



HM TREASURY



HM Revenue
& Customs

Integrating the operation of income tax and National Insurance contributions

Next steps

November 2011



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Foreword

The Government's priority is returning the UK economy to balanced, sustainable growth. A competitive, stable tax system is a precondition for growth. Also vital is a simpler personal tax and welfare system that makes work pay and is better understood.

We have increased the income tax personal allowance to £7,475 and are committed to raising it further to £10,000. We are committed to implementing major simplification to the benefits system through the introduction of Universal Credit and reforms to the State Pension. We are making improvements to the operation of PAYE through the introduction of Real Time Information from 2013. And, in parallel with this paper's publication, we are launching a discussion document on modernising the personal tax system to provide greater transparency for individual taxpayers.

Building on these reforms, at Budget 2011 the Government announced its intention to look at ways to integrate the operation of income tax and National Insurance Contributions. This is a challenging issue, and has been looked at, but not pursued, several times by previous governments. However, the Government strongly believes it is worth looking at again. There is scope to explore the issues in partnership with external stakeholders in more depth than previous work. We do so with the following objectives: reducing burdens on employers, removing economic distortions and improving transparency, achieving fairer outcomes for individuals, and cutting government's administrative costs.

Since Budget 2011, we have run a call for evidence. This has confirmed the appetite for reform from employers, tax and payroll professionals, but also the need to progress with sufficient care, working alongside stakeholders to identify options that will meet these objectives. Stakeholders have emphasised the need for an open approach, requesting that the Government sets out its plans at each stage.

The OTS recommended that the Government set out a timetable for reform of income tax and NICs and commence work by the end of 2011. This paper is our response to that recommendation. It summarises the results of the call for evidence, sets out some objectives and principles for reform and an indicative timetable for consultation and implementation. It also explains some of the challenges that must be overcome if reform is to succeed.

There is much work to be done to identify and explore options, and to confirm that the benefits of integration exceed the potential upheaval of getting there. We are establishing a number of working groups to help us. In this area, as with many aspects of tax reform, a consultative and deliberate approach is desirable. Subject to the outcome of this work, at Budget 2012 the Government will provide an update on progress, including the timetable for further rounds of detailed and extensive consultation on any proposed options. I look forward to continuing to work with interested parties on this important area of reform.



David Gauke, Exchequer Secretary to the Treasury

November 2011

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Introduction

1.1 Income tax and National Insurance Contributions (NICs) are significant elements of the tax and welfare system, but have different origins and purposes, and have developed separately over time.

1.2 Income tax is the single largest tax levied by government, with receipts of £153.5 billion in 2010/11.¹ It is paid by individuals on the basis of their total income. Income tax receipts are paid into the Consolidated Fund, which finances general government expenditure.

1.3 NICs fund the UK's National Insurance system, which was established in 1911 and significantly expanded in 1948. Total receipts from NICs were £96.5 billion in 2010/11.² NICs are paid by employees, and their employers, on their employment earnings, and by the self-employed on their profits. Receipts are paid into the National Insurance Fund, which finances state pension payments and other contributory benefits, as well as part funding the National Health Service. The National Insurance system is based on the premise that individuals should make insurance payments (NICs) out of their earnings in return for replacement earnings, should they find themselves unable to work, or in their retirement.

Objectives for reform

1.4 The fact that employers have to operate two different systems is a cause of complexity and distortion in the tax system. The Office of Tax Simplification (OTS), in its interim report on small business taxation, highlighted the integration of income tax and NICs as an area fundamental to delivering genuine simplification for businesses.³ It also highlighted that maintaining two separate systems leads to a number of anomalies that provide incentives for employers and individuals to make decisions that are wholly tax driven and would not otherwise make commercial sense.

1.5 It is therefore appropriate that the Government looks to simplify the operation of income tax and NICs. At Budget 2011 the Government announced that it would consult on options for reform. From July to September HMRC and HM Treasury ran a call for evidence to understand why and where employers currently experience burdens in the system.

1.6 Any reform of the operation of income tax and NICs will need to contribute to the Government's wider ambitions for the tax and benefit system. Reforms will have to stand up to the principles for the tax system that the Chancellor outlined at Budget 2011:

- taxes should be efficient and support growth;
- taxes should be certain and predictable;
- taxes should be simple to understand and easy to comply with; and
- the tax system should be fair, reward work, support aspiration and ask the most from those who can most afford it.

¹ ONS figures

² ONS figures

³ *Small business tax review*, Office of Tax Simplification, March 2011

1.7 The objectives for reforming the operation of income tax and NICs were outlined in the call for evidence. The Government wants to identify proposals that will:

- **Reduce burdens on employers.** Employers are required to understand and comply with two different systems and two different sets of rules. Integration has the potential to make compliance simpler and cheaper.
- **Remove distortions in the economy and improve transparency.** As the OTS noted, maintaining two systems leads to a number of anomalies that provide incentives to distort behaviour. More generally, many individuals may find it hard to understand how much they will pay under the two systems. A more integrated system may be more transparent, helping individuals make better decisions regarding their employment.
- **Deliver fairer outcomes.** The current systems deliver different outcomes depending on the nature of a person's employment (Box 2.A in Chapter 2). Under the current system, employees with similar circumstances and income may pay different amounts and receive different benefit entitlements. Greater integration may be able to improve the fairness of outcomes by making it more likely that employees with similar circumstances pay similar amounts and gain similar contributory benefit entitlements.
- **Cut administrative costs for government.** HMRC spends around £1 billion on Pay As You Earn (PAYE) administration each year. Any changes to the current system will entail up-front costs. But if closer integration can reduce complexity (for employers and for government), it may be able to reduce the likelihood of error and HMRC's overall costs of collection in the longer term.

