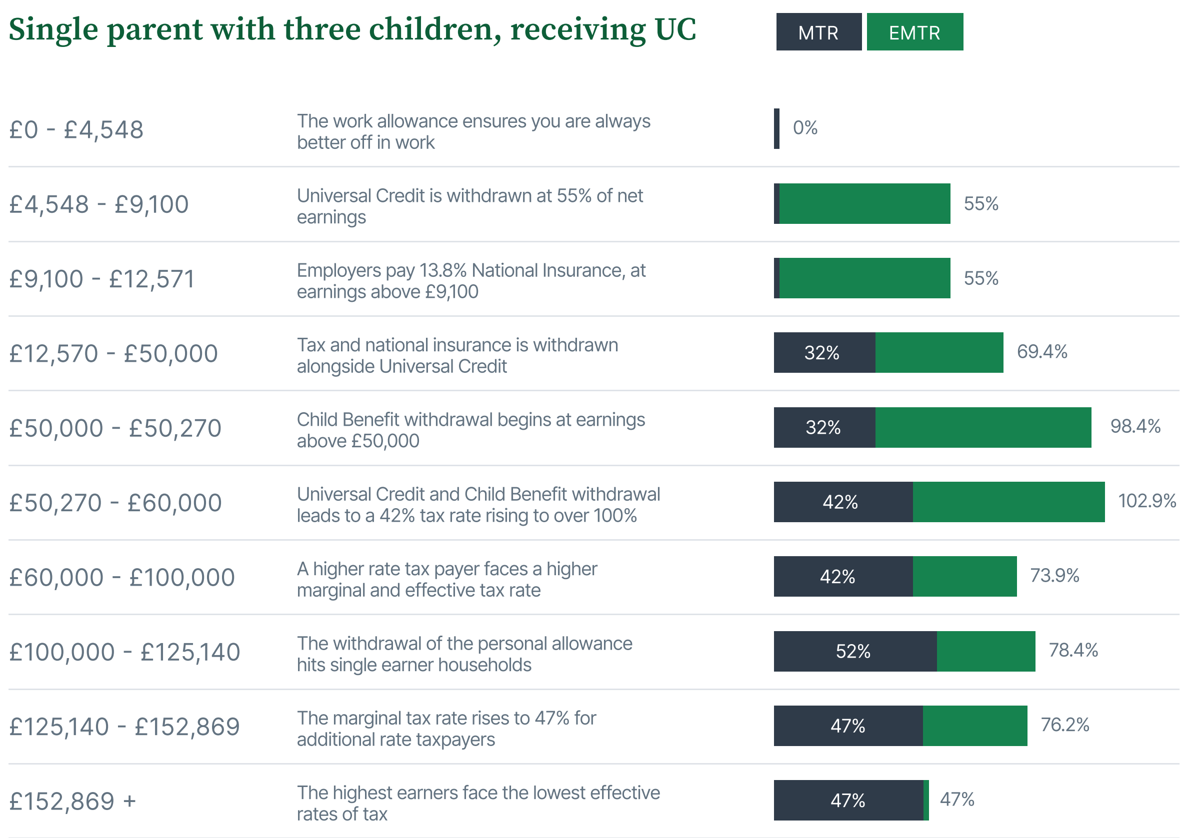

Chart 2: marginal tax rates for a single parent with three children, receiving Universal Credit. MTR means marginal tax rate, EMTR means effective marginal tax rate.

The marginal and effective marginal tax rates for households in receipt of Universal Credit at different earning levels are shown in Chart 2. This chart does not take into account employer National Insurance contributions, student loan repayments for graduates, the loss of passported support such as Free School Meals, free prescriptions, or the loss of tax-free childcare at net earnings above £100,000, so the effective marginal tax rates are likely to be higher.

The effective marginal tax rate under Universal Credit is around 70% when combined with Income Tax and National Insurance. Only when Universal Credit is fully withdrawn does the effective marginal tax rate fall. The effective tax rate faced by the highest earners (in this case, those earning over £153,000) is the lowest at 47%.

The lack of a progressive effective tax rate caused by the interaction of the benefit and tax systems existed under the legacy benefit system as well, and was notably worse for the lowest earners. Universal Credit makes these interactions more transparent, and highlights where we need to better align Universal Credit and the tax system.

High Income Child Benefit Charge

People earning over £50,000 per annum are affected by the High Income Child Benefit Charge (HICBC). Child Benefit is reduced by 1% for every £100 of income over £50,000 a year, meaning Child Benefit is lost completely if an individual earns over £60,000 per annum. Dual earner couples aren't affected if they each earn below £50,000, which means together they can earn up to £100,000 and not be impacted.

Chart 2 shows that the household with three children in our example would lose £2.90 in overall take home income for every additional £100 they earn between £50,270 and £60,000 per annum. This produces an effective tax rate of 102.9%.

This is due to the combination of the High Income Child Benefit Charge alongside the higher rate of income tax (40%) and the UC taper rate (55% of net income). If we include the employer contribution to National Insurance of 13.8%, the total rate of tax returned to the Treasury is £1.17 for every £1 earned within this income range.

> "Some families in the UK bear a disproportionately high tax burden, particularly those where one parent stays home to care. At some points of the income distribution it is not worth earning more. Removing the cliff edges would help many struggling families.

Withdrawal of the tax free allowance above £100,000

The tax free personal allowance of £12,570 falls by 50p for every £1 earned above £100,000, meaning it is fully withdrawn at earnings of £125,140.

The withdrawal of the tax free personal allowance means that a dual earner couple, each earning £62,570, is over £14,000 better off after tax than a single earner household earning £125,140. Universal Credit mitigates against this, lowering the difference to £5,000 as UC income is assessed on a household basis.

