Saving penalties

Reforming the capital rules in Universal Credit

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Summary

Means-tested benefits in Britain are built on the principle that individuals with significant financial resources should use those before turning to the state for help. That's why wealth – as well as income – is assessed when determining eligibility and entitlement levels for means-tested support. Few would argue that demonstrably rich people should receive equal support from the state than those with less resources to draw on. But although income means-testing has been widely studied and debated, capital means-testing has received far less attention. With the current capital thresholds in Universal Credit (UC) currently under review – after being neglected for nearly 20 years – now is the time to assess whether these rules are fit for purpose. In this paper, we look at how capital rules affect UC recipients, where the system is falling short, and what could be done to improve it.

In the UC system, the first £6,000 of a family's wealth is 'disregarded' – effectively the base level of wealth that the Government judges should not be touched. But between £6,000.01 and £16,000 wealth is subject to a 'tariff income' charge of £4.35 per month for every £250 held, which is added to the family's actual income to work out their UC entitlement. This gets around the difficulty of measuring income from capital – which is often paid annually – on a monthly basis. Families with savings exceeding £16,000 are subject to a sharp cliff edge and become ineligible for UC altogether. The rules apply to all recipients of UC, regardless of their circumstances, but certain forms of capital are exempt, most notably primary residences and pension pots.

Although we do know how many families affected by the capital rules would claim benefits otherwise, it is clear the rules are reducing or eliminating entitlement for many. We estimate that 2 million families who would have been eligible for Universal Credit on the basis of income in 2020-22 have reduced entitlement because of the capital rules (20 per cent of the 10 million working-age families who had sufficiently low income to qualify for UC support). Among them are around 830,000 families who would face a partial reduction and around 1.2 million families who would lose their entitlement entirely. There are undoubtedly some very wealthy families in this group: 12 per cent (240,000 families) had capital between £50,000.01 and £100,000 (excluding property they live in and pension pots), and 16 per cent (315,000 families) held over £100,000. But nearly half (47 per cent) had relatively modest capital of £16,000 or less.

So, many families are affected by the capital rules, with widely varying circumstances. This raises important questions about their effectiveness and fairness. Our analysis shows there are three shortcomings in the way the current system operates.

First, the capital limits undermine other government policies. This is particularly true in the case of Help to Save, a scheme designed to promote saving among UC recipients, but which is counted as capital for the purpose of determining entitlement, making it difficult for some to build up their savings. Likewise, Lifetime ISAs (LISAs), are designed to promote long-term – rather than precautionary – saving. It seems contradictory to expect people to run them down before being eligible for benefit support, not least because there are strict penalties to withdrawing savings. To address these inconsistencies, savings in Help to Save accounts and LISAs should be disregarded from the capital rules.

Second, the freezing of the capital thresholds at £6,000 and £16,000 since 2006 means many more recipients now face reduced or lost entitlements. In 2006-08, 35 per cent of working-age families in the UK had savings above £6,000, and 23 per cent exceeded £16,000. By 2020-22, these figures had risen to 45 per cent and 32 per cent. Had the thresholds risen with inflation, they would now be over £10,000 and £27,000, respectively. Ultimately, freezing them means successive governments have sidestepped the political decision of where the limits should fall while presiding over a system that excludes increasing numbers of families based on their capital.

There is no clear rationale for the current level of the thresholds, so restoring their real 2006 value – at an estimated cost of £800 million – is far from a 'no brainer', not least because of bigger priorities for resources within the benefit system. However, it is clearly unsustainable to keep the thresholds frozen indefinitely, and there is some evidence that the current thresholds are impacting families who are struggling financially: 32 per cent of those who lose some UC entitlement and 29 per cent of those who lose all their UC entitlement due to the capital rules report they struggle to keep up with financial commitments at least some of the time, compared to just 18 per cent of families who are not entitled to UC based on their income. We therefore recommend that the Government commits to indexing the thresholds with inflation, starting in April 2026. Assuming an overall UC take up rate of 80 per cent, we estimate that this would cost £135 million in 2029-30.

And third, the capital rules in UC potentially discourage low-income individuals from saving, reducing their financial resilience. The 'cliff edge' at £16,000 creates a very strong disincentive to save, particularly for those whose savings approach the threshold; a family with £16,000 in savings may still qualify for some UC but saving just one penny more would result in losing their entire entitlement. And survey evidence shows some evidence of the capital rules influencing saving behaviour. In the two years leading up to March 2023, 7 per cent of UC recipients reported that they avoided saving due to the risk of losing benefits, with this figure at 12 per cent among those that said they could afford to save.

The Government should look at the cliff edge at £16,000 as part of its upcoming review of UC. Families losing all their UC entitlement due to an extra penny of savings is incompatible with the aim of UC to eliminate similar effects in the income tests of legacy benefits. The system would be fairer if the upper threshold were removed and entitlement tapered using tariff income, as is the case in Pension Credit, for example. We estimate this change would cost £900 million and extend UC entitlement to 270,000 families. But this reform must be considered alongside other challenges in the system – most obviously the two-child limit – but also the benefit cap and frozen housing support. Abolishing the upper capital limit should not be seen as an immediate priority, but this reform would be a necessary step toward fully realising UC's original vision of a system free from cliff edges, poverty traps, and perverse incentives.

Overall, targeted reforms to the capital rules – such as exempting savings in Help to Save accounts and LISAs – should provide more flexibility for low-to-middle income families in building meaningful financial resilience, both for unexpected income shocks and long-term goals like home ownership or retirement. For example, a family with two adults fully utilising their Help to Save accounts could save up to £13,200 – £6,000 within the disregarded threshold plus £7,200 in Help to Save – without losing any UC entitlement. And exempting LISAs would provide even greater scope for building long-term savings. Indexing the capital thresholds from 2026-27 would help maintain fairness over time, preventing the system from becoming punitive toward those with modest savings. The Government should also consider more ambitious changes – such as abolishing the £16,000 upper limit altogether. Doing so would further improve the system, but they must be balanced against other policies that would be more effective in bringing down poverty.

It's high time we revisited the long-neglected capital rules in the benefit system

Means-tested benefits in Britain are built on the principle that individuals with significant financial resources should use those before receiving state support. That's why wealth – as well as income – is assessed when determining eligibility and entitlement levels for means-tested support. Few would argue that people with substantial resources are in equal need of public support as those without.

While income means-testing has been widely studied and debated, capital means-testing has received far less attention. This is an oversight, not least because wealth plays a critical role in living standards.[1] And despite rising asset values, capital thresholds have remained unchanged in cash terms since 2006. With the Government now reviewing Universal Credit (UC), now is the time to assess if the current rules are fit for purpose.

In this paper we take a deep dive into how the capital rules operate, focusing on means-tested support for working-age families, particularly within UC, the main working-age benefit. We examine who they affect and whether the current system is delivering fairness and efficiency. We then explore the shortcomings of the current approach and propose options for reform.

BOX 1: **The current capital rules can be traced back to the post-war development of the welfare state**

Following the Second World War, The National Assistance Act of 1948 created a comprehensive, nationwide safety net for the first time. The original promise, outlined by the landmark Beveridge Report of 1942, was a freedom from want, with contributory payments providing universal benefits that covered unemployment, sickness, and retirement, with extra support through family allowances. The expectation was that means-testing would play a limited role in the social security system, with the vast majority covered by flat rate national insurance contributions.[2] However, the contributory system often provided insufficient support, necessitating means-tested top-ups, which included capital assessments.[3]

Initially, capital limits were generous – set at £375 for National Assistance (equivalent to nearly £12,900 in 2025-26)

1 S Marchal et al, Singling out the truly needy: the role of asset testing in European minimum income schemes, Institute for Social and Economic Research (ISER), University of Essex, April 2020.
2 N Crafts, The welfare state and inequality: were the UK reforms of the 1940s a success?, IFS Deaton Review of Inequalities, February 2023.
3 A Deacon, An End to the Means Test? Social Security and the Attlee Government, Journal of Social Policy, 1982.

and applied to individuals rather than families.[4] Reforms in 1966 and 1988 changed the shape of the capital rules to resemble those used in UC today, including disregards, upper limits, tariff income assumptions, and penalties for deliberate capital deprivation.[5] Over time, the erosion of contributory benefits expanded means-testing, subjecting more households to capital limits.[6]

The New Labour Government departed from capital assessments in favour of taking into account the actual income from capital when it introduced tax credits (with a £300 per year disregard of income from savings, investments, pensions, property, or foreign income).[7] This allowed many working families and families with children to receive means-tested support despite significant savings. This came to end when tax credits were rolled into UC, which mirrored the capital rules in Income Support and Jobseeker's Allowance for all recipients.

Capital rules are complex and create a 'cliff edge' within the system

For the purposes of UC, the first £6,000 of a family's capital is disregarded. Recipients with capital exceeding £16,000 are ineligible. Any savings between £6,000.01 and £16,000 are subject to a 'tariff income' of £4.35 per month for every £250 of capital – this amount is treated as 'unearned income' and reduces a family's UC entitlement by £1 for every £1 of tariff income.[8] For example, a family with savings of £14,500 has £8,500 over the limit of £6,000, meaning their UC entitlement is reduced by £147.90 per month.[9]

The tariff income used in UC sidesteps the difficulty of measuring monthly income from capital. This is important because UC's monthly income assessment would give very uneven results if capital income were included as, in many cases, this is received annually (for example interest on many types of savings products). So, basing means-testing on families' stock of capital has some benefits. But the formula for calculating tariff income in UC implies a 21 per cent annual return above £6,000 – far higher than most people receive in practice.