Next steps for reform

1.8 The OTS recommended that the Government set out a timetable for reform and commence work by the end of 2011.⁴ This paper addresses that recommendation.

- Chapter 2 provides a brief overview of the way income tax and NICs currently work.
- Chapter 3 summarises the results of our call for evidence, and our conclusions. Overall, there is a strong case for developing proposals for reform, focused on the areas identified in the call for evidence. However, the evidence suggests it would not be appropriate to rush this reform and that instead the Government should embark on extensive consultation, in recognition of the scale of this reform and its potential impacts.
- Chapter 4 describes the Government's parameters, objectives and principles for reform. It also describes the challenges that must be overcome for reform to succeed. The Government intends to work with stakeholders to explore how reform could be delivered and satisfy itself that its benefits sufficiently outweigh the transitional costs of putting it in place.
- Chapter 5 sets out a programme of engagement and consultation and an indicative timetable for reform.

⁴ *Small business tax review*, Office of Tax Simplification, March 2011

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The current operation of income tax and NICs

The structure of income tax and NICs

Income tax

2.1 Income tax is paid by individuals on the basis of their total annual income including earnings, pensions, and income from savings and investments. A person of any age is liable to income tax on all their total worldwide annual income if they are resident, ordinarily resident, and domiciled in the UK. Employees pay income tax on their salary and on benefits in kind from their employment. The self employed pay income tax on the profits from their business. There are three main rates of income tax, though special rates apply to certain types of income such as savings and dividends (Table 2.A).

Table 2.A: Rates of income tax applicable to earnings from employment (2011/12)

Rate name	Charged on	Rate
Basic	Taxable income (above personal allowance) up to £35,000	20 per cent
Higher	Taxable income of £35,001 to £150,000	40 per cent
Additional	Taxable income over £150,000	50 per cent

Source: HMRC / HM Treasury

2.2 Individuals are entitled to a personal allowance, which is an amount of income on which they are not required to pay tax. For most individuals the personal allowance is £7,475, with higher allowances for those over the age of 65. Further allowances are available for blind people, and for married couples where one spouse was born before 6 April 1935.

2.3 There are also various exemptions and reliefs from income tax. For example, relief is given for certain business expenses paid for by employees. Relief from income tax is given on payments of contributions to registered pension schemes. And gifts to charity attract tax relief through the Gift Aid and Payroll Giving schemes.

NICs

2.4 NICs have developed a quite different structure to income tax, reflecting their different purpose. The National Insurance scheme was designed in order that individuals, their employers and the state would all have a role. There are therefore differing NICs charges ('classes') on employees and on employers, and further arrangements for the self employed. The rates and thresholds of each class differ (Table 2.B) and there are reduced rates for certain groups.¹

¹ For example, those who contract out of the additional state pension, called State Second Pension, pay a lower rate of NICs.

Table 2.B: Main NICs rates (2011/12)

Rate name/ Class	Charged on	Rate
<i>Employee NICs</i>		
Class 1 (primary) – main rate	Earnings of £139 to £817 per week ^a	12 per cent
Class 1 (primary) – additional rate	Earnings above £817 per week	2 per cent
<i>Employer NICs</i>		
Class 1 (secondary)	Earnings of £136 per week and above ^b	13.8 per cent
Class 1A	Benefits in kind provided by the employer	13.8 per cent
Class 1B	Certain earnings and expenses under a PAYE Settlement Agreement agreed between an employer and HMRC ^c	13.8 per cent
<i>Self employed NICs</i>		
Class 2	N/A	Flat rate of £2.50 per week
Class 4 – main rate	Taxable profits from self-employment between £7,225 and £42,475	9 per cent
Class 4 – additional rate	Taxable profits from self-employment above £42,475	2 per cent
<i>Source: HMRC / HM Treasury</i>		
^a £139 is the current primary threshold, above which Class 1 NICs are payable by employees. £817 is the upper earnings limit, above which a lower rate is payable		
^b £136 is the current secondary threshold, above which Class 1 NICs are payable by employers		
^c PAYE Settlement Agreements are a facility for reporting some types of irregular or unusual benefits in kind and expenses in a single payment		

Employee NICs

2.5 Employees pay NICs on their earnings, with each employment considered separately. NICs are assessed on earnings in each earnings period, with a threshold in each period below which NICs are not due. There are two main rates of NICs on earnings, but there are also separate rates, for example, for those who are contracted out of the State Second Pension. Unlike income tax, NICs are not paid on all types of income. For example, no NICs are paid on pension income or interest from savings. And employee NICs are not payable on most benefits in kind from employment (for example company cars and fuel and private medical insurance). Employee NICs are not paid by those above State Pension age, or below the age of 16. Thus, although employee NICs and income tax are more closely aligned than they once were, there remain significant differences between them (Table 2.C).

Table 2.C: Comparison of income tax and NICs paid by employees

	Income tax	Employee National Insurance
Who pays?	No age limit.	16 to State Pension age.
What is it paid on?	On all income including earnings, pensions and income from savings or investments and benefits in kind.	On most earnings from employment, but not on most benefits in kind.
Period of assessment	Assessed on total annual income. Deductions by employers through PAYE are based on pay to date (cumulative). Liability finalised following the end of the tax year.	Assessed on earnings in each earnings period (non-cumulative). Liability finalised at the point that the earnings are paid.
Liability across employments	Earnings from separate employments aggregated.	NICs liability calculated on each employment in isolation (non-aggregated).
Structure of charge	Above the personal allowance, tax is applied at three rates (rising as income rises) on different bands of income.	Applied at two main rates on different bands of earnings above the primary threshold with the rate for the higher band lower than that for the lower band.
Entitlements provided	No entitlements.	Entitlement to contributory benefits, including the State Pension, and statutory payments.

