

Closer alignment of income tax and national insurance: at a glance

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Who are the OTS?

The Office of Tax Simplification (OTS) provides independent advice to the government on areas where the tax system could be made simpler for everyone involved.

What is national insurance?

Taxpayers have been paying national insurance contributions (sometimes called NICs) to qualify for certain benefits including the state pension, since 1911. It's important that taxpayers continue to pay enough national insurance to qualify for these benefits.

Why did the OTS review income tax and national insurance?

Today, taxpayers can have many different working patterns. National insurance was designed for the working patterns of yesterday, when a single job (often for life) was more common. It is calculated in a different way to income tax. The government asked the OTS to see whether national insurance could be simplified, to create both a simpler and a fairer system that supported modern working patterns. The OTS published two reports in March and November 2016.

What is the problem with the way national insurance works now?

Income tax and national insurance are calculated in different ways, but each has a tax free allowance.

Income tax is calculated on someone's income for the whole year, by adding all their jobs together.

The tax free allowance is deducted from their total income for the year, and they pay tax on the rest. If an employee receives company benefits, such as a car or health insurance, they do not pay national insurance on these benefits but they will pay income tax.

National insurance is calculated separately on each pay packet from each job. A tax free allowance is given on each pay packet from each job. This means that if someone has two jobs at the same time, they get two tax free allowances. This is illustrated below:

Income for the year 2015 to 2016	Income tax	National insurance	Total tax
£15,000 earned from one employer spread equally over 12 months	£880	£832	£1,712
£15,000 earned from one employer in one month with no income the rest of the year	£880	£572	£1,452
£5,000 earned from each of 3 employers, spread equally over 12 months	£880	£0	£880

These different outcomes are also reflected in the benefits people are entitled to, so some do not build up pension rights. A simpler, and fairer, system would treat every employee's income in the same way, for both income tax and national insurance.

How should national insurance be calculated on income from jobs?

The OTS believes national insurance should be calculated in the same way as PAYE income tax. This means that both taxes would be calculated on an employee's total income, on the same amounts. National insurance would not be calculated separately on each pay packet from each job, but on all jobs added together with one tax free allowance split between them.

Why is this simpler?

The two systems will work in the same way, which will be easier for employers to operate and for taxpayers to understand.

Why not merge the two?

Although merging income tax and national insurance into one tax would create the most simple system for taxpayers, national insurance has a different purpose to income tax and the government wishes to keep them separate.

What impact could changing national insurance have on taxpayers?

Some would pay more national insurance and some would pay less. About 40% of all employees who pay NICs could see some change. Typically, those paying less national insurance would be part-time employees, women, those under 35, and those in lower paid service industries. Typically, those paying more national insurance would be people with more than one job and those who earn over £20,000 a year. The benefits system could partly balance some lower income households: although they would pay more national insurance and they may be entitled to more benefits and universal credits.

What are the numbers?

About 5.5 million people could pay an average of £242 more national insurance.

About 7.6 million people could pay an average of £169 less national insurance. These tend to be lower income households.

For some, these amounts would be a 'one off'. For others, the difference would repeat each year.

Broadly, the Exchequer would not benefit: the changes would balance each other out.

Lower income households could be entitled to more benefits and universal credits.

What about employers' national insurance?

At present, employers' NICs are calculated at 13.8% of employees' weekly or monthly pay, generally over a threshold of £156 per week / £676 per month. This means that employers do not pay national insurance on some lower paid part-time workers. This payment doesn't make any difference to the employee's national insurance record, or the benefits they can claim.

A simpler system might be a tax that is calculated on the total cost of an employer's payroll, with no tax free allowance, but at a lower rate of tax instead. The OTS has tested various ways of doing this. Some of these have big impacts on different employers. Though the OTS has a preferred option, we recommend that further work is done to find the right balance between a simpler tax and a fair outcome for employers.

When would these changes happen?

The OTS suggest a 5 year timetable for the full package of reforms, so that the impact on taxpayers and employers can be carefully considered. National insurance needs modernising and the time to begin that change is now. There is an opportunity to make these changes alongside HMRC's Making Tax Digital programme. Taxpayers will then be able to review and update all their tax affairs through HMRC's on-line Personal Tax Account.

Can anything really be done - what do taxpayers think?

The OTS has spoken to taxpayer groups and employers and found support for a simpler and fairer system that supports changing working patterns. However, they note there would be set up costs and the need for a measured timetable, with the impact fully understood at each stage.

What do the OTS recommend happens next?

The OTS recommends the government starts now to reform national insurance, to create a system that is simpler, works better for everyone and is fit for the future. The next step is a wider public discussion on the implications for jobs and benefits, household income and the Exchequer.