4 More precisely, the smaller of the two following amounts were disregarded: the aggregate of any war savings in question, or £375. For more information see: HM Government, National Assistance Act 1948.

5 HM Government, Ministry of Social Security Act 1966; HM Government, The Income Support (General) Regulations 1987. Disregards are the amount of capital that is ignored, so does not affect the amount of benefits a recipient gets. Upper limits are the maximum amount of capital a family can have and still get the benefit. Tariff income is the amount that is assumed to be the claimant's income from their capital, regardless of how much income they actually receive. This reduces the amount of means-tested benefit they can get. Deliberate capital deprivation is when someone deliberately deprives themselves of capital in order to increase the amount of benefit they can get or to become entitled to a benefit. If the DWP decide this has occurred, they can be found to have 'notional capital'. This can reduce their entitlement to a benefit in the same way as actual capital. There are complex rules for how this notional capital reduces over time.

6 J Hills, Inclusion or Insurance? National Insurance and the future of the contributory Principle, CASEpaper 68, Centre for Analysis of Social Exclusion London School of Economics, May 2003.

7 HM Treasury, The Modernisation of Britain's Tax and Benefit System Number Four - Tackling Poverty and Extending Opportunity, 1999; HM Government, Tax Credits (Definition and Calculation of Income) Regulations 2002.

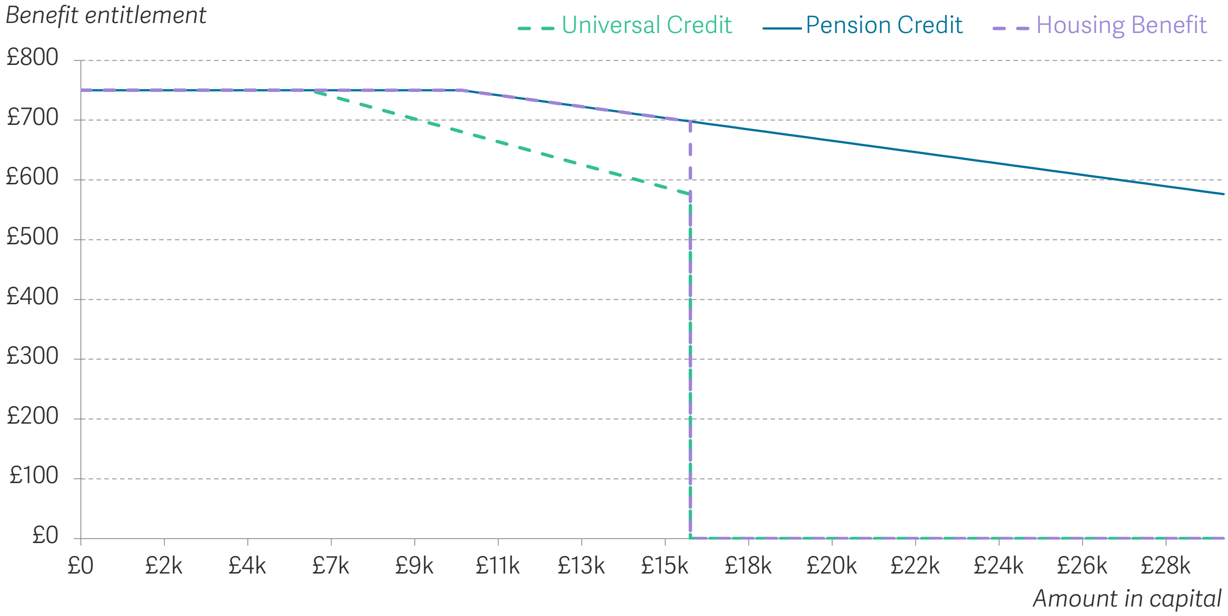
8 Meaning 55p of UC entitlement is withdrawn for every £1 of tariff income.

9 Department for Work and Pensions, Universal Credit: money, savings and investments.

Capital rules also apply to other means-tested forms of support, most obviously Pension Credit and Housing Benefit for pensioners.[10] Figure 1 shows that the capital rules within pensioner benefits are more generous: for Pension Credit recipients, the first £10,000 of capital is ignored, the tariff income for capital above £10,000 is calculated at £1 per week for every £500 (so at half the rate used in UC), and there is no upper limit. Housing Benefit for pensioners follows the same rules as Pension Credit but has an upper capital limit of £16,000.

FIGURE 1: **UC entitlement is subject to a sharp cliff edge**

Illustration of the impact of the capital rules for UC, Pension Credit and Housing Benefit for an entitlement of £750 a month



SOURCE: RF analysis.

For the purposes of means-testing, 'capital' includes savings, investments, and property. Some types of capital are excluded (or 'disregarded'), such as:

- Property that is used as the recipient's primary residence, or is occupied by a close relative of the recipient who is over State Pension age or has limited capability work, or a former partner that is a single parent;[11]
- Personal possessions;
- Personal pension schemes;[12]

10 There are also capital rules in the default Council Tax Reduction schemes mirroring those in Universal Credit for working-age families and Housing Benefit for pensioners.

11 Property that is lived in by a former partner who is not a single parent is disregarded for 6 months.

12 For recipients over 55, pension withdrawals can impact UC entitlement. Lump sum withdrawals from pension drawdown products are treated as capital for the purposes of means-testing. For those saving into a pension, if a recipient puts capital into their pension scheme this is classed as deprivation of capital and the recipient is treated as still having that capital for a period of time.

- Business assets if the recipient continues to work in that business;
- Personal injury payments and special compensation schemes;[13]
- Funeral plan payments; and,
- Social services and community care payments.

These disregarded items represent forms of capital the Government would not expect a family to run down before claiming benefits.

There are also relatively complex rules around the pace at which existing capital can be run down (so-called 'deprivation' of capital). These rules attempt to define instances in which someone is deemed to have deliberately reduced or given away their savings in order to qualify for, or increase, their UC entitlement. If the Department for Work and Pensions (DWP) decides this has happened, then claimants are treated as still having the assets – known as 'notional capital'.

This notional capital is treated like actual capital; if it is above the capital limits the claimant is not entitled to the benefit, if it is below the capital limit the claimant is assumed to get 'notional income' from the capital. And there are complex rules for how notional capital reduces over time. If the notional amount is higher than £16,000 the notional capital is reduced each month by the amount of UC they would have received without including the notional capital in the calculation; if it is between £6,000 and £16,000, it reduces each month by the amount of tariff income it is calculated as yielding.[14] This means a claimant can be left with no income or capital for a period if they are found to have deliberately deprived themselves of savings.

Using savings to pay off debts or buy 'reasonable' goods and services is generally permitted, but the lack of a clear list of allowable expenses creates uncertainty for UC recipients. Furthermore, deprivation of capital can apply to capital that was received before someone is claiming benefits meaning that there is no 'safe' period in which future recipients can spend their capital without being captured by this rule.

13 Payments from the following special compensation schemes are not counted as money, savings or investments: Child Migrants Trust scheme for former British child migrants; Grenfell Tower fire; Horizon IT system or Bates and Others v Post Office Ltd from the Post Office or secretary of state Imprisonment; forced labour, injury, property loss, or loss of a child during World War II; infected blood compensation schemes; Institutional Child Abuse in the UK; LGBT Financial Recognition Scheme; London Bombings on 7 July 2005; Manchester Bombing on 22 May 2017; National Emergencies Trust; terrorist attacks in London on 22 March 2017 or 3 June 2017; Vaccine Damage Payment Scheme; variant Creutzfeldt-Jacob Disease (vCJD) diagnosis; Victims of Overseas Terrorism Compensation Scheme; Victoria Cross or George Cross; Windrush Compensation Scheme. For more information see: Department for Work and Pensions, Universal Credit: money, savings and investments, February 2025.

14 HM Government, The Universal Credit Regulations 2013.

We estimate that around two million families who would otherwise be eligible for UC are affected by the capital rules

There is no publicly available data on how many families are impacted by the capital rules, either for those who lose some or all their entitlement. So, using data from the Wealth and Assets Survey, a comprehensive source of data on families' holdings of capital assets and debt, we have estimated how many families would have qualified for means-tested benefits based on their income in 2020-22, but would have lost some, or all, of their entitlement due to the capital rules.[15] We assess who is affected by these rules solely based on entitlement and do not consider how many affected families would have actually claimed benefits.

