

Technical Appendix

Underlying modelling and analysis for each of the policies in the Rates and Wrongs paper.

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1 Free Childcare Hours and Tax-Free Childcare

1.1 Policy Background

Families are currently eligible for free childcare hours mainly through two government schemes: Free Childcare for Working Parents (FCWP) and 15 hours free childcare for 3 and 4-year-olds.

FCWP has, since September 2025, entitled families with children aged between 9 months and four years to 30 hours per week of free childcare. This scheme has a number of requirements but the relevant one for this paper is that both parents of the relevant child must not have an "expected adjustable net income of over £100,000 in the current tax year". This creates a notch in the tax system where households earning just above the threshold can miss out on all of the free childcare hours. The value of these free childcare hours can be large, especially for children aged 2 and under, and those living in London (where the cost of early years is higher). For example, a child born on 1st January 2024 that is growing up in Westminster was entitled to childcare worth approximately £16,480.80 in the year 2025/26.

The other scheme is 15 hours free childcare for 3 and 4-year-olds. This childcare has no restriction based on income so households where parents have incomes over £100k are eligible for these 15 hours. The two schemes cannot be claimed simultaneously so parents eligible for both will only get a maximum of 30 hours per week of childcare for 3 and 4-year-olds.

The childcare entitlement of 30 hours per week is only available for 38 weeks in a year (a total of 1140 hours). The annual hourly entitlement to childcare varies with the date of birth of the child. The hours can only be claimed from the start of three dates: 1st January, 1st April and 1st September. The child must be at least 9 months old on the start date to be eligible for the childcare for that term, creating discontinuities in entitlement based on date of birth.

As can be seen in Table 1, the hourly funding rate varies considerably by the age of the child and the local authority of the providers ¹

¹We discuss this more later but this essentially means that there is a much greater disincentive to supply labour for high earners in the most productive regions of the UK.

Table 1: Maximum Value of Childcare Subsidies by Age and Location

Age of Child	Location	Hourly Funding Rate	Value of Subsidy
Under 2	National Average	£11.54	£13,156
2 years old	National Average	£8.53	£9,724
3 and 4 year olds	National Average	£6.06	£3,454
Under 2	Inner London	£15.95	£18,183
2 years old	Inner London	£11.61	£13,235
3 and 4 year olds	Inner London	£8.07	£4,600

Uses 2025-26 funding rates. Inner London rate is the median for the region.

1.2 Creating a Synthetic Microsimulation

There is not a publicly available dataset with the gross incomes (not adjustable net incomes) of parents of nursery age children and the implicit childcare subsidy they receive. HMT responded to an FOI in November 2025 confirming they do not hold information relating to the number of “parents of children aged between 9 months and 4 years who are impacted by the £100,000 threshold when measured by gross income, rather than adjusted net income.” This is a crucial piece of evidence which is required to fully estimate the fiscal cost of the childcare related cliffs; many parents substantially increase their salary sacrifice pension contributions to ensure that their ANI is below £100k. To demonstrate the strength of this behaviour change, we have created a synthetic dataset that recreates known facts about this group of people to see the effect of the tax cliff and to simulate new policy effects.

1.2.1 The Children

The model uses the forecast number of births for England over the next 10 years and the actual number of births in England over the previous 5 years. The sources for this are the ONS.

The children are then assigned a birthday in each year with the probability of having been born in the UK on any particular day in 2024. This is to ensure that the seasonal variation in births is picked up in the dataset - entitlement to early years can sometimes vary by over £10k depending on the date of birth of the child.

1.2.2 The Parents

The simulation assumes that every child has two parents and no siblings. This is the most conservative way of modelling the fiscal impact of the policy change as multiple children increase the total value of the household's childcare subsidies, increasing the incentive for the family to cut their incomes to under £100k. Likewise, the requirement of two parents means that, where both earn over £100k, it has to be worthwhile for them both to cut their ANI to under £100k, a greater hurdle.

