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Answers

Exam-style questions

Questions on income tax

David Horner

This resource provides answers to the questions posed in the Exam-Style Questions column, in the November 2024 issue of ECONOMIC REVIEW.

Question 1

Using Table 1, calculate the amount of income tax paid by someone in England earning £37,500 in 2024. Give your answer to the nearest pound. (2 marks)

Answer

$$£37,500 - £12,570 = £24,930$$

$$£24,930 \times 0.20 = £4,986$$

$$\text{Answer} = £4,986$$

- 1 mark for correct answer not rounded to 2dp (e.g. £4,985.80 if student has calculated $£37,500 - £12,571 \times 0.20$).
- 1 mark for correct method but incorrect final answer.

Question 2

Explain how the data in Table 2 show that the UK's public finances may have improved since 2020. (4 marks)

Answer

Relevant points include:

- Tax receipts increased from 2020/21 to 2023/24, from £584bn to £828bn, so government income rose over the period.
- Government spending fell (slightly) from 2020/21 to 2023/24, from £1172bn to £1142bn, so government outflows fell over the period.
- The difference between tax receipts and government spending fell over the period, from (-) £588bn to (-) £314bn, showing a reduction in the annual budget deficit.
- Tax receipts grew by a greater percentage (41.8%) than government spending (-2.6%) over the period.

Question 3

With the help of a diagram, explain why an increase in income tax may not increase the government's tax revenue. (9 marks)

Answer

- Definitions, e.g. of income tax, direct tax, tax revenue, fiscal policy.
- Reasons why income tax rises may reduce tax revenue, e.g. reduced incentive to work as income tax begins to take a higher percentage of income; increased incidence of tax avoidance/evasion; increased movement of workers overseas ('brain drain').
- Reference to data in Tables 1 and 2.
- Use of relevant diagram(s), e.g. Laffer curve, AD/AS diagram.

Question 4

Evaluate the view that the government should reduce income tax in the UK. (25 marks)

Answer

Possible issues to include:

- Understanding of income tax, direct taxation, progressive tax, fiscal policy, supply-side economics.
- Reference to Tables 1 and 2.
- Knowledge of UK tax system.

Arguments for reducing income tax:

- Increase in real disposable incomes, therefore increasing average living standards.
- Short run economic growth.
- Positive multiplier effects.
- May increase government tax revenue (Laffer curve).
- May increase incentives to work, reducing unemployment.
- Supply-side improvements and links to UK productivity.
- May attract foreign investment.

Arguments against reducing income tax:

- May stoke demand-pull inflation, increasing cost of living and worsening living standards.
- May reduce government tax revenue (Laffer curve).
- May limit ability of government to provide important services in the future.
- Current state of public finances.