Source: HMRC / HM Treasury

Employer NICs

2.6 Employers are also required to make contributions to the National Insurance scheme. Employer NICs (Class 1 secondary) are structured in the same fashion as employee NICs (Class 1 primary) and are payable on the same earnings. They are designed to be one contribution with two elements (employee and employer). Like employee NICs, liability is determined per pay period and per employment on earnings. However, unlike employee NICs, employer NICs are also payable on earnings paid to employees over state pension age. Employers are also required to pay NICs on the benefits in kind that they provide to their employees (Class 1A NICs) and on items included in PAYE Settlement Agreements (Class 1B).²

2.7 The position of an employer as a secondary contributor (someone who is liable to pay Class 1 secondary NICs) is significant for the UK's social security system. It is the position of an employer as a secondary contributor which makes them legally responsible for the payment of employee and employer NICs, and for the collection of student loans. Student loan repayments, deducted by the employer are based on the earnings that attract Class 1 secondary NICs. Secondary contributors are also responsible for administering and part-financing statutory payments (Statutory Maternity Pay, Statutory Paternity Pay, Additional Paternity Pay, Statutory Sick Pay, and Statutory Adoption Pay).

Self employed NICs

2.8 The self employed pay NICs based on the taxable profits of their business above an annual threshold and these (Class 4 NICs) are collected through the self assessment system. Class 4 does not give the self employed entitlement to contributory benefits. Instead they are required to pay an additional amount of NICs at a flat weekly rate of £2.50 (Class 2 NICs), which can provide them with access to certain contributory benefits.

² PAYE Settlement Agreements are a facility for reporting some types of irregular or unusual benefits in kind and expenses in a single payment

The contributory principle and contributory benefits

2.9 Unlike the income tax system, individuals' payments of NICs are underpinned by a 'contributory principle'. Individuals contribute to the scheme while in work in order to receive financial support while out of work, for example through illness, maternity, bereavement, unemployment or in retirement. This financial support is given via a range of contributory benefits, set out in Table 2.D. NICs credits are available for individuals in a range of circumstances who are unable to pay NICs, for example people who cannot work through illness or who are carers.

2.10 For individuals, the payments of NICs therefore need to be recorded over their whole working life as they prove entitlement to access contributory benefits, particularly the State Pension. Entitlement to some contributory benefits is determined by the number of qualifying years that an individual has built up through the payment of NICs during their working life (Table 2.D). All payments of Class 1 or Class 2 NICs are entered for each individual on their National Insurance record and the Department for Work and Pensions (DWP) uses this to determine the amount of contributory benefit that is payable to each individual who makes a claim. Individuals may make voluntary payments of NICs (Class 3 NICs and in some cases Class 2) in order to ensure they have an adequate contributions record.

2.11 Employers NICs are paid into the National Insurance Fund and help finance contributory benefits. However, although payments are determined per employee, they are not recorded against the individual's contributions record, so are not taken into account when determining entitlement to benefits.

Table 2.D: Contributory benefits and statutory payments

Benefit	Operation	Current entitlement test for employees ^a
State Pension	Currently comprised of two elements, the basic State Pension and the additional (Second) State Pension. In 2011-12, a single person over State Pension Age can get up to £102.15 a week basic State Pension.	Individuals require 30 qualifying years to receive the full basic State Pension. ^b A qualifying year is achieved by paying Class 1 NICs on earnings of 52 times the lower earnings limit (LEL), currently £102, or through a combination of Class 1, 2, 3 NICs and NICs credits.
Contributory Jobseeker's Allowance	A weekly benefit of £67.50 (or £53.45 for those under 25) paid for six months to those unemployed and seeking work.	First condition: in at least one of the previous two complete tax years, the employee must have paid (or been treated as having paid) ^c 26 Class 1 contributions on earnings of at least the lower earnings limit (LEL). Second condition: For each of the previous two tax years, a claimant must have been paid or credited with Class 1 NICs on earnings of 50 times the lower earnings limit for that tax year.
Employment and Support Allowance	A benefit paid to those unable to work through illness or disability. Comprises a weekly payment of £67.50 (or £53.45 for those under 25) paid for a 14 week assessment period, followed by a payment of £94.25 or £99.85 depending on assessment.	For employees, conditions are as for Contributory Jobseeker's Allowance