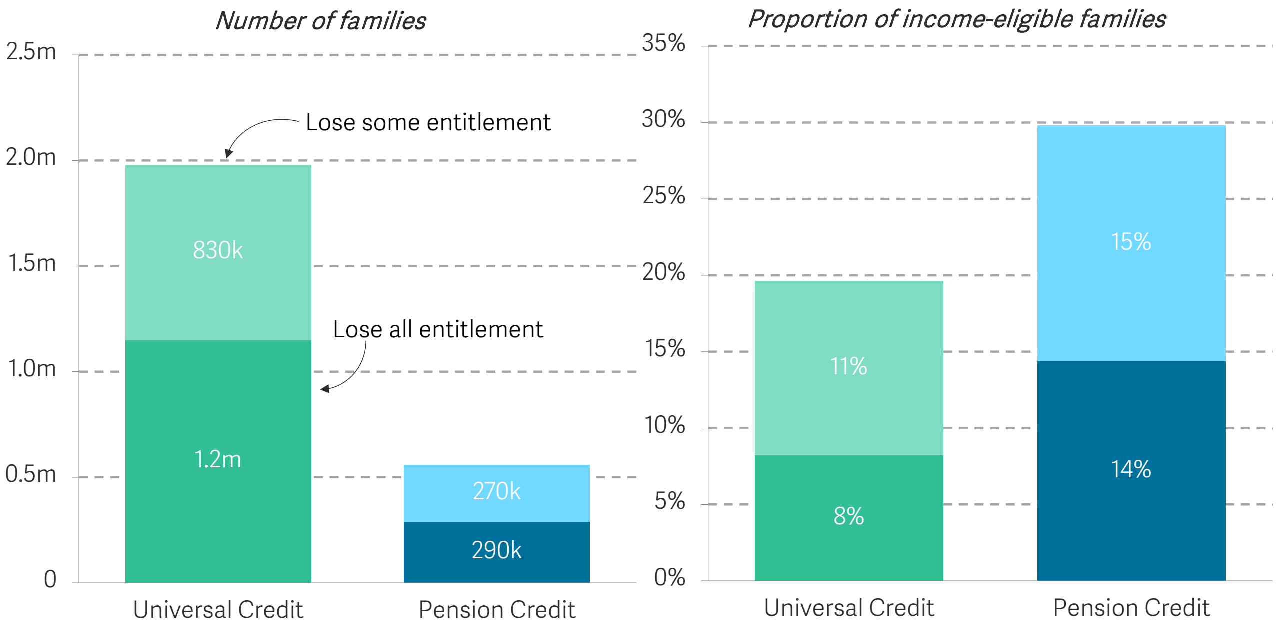
We estimate that in 2020-22, 10 million families would have met UC's income criteria but around 2 million of them experienced a reduction in entitlement due to the capital rules (Figure 2).[16] Of these, 830,000 families faced a partial reduction, while 1.2 million families saw their entitlement wiped out entirely. For comparison, Figure 2 also illustrates the impact of capital rules on Pension Credit entitlement: nearly 600,000 eligible pensioner families were affected, with 270,000 families facing a partial reduction, and 290,000 families losing entitlement completely.

15 The analysis in this report is based on data from the ONS's Wealth and Assets Survey (WAS), which is widely regarded as the most comprehensive source of information on household balance sheets in Britain. To ensure the robustness of our findings, we compare the distribution of income and capital in the WAS with other datasets. Data from the DWP's Family Resources Survey (FRS) shows that income distributions are broadly similar across the two sources, giving us confidence in the WAS income measure. However, reported capital holdings are significantly higher in the WAS than in the FRS – a difference we believe reflects the fact that the WAS is better at capturing household wealth. For example, households in the 5th vigintile of the income distribution held around £29,000 in capital in the WAS, compared to just £17,000 in the FRS. As a result, using the WAS instead of the FRS suggests that more families are affected by the capital rules. For example, in the 5th vigintile of the income distribution, 47 per cent of households had capital above £6,000 in the WAS, compared to just 23 per cent in FRS. Comparisons are for years 2020-21 to 2021-22 (inclusive).

16 Some of the families we identify as entitled to UC would have been claiming legacy benefits instead in 2020-22.

FIGURE 2: **2 million families in Britain have their social security entitlement reduced as a result of the capital rules**

Number (left panel) and proportion (right panel) of families that are eligible for means-tested benefits based on their income but lose some or all their entitlement due to the capital rules, by benefit type: GB, 2020-22



NOTES: Many families entitled to Universal Credit would also have been entitled to legacy benefits. We do not consider these in the analysis as legacy benefits mostly closed to new claims in 2019.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

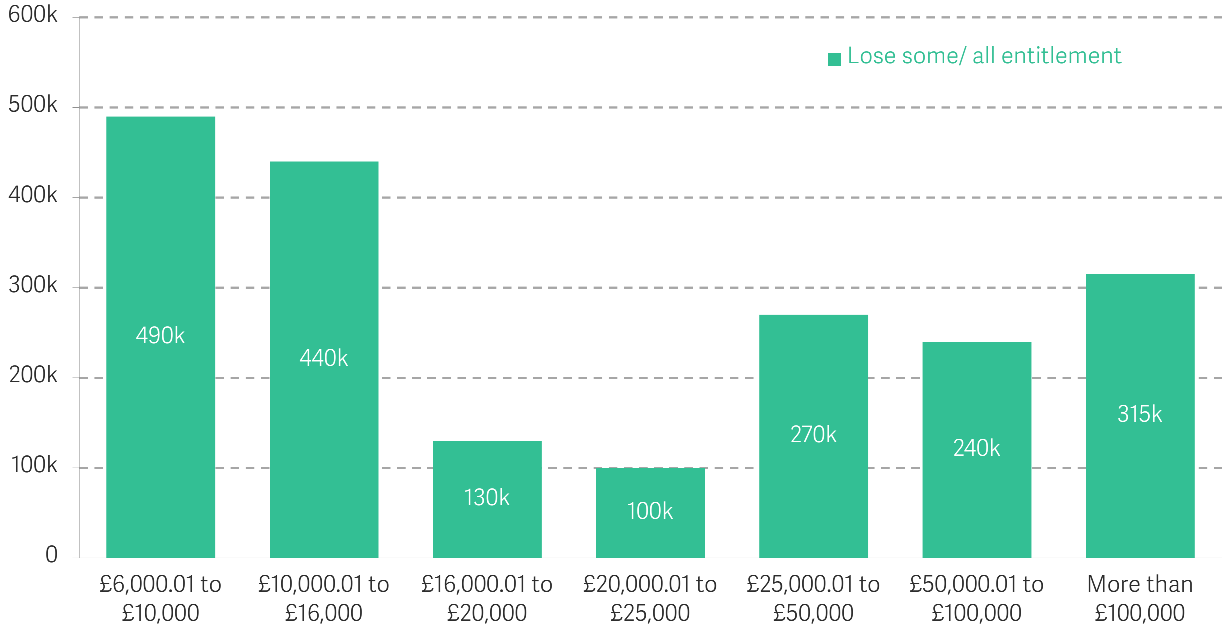
Despite having more generous capital allowances, low-income pensioners are more likely to have their means-tested support affected by capital rules. Three-in-ten (30 per cent) pensioner families eligible for Pension Credit based on their income lose some or all their entitlement as a result of the capital they hold, compared to one-in-five (20 per cent) working-age families eligible for UC.

Capital holdings among families affected vary widely and, for most, are held in easy-access accounts

As shown in Figure 3, nearly half of families affected by the UC capital rules – 47 per cent, or around 930,000 families – had relatively modest savings of £16,000 or less in 2020-22. However, a significant minority hold far greater assets despite meeting the income criteria for support. Around 240,000 families (12 per cent) had capital between £50,000.01 and £100,000, while 315,000 families (16 per cent) had savings exceeding £100,000. While the precise use of these funds is unclear, these households would typically be classified as 'asset-rich but income-poor,' suggesting they may be drawing on their savings to cover living costs.

FIGURE 3: **Nearly three-in-ten families impacted by the capital rules had £50,000 or more in capital**

Number of families that are eligible for UC based on their income but lose some or all their UC entitlement due to the capital rules, by family capital: GB, 2020-22



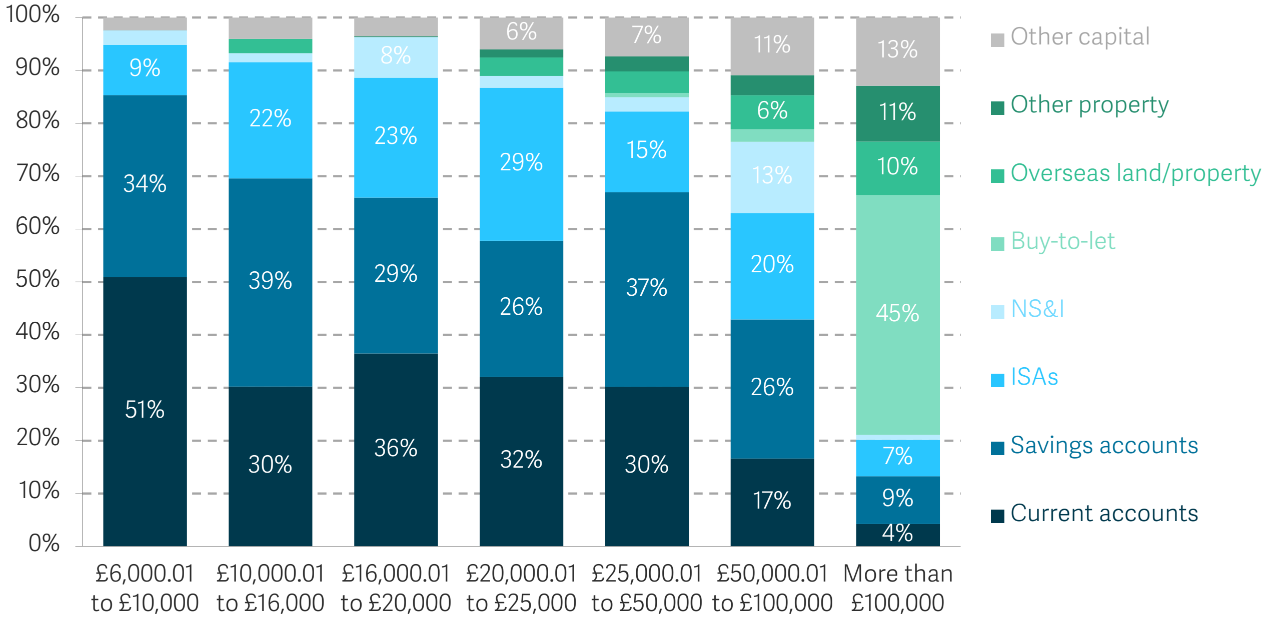
NOTES: Family capital is wealth which counts towards the Universal Credit capital rules.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

Most of the capital holdings of families that meet the income criteria for UC but whose entitlement is reduced by the capital rules are held in what could be considered 'easy access' accounts. Figure 4 shows that, for families with £50,000 or less in capital, more than 80 per cent of their wealth was held in current accounts, savings accounts, ISAs, or National Savings and Investment products (such as premium bonds). However, for those with more substantial capital holdings, above £100,000, the majority (66 per cent) is tied up in other property, primarily buy-to-let investments. Unlike easy-access accounts, this type of wealth is more challenging to liquidate.[17]

17 Specific rules dictate how property assets are assessed within the UC system. In certain cases, the value of additional properties may be disregarded, typically for six months, with possible extensions. This applies in situations such as: a person leaving their former home following a relationship breakdown; acquiring a property but not yet moving in – for example, if they have initiated legal proceedings to occupy it as their primary residence or are undertaking essential repairs needed for habitation; or if a person is actively taking reasonable steps to sell the property. These exemptions are designed to provide temporary relief for individuals navigating significant life changes, ensuring their property assets do not immediately impact their UC entitlement. For more information see: Child Poverty Action Group, Welfare Benefits and Tax Credits: Handbook 2024/25.

