Workers' contributions

Employment Tax

01 July 2016

Bill Dodwell considers the challenges involved in reforms to NICs

In March, The Office of Tax Simplification published a long report where it argued that the UK should make major reforms to national insurance (see the article by Marian Drew and Angela Brown in the May issue of *Tax Adviser*). The OTS put forward four main recommendations: that employer's national insurance contributions should be de-coupled and turned into a payroll tax (rather like Apprenticeship Levy); that the NIC base should be the same as the income tax base; that employee NIC should be put on an annual, cumulative basis, just like PAYE; and, finally, that the rate of self-employed NIC should be the same as employee NIC. Suitably impressed, the government asked the OTS to continue its work and make more detailed recommendations.

There are big challenges here. HMRC estimates that 7.1m workers would pay an average of £175pa less NICs (£1.2bn in total), and 6.3m workers would pay on average £275pa more NICs (£1.7bn in total). On average, those who pay more have higher incomes than those who would pay less, with the biggest numbers paying more in the £30–50,000 income category. What are the underlying reasons? Many people work for only part of the year. This means that they will not receive the full benefit of the current £8,000 annual exemption. A few people working for part of the year actually get too much charged at the 2% rate, instead of the 12% rate. The other common circumstance is when individuals have multiple jobs and either do not pay NIC as each job is below the £8,000 threshold, or get the benefit of the exemption more than once. Apparently about 50,000 people have multiple jobs where each one is below the lower threshold. The final important issue is fluctuating incomes (typically commission, or bonuses and potentially pay rises), where the employee may well have months or weeks that go above the upper threshold whilst the overall yearly income would result in more being charged at 12%. The calculations don’t take account of the impact of tax credits – either working tax credits or universal credit. Some of those paying more might qualify for higher universal credit (although not for higher tax credits, due to the different way the systems work).

The OTS makes a remarkable leap in proposing that the self-employed rate of NIC be increased to match the employed rate. They point out, entirely fairly, that the self-employed will in future benefit from the new (higher) state pension, which will offer them a much better return than the old one. The self-employed do not benefit from other contributory benefits, though, such as jobseeker’s allowance, maternity pay and sick pay. The OTS recommends that they should pay an extra 3% – up to £1,000 annually – and qualify for these benefits. There must be some concern around the burden of proof here, where employers may have a regulatory role. Further, there isn’t an easy way to cover the risks that the self-employed often bear, which is often regarded as the main reason for a lower NIC rate. Amusingly, in Ireland, the income tax rate for the self-employed is actually higher, on the supposition that they will claim extra expenses of presumed dubious merit!

HMRC estimates that the number of self-employed has grown from 3.5m in 2013/14 to 4.7m currently. After the recession the numbers started to increase as no doubt some employees lost their jobs and took up self-employment. More recently, though, the numbers of both employees and self-employed have increased. It is this angle which has inspired the OTS to suggest that NIC from both groups should be the same, not least because some will in fact undertake part-time employment alongside self-employment. Whether this is in fact ‘true’ employment is unknown; there are signs that some major engagers prefer to remove the risk of getting it wrong by applying PAYE unless individuals have a service company.

The report highlights several of the issues of the base. There is no NIC relief for individual pension contributions, or for expenses borne by the individual. Excluding employer pension contributions from NIC has given rise to expensive salary sacrifice arrangements – a benefit not open to the self-employed. Benefits in kind have odd NIC rules, although it’s not easy to quantify everything every month and put it through the payroll. On the other side, termination payments are not subject to NIC, as the recent Spurs case confirmed. Those over 65 do not pay NIC on employment income (although their employers do) and pension income isn’t subject to NIC. Perhaps the place to start is by unifying the base for benefits, expenses and termination payments.

Replacing employers NIC with a payroll tax, presumably operated in a similar way to the Apprenticeship levy, would be a simpler approachwith fewer obvious challenges.

The underlying challenge with the recommendations is whether any government will be keen to ask 6.3m employed and 4.7m self-employed to start paying additional NIC. The so-called simplification benefits don’t stand out so obviously that the unlucky 11m people will see their contribution as simply part of the greater good. Of course, the OTS does note that many don’t understand NIC, so perhaps they won’t notice – but we are very much in an era where the objections of ‘losers’ play a great part in tax policy.