Bereavement benefits	<p>Under certain conditions, a spouse with a deceased partner may be eligible for:</p> <ul style="list-style-type: none"> • Bereavement Payment. A one-off £2,000 tax- free payment. • Widowed Parent's Allowance (WPA). A weekly payment of up to £100.70 if a parent. People entitled to WPA can also get half of their late spouse or civil partner's Additional State Pension • Bereavement Allowance. A weekly payment for up to 52 weeks of up to £100.70, depending on age. 	Entitlement tests vary for each, but depend upon contribution levels and are linked to the LEL.
Statutory Maternity Pay (SMP)	<p>Paid for up to 39 weeks to help women take time off work around the time of giving birth. Paid for the first six weeks at 90 per cent of the employee's average weekly earnings (calculated over a relevant period). Then paid at either the weekly standard rate, currently £128.73, or 90 per cent of the employee's average weekly earnings, whichever is less.</p>	Various conditions including: the employee must have been continuously employed by the same employer for 26 weeks going into the 15 th week before the week the baby is due (the qualifying week); average weekly earnings (at the qualifying week) are not less than the LEL.
Ordinary Statutory Paternity Pay (OSPP)	<p>Paid to help an employee take time off to care for a baby, support the mother after giving birth or to take time off work when adopting a child. Paid for one or two weeks at the lower of the weekly standard rate, currently £128.73, or 90 per cent of the employee's average weekly earnings (calculated over a relevant period).</p>	Entitlement conditions include: the employee must have been employed continuously for at least 26 weeks before the relevant week and continues to work up to the date the baby is born, or child adopted; average weekly earnings (at the relevant week) are not less than the LEL. ^d
Statutory Adoption Pay (SAP)	<p>Paid to help an employee (male or female) take time off work when adopting a child. Can also be paid when an employee is adopting a child from abroad. Paid at the lower of the weekly standard rate, currently £128.73, or 90 per cent of the employee's average weekly earnings (calculated over a relevant period). Can be paid for a maximum of 39 weeks.</p>	Entitlement conditions include: the employee must have been employed continuously for 26 weeks into the relevant week; average weekly earnings (at the relevant week) are not less than the LEL.
Additional Statutory Paternity Pay (ASPP)	<p>Paid to eligible fathers, partners, civil partners of mothers and adopters, usually where SMP or SAP has been brought to an end by the mother or adopter returning to work. The employee must be taking time off to care for the child. Paid at the lower of the weekly standard rate, currently £128.73, or 90 per cent of the employee's average weekly earnings (calculated over a relevant period). Usually paid for a maximum of 19 weeks.</p>	Entitlement conditions include: the employee must have been employed continuously for 26 weeks into the relevant week and must continue to work up to the end of the week before ASPP begins; average weekly earnings (at the relevant week) are not less than the LEL. ^d
Statutory Sick Pay (SSP)	<p>Paid at the current weekly rate of £81.60. Maximum entitlement is 28 weeks.</p>	Entitlement conditions include: the employee must have performed some work under their contract of service; average weekly earnings (at the moment of becoming unfit to work) are not less than the LEL.

Source: DWP / HMRC / HM Treasury

^a Self-employed individuals are subject to different eligibility tests.

^b Individuals with fewer than 30 qualifying years receive proportionally less basic State Pension. And there are additional conditions to receive the State Second Pension.

^c Employees whose weekly earnings exceed the lower earnings limit, currently £102, are treated as paying Class 1 NICs even though they will not make any actual NICs payments unless their weekly earnings also exceed the primary threshold, currently £139.

^d There are different entitlement conditions for OSPP and ASPP in cases where employees are adopting a child from abroad.

The administration of income tax and NICs

2.12 The vast majority of income tax payable by employees and pensioners is collected by employers or pension providers through the Pay As You Earn (PAYE) system. This system places responsibilities on all employers across the country for collecting income tax and NICs. There are over 1.2 million employers in the UK, the majority of which are small and medium size enterprises,³ Altogether these organisations employ around 29 million individuals.

2.13 PAYE is designed around the principle that contact between HMRC and the taxpayer should be minimised. HMRC provides employers with a tax code for each employee that determines how much tax should be deducted and paid through PAYE. It is cumulative and deducts income tax on a weekly or monthly basis by reference to the employee's income to the pay date. It spreads the personal allowance and tax rates across the tax year, offering a certain amount of flexibility in when tax is paid. For most basic-rate taxpayers this means they have no dealings with HMRC, other than receiving a coding notice.

2.14 Benefits in kind and certain expenses are generally reported through the P11D process which requires the employer to provide details to HMRC and to the employee after the end of the tax year. The liability is then paid by the employee through a year-end self assessment and/or adjustments to the amount of tax they pay in the following year (through changes to their tax code).

2.15 Like income tax, NICs on earnings from employment, including certain expenses payments, are collected through the PAYE system. To administer this, the employer needs to know whether and at what rate to apply NICs (for example, they need to know if the employee is above State Pension age in which case no employee NICs applies). HMRC provides a set of NICs 'category letters' and by reference to this employers must work out which is the appropriate rate of NICs for each employee. Employers must select the correct category letter for each employee. There are currently 20 category letters; in April 2012 this will reduce to 14 as a result of the abolition of contracting out of the State Second Pension for employees in defined contribution pension schemes.⁴ No account of earnings from other employments needs to be made because liability for NICs is determined for each employment independently of any others. And as NICs are not calculated cumulatively no account needs to be taken of earnings in other pay periods. Employers NICs (Class 1 secondary) are also collected through the PAYE system. Employers NICs payable on benefits in kind (Class 1A) and PAYE Settlement Agreements (Class 1B) are collected after the end of the tax year through the P11D process.

2.16 Under the current PAYE system, employers calculate the amount of tax and Class 1 NICs that each employee needs to pay, deduct this sum from the earnings they pay to their employees and send this, together with their own employer NICs, to HMRC on a monthly or quarterly basis. However, they do not send HMRC information that explains the breakdown of each payment between employees or between tax and NICs. Therefore, at the end of the tax year employers have to report to HMRC the earnings they have paid and the deductions they have made for each employee. Almost all employers are now required to file this information online.

2.17 Progressively, from April 2013, there will be changes to employer payroll processes with the introduction of Real Time Information. Instead of requiring information at the end of the tax year HMRC will require employers to submit information whenever they pay their employees, whether that is weekly, monthly etc. There will be no change in the date for paying amounts to HMRC.⁵

2.18 Not all income tax and NICs are collected through PAYE. There are 3.5 million self employed taxpayers that pay income tax via Self Assessment. Self Assessment also applies to employees with more

³ Figures according to *Business Population Estimates for the UK and Regions 2011*, BIS

⁴ See for more information http://www.direct.gov.uk/en/Pensionsandretirementplanning/StatePension/DG_180010

⁵ For more information on plans on improving the PAYE system through Real Time Information please visit <http://www.hmrc.gov.uk/news/improve-pay.htm>.

complex tax affairs, including company directors and individuals with incomes of over £100,000. Some individuals pay through both PAYE and Self Assessment.