FIGURE 4: **The wealth of those affected by capital rules is generally held in easy-access accounts**

Type of wealth held by families that lose some/all their UC entitlement as a result of the capital rules, by family capital: GB, 2020-22



NOTES: 'Other property' excludes any property the family lives in.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

Couples, older adults, early retirees, and the self-employed are most likely to be impacted by the capital rules

Couples are more likely to be impacted than single individuals. Indeed, Figure 5 shows that, among couples below the State Pension age (SPA) who meet the income criteria for UC, 38 per cent (190,000 couples) see their entitlement reduced as a result of their capital – 11 per cent experience a partial reduction, while 27 per cent lose their entitlement entirely. In comparison, 17 per cent (830,000) of single people below the SPA are affected by the capital rules.

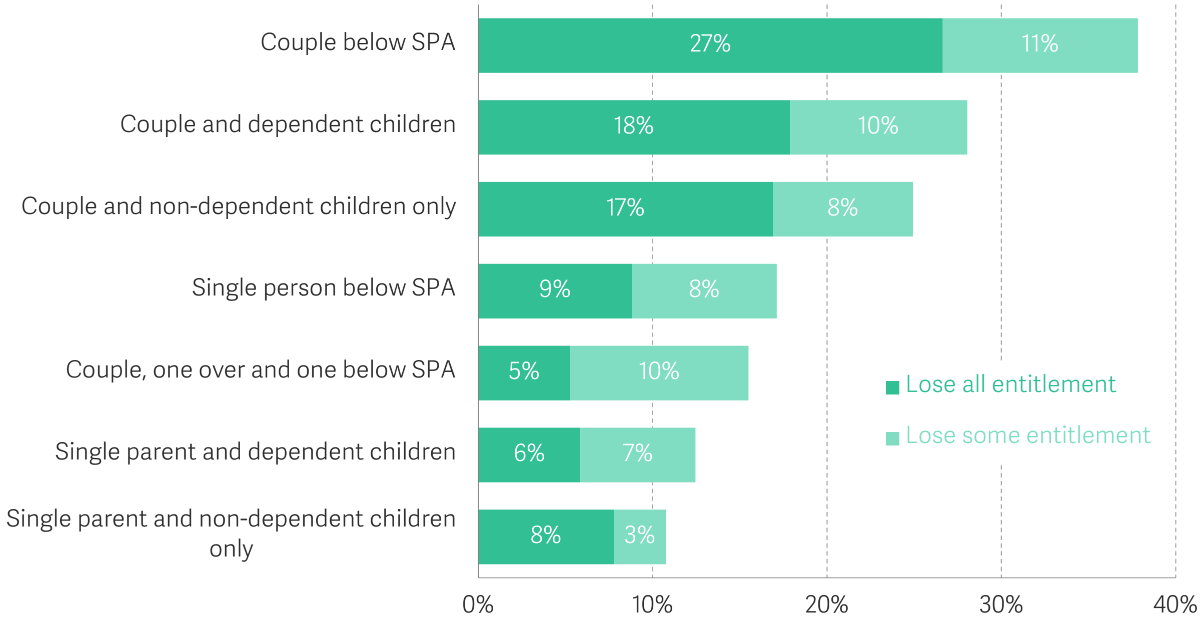
The higher likelihood of couples being affected is unsurprising, as there is no separate capital limit for couples versus single individuals. It is easier for two people to accumulate savings exceeding the £6,000 threshold. Conversations with welfare rights workers highlighted that this aspect of the system was not well understood:

> *"[The capital rules] are not one of the most common rules you get into when you're in welfare rights, because often people don't have the capital. But one of the times when it did suddenly become a massive issue was during the pandemic where you had lots of people coming into the benefit system for the first time.*
>
> *I remember there being a lot of shock when couples realised, oh, my partner who has a £12,000 inheritance from a granny, which I have absolutely no entitlement*

or access to now means that I can't get UC. So it's just one of those times where people were very shocked that there was a couple capital rules rather than individuals."

FIGURE 5: **Couples are more likely to be impacted by the capital rules**

Proportion of families that are eligible for UC based on their income but lose some or all their UC entitlement due to the capital rules, by family type: GB, 2020-22



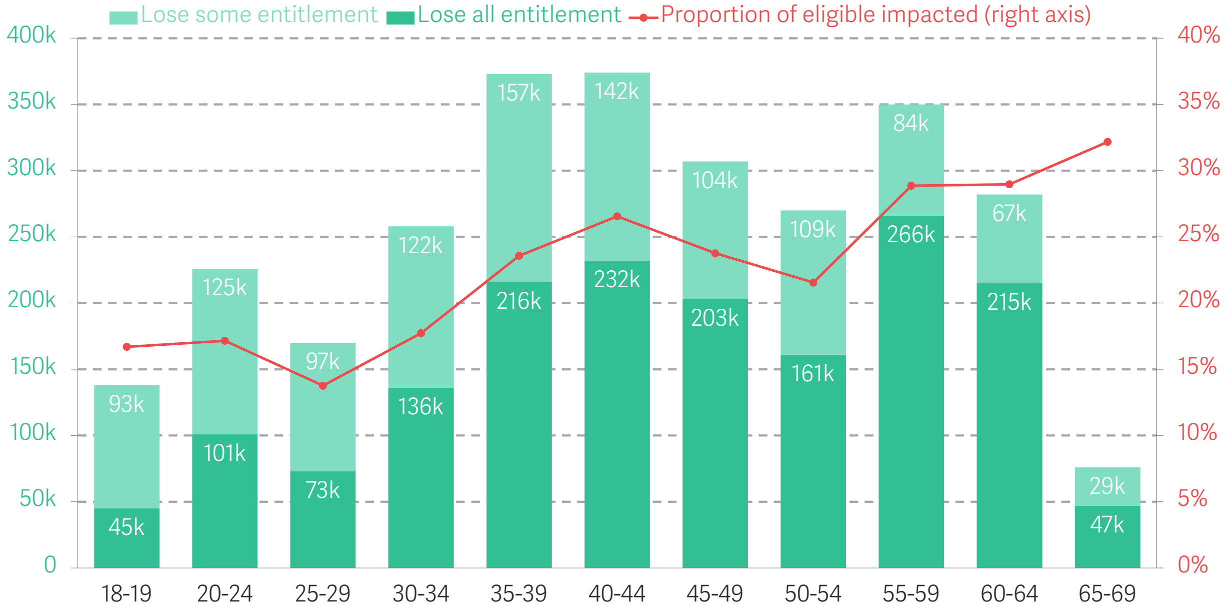
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

Older working-age people are also more likely to be affected by the capital rules. Figure 6 shows that, in 2020-22, there were more people in the 35-39 and 40-44 age groups who were impacted by the capital rules – around 375,000 in each. But the proportion of people affected was higher for older age groups: 29 per cent of 55-59-year-olds and 60-64-year-olds that met the income criteria for UC experienced a reduction in entitlement, rising to 32 per cent among those aged 65-69. This compares to 24 per cent of 35-39-year-olds, and less than 20 per cent for all age groups younger than 35. Again, this is not surprising: older people tend to have greater savings and assets. In previous work we have shown that there is a strong life-cycle pattern to wealth whereby younger people start with low wealth and accumulate it over time (at least for a typical person), with wealth peaking around retirement age.[18]

18 M Broome & J Leslie, Arrears fears: The distribution of UK household wealth and the impact on families, Resolution Foundation, July 2022.