Parents' incomes are assigned using the total incomes in the 2022-23 SPI data where only those aged 25 to 44 are considered and the sex of each of the partners is different (both assumptions can be relaxed). The dataset ensures there is a correlation coefficient between each of the male and female partner's incomes of around 0.5.

The parents are then assigned their child at random.

1.2.3 Inflaters and Childcare Subsidy

The maximum entitled number of childcare hours in each funding age group (under 2, 2 year old and 3 & 4) is modelled for each financial year. The national average funding rate is used to calculate the value of the subsidy in each financial year. Different funding rates are used as a sensitivity test. The average rates for all of London are used as well as just Inner London. Both lead to higher static costs but stronger behavioural change. Up to £2000 is then added to the subsidy to simulate the effect of Tax Free Childcare.

Incomes and the Childcare hours funding are increased in line with the OBR's forecast for average earnings growth. The tax system keeps in line with the Government's current personal taxation plans.

1.3 The Exogenous labour and Endogenous Pension Model

We model the household's response to the tax system as a choice over pension contributions. The agent treats their gross labour income Z as fixed (exogenous labour supply) but chooses the optimal allocation between current consumption (c) and future pension wealth (p) to maximize utility.

1.3.1 Utility Function

We employ a Quasi-Linear utility function. This specification implies that the demand for pension savings is driven by the relative price (tax relief) rather than wealth effects.

$$U(c, p) = c + \gamma Z \ln(p) \quad (1)$$

Where:

- c : Post-tax income
- p : Pension contribution through salary sacrifice
- Z : Gross Income (Exogenous)
- γ : Preference parameter for pension saving (representing the marginal propensity to save).

1.3.2 The Budget Constraint

The household's consumption is determined by the residual income after taxes and pension contributions. The tax function $T(\cdot)$ is non-linear and represents the schedule for an employee without any Student Loans or other marginal taxes (Only Income Tax and Employee National Insurance).

$$c = Z - p - T(Z - p) + B \cdot \mathbb{I}(Z - p \leq K) \quad (2)$$

Where $K = \pounds 100,000$ is the threshold for the childcare benefit withdrawal.

1.3.3 Optimization

Since the marginal tax schedule is piecewise constant (stepped), the optimization problem cannot be solved by a single First Order Condition. Instead, the agent solves for the local optimum within each distinct tax band and then performs a global comparison.

Step A: Interior Solutions (Within Bands)

For any tax band j with a constant marginal tax rate τ_j , the agent maximizes:

$$\max_p [(Z - p)(1 - \tau_j)] + \gamma Z \ln(p) \quad (3)$$

First Order Condition:

$$\frac{\partial U}{\partial p} = -(1 - \tau_j) + \frac{\gamma Z}{p} = 0 \quad (4)$$

This yields the optimal pension contribution conditional on being in tax band j :

$$p_j = \frac{\gamma Z}{1 - \tau_j} \quad (5)$$

Given that gross income is exogenous, the value of p_j which places the agent in the corresponding tax band is chosen. This yields p_{normal} .

Step B: Corner Solutions (Bunching)

The agent also evaluates the specific strategy of bunching exactly at the threshold K to retain the benefit B .

$$p_{bunch} = \max(0, Z - K) \quad (6)$$

In this scenario, consumption is fixed at $c_{bunch} = K - T(K) + B$.

1.3.4 Global Maximization

The agent compares the indirect utility between the two strategies. They only choose to bunch at £100k if the utility from doing so is greater than from the optimal pension saving scenario and a friction value (in our central scenario, that is £1k).

$$p^* = \begin{cases} p_{bunch} & \text{if } U(c(p_{normal}), p_{normal}) + friction < U(c(p_{bunch}), p_{bunch}) \\ p_{normal} & \text{else} \end{cases} \quad (7)$$

Agents only choose to respond if they can secure themselves £1k of extra net income - this compensates for the planning and tax advice which may be required to embark on Salary Sacrifice.