2.19 It is important to recognise that the PAYE system also enables other Government policies to be delivered. These include the collection of income contingent student loan repayments and the operation of statutory payments.

Outcomes for individual earners

2.20 Under the current system employees with similar circumstances and earnings may pay different amounts of NICs. The fact that NICs are calculated per pay period and per employment means that the amount an individual is liable for can depend on their working pattern (Box 2.A). This can sometimes mean that employees with similar earnings end up with different contributions records and therefore different access to contributory benefits.

Box 2.A: Examples of unfairness in the current NICs system

Employees with fluctuating earnings

Fred is paid £130 a week but for thirteen weeks in the year he undertakes some overtime and his earnings rise to £230 in each of those weeks. In total Fred earns £8,060 for the year. He is only required to pay NICs in those weeks where his earnings reach the primary threshold of £139. Fred pays £141.96 in NICs over the year.

$$(13 \text{ weeks} \times (\pounds 230 - \pounds 139) \times 12 \text{ per cent})$$

Freda earns exactly the same amount as Fred: £8,060 for the year. However, her earnings are spread evenly across the year. She earns £155 a week. She therefore pays NICs every week on earnings above the primary threshold of £139. She pays £99.84 in NICs over the year.

$$(52 \text{ weeks} \times (\pounds 155 - \pounds 139) \times 12 \text{ per cent})$$

Freda therefore pays less NICs across the year than Fred despite having the same overall earnings. This is because Freda's earnings are above the employee's NICs threshold in each earnings period and she is therefore entitled to the maximum weekly amount of NICs-free pay every week.

Employees with multiple employments

Lewis earns exactly the same as Louise but he has only one full time job, which pays him £260 per week. In total Lewis earns £13,520 but is required to pay £755.04 in NICs.

$$(52 \text{ weeks} \times (\pounds 260 - \pounds 139) \times 12 \text{ per cent})$$

Louise has two part-time jobs. In each job she earns £130 per week. In total Louise earns £13,520 over the year. However, because her weekly earnings in each employment are below the primary threshold of £139 Louise pays no NICs.

Louise therefore pays no NICs at all despite earning the same amount as Lewis.

Despite paying different NICs, in this example Fred, Freda, Lewis and Louise would all have a full NICs contributions record for the year. This is because their weekly earnings are above the lower earnings limit of £102 per week.

3

Summary of findings from the call for evidence

3.1 Shortly after Budget 2011 HM Treasury and HMRC published a call for evidence. It ran from July to September and received a good response, with over 70 submissions. These came from a variety of organisations, a number of which had surveyed their members to put together a broad evidence base. The respondents comprised:

- three employer organisations;
- nine trade unions and bodies representing particular sectors;
- five small employers;
- seven representative organisations for tax and finance professionals;
- 13 individual tax professionals (including some writing on behalf of accountancy firms);
- the Chartered Institute of Payroll Professionals (CIPP) and five providers of payroll services;
- three providers of payroll software; and
- 16 (unaffiliated) members of the public.

Annex A lists the respondents in full.

3.2 In support of this exercise, HM Treasury and HMRC also conducted a small programme of informal bilateral meetings with organisations and experts representing business interests, payroll and tax expertise. These were used to help to supplement and validate the results of the call for evidence.

3.3 This chapter summarises the evidence provided in submissions. Annex B summarises responses according to each of the questions posed. It is important to recognise that a call for evidence provides useful qualitative insights but is not a robust quantitative data collection exercise. We have sought to indicate the general strength of response and state where certain perspectives came from particular groups.

Objectives for reform

3.4 Most respondents welcomed the Government's consideration of greater integration of income tax and NICs. Taken together, responses suggest there is a clear appetite for reform. The majority of responses argued that there were potential gains to be made from greater operational alignment. Most responses focused on making the system of National Insurance more like income tax, rather than the other way around.

3.5 The call for evidence asked for views on the objectives of reducing burdens on employers, removing economic distortions, and providing fairer outcomes for individuals. Many responses stated that these objectives and scope were broadly correct. A minority of respondents called for a complete merger, with the abolition of the National Insurance system, but most accepted the parameters set out at Budget 2011 and concentrated their response on operational integration. A summary of responses received in relation to each of these objectives is set out below.

Reducing burdens on employers

3.6 Employers, payroll operators and tax practitioners provided the greatest detail on employer burdens. A number of bodies had surveyed their members to obtain additional insights. It should be noted that not all of the issues summarised below will apply to all employers. For instance, small employers with simpler staff arrangements are likely to experience fewer of these issues.

3.7 The responses suggest that the differences between income tax and NICs are a source of considerable administrative burden for employers. Respondents also highlighted several features of the current National Insurance system which create additional administrative work.

3.8 Respondents were asked to provide general comments on the cause of employer burdens, and also to rate the most time consuming tasks on a scale of 1-5. Both sets of answers suggest that **the primary concern to employers is the amount of time required to familiarise themselves with the differences between income tax and NICs.**

3.9 Another area of concern is the **time taken to perform the actual calculations**, as despite the widespread use of payroll software (Box 3.A), manual interventions are still often necessary for a range of purposes. **Explaining the system to employees** is also potentially difficult and time-consuming.

Box 3.A: Use of payroll software

Payrolls have become increasingly automated over recent decades. Previous government estimates suggested that by 2007 only around 210,000 employers out of around one million were conducting their payroll manually.¹ This figure was expected to decrease significantly further over time.