FIGURE 6: **Older people are more likely to be impacted by the capital rules**

Number and proportion of adults that are eligible for UC based on their income but lose some or all their UC entitlement due to the capital rules, by age group: GB, 2020-22



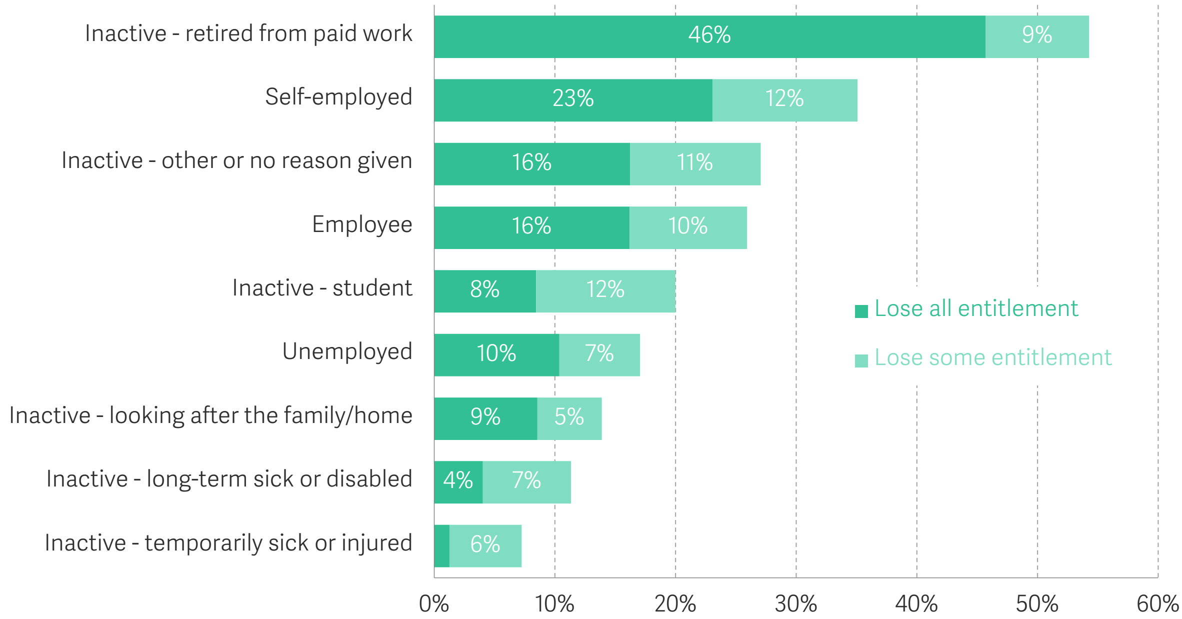
NOTES: Adults in families receiving UC are shown separately, but children are excluded.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

For similar reasons, retirees and the self-employed are disproportionately impacted. As shown in Figure 7, among early retirees eligible for UC based on their income, 54 per cent (280,000 people) saw their entitlement reduced – with 9 per cent experiencing a partial reduction and 46 per cent losing their entitlement entirely. This is partly because, while not all early retirees are wealthy, early retirement is increasingly a privilege of the well-off: in 2002-03, retirement rates among 55-64-year-olds were fairly similar across the wealth distribution – 20 per cent of the poorest fifth were retired, compared to 28 per cent of the wealthiest fifth; by 2018-19, only 7 per cent of the poorest fifth were retired, compared to 24 per cent of the wealthiest fifth.[19] Our analysis supports this trend, showing that, in 2020-22, more than half (52 per cent) of early retirees affected by the capital rules were living in families with capital holdings of £50,000 or more. Many early retirees are also likely to be deterred from claiming UC due to conditionality requirements, which would require them to engage in work-related activities to receive full entitlement.

19 J Cribb, Early retirement increasingly concentrated amongst the wealthy, Institute for Fiscal Studies, November 2023.

FIGURE 7: **Early retirees and the self-employed are more likely to be affected by the capital rules**

Proportion of adults that are eligible for UC based on their income but lose some or all their UC entitlement due to the capital rules, by economic activity status: GB, 2020-22



SOURCE: RF analysis of ONS, Wealth and Assets Survey.

The self-employed also experience significant reductions in their UC entitlement due to the capital rules. We estimate that, among those who would have met the income criteria in 2020-22, 35 per cent (320,000 people) had sufficient capital to reduce their entitlement: 12 per cent would've faced a partial reduction with nearly a quarter (23 per cent) losing their entitlement entirely. This may in part reflect irregular payment cycles in self-employment. In such cases, the interaction of self-employment and the capital rules exacerbates a broader incompatibility between the irregular payment cycles that are typical for the self-employed and the structure of UC. This can leave self-employed recipients of UC receiving lower awards than employed recipients with identical earnings in the long term.

There are three clear shortcomings of the current capital rules

Our analysis shows that the capital rules impact a substantial number of families, each facing different financial circumstances. This raises important concerns about the rules' effectiveness and fairness. While means-testing has long been a topic of debate, below we discuss three clear ways in which the current capital rules governing UC eligibility are creating problems.

First, the capital rules undermine other government policies to incentivise saving

The UK faces a well-documented challenge of persistently low levels of saving, especially among low-to-middle income households.[20] This isn't due to a lack of government intervention. Successive Governments have introduced various policies aimed at boosting savings, usually by offering direct bonuses to encourage people to save. But the system of capital rules is undermining some of the policies put in place, notably the Help to Save scheme and Lifetime ISAs (LISAs).[21]

Help to Save is designed to boost the financial resilience of UC recipients by offering a 50 per cent government bonus on savings of up to £50 per month. Previously, eligibility was limited to individuals in work receiving UC (with take-home pay above £658.64 per month), Working Tax Credit, or those eligible for Working Tax Credit and receiving Child Tax Credit.[22] However, the Autumn 2024 Budget announced an expansion of eligibility. From April 2025, the Help to Save scheme will be available to all UC recipients in work, removing the previous income threshold.[23] The Government estimates that this change will allow around 3 million additional people to participate in the scheme.[24]

Help to Save accounts remain open for four years, meaning that participants can save up to £3,600 over the full term. Since each working family member can open an account, a couple on UC could collectively save up to £7,200. However, under the current capital rules, these savings could lead to a reduction in UC entitlement as they would be counted towards capital thresholds and cause benefits to be tapered away. This undermines the original intention of the scheme, making it very difficult for some claimants to build meaningful savings.

LISAs also involve direct government transfers to encourage saving. They are available to individuals aged 18 to 40, though contributions can continue until age 50. Account holders can save up to £4,000 per year, with the government providing a 25 per cent bonus, capped at £1,000 annually. However, LISAs come with strict withdrawal restrictions – funds can only be accessed without penalty for retirement, purchasing a first home, or in cases of terminal illness. For any other reason, withdrawals incur a 25 per cent penalty, meaning savers lose more than the government bonus.[25]

20 M Broome, I Mulheirn & S Pittaway, Precautionary tales: Tackling the problem of low saving among UK households, Resolution Foundation, February 2024.
21 M Broome, I Mulheirn & S Pittaway, Precautionary tales: Tackling the problem of low saving among UK households, Resolution Foundation, February 2024.
22 M Broome, A Corlett & J Leslie, ISA ISA Baby: Assessing the Government's policies to encourage household saving, Resolution Foundation, January 2023.
23 HM Treasury, Autumn Budget 2024, October 2024.
24 HM Treasury, Help to Save Reform, October 2024.
25 For more information see: https://www.gov.uk/lifetime-isa, accessed April 2025.

Despite these restrictions, LISAs are currently counted as capital under means-tested benefits, meaning recipients are expected to run them down before they can access their full benefit entitlement. Research from Nest Insight highlights that for savings to protect individuals from financial distress, they must be readily accessible, which LISAs are not.[26] The withdrawal penalty discourages premature withdrawals, meaning many savers won't use LISA funds even in emergencies, potentially worsening financial hardship.

Arguably, the Government promotes saving through other ISA products including cash, stocks and shares, and innovative finance ISAs. Individuals can currently save up to £20,000 per year across these types of ISAs with no tax on dividends, interest, or capital gains. ISAs are hugely popular with over 22 million holders in 2021-22, giving around 42 per cent of UK adults access to tax-free savings or investment options.[27] But the case for exempting ISAs from capital rules – either partially or fully – is much weaker. Unlike Help to Save and LISAs, standard ISAs are accessible to everyone and do not have any restrictions on access to funds. Moreover, exempting ISAs from the capital rules would undermine the principle that people should be expected to draw on their own resources to some extent before relying on public support, given the large proportion of the population that hold savings in ISAs. For these reasons, we do not advocate excluding ISAs from the capital rules.

Second, frozen thresholds mean more families are being pulled into being affected by the capital rules

The UC capital rules thresholds of £6,000 and £16,000 have remained frozen since 2006. As a result, more recipients are now seeing their entitlements reduced or lost entirely. Had these thresholds risen in line with consumer price inflation (CPI), they would currently stand at over £10,000 and £27,000, respectively.[28] While the typical working-age family in 2020-22 – with £4,300 – would not have been impacted by the capital rules, frozen thresholds have crept down the wealth distribution, meaning a growing number of families are now potentially affected, as shown in Figure 8. In 2006-08, just 35 per cent of working-age families had capital above £6,000, and 23 per cent had capital in excess of £16,000. By 2020-22, these proportions had risen to 45 per cent and 32 per cent, respectively. As a result, the share of working-age families who would not be eligible for UC in the face of an income shock has risen significantly.

26 J Phillips & E Stockdale, Savings for all — What works to support savings inclusion?, Nest Insight. June 2024.
27 HM Revenue & Customs, Annual savings statistics 2024, December 2024 and ONS, Population estimates for the UK, England, Wales, Scotland and Northern Ireland: mid-2023, October 2024.
28 Based on uprating the thresholds annually in April by the previous September's CPI figure as per benefit uprating convention.