This discrete choice framework naturally generates:

- **Smooth responses:** Agents gradually increasing pensions as γ rises.
- **Clumping:** A mass of agents setting $p = Z - 100,000$ because the utility jump from the benefit B outweighs the liquidity cost of the extra saving.

1.3.5 Calibration of γ

The parameter γ determines the baseline savings rate. A conservative estimate of $\gamma = 0.04$ has been used here. Where $\tau = 0$, workers will naturally save 4% of their income.

1.3.6 Modelling a Taper

Under a taper policy, the binary cliff edge is replaced by a gradual withdrawal rate s (e.g., 3%). Agents decide whether they want to opt-in to the childcare benefits, leading to an indefinite taper above £100k, or to avoid the additional charge. Mechanically, this acts as a surcharge on the marginal tax rate for Adjusted Net Income above K . The effective marginal tax rate τ_{eff} becomes:

$$\tau_{eff} = \begin{cases} \tau_{base} + s & \text{if } K < (Z - p) \\ \tau_{base} & \text{otherwise} \end{cases} \quad (8)$$

The optimization problem remains very similar to Step A (Interior Solutions). The agent calculates the optimal pension p^* using the First Order Condition,

but substituting τ_{eff} for τ_j . They then compare this scenario against one where the original optimal pension provision is used and where no childcare benefit is received. Simply, they compare whether it is worth paying the surtax in order to gain the additional net income from the childcare policy (this is the case for almost all couples where the s value is small. The higher utility alternative is chosen.

Under the Taper, the friction parameter is dropped.

1.3.7 Results

Table 2: Projected Net Fiscal Impact of Childcare Entitlements (£bn): Endogenous Pension, Exogenous Labour

Taper Rate	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32
Abolish Cliff	0.070	0.077	0.091	0.132	0.147	0.172
1%	0.106	0.120	0.136	0.224	0.247	0.282
2%	0.150	0.169	0.187	0.282	0.310	0.352
3%	0.189	0.212	0.232	0.333	0.365	0.412
4%	0.223	0.247	0.271	0.375	0.413	0.465
5%	0.253	0.279	0.305	0.413	0.454	0.512

This assumes full utilisation of FCWP and £500 utilisation of TFC. It also assumes a friction parameter of £1000.

1.4 Endogenous Labour Supply and No Pension Model

We model the household’s response to the tax system as a discrete choice over labour. The agent no longer optimizes their pension contributions (which are now treated as exogenous or zero); instead, they can choose to reduce their labour supply in response to the tax cliff edge; they choose $h \in \{1, 0.9, 0.8, 0.7, \dots\}$ to maximize utility.

1.4.1 Utility Function

We employ a Quasi-Linear utility function with iso-elastic labour supply. This specification eliminates income effects on labour supply, isolating the substitution effects driven by the tax notch.

$$U(c, h) = c - \frac{\alpha}{1 + \frac{1}{\epsilon}} h^{1 + \frac{1}{\epsilon}} \quad (9)$$

Where:

- c : Net consumption.

- h : Labour hours (normalized such that $h = 1$ represents status quo full-time work).
- Z_{pot} : Potential Earnings Capacity (Exogenous scalar).
- α : Disutility of labour parameter (calibrated individually).
- ε : Frisch elasticity of labour supply.

1.4.2 The Budget Constraint

The household faces a budget constraint defined by the tax function $T(\cdot)$ and the conditional Child Benefit B . The benefit is withdrawn if "Adjusted Net Income" (ANI) exceeds the threshold $K = \text{£}100,000$.

$$c = w \cdot h - T(w \cdot h) + B \cdot \mathbb{I}(w \cdot h \leq K) \quad (10)$$

This creates a non-convex budget set. To solve the optimization problem, we evaluate two distinct regimes for each household and select the global maximum.

1.4.3 Calibration of α

To ensure the model reproduces the status quo distribution, we calibrate α_i for each individual i such that their observed choice ($h_i = 1$) is optimal under the current tax system.

