

## Closer alignment of income tax (IT) and NICs

### Introduction

The differences between IT and NICs have often been cited as a major source of complexity in the UK's tax system, and in July 2015 the OTS was asked by the Chancellor to consider the impacts, costs and benefits and the steps necessary to bring the two taxes on employment / self-employment closer together to create a simpler and more modern system.

The full report, published in March 2016, is available online<sup>1</sup> and concludes that bringing IT and NICs closer together would create a simpler and more equitable system for taxpayers, better fitted for current and emerging working patterns.

In it, the Office of Tax Simplification (OTS) proposes a number of steps towards closer alignment, but cautions that the impacts need to be carefully understood and considered. In particular, the OTS recommends that further work should be done to understand the impact of proposed structural changes to the Class 1 NICs system - both to primary (employee) and secondary (employer) NICs.

During the review it became apparent that the options to align the two charges, and simplify the overall system, should focus on reform of NICs rather than IT; two core issues with NICs being that:

- the same annual earned income, derived from different working patterns, could result in a different NICs outcome. For example, two part time jobs against one full time job; and
- the charge on employers is directly related to individual employees, but does not impact their contribution record.

In its report the OTS proposed that it more fully explore both these areas.

The government has since commissioned this work by way of two further reviews into the impact of proposed structural changes to NICs, within the terms of reference below, and to publish its findings in advance of Autumn Statement 2016.

The government will then respond in full to the OTS's work in this area.

### Terms of Reference for the further reviews

The government has asked the OTS to undertake two further reviews, building on the work and recommendations in its earlier reports:

1. a review on the impact of moving employee NICs to an annual, cumulative and aggregated basis ('ACA') similar to PAYE IT. NICs is currently calculated on a pay period basis; and
2. a review on the reform of employer NICs to a payroll based charge.

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<sup>1</sup> <https://www.gov.uk/government/publications/closer-alignment-of-income-tax-and-national-insurance-contributions>

Whilst these structural changes could be considered in isolation, if the basis of assessment for Class 1 primary NICs moves to ACA, it would be natural to review the basis for Class 1 secondary NICs at the same time.

The OTS will publish a further report ahead of Autumn Statement 2016. The government will then respond in full on all the OTS's proposals to bring IT and NICs closer together.

The merger of IT and NICs, the extension of NICs to non-earned income or to pension income, and international cross-border issues, are outside the scope of these specific reviews. However, the OTS has received (and will no doubt continue to receive) a range of views on these issues, and may reflect these where they contribute to future debate on simplification.

### **Aims and objectives**

1. ACA: further explore the impact of ACA, as a simpler and more inclusive system, on individuals, business, the Exchequer and the administration, with a view to setting out options and recommendations for consideration prior to implementation.
2. Payroll based tax: further explore the impact on, employers (including the sectoral impact), the Exchequer (with the assumption that overall receipts would remain the same) and the administration of a move to a payroll based tax, with a view to setting out options and recommendations for consideration prior to implementation.

The report will set out who might pay less and who might pay more (the 'gainers and losers'), and the benefits and challenges of an ACA system of employee's NICs and a payroll tax system of employer NICs including implementation and transitional issues.

The report is contingent on the availability of new data within the timescale, either based on deeper analysis of existing sources or on commissioning new data sets.

The report will enhance understanding and engagement with these issues with all impacted parties.

### **Framework for the reviews**

The review will consider evidence already available, and commission and publish new analysis and data on these impacts, to encourage an informed public debate on the issue.

The OTS will consider the impact of trends affecting the economy, business structures and working patterns, and will consider the opportunities offered by HMRC's Making Tax Digital.

The options and recommendations will:

- aim to make the administration of the NICs system simpler to deal with for individuals, businesses and advisers;
- improve understanding and transparency; and
- be cost effective for business and individuals (admin burden) and HMRC (operating costs) and be attainable in the medium term (5 years).

The OTS will have regard to the wider Exchequer implications, including the consequential impact on benefits entitlement.

## **Resources and methodology**

The OTS will work closely with data specialists, including HMRC's Knowledge, Analysis and Information (KAI) experts. The OTS will also engage with HM Treasury, BIS and DWP, and operational, digital and policy specialists from HMRC. The team will will work with HMRC's Administrative Burdens Advisory Board (ABAB). The OTS team will have a mix of significant private sector and HMRC / HMT experience.

The team will consult with representatives from impacted stakeholder groups and directly with employers. However, the nature of this project means that the emphasis will be on data analysis and testing. As always, the OTS will welcome contributions from interested parties and may consider commissioning surveys.

A consultative committee will provide specialist guidance and challenge.