FIGURE 8: **In 2006-08, two-thirds of working-age families would have received full support from UC if they lost their income, by 2020-22, this had dropped to just over half**

Proportion of families with capital above £6,000 and £16,000: GB, 2006-08 and 2020-22

NOTES: Families are classed as working age if the oldest person in the family is below State Pension age. Capital is wealth which counts towards the Universal Credit capital rules.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

However, this does not mean that 32 per cent of families in Britain would receive no support from the welfare state in the event of job loss. Individuals with capital above £16,000 can still qualify for contributory support, as discussed in Box 2. Furthermore, as discussed in previous research, there is scope to expand UC support to families affected by the capital rules in the event of a recession by limiting or temporarily suspend the capital rules.[29]

BOX 2: **Contributory JSA provides some income insurance for those not eligible to claim UC**

Unlike UC, Contributory Jobseekers Allowance (c-JSA) is not means-tested, meaning eligibility is unaffected by savings or other household income. However, it does have strict qualifying criteria based on an individual's National Insurance (NI) contributions in the two preceding tax years. An adult claiming in September 2025 would need to have paid at least 26 weeks' NI contributions on earnings at the Lower Earnings Limit (LEL) in one of the tax years 2023-24 or 2024-25. Additionally, they must have paid NI contributions

29 M Brewer & K Handscomb, This time is different – Universal Credit's first recession: Assessing the welfare system and its effect on living standards during the coronavirus epidemic, Resolution Foundation, May 2020.

or received NI credits on earnings of at least 50 times the LEL in both years.[30] Furthermore, c-JSA is only available for 182 days (about six months) as it is designed to help cover living costs while the recipient looks for a new job.

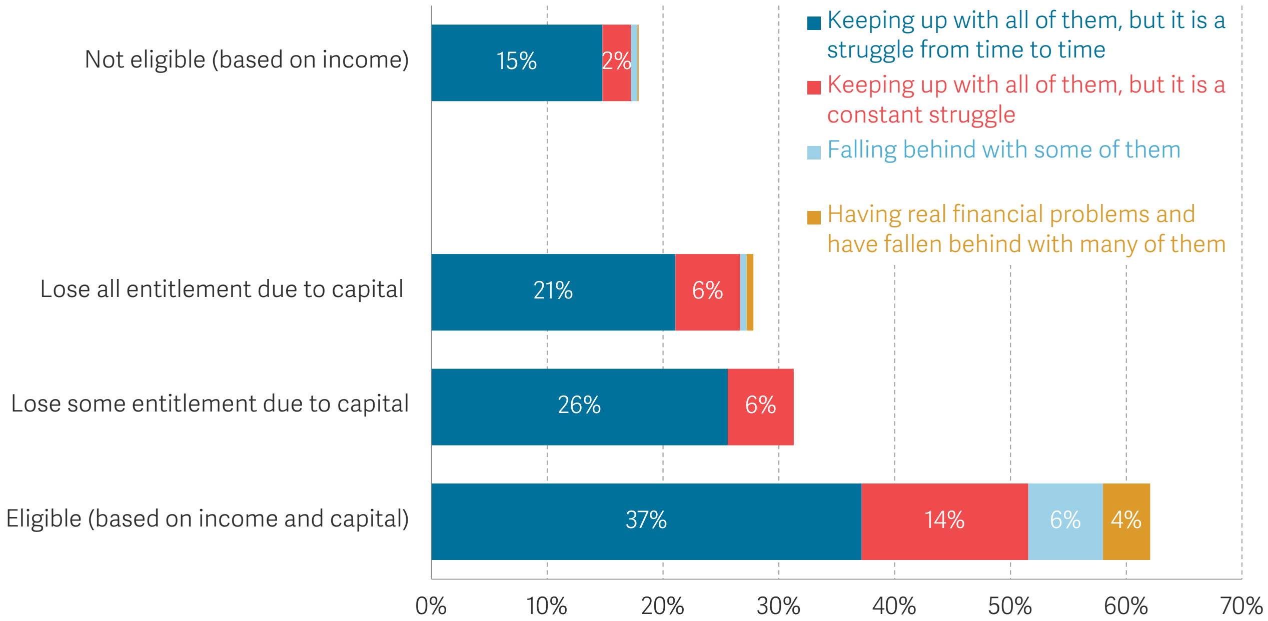
But the bigger problem, as highlighted in previous research, is that neither UC nor c-JSA provide an adequate safety net for those facing job loss. The UK's replacement rates for a single earner on an average wage are among the lowest in the OECD, primarily due to the flat-rate nature of unemployment benefits, which are unrelated to previous earnings. In its Pathways to Work Green Paper, published in March 2025, the Government outlined its intention to address this by replacing Contributory JSA and Employment and Support Allowance (c-ESA – the main contributory benefit for those with limited capability for work due to their health) with a single, time-limited contributory benefit, paid at the higher c-ESA rate.[31] The plan to introduce a higher-rate unemployment benefit is welcome, but there will be losers amongst those previously eligible for c-ESA. The proposed changes introduce a time limit for claiming c-ESA for those placed in the Support Group, who can currently claim the benefit for as long as their condition qualifies them.

There is also evidence that the current thresholds are impacting families who are struggling financially. Figure 9 shows that 32 per cent of families who lose some UC entitlement and 29 per cent who lose all their UC entitlement due to the capital rules report they struggle to keep up with financial commitments at least some of the time. These figures are lower among families who are not eligible for UC based on their income: 18 per cent report struggling to keep up with bills at least some of the time. This suggests that some families impacted by the capital rules may not simply be able (or willing) to run down their capital to cover their living expenses, and that the capital rules are more likely than the income means-test to deny UC to families that are struggling financially.

30 For a more detailed explanation of the Contributory JSA eligibility criteria, including exceptions to the conditions set out above, see: Child Poverty Action Group, Welfare Benefits and Tax Credits Handbook, 2023/24, April 2023.
31 Pathways to work: reforming benefits and support to get Britain working, DWP, March 2025.

FIGURE 9: **Families whose capital is too high for them to get UC are more likely to report struggling with bills than families whose income is too high for them to get UC**

Proportion of adults eligible for UC based on their income that report struggling with bills and credit commitments, by whether they are affected by the capital rules: GB, 2020-22



SOURCE: RF analysis of ONS, Wealth and Assets Survey.

And third, the capital rules create a 'cliff edge' in the system that seems to be disincentivising saving for some UC recipients

One of the main criticisms of the capital rules is that they discourage those on low incomes from building a financial safety net, reducing their ability to cope with unexpected expenses. This concern is not new. In fact, as far back as the Beveridge Report of 1942, which laid the foundation for Britain's modern welfare state, Sir William Beveridge warned that means-testing "penalises what people have come to regard as the duty and pleasure of thrift, of putting pennies away for a rainy day".[32]

The cliff edge within the current capital rules creates a particularly strong disincentive to save, especially for those whose savings approach the £16,000 threshold. For example, a family entitled to £750 in UC based on their income would see their entitlement reduced to £576 if they had £16,000 in savings. However, if they saved just a penny more, they would lose their entitlement entirely.

International evidence suggests that asset tests actively discourage asset holding among low-income households.[33] For example, a study in the US found that the asset

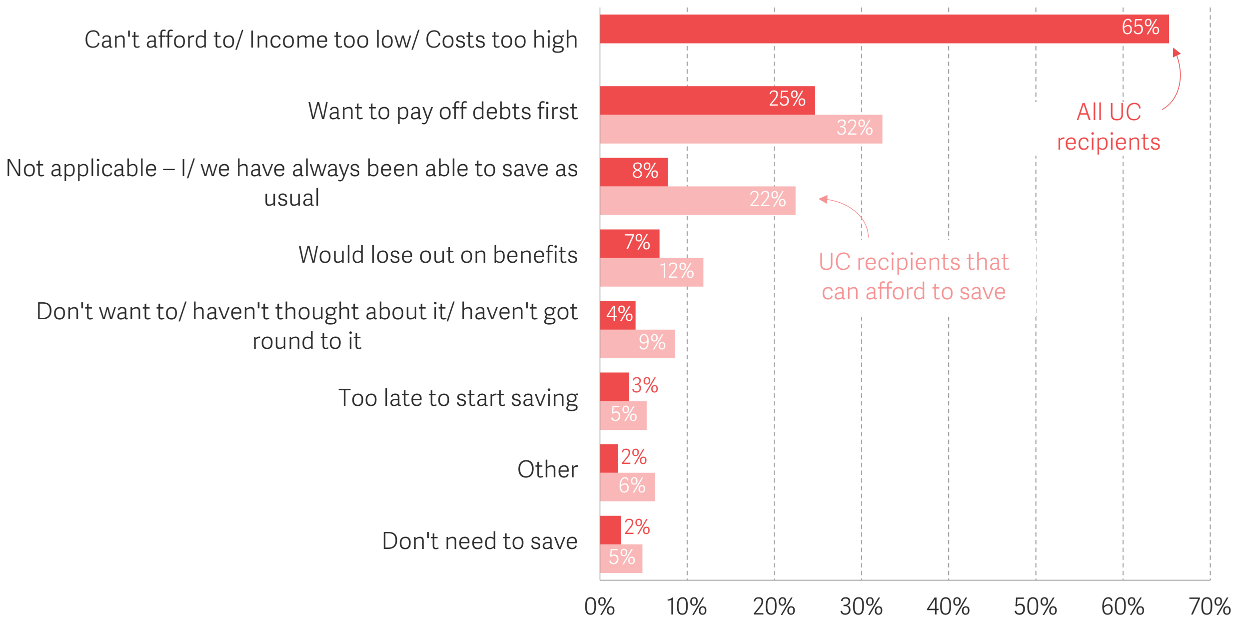
32 W Beveridge, Social Insurance and Allied Services, November 1942.
33 For more literature see: H Chen & R I. Lerman, Do Asset Limits in Social Programs Affect the Accumulation of Wealth?, Opportunity and Ownership Project, The Urban Institute, August 2005, and G McDonald, P R. Orszag, & G Russell, The Effect of Asset Tests on Saving" Gordon McDonald and Gina Russell, Retirement Security Project, June 2005.

limit in the Aid to Families with Dependent Children (AFDC) programme discouraged wealth accumulation, with a $1 increase in limits corresponding to a $0.30 rise in recipients' wealth.[34] Similarly, research on Denmark's "old-age check" found that asset tests depress liquid savings among low-income pensioners, with a notable concentration of savings just below the $15,000 threshold, which shifted when the limit was raised.[35]

Survey evidence suggests the UK's capital rules also discourage saving, although arguably not dramatically so. Figure 10 presents the reasons UC recipients gave for not saving, or not saving more, during the two years leading up to March 2023. Around two-thirds of recipients (65 per cent) reported that they simply could not afford to save. A further 25 per cent cited wanting to pay off debt as a barrier to saving. Only 7 per cent of all recipients said they avoided saving due to the risk of losing benefits. However, among those who could afford to save, this proportion rises to 12 per cent – suggesting a sizable minority of recipients' saving behaviour is influenced by the capital rules.