Using the inverse of the labour FOC:

$$\alpha_i = w_i(1 - \tau_i) \quad (11)$$

This ensures that any deviation from the status quo in our counterfactual simulations is driven purely by changes in the tax incentives τ or the benefit rules B .

1.4.4 Optimisation

We find the maximum h that only just brings total income below $\text{£}100\text{k}$.

$$h_{bunch} = \max h \mid h \cdot Z \leq 100,000 \quad (12)$$

1.4.5 Global Maximization

This is very similar to the previous model. The agent compares the indirect utility between the scenario where $h = 1$ and $h = h_{bunch}$. They only choose to bunch at $\text{£}100\text{k}$ if the utility from doing so is greater than from the normal income (with its associated disutility) and a friction value (in our central scenario, that is $\text{£}1\text{k}$).

1.4.6 Results

Table 3: Projected Net Fiscal Impact of Childcare Entitlements (£bn): Endogenous Labour, No Pension

Taper Rate	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32
Abolish Cliff	0.330	0.349	0.399	0.427	0.462	0.507
1%	0.398	0.427	0.483	0.518	0.560	0.615
2%	0.472	0.508	0.569	0.611	0.662	0.726
3%	0.537	0.580	0.646	0.694	0.752	0.825
4%	0.595	0.643	0.715	0.767	0.832	0.912
5%	0.647	0.700	0.775	0.833	0.903	0.99

This assumes full utilisation of FCWP and £500 utilisation of TFC. It also assumes a friction parameter of £1000 and Frisch elasticity of 0.3.

2 Personal Allowance Withdrawal

The withdrawal of the Personal Allowance causes substantial bunching at the £100k kink in the tax system. For an employee, the marginal tax rate increases from 42% to 62% at this point, disincentivizing work at or around this threshold. There are approximately 20% more people with incomes bunched around the threshold than would be expected if the density of income remained smooth at the kink. This causes significant distortions in labour supply and tax revenue.

This issue is further exacerbated for individuals with undergraduate and post-graduate student loans, where the effective marginal tax rate can be 15 percentage points higher. The 62% tax rate caused by the withdrawal of the Personal Allowance generally ends at £125,140, where the marginal rate drops to 47%.

We simulate the fiscal effects of various policies intended to mitigate the impact of this sharp kink in the tax system while also reducing the peak effective marginal tax rate.

2.1 How much bunching?

We use the Survey of Personal Incomes: Public Use Tape 2022-23 to conduct a bunching analysis of the change in the marginal tax rate at the £100k kink.

This paper estimates the average compensated elasticity of taxable income with respect to marginal tax rates, following the methodology of Saez (2010). Estimating the average elasticity is necessary for two reasons. First, agents possess heterogeneous elasticities, meaning some are more responsive to tax schedule kinks than others. This heterogeneity is essential to explain why bunching occurs at specific thresholds while some density remains just above the kink.