Single earner households lose out through the HICBC and the withdrawal of the tax free allowance. Together, these two measures save the Treasury around £1.5bn per year, but they create complexity, penalise families and damage work incentives.

We believe you could remove these 'couple penalties' in the tax system, and more effectively raise a similar amount of revenue by increasing the additional rate of tax from 45% to 50%. If lower earners can face marginal rates above 50%, then the highest earners can too.

The pandemic illustrated how we all may need financial support at some point. If we can better align the tax and benefit systems, we can begin to eliminate the false distinction between 'taxpayers' and 'claimants', build support for social security and make Universal Credit as much a ladder as a lifeline.

Recommendations

Bring Universal Credit and the tax system closer together

Higher earners on Universal Credit feels like an oxymoron, and the initial reaction to finding that higher rate taxpayers are able to claim support is typically negative.

However, once people understand that rents are behind the rising cost of Universal Credit, that it helps families access childcare in order to be able to work, and allows people to keep more of what they earn, they begin to understand that Universal Credit works as it should.

Universal Credit exists to support the vast majority of low income households, whether in or out of work. Only a small fraction - around 3% - of those eligible for Universal Credit will be higher rate taxpayers, and they will only be eligible if they need support towards rent or childcare.

Yet this analysis shows that further reform is needed. We call on the government to ensure people have an adequate safety net, and that the system is progressive and fair to people in work whatever their level of earnings:

- **Invest in out of work support in Universal Credit.** For families with children living in high cost areas, support is clearly inadequate because of the Benefit Cap and the two child limit (which hits families both in and out of work), and because the cost of housing is not fully covered by social security.
- **Remove the savings limit in Universal Credit.** There is no savings limit under Tax Credits or Pension Credit, and savings under Universal Credit are already means-tested by applying a notional income of £4.35 a week for every £250 in savings. Removing the savings limit would bring the needs allowance firmly into the tax system, helping younger families in particular who otherwise feel 'stuck' renting.
- **Ensure effective marginal tax rates are below 80%.** Remove the High Income Child Benefit Charge and the withdrawal of the tax-free personal allowance, to remove couple penalties within the system and ensure effective marginal tax rates are progressive rather than punitive.

People need to be protected from the rising cost of living. Organisations working on the front line see the impact of inadequate levels of support, as households turn to food banks because their housing support doesn't cover their rent, the support for children doesn't cover their children's needs, and their food and energy costs are soaring.

The best solutions would tackle the structural causes for the high cost of Universal Credit, which largely lie outside of the social security system, particularly ill health and the high cost of housing.

However, these will require longer term reforms. In the meantime, the government should invest in Universal Credit to ensure firstly that out of work support is adequate, and tackle unfairness evident in the interaction of the tax and benefit systems.

A package of support that combines in and out of work support, where people see themselves benefiting from social security as well as paying for it, can increase support for social security, tackle inequality, and improve living standards for claimants and non claimants alike.

People and organisations should check eligibility for Universal Credit

This paper was partly inspired by work for clients in the financial services and utilities sectors. They have been surprised at how many of their customers we have been able to help, and by how much. On average, households claiming for the first time gain over £4,000 a year, while existing claimants are typically over £1,500 a year better off.

People should not feel any reluctance to access support. Universal Credit combines in and out of work support, and replaces Tax Credits which were squarely targeted to in work households. If higher earners are able to access Universal Credit, it is because they have high needs. While they get much less support than if their earnings were lower, access to Universal Credit can help tap into additional support, including this year's £900 cost of living payment, free prescriptions, cheaper broadband and social tariffs.

We estimate that around £19bn of social security and other support goes unclaimed each year, typically because people are unaware of their entitlement.

- People can check their eligibility using one of the benefit calculators on GOV.UK. This report shows that households with savings below £16,000 who rent or have children are particularly likely to be eligible.
- Organisations that want to support their customers can integrate assessments for support into their collection and recovery processes, and proactively identify people who are struggling and who could benefit from support.

Policy in Practice runs the Better Off Calculator, one of the benefit calculators on GOV.UK, and helps local authorities and corporate sector clients to identify customers who are struggling, helping them to access support.

As a team of policy experts, we understand that families on the lowest incomes often have the most complicated finances, and waste time because government departments aren't able to talk to each other effectively. Our tools bring these silos together, to make policy simple for people to understand, giving them the clarity and confidence they need to make positive decisions.

Contact us to learn more about our 'passport' service, enabling people on lower incomes to automatically be assessed and apply for unclaimed support.

About Policy in Practice

Families on the lowest incomes have the most complicated finances, often because government departments aren't able to talk to each other effectively.

Policy in Practice sets out to make government policy simple to understand, empowering people with the clarity and confidence they need to make positive decisions. As a team of policy experts, we have developed three core services that overcome departmental silos to help individuals tackle rising living costs and build resilience, enable councils to be proactive and track the impact of their intervention, and improve safeguarding decisions while saving social workers time.

Better Off is used by over 2 million people each year to help advisors assess eligibility for the widest possible range of support without needing to be experts in the benefit system. It is free for individuals and is available for advisors, as an API, and as a self-serve tool for your website.

LIFT (Low Income Family Tracker) is an analytics platform used by over fifty local authorities. It combines your benefits administration data with advanced analytics to identify and support people with low financial resilience by increasing take-up of financial assistance to prevent homelessness, arrears or to increase take-up of support.

MAST (Multi Agency Safeguarding Tracker) is a service backed by the LGA and NHS digital that links data across adult's, children's, fire, police and health on a daily basis. This helps frontline staff to proactively identify where there are multiple contacts with the same individual or family, and make better informed safeguarding decisions.

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BetterOff Calculator

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