FIGURE 10: **There is some evidence that the capital rules are acting as a disincentive to save for some**

Reason for UC recipients not saving in the in the last two years reason: UK, 6-13 March 2023



NOTES: All respondents (n= 10,122), in receipt of UC (n=733), in receipt of UC and can afford to save (n=255). Question asked: "Thinking about the last six months (i.e. from September 2022 to now), Which, if any, were your reasons for not saving, or not being able to save more?" Those that cannot afford to save are defined as those that answered "Can't afford to/ Income too low/ Costs too high".
SOURCE: RF analysis of YouGov, adults age 18+ Cost of Living Crisis March 2023 wave.

34 E Powers, Does Means-Testing Welfare Discourage Saving? Evidence from the National Longitudinal Survey of Women, Federal Reserve Bank of Cleveland, December 1995.
35 N Johannesen, J Sæverud & E Saez, Taxing the wealth of the poor: Evidence from the Danish Old-Age Support Asset Test, National Bureau Of Economic Research, November 2024.

All this suggests that the low generosity of UC may limit the extent to which the capital rules act as a saving disincentive. If the basic rate of UC were high enough to allow even modest savings, the savings disincentive created by the capital rules might become more problematic. However, at present, the rules do not appear to act as a disincentive to save for many, as most families eligible for UC hold capital well below the £6,000 threshold. This issue was also raised during a roundtable with welfare rights workers:

> *"We don't actually see that many people who have got problems with capital because hardly any of them have got £6,000 of any of the types of capital or savings that would get covered by the rules. So it doesn't really come up that often."*

There is a strong case for reforming the capital rules, but any changes should be weighed against other pressures on the system

In this section we set out options for reform, set in the context of other pressures on the benefit system.

To start, it is worth considering the most straightforward way to address criticisms of the capital rules – that is, abolish them entirely. Our view is that there are three strong reasons not to do this. First, as shown above, doing so would make an additional 2 million families eligible for UC, and a significant proportion of these have substantial capital holdings – around 315,000 families who would become eligible have over £100,000 in capital. This would violate the principle that families are expected to use their own resources to some extent before receiving state support. Figure 12 illustrates the average annual gain per family if the capital rules were removed. Those with modest savings (below £16,000) would gain the least, as they are already eligible for UC and would only see a small increase due to the removal of the tariff income taper. In contrast, families with more substantial assets would gain significantly, with families holding between £25,000.01 and £50,000 benefiting the most – receiving an average of £5,500 per year.

The second reason for not abolishing the UC capital rules is that it would come at a significant fiscal cost – assuming an overall UC take up rate of 80 per cent, we estimate around £2.3 billion by 2029-30.[36] This reform would not be well-targeted as it would benefit relatively rich households, so it would not be effective in achieving the most

36 This would rise to an estimated £6 billion if the capital rules for Pension Credit and pensioner Housing Benefit were also removed. Policy costings are estimated using DWP, Family Resources Survey and the IPPR tax-benefit model. We assume an overall Universal Credit take-up rate of 80 per cent, and certain groups have a higher or lower propensity to claim the benefit in the model. Particularly relevant for this analysis, families in work and families with lower UC entitlement are modelled as having a lower likelihood of claiming. For example, after abolishing the capital rules, 63 per cent of newly eligible families are modelled as claiming UC. These costings may be overestimations as the reforms, particularly abolishing the capital rules entirely, would likely lower the overall take-up rate of UC. However, as the true take-up rate of Universal Credit is not currently published, the true costing may be higher or lower. Additionally, costings may be an underestimation due to potential under-reporting of capital holdings in the Family Resources Survey.

pressing policy goals in the benefit system of raising living standards and reducing poverty. At a time when the real value of basic working-age benefit support has fallen considerably over a decade and a half, and child poverty rates are on an upward trend, other targeted reforms to UC should take priority.[37] Previous research highlights that abolishing the two-child limit and the benefit cap could lift an estimated 500,000 children out of poverty by 2029-30.[38] While these reforms would cost £4.5 billion, they remain the most effective anti-poverty measures the Government could implement.

Finally, in a system without capital rules, income from capital would need to be factored into the income means-test. Currently, the capital rules allow the DWP to sidestep this by treating interest income as part of the capital balance – for example, £50 of interest income is simply added to the total capital. However, as Box 3 highlights, integrating capital income into UC assessments presents significant challenges, making implementation complex.

BOX 3: **Assessing income from capital instead would likely be too administratively complex for UC**

Unlike UC, the tax credits system had no capital rules, in a bid to avoid discouraging families in work or those with children from saving, but included income from capital in its income assessment. This reflected the original intention of tax credits to extend support much further up the income distribution than previous means-tested benefits. So why not do the same thing with UC?

A key difference with tax credits was that it was based on an annual assessment period, which allowed reasonably accurate calculations that take into account sporadically paid capital income. [39] Families in receipt of tax credits were still subject to capital rules if they were claiming other benefits to cover unemployment, incapacity or housing costs.

Assessing income from capital in UC would be challenging, given its monthly income assessments. Since capital income is often paid annually, a single lump-sum payment – such as yearly interest from savings – would significantly reduce (or eliminate) a recipient's UC entitlement for one month, while leaving it untouched for the remainder of the year.

37 M Brewer & A Clegg, Ratchets, retrenchment and reform: The social security system since 2010, Resolution Foundation, June 2024; A Clegg and A Corlett, Turning the tide: What it will take to reduce child poverty in the UK, Resolution Foundation, February 2025.
38 A Clegg and A Corlett, Turning the tide: What it will take to reduce child poverty in the UK, Resolution Foundation, February 2025.
39 A Clegg, In credit?: Assessing where Universal Credit's long roll-out has left the benefit system and the country, Resolution Foundation, April 2024.

Money saved through Help to Save and LISAs should be excluded from the capital rules

While abolishing the capital rules should not be considered a priority reform, the Government could introduce smaller reforms to improve the system. As discussed, including savings from Help to Save accounts in capital assessments risks undermining the scheme's effectiveness. So, to truly support saving among low-income households Help to Save balances should be excluded from capital assessments. This would let a two-adult household fully using the scheme save up to £13,200 – £6,000 within the disregarded threshold plus £7,200 in Help to Save – over four years without affecting their UC entitlement.

LISAs should also be exempt. The withdrawal penalty on LISAs discourages access outside of home purchase or retirement, making them more like long-term savings products – similar to pensions, which are excluded from capital tests. Aligning their treatment with that of traditional pensions would ensure greater policy consistency. Moreover, if individuals are expected to draw on savings before qualifying for support, they should not be penalised for doing so. Assuming the withdrawal penalty remains in place, excluding LISAs from capital assessments would address this inconsistency.

By making these changes, the Government would enable low-to-middle income families to build meaningful savings for long-term goals, like buying a home or saving for retirement, without compromising their access to the benefit system. Consider two individuals: one has saved £20,000 in a Lifetime ISA (LISA) for a house deposit; and another who has just used £20,000 as a deposit to purchase a home.

If both face an income shock, the saver would be ineligible for UC and expected to spend down their savings before receiving support. This would take them further away from homeownership and mean they could potentially qualify for housing support for longer once they were eligible for UC. In contrast, the recent homebuyer – having converted their savings into property – would qualify for UC, albeit with different treatment of housing costs. Exempting LISAs from capital rules would prevent this unfairness, allowing prospective homeowners to retain their deposits and access support during tough times, without derailing their efforts to get on the housing ladder.

The Government should address the declining value of the capital rules' thresholds by uprating them in line with inflation

More and more families are being pulled into the system of capital limits. One option, then, is simply to restore the capital thresholds in real terms to their values when they were introduced in 2006. Under this approach families with £10,000 or less in capital would be entitled to full UC support, families with capital between £10,000.01 and £27,000 would see their entitlement gradually tapered and families with over £27,000 in capital would not be eligible for UC. Data from 2020-22 suggests that raising the thresholds to these levels would ensure that 61 per cent of working-age families remain fully insured by UC in the event of an income shock – just four percentage points lower than in 2006-08.

As shown in Figure 11, around 1.1 million families would benefit from uprating the current thresholds, with almost half of these (45 per cent) holding capital between £6,000 and £10,000. Meanwhile, Figure 12 highlights that the small group (around 22,000 families) with capital between £25,000 and £27,000 would gain the most, with an average increase of £4,990 per year in UC entitlement.