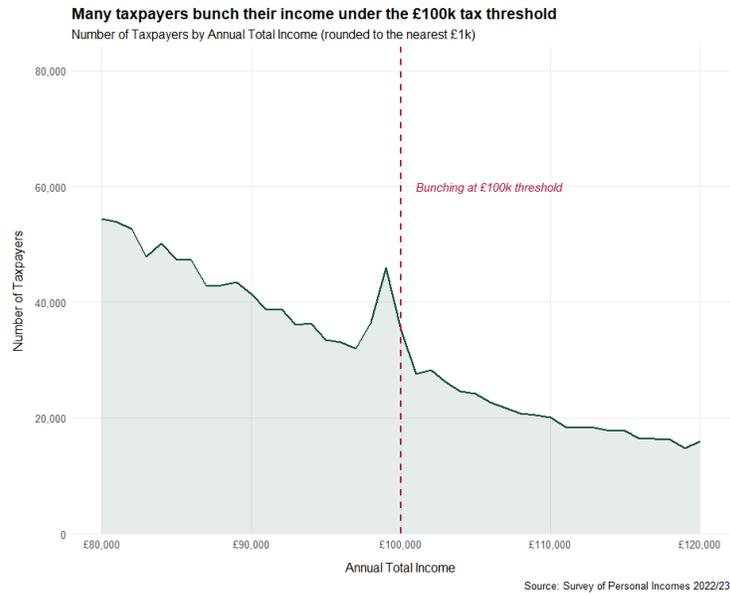


Figure 1: Bunching of income at £100k in the SPI

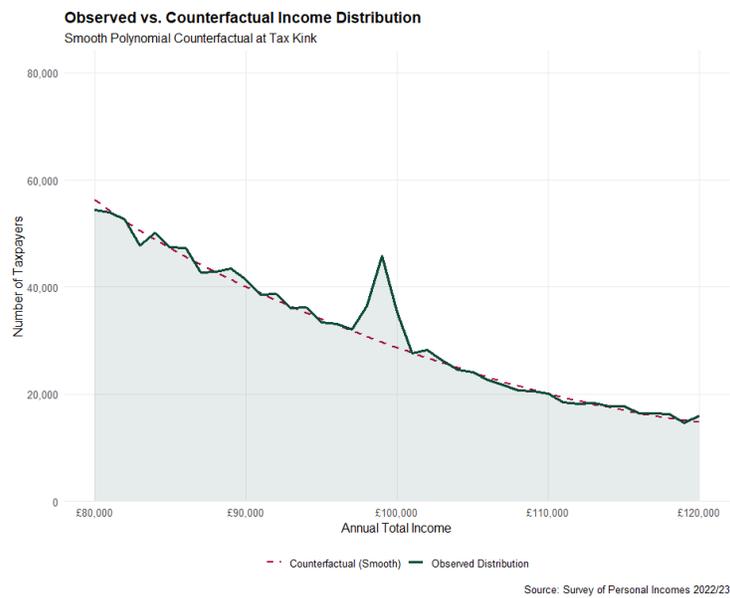


Figure 2: Smooth counterfactual at £100k tax kink

Second, agents face optimisation frictions in the short run; consequently, elasticity is expected to be higher in the long term as employees renegotiate contracts and seek roles that align with their optimal labour-leisure bundle.

We group observations from the SPI into £1,000-wide bins based on the Total Income variable. A flexible local counterfactual is generated (see Figure 2), which estimates the counterfactual distribution of income in the absence of the £100k kink. This allows for the calculation of the excess mass (b) at the kink (z^*).

$$B = \sum_{j=z^*-\text{window}}^{z^*+\text{window}} (\text{actual_count}_j - \text{predicted_count}_j) \quad (13)$$

The window on either side of the kink is varied as a sensitivity measure. Because agents generally undershoot the threshold, slightly wider windows are necessary to capture the full effect. The normalised excess mass (b) is then calculated; this represents the excess number of individuals scaled by the counterfactual density at the threshold z^* .

$$b = \frac{B}{\hat{h}(z^*)} \quad (14)$$

This is then used to calculate the average compensated elasticity (\bar{e}).

$$\bar{e} = \frac{b}{z^* \cdot \frac{dt}{1-t}} = \frac{b}{\pounds 100k \cdot \frac{0.62-0.42}{1-0.42}} \quad (15)$$

Estimates for the average compensated elasticity across different window specifications are presented in Table 4. The elasticity estimate generally stabilizes when the excluded window is set at or above £2,000; consequently, an elasticity of 0.052 is used for the modeling in the subsequent section.

Table 4: Sensitivity of Elasticity Estimates to Estimation Window

Window	£0	£1,000	£2,000	£3,000	£4,000
Excess Mass (B)	6,591	22,630	29,794	30,411	30,185
Elasticity (\bar{e})	0.008	0.036	0.052	0.053	0.052

2.2 Policies to Model

This paper models the fiscal impact of six policy scenarios designed to address the £100,000 tax kink. The first scenario eliminates the withdrawal of the Personal Allowance, reducing the marginal tax rate for employees earning between £100,000 and £125,140 from 62% to 42%. The second scenario removes the Personal Allowance withdrawal while simultaneously lowering the Additional

Rate threshold to £100,000.

