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Office of Tax Simplification reports on alignment of income tax and National Insurance

I am writing to thank you for your two reports on the alignment of income tax and National Insurance contributions. The reports provide a thorough analysis of these important issues, and I am grateful to you and your team for your work.

1. You have rightly highlighted that the current operation of National Insurance contributions (NICs) has some unnecessary complexities. I agree that, where it makes sense to do so, income tax and NICs should be aligned in order to make the tax system simpler for individuals and businesses. However, as you have set out, making significant changes in this area can increase costs for businesses and some individuals. Your analysis also demonstrates that there are a range of challenges that would need to be taken into consideration before proceeding with reform.
2. As I announced in the Autumn Statement, I am taking action in a number of areas that you highlighted, in order to reduce complexity and to make the tax system easier to understand:
 - First, I have announced that the primary and secondary thresholds will be aligned – removing the discrepancy of a one pound difference between the two thresholds and reducing complexity for employers.
 - I also agree that there is no rationale for different debt recovery periods for NICs and income tax; HMRC will therefore be consulting on amending the relevant legislation.
 - As you have noted (and previously recommended) the abolition of Class 2 NICs in 2018 (as announced at Budget 2016) will also reduce complexity for the self-employed. Following the abolition of Class 2, the structure of Class 4 NICs for benefit entitlement will largely be aligned with the structure of employee NICs.
 - Your March report highlights the differences between the income tax and NICs treatment of employee expenses; I realise that this is a complex area and therefore propose to launch a call for evidence at Budget 2017 on the tax treatment of non-reimbursed expenses.
3. In addition to the measures I have announced at Autumn Statement, HMRC have already started work on a number of the other recommendations that you made in March: increasing transparency through the use of personal tax accounts and aligning guidance on

income tax and National Insurance. I recognise that change cannot happen overnight, I have therefore asked officials to consider where any future changes to NICs and income tax can be aligned to avoid future complexities arising.

4. I am particularly grateful for your work on aligning the calculation of income tax and NICs by moving the calculation of NICs to an annual, cumulative and aggregated basis. I am aware that this is an area of significant interest and your reports have made a valuable contribution to the debate on this important issue.
5. As the report sets out, there are potential gains from moving NICs onto an annual basis – including making the interaction between income tax and NICs easier to understand. However, the reform would also be a major upheaval, with consequences for the labour market and a large number of individuals and businesses. On the basis of the scale of change required, I do not consider now to be the right time to make this major reform but I am grateful to you for bringing these issues to light.
6. Lastly, you set out some options for reform of employer National Insurance. I have asked officials to consider the details of the options that you have set out and to keep this under review.
7. There are also wider issues with the different tax treatment of different forms of labour, highlighted by the growth in self-employment and the number of single person incorporations. This not only causes complexity but also - as the OBR has highlighted (in relation to the growth in incorporations) – is resulting in increased fiscal costs to the Exchequer. The Government will therefore also look at how it can ensure that the taxation of different ways of working and different forms of employee remuneration is fair, sustainable and efficient.
8. Thank you again for your work in this area. I hope that the changes that I have announced in response to your reports will contribute to a simpler tax and NICs system.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Philip Hammond', with a horizontal line under the name.

PHILIP HAMMOND