There was, however, no compelling rationale for the decision to set the thresholds at £6,000 and £16,000 in the first place. And where the thresholds are set is ultimately a political decision, one that successive Governments have sidestepped by leaving them frozen. On top of that, the cost of restoring their value to their 2006 level in real terms – an estimated £800 million in 2029-30 – should not be considered a priority investment for the benefit system.[40]

That said, it's clearly unsustainable to keep the thresholds frozen indefinitely, and there is some evidence that the current thresholds are starting to impact families who are struggling financially, as show in Figure 9 above. We therefore recommend that the Government commits to indexing the thresholds with inflation from 2026-27, at an estimated cost of £135 million in 2029-30. This would maintain the value of the thresholds going forward, ensuring that ever increasing numbers of families do not become impacted.

The Government should also consider removing the 'cliff edge' from the upper capital limit

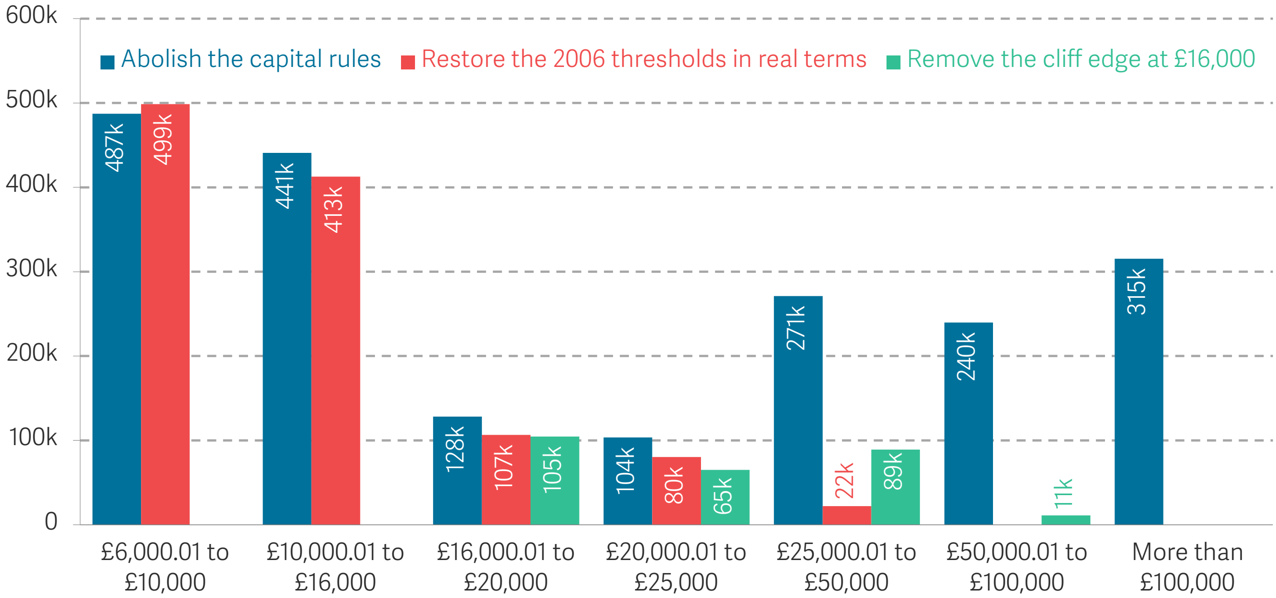
Abolishing the upper capital limit at £16,000 and instead gradually tapering UC entitlement away using tariff income rules, as is the case with Pension Credit, would remove the arbitrary cliff-edge which disincentivises saving. These types of cliff-edges create perverse incentives in the benefit system and contribute to complexity; indeed, one of the aims in introducing UC was to remove similar cliff-edges in the legacy benefit system's income assessments.[41] We estimate that removing the £16,000 threshold would cost £900 million in 2029-30, and around 270,000 families would see their entitlement increase (see Figure 11), with two-thirds (63 per cent) having capital holdings of between £16,000.01 and £25,000. To be clear, there are more pressing priorities for reform in the benefit system, specifically the continued existence of the two-child limit, the benefit

40 M Brewer & A Clegg, Ratchets, retrenchment and reform: The social security system since 2010, Resolution Foundation, June 2024.
41 A Clegg, In credit?: Assessing where Universal Credit's long roll-out has left the benefit system and the country, Resolution Foundation, April 2024.

cap and the freeze in housing support. But the full realisation of UC's initial aim to create a system without cliff edges, poverty traps and perverse incentives would require abolishing the upper capital limit. This should be considered as part of the DWP's upcoming review of UC.

FIGURE 11: **Abolishing the capital rules would mean more than 315,000 families with more than £100,000 in capital become entitled to UC**

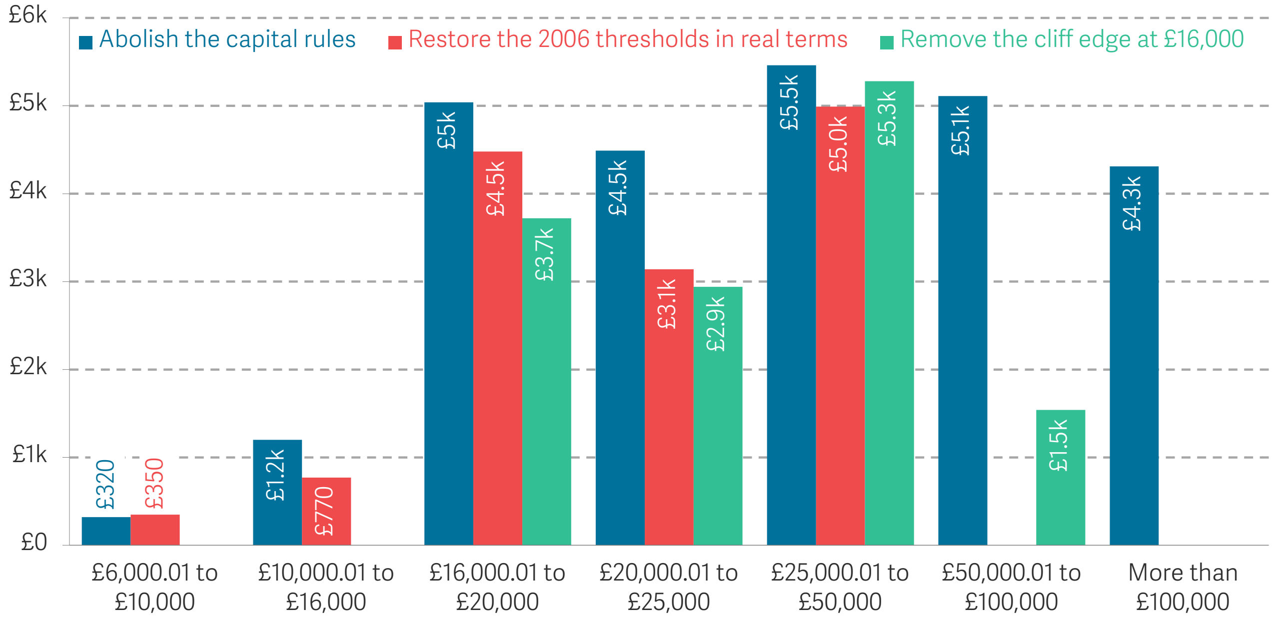
Number of families that would benefit from increased UC entitlement as a result of various policy options, by family capital: GB, 2020-22



NOTES: A small number of families with just over £6,000 in capital see their UC entitlement increase from restoring the real value of the capital thresholds but who do not benefit from abolishing the capital rules, as their income from capital reduces their UC entitlement by more than the capital rules. Family capital is wealth which counts towards the Universal Credit capital rules.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

FIGURE 12: **Those with larger capital holdings would gain the most from amendments to the rules**

Average annual amount gained from various policy options, by family capital: GB, 2020-22



NOTES: Family capital is wealth which counts towards the Universal Credit capital rules.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

The Government should prioritise targeted reforms that support long-term savings while preserving fairness in UC

As we have outlined, there are some clear shortcomings with the existing capital rules. But while scrapping them entirely would address these, it would come with a hefty price tag and is not the best way to achieve the Government's rightly ambitious aims of reducing poverty and improving living standards. It would also create practical difficulties in measuring income from capital within UC's monthly assessment periods.

But that does not mean the Government should continue to ignore this long-neglected part of the benefit system. Targeted reforms can be used to support long-term savings while preserving fairness in means-testing. Exempting savings in Help to Save accounts and LISAs would give low-to-middle income families greater flexibility to build financial resilience – for both short-term shocks and long-term goals like home ownership or retirement. Indexing the capital thresholds from 2026-27 would help maintain fairness over time, preventing the system from becoming increasingly punitive toward those with modest savings.

More ambitious changes, such as removing the £16,000 upper limit, could further strengthen the system. However, these must be weighed against higher priorities in the benefit system, like the removal of the two-child limit, benefit cap and Local Housing Allowance freeze, and the overall inadequacy of benefit levels. Nonetheless, such reforms should remain part of a long-term strategy for a fairer, more supportive welfare system.

Annex 1

Data citations:

- Family Resources Survey (series page here):
    - Department for Work and Pensions, NatCen Social Research. (2021). Family Resources Survey. [data series]. 4th Release. UK Data Service. SN: 200017, DOI: http://doi.org/10.5255/UKDA-Series-200017
- Households Below Average Income (series page here):
    - Department for Work and Pensions. (2021). Households Below Average Income. [data series]. 3rd Release. UK Data Service. SN: 2000022, DOI: http://doi.org/10.5255/UKDA-Series-2000022
- Wealth and Assets Survey (series page here):
    - Office for National Statistics. (2019). Wealth and Assets Survey. [data series]. 2nd Release. UK Data Service. SN: 2000056, DOI: http://doi.org/10.5255/UKDA-Series-2000056

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