The remaining four policies target a peak marginal rate between 50% and 55%, extending this rate until an individual’s net income is equalized under both the current and proposed systems. As this calculation often results in non-standard threshold figures, the new Additional Rate thresholds are rounded to the nearest £5,000. Consequently, very high earners are left marginally worse off (by less than £250 in net income) without a change to their marginal tax rate. A summary of these scenarios is provided in Table 5.

Table 5: Summary of Policy Scenarios: Personal Allowance (PA) and Additional Rate Adjustments

Policy Scenario	Marginal Rate at £100k	Additional Rate Threshold	Change in Net Income*
Current System	62%	£125,140	–
End PA Withdrawal	42%	£125,140	+£5,028
End PA Withdrawal + Lower Threshold	47%	£100,000	+£3,771
Spread PA (Peak 50%)	50%	£230,000	-£129
Spread PA (Peak 52%)	52%	£180,000	-£229
Spread PA (Peak 54%)	54%	£155,000	-£79
Spread PA (Peak 55%)	55%	£150,000	-£229

**For taxpayers earning above the Additional Rate threshold.*

A significant drawback of policies that merely remove the Personal Allowance (PA) withdrawal is that they provide a windfall transfer of several thousand pounds to every taxpayer earning above £125,140. Because these individuals already face the higher marginal rate, the policy does not reduce their marginal tax rate and thus fails to induce an increase in labour supply. As demonstrated in the following sections, these ”clean-up” policies are considerably more expensive than the rate-spreading options, which redistribute the tax burden more efficiently.

2.3 Modelling the Policies

2.3.1 Static Response

The initial modeling stage calculates the static fiscal impact of each policy. The primary data source is the Survey of Personal Incomes (SPI) Public Use Tape

2022/23. Each observation’s total income is updated using the average earnings growth forecasts from the most recent OBR Economic and Fiscal Outlook. For simplicity, all income is treated as employment income.²

The proposed tax regimes are applied to each observation’s total income, and the static fiscal impact is calculated at the individual level. These results are then aggregated into nationally representative figures using the SPI grossing factors (FACT). The outcomes of this exercise are presented in Table 6.

Table 6: Projected Annual Fiscal Impact by Policy (£bn): Static Response

Policy	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32
End PA Withdrawal	-7.90	-8.27	-8.69	-9.16	-9.73	-10.41
End PA Withdrawal + Lower Threshold	-5.93	-6.20	-6.52	-6.87	-7.30	-7.81
Spread PA (Peak at 50%)	-2.63	-2.76	-2.91	-3.08	-3.28	-3.51
Spread PA (Peak at 52%)	-1.60	-1.69	-1.79	-1.90	-2.02	-2.16
Spread PA (Peak at 54%)	-1.10	-1.16	-1.23	-1.30	-1.38	-1.47
Spread PA (Peak at 55%)	-0.74	-0.78	-0.84	-0.89	-0.93	-0.99

2.3.2 Labour Response

The behavioral impact is modeled using a methodology similar to the static analysis. However, each observation’s income now adjusts endogenously in response to changes in the marginal tax rate. The income response to an adjustment in the marginal tax rate is defined by the following equation:

$$\Delta z = -e \cdot z \cdot \frac{dt}{1-t} \quad (16)$$

This equation is used to determine the post-reform income for each agent. While the elasticity derived from the bunching analysis is used initially, we allow this value to scale upward to a maximum of 0.15 as optimization frictions dissipate over time. The relevant tax schedules are then applied to these adjusted incomes

²While this assumption overlooks the differing tax treatments of investment or dividend income, the analysis focuses on the marginal changes in fiscal revenue resulting from these policies. These relative shifts are unlikely to be as significantly affected by this assumption as the absolute revenue totals.

to compute the behavioral fiscal impact of each policy. The results of this simulation are presented in Table 7.