Use of payroll software varies between simple, off-the-shelf software, typically used by small employers, to large bespoke systems used by major employers (who may have several separate systems). The basic software used by many small and medium size organisations will perform the majority of calculations required each pay period and at year-end. However, the employer still needs to understand the income tax and NICs system:

- to set up the software correctly when setting up a payroll;
- to select the correct NICs category letter for each employee;
- to perform more complex processes not handled by the software (e.g. treatment of benefits in kind);
- to make corrections (e.g. to an over- or underpayment in the previous pay period);
- to perform a sense check of the software results; and
- to explain the payments to employees.

A related issue is the extent to which the payroll operation is outsourced. Many employers employ agents to run some or all of their payroll operation. An employer who outsources may have less need to understand the systems. However, differences between income tax and NICs may still create complexity for the agent, which will feed through into higher charges for the employer.

3.10 The different definition and treatment of earnings and expenses for income tax and NICs was the **most common issue cited by respondents**. Payroll operators have to understand what tax and NICs should be paid on, which differ in a number of respects. Once these differences are understood, the method for

¹ *Income tax and national insurance alignment: an evidence-based assessment*, HM Treasury, October 2007

processing benefits in kind and expenses may differ again, and require manual work to determine and pay NICs for employees. Termination payments and benefits in kind were both widely cited as examples of issues which require separate treatment for income tax and NICs.

3.11 The pay period basis for NICs was cited almost as frequently as creating administrative burdens. Respondents argued that making retrospective amendments to NICs payments is difficult, unlike the income tax system which provides greater flexibility to correct any mistakes over the course of a year and beyond the year end. Correcting over and underpayments of NICs (where employees' or directors' earnings are aggregated for NICs) and calculating the value of expenses from specific pay periods were highlighted as tasks made more difficult and time consuming to perform under this pay-period system.

3.12 The different treatment of internationally mobile employees under tax and NICs was also highlighted as a clear issue by respondents. They expressed the view that the legislation determining NICs liability is unclear and that significant manual work can be needed to process PAYE for these individuals. The majority of those who responded on this issue argued that the differences create a range of difficulties and leave employers vulnerable to mistakes and at risk of fines by HMRC.

3.13 A further issue, and one highlighted mainly by tax practitioners, are the **different definitions of employment status** for some groups under income tax and NICs. Respondents argued that relying on legislation to determine the employment status of certain self employed occupations (such as entertainers) creates uncertainty for employers and necessitates additional manual work, as often these workers are not in the PAYE system but are on self assessment for income tax purposes.

3.14 In addition to the differences between NICs and income tax, a large number of respondents commented on what they perceived as the complexities of the NICs system itself. The most commonly cited difficulties with the NICs system were the following:

- **Identifying the appropriate NICs rate for each individual via the NICs category letters.** A number of respondents highlighted this as time-consuming and an ongoing cause of error.
- **Differences in thresholds,** both between the primary and the secondary NICs thresholds, and between the difference between the primary threshold for NICs and the personal allowance for income tax. Submissions were not always clear on the nature of the specific burden arising from these misalignments, but they were seen to complicate any manual calculations and contribute to a genuine misunderstanding of NICs which made it difficult to explain the system to employees.
- **The process for Directors' NICs.** According to some submissions, the existence of a separate, annual system for this group necessitates additional manual work for payroll operators and can lead to over or under payments.
- **The calculation and recovery of statutory payments.** A few respondents stated they found these processes cumbersome.

3.15 Responses suggest that these issues are not just a matter for the operation of payroll and tax compliance: they make a number of other aspects of business more difficult. These include making decisions regarding secondments or sending staff abroad, and determining remuneration and termination packages.

Removing economic distortions

3.16 Tax practitioners and large businesses provided most of the comments on economic distortions.

3.17 The most frequently cited distortion related to the earnings period basis for National Insurance. Respondents pointed out that individuals in multiple employments may pay less National Insurance than those with a single, full time employment, even if their overall annual earnings are the same.

3.18 A smaller number of submissions identified the following potential distortions:

- The fact that employee NICs are not charged on benefits in kind. Some respondents argued this encourages employers to pay their staff through non-cash means.
- The lower NICs rate for the self employed. Some respondents stated this provides an incentive for employers to engage individuals without a formal contract of employment or for employees to disguise their employed status.
- The existence of the employer contribution. Some respondents argued that, because it does not link directly to employees' contributory benefit entitlement, it is simply an additional tax on labour, but one less visible to the employee.

Fairness

3.19 The call for evidence defined fairness in terms of the extent to which the system delivers the same outcome for individuals with the same earnings.

3.20 A large number of respondents recognised that the current NICs system treats people with the same level of earnings, but with differing numbers of employments, in different ways. As set out in Chapter 2, the non-aggregated structure of National Insurance can result in individuals with similar levels of employment income paying different amounts of NICs, and this was seen as unfair by a number of different types of respondent.

3.21 A number of submissions also pointed to the rate structure of National Insurance as unfair. The existence of the lower two per cent charge for those earning over a certain level was viewed as regressive by a number of respondents. A small number of respondents also cited the lower rate of NICs for the self employed as unfair.

3.22 Submissions raised other issues under the heading of fairness:

- A few respondents identified the fact that employee NICs are not charged on benefits in kind as a source of unfairness (as well as an economic distortion), as individuals can reduce their contributions through being remunerated in a certain way.
- A few submissions, mostly from individual members of the public and tax practitioners, discussed the contributory principle that underpins the National Insurance system. Several questioned the strength of the contributory element and argued that National Insurance was simply a tax, and it would be more transparent to call it so.