Table 7: Projected Annual Fiscal Impact by Policy (£bn): Labour Response Adjusted

Policy	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32
End PA Withdrawal	-7.30	-7.01	-6.70	-6.50	-6.32	-6.78
End PA Withdrawal + Lower Threshold	-5.42	-5.15	-4.87	-4.67	-4.49	-4.82
Spread PA (Peak at 50%)	-2.32	-2.12	-1.91	-1.78	-1.62	-1.76
Spread PA (Peak at 52%)	-1.37	-1.21	-1.03	-0.94	-0.81	-0.89
Spread PA (Peak at 54%)	-0.92	-0.78	-0.64	-0.59	-0.48	-0.53
Spread PA (Peak at 55%)	-0.62	-0.55	-0.47	-0.49	-0.44	-0.49

2.3.3 Pension Response

The modeling thus far has focused on the labour supply response. However, high earners frequently mitigate their tax liability through increased pension savings; specifically, many within the 62% band utilize salary sacrifice. As salary sacrifice arrangements are not captured in the Survey of Personal Incomes, a theoretical model is employed to simulate this effect. Following the methodology used in the childcare section of this paper, we estimate the change in taxable income resulting from shifting marginal tax rates.

The results of this analysis, combined with the labour supply response, are presented in Table 8.

Table 8: Projected Annual Fiscal Impact by Policy (£bn): Labour and Pension Response Adjusted

Policy	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32
End PA Withdrawal	-4.71	-4.34	-3.95	-3.64	-3.37	-3.67
End PA Withdrawal + Lower Threshold	-3.39	-3.08	-2.75	-2.48	-2.24	-2.44
Spread PA (Peak at 50%)	-1.21	-1.01	-0.79	-0.65	-0.49	-0.58
Spread PA (Peak at 52%)	-0.60	-0.46	-0.29	-0.21	-0.09	-0.15
Spread PA (Peak at 54%)	-0.34	-0.24	-0.12	-0.09	-0.03	-0.07
Spread PA (Peak at 55%)	-0.20	-0.16	-0.11	-0.14	-0.16	-0.22

3 Higher Income Child Benefit Charge

This is modelled in a similar fashion to Section 1. We outline the differences below.

3.1 The Synthetic dataset

The main difference is that the value of the child benefit for a couple is determined by the number of children in each household. The number of children is assigned at random following the distribution of children in the population.

3.2 The Policy

HICBC is currently levied on the highest earning parent in a household where between £60k and £80k of the highest earning parent’s income, in adjusted net income, they repay all of their Child Benefit.

3.3 The Model

3.3.1 Static Model

In this model, the policy for this area is computed with no behavioural response. The policy that is modelled is to double the repayment window from £60k-£80k to £60k-£100k and halve the taper rate of the HICBC. This policy is both simple and reduces the number of individuals paying very high marginal tax rates. The number of individuals paying an effective marginal tax rate of over 50% as a

Table 9: High Income Child Benefit Charge (HICBC) Taper Rates

Number of Children	Child Benefit Amount (£)	HICBC Taper Rate	Proposed Taper Rate
1	£1,354.60	6.8%	3.4%
2	£2,251.60	11.3%	5.6%
3	£3,148.60	15.7%	7.9%
4	£4,045.60	20.2%	10.1%
5	£4,942.60	24.7%	12.4%
6	£5,839.60	29.2%	14.6%
7	£6,736.60	33.7%	16.8%
8	£7,633.60	38.2%	19.1%
9	£8,530.60	42.7%	21.3%
10	£9,427.60	47.1%	23.6%

Note: The 'Spread' scenario assumes the withdrawal is conducted over a wider income band (e.g., £100k–£200k), effectively halving the marginal rate impact for families.

result of HICBC in 2029/30, is reduced by over 70%. The number at an effective marginal rate of over 60% is reduced by over 80%. It is still possible to face very high marginal tax rates under this policy but that is concentrated in the small proportion of the population who have a very high number of children. For example, an employee with 10 children in 2026/27 would face an effective marginal tax rate of 66% compared to 90% under the current system.

3.3.2 Labour Response

In this model, estimates of the average taxable elasticity of income from Section 2 of this paper are used to change the incomes of the highest earning individual in the household. These can both increase or decrease in response to their change in marginal tax rate (parents earning between £80k and £100k will see their marginal tax rate increase).

3.3.3 Pension Response

In this model, the previous labour adjustments are still used. There are also salary sacrifice pension contribution adjustments made in response to a change in the effective marginal tax rate. This is done in the same way as Section 1 and 2.

3.4 Results

Table 10: Projected Net Fiscal Impact of Spreading the HICBC (£bn)

Model	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32
Static	-0.264	-0.280	-0.298	-0.319	-0.345	-0.376
Behavioural (Labour Response)	-0.215	-0.172	-0.125	-0.124	-0.122	-0.120
Behavioural (Labour + Pension)	-0.064	-0.062	-0.059	-0.050	-0.043	-0.033

Assumes full uptake of Child Benefit

4 The Carer’s Allowance

4.1 Policy Background

Households where one individual spends over 35 hours per week providing unpaid care to another individual may be eligible for Carer’s Allowance. This is a benefit paid to the provider of the unpaid care worth around £4,300 in 2025/26. Whilst there are various eligibility criteria, the relevant one for this paper is that net earnings (after Income Tax, National Insurance and care related expenses) must be less than £196 a week (around £10k a year). If a claimant’s earnings rise over this income threshold, they become ineligible for the benefit in its entirety, presenting a substantial notch in the tax system. Besides being economically damaging to have such a harsh threshold, it is profoundly unfair to one of the most vulnerable and deserving groups in society.

Carer’s Allowance (CA) and Universal Credit (UC) interact. UC payments are reduced by the same amount as the individual’s Carer’s Allowance award. This means that individuals in receipt of UC payments greater than their CA payments are not subject to this earnings-related tax notch. Instead, their payments are tapered away at the 55% UC taper. However, the large number of claimants with small UC awards or who are not in receipt of Universal Credit are subject to this harsh cliff.

This section models the static cost of introducing a either a 55% or 25% taper to Carer’s Allowance.

4.2 Data & Modelling

This modelling uses an entirely different dataset to before: the Family Resources Survey 2022-23.

In the dataset, we are able to identify which individuals care for people for over the necessary 35 hours per week. We then see whether the Carer receives Carer’s Allowance and Universal Credit (and how much). We also see their net income.³

We compute the weighted take-up rate for Carer’s Allowance conditional on the individual providing enough unpaid care (according to the Family Resource Survey) and find the individuals who could theoretically gain under the taper. For example, with a 55% taper, someone earning £200 per week should expect to get a net fiscal gain of £81.10.

Only some of these theoretically eligible people will eventually claim Carer’s Allowance. A Monte Carlo simulation selects which of the theoretically eligible will actually go on to claim CA under the new system. The Net Fiscal Transfers per household are then scaled to be nationally representative using the survey weights.

The FRS has very few observations of individuals who would gain under this policy due to the limited size of the overall survey. The Monte Carlo simulation computes this assignment of CA 1000 times to find an approximate distribution. In general, this model suggests that a taper of this kind would cost £100m. However, it must be noted that this estimate is highly uncertain.

4.3 Results

Table 11: Projected Net Fiscal Impact of introducing a Carer’s Allowance Taper (£bn)

Taper Rate	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32
55%	-0.095	-0.097	-0.098	-0.101	-0.100	-0.108
25%	-0.256	-0.261	-0.265	-0.277	-0.279	-0.293

³The `netearn` variable does not deduct care related expenses from the Carer’s net income. This is a little imprecise and does lead to a small number of observations where recipients have incomes higher than the average