Suggestions for reform

3.23 The call for evidence was focused on identifying issues with the current system. However, it also asked respondents for suggestions on how we could meet our objectives for reform. Some called for a complete merger of income tax and NICs (or the abolition of NICs) but the majority accepted the parameters set out at Budget 2011 (which are restated in Chapter 4) and made suggestions for alignment, simplification or operational integration. A more detailed list of all the suggestions made is included under question 3 in Annex B.

Employer burdens

3.24 Many respondents argued that a complete merger would be necessary to meet this objective, although most recognised that this was not the Government's objective. The most common suggestion was moving NICs to an annual and cumulative basis, mirroring the system for income tax, although respondents were not clear how this could best be achieved. The second most frequent suggestion was aligning the definition and treatment of earnings such that the basis for charging NICs replicates that for income tax (including benefits in kind, business expenses, termination payments and pension contributions) and a simplification of the systems used to process and report both forms of income.

3.25 Respondents frequently recommended simplifying the system for processing benefits in kind. There were differences in opinion on how this might be achieved. The majority felt that the process should follow the NICs treatment; either having one class, and one single process, for all benefits in kind, or leaving two classes but simplifying the reporting procedures for both.

3.26 Other common suggestions included reforming the special rates for certain groups, the collection and penalty regimes, the rules and procedures for internationally mobile employees, the NICs primary and secondary thresholds and employer NICs.

Economic distortions

3.27 The most common proposal was to move NICs to an annual, cumulative and aggregated basis to mirror income tax. Several argued in favour of charging NICs on dividends, or undertaking some other form of action, in order to reduce the practice whereby individuals pay themselves in dividends rather than drawing a salary.

3.28 Other suggestions included equalising the NICs rates for the self employed and employees, and abolishing employer NICs. Trade Unions, and a number of individuals, recommended strengthening the contributory element to NICs to provide a stronger work incentive to individuals.

Fairness

3.29 Many submissions argued that moving NICs to an annual, cumulative and aggregated system would deal with the current disparities in treatment. A few respondents proposed that NICs should have a more progressive rate structure. A few also argued in favour of levying Class 1 NICs on benefits in kind, to ensure that individuals do not avoid NICs through being paid in benefits in kind rather than salary.

Areas of concern

3.30 Whilst the majority of responses expressed a clear appetite for reform, respondents also identified some concerns about greater integration.

3.31 Tax professionals and employers expressed concern that reform could actually increase administrative burdens on employers, if not implemented carefully. Their concerns were mainly related to the transitional costs of moving to a new system, and the potential impacts on smaller businesses. There was strong support for a staged approach to any reform, with a clearly communicated timetable for changes, giving sufficient time for employers to prepare.

3.32 A related concern was the difficulty employers and HMRC may have in delivering reform in a short time frame, particularly given the major PAYE reforms already underway (Real Time Information).

Conclusions

3.33 The majority of submissions to the call for evidence endorsed the Government's view that closer integration of the operation of income tax and NICs has the potential to reduce burdens, remove distortions and improve fairness. Evidence provided suggests that the differences between income tax and NICs do create burdens for employers: the period of assessment and the basis of charge being the two main sources of difficulty. Respondents also highlighted several features of the current NICs system which employers find complicated in their own right, rather than stemming from their difference to income tax, such as the process of identifying NICs category letters for employees.

3.34 However, recognising the scale of this reform and its potential impacts, the call for evidence also confirmed the need to proceed carefully with extensive consultation. Respondents recognised the challenges of closer alignment, but they did not see these as insurmountable.

3.35 In light of these results, Chapter 4 sets out the Government's parameters, objectives and principles for reform, and Chapter 5 summarises the engagement strategy for further consultation.

4

Reform: parameters, principles and challenges

4.1 The results of the call for evidence have confirmed the Government's belief that closer integration of the operation of income tax and NICs has the potential to reduce burdens on business, remove economic distortions and improve fairness. This could be a major step forward in simplifying the tax system. But it is clear that reform on this scale also comes with significant challenge and there is therefore a need to progress with care.

4.2 The Government believes that in light of the call for evidence, and the recommendations of the OTS, the Mirrlees Review and others, it is right to continue to examine the issue. The issue of income tax and NICs integration has been examined by several previous governments. However, recent work by government on the issue was limited in scope¹ and there is the potential to explore the issues with stakeholders in more depth. In addition, the reforms the Government is committed to in the related areas of tax transparency, PAYE Real Time Information, State Pension and Universal Credit open up opportunities not available to previous governments.

4.3 This chapter explains the parameters for further work. It also sets out the objectives and principles that the Government will apply in considering options for reform. Finally, it describes some of the challenges likely to arise along the way and that must be overcome to make reform a success.

Parameters

4.4 At Budget 2011, the Government established some parameters for this work:

- The Government will maintain the contributory principle that underpins National Insurance. Those in employment will continue to pay or be treated as paying National Insurance in order to receive financial support while out of work, whether through illness, unemployment or in retirement. As such, NICs will need to retain an identity distinguishable from income tax.
- National Insurance will remain a charge on the earnings of working-age individuals. The Government does not intend to extend NICs to other forms of income such as pensions, savings and dividends. The Government sees NICs as remaining a system based on payments from employment earnings, in return for replacement earnings when out of work. Nor does the Government plan to extend NICs to individuals above State Pension Age.

4.5 However, these parameters do not constrain the scope for the operation of National Insurance to be fundamentally reformed. The National Insurance system needs reform to reflect changes in the labour market over the past 60 years. The system put in place in 1948 was designed for a labour market in which most households had only one (male) earner, most earners had only one employment, and very few worked overseas. The labour market has since become markedly less homogenous, with greater part-time working, more people working for several employers, more people working in both employment and self-employment, and much greater international movement. There may be ways to change the way the system works to better suit the modern labour market.

¹ *Income tax and national insurance alignment: an evidence-based assessment*, HM Treasury, October 2007. This was the most recent government work on the issue. A small number of stakeholder groups were involved in that work, but no formal consultation was conducted.

4.6 The Government recognises that this falls short of the full merger of income tax and NICs called for by, amongst others, the Institute for Fiscal Studies.² However, the Government wants to explore whether closer operational integration that retains a separate NICs identity is a worthwhile goal on its own merits.

Objectives and principles

4.7 The Government's vision is a simpler, fairer and more efficient system that employers and individuals can understand. Chapter 1 set out the Government's four objectives. From these objectives come a number of principles (Box 4.A). The Government will apply these principles when identifying proposals and assessing the advantages and disadvantages of each.

Box 4.A: Objectives and principles for reforming the operation of income tax and NICs

The Government wants to identify proposals that will:

- 1 Reduce burdens on employers.**
 - Income tax and NICs should be easier for employers and payroll agents to operate.
 - HMRC should provide an integrated service to employers.
- 2 Remove distortions in the economy and improve transparency.**
 - The structure of income tax and NICs should not encourage employers to employ or pay their employees in certain ways.
 - It should be easier for employers and payroll agents to understand how to calculate tax and NICs liabilities.
 - Individuals should find it easier to understand how their tax and NICs liabilities have been calculated.
 - Individuals should be clear about the benefit entitlement they accrue through making contributions.
- 3 Deliver fairer outcomes.**
 - Employees with similar circumstances should pay similar amounts of NICs and receive similar benefits.
- 4 Reduce administrative costs for government.**
 - Government's administration of income tax, NICs and related benefits should be as efficient as possible.

Objective 1: reduce burdens for employers

4.8 **Income tax and NICs should be easier for employers and agents to operate.** The Government is already making progress here by introducing Real Time Information, which once bedded in, will make PAYE simpler and more efficient for employers. Looking further, the call for evidence has suggested a number of areas where the process for calculating and administering income tax and NICs could be made simpler:

- The call for evidence suggested that the income tax and NICs treatment of earnings should be the same. There may be scope to more closely align the treatment of benefits in kind, business expenses and other differences to make things simpler. Careful consideration will

² *Mirrlees Review: Reforming the tax system for the 21st century*, Institute of Fiscal Studies, September 2011

be given to what if any role there should be for the payrolling of reportable benefits in kind in a reformed system. Similarly, the role of the existing end of year reporting processes, particularly the P11D, will need consideration.

- The call for evidence also highlighted the issue of different assessment periods between income tax and NICs. A different structure of NICs may enable a more integrated operation for employers. A priority for further work will therefore be to explore the options. This will include, but not be restricted to, consideration of the following:
 - **Annual NICs.** Whether assessment for NICs should be based on the tax year as it is for income tax.
 - **Cumulative NICs.** Whether liability for NICs should be based on earnings over the year-to-date, rather than assessed independently in each pay period.
 - **Aggregated NICs.** Whether earnings should be considered across employments when determining NICs liability, rather than per each employment.

4.9 The Government sees the main path to integration as bringing NICs closer to income tax, rather than vice versa. In general, respondents to the call for evidence expressed the view that the current NICs system is the more problematic. And reform in this direction would be a continuation of changes that have gradually made NICs more like income tax over recent decades. The alternative – moving income tax closer to NICs – would imply changing the annual assessment of income tax to a pay period basis, which could be unworkable given the need to cover non-earnings forms of income. Nevertheless, there may be specific instances where it would be more appropriate to align the income tax treatment of certain earnings and benefits in kind to the current NICs treatment.

4.10 HMRC should provide an integrated service to employers. HMRC's services are already heavily aligned in process, support and guidance that it gives to employers on income tax and NICs. For example, there is a single helpline for employers and the P11 calculator covers both income tax and NICs. The call for evidence suggested there are opportunities to integrate services even further and HMRC is keen to work with employers to identify ways to simplify the system.

Objective 2: remove distortions in the economy and improve transparency

4.11 The tax and welfare system needs reform if it is to support a strong economy, and reform of the operation of income tax and NICs can play a vital part. As stated in the recent Institute for Fiscal Studies review led by James Mirrlees, the current system is unnecessarily complicated and induces too many people not to work or to work too little. By creating a simpler and more rational system, minimizing disincentives where they matter most, there is potential to deliver major economic gains.³

4.12 Employers should not be encouraged to employ or pay their employees in certain ways because of the structure of income tax and NICs . The call for evidence identified some concerns about bias in the current system towards part-time staff and non-cash remuneration. The Government would like to explore these concerns more and assess whether they are a problem and if so, how significant they may be. Any reforms should minimise such distortions.

4.13 It should be easier for employers and payroll agents to understand how to calculate tax and NICs liabilities. As set out in Chapter 3, despite widespread use of software, it is still necessary for payroll operators to understand the calculation and treatment of earnings for a variety of purposes. By more closely aligning the treatment of earnings and the assessment periods, operators will have fewer differences to deal with. In short, the system should become more transparent to them, and they should find it easier to understand and explain what their software is doing for them.

³ *Mirrlees Review: Reforming the tax system for the 21st century*, Institute of Fiscal Studies, September 2011

4.14 Individuals should find it easier to understand how their tax and NICs liabilities have been calculated.

As for employers and payroll operators, the fewer differences between income tax and NICs, the greater the level of understanding should be amongst individuals. In parallel to this paper, the Government is publishing a discussion document on improving the transparency of the personal tax system, including consideration of innovations made in other countries.⁴

4.15 Individuals should be clear about the benefit entitlement they accrue through making contributions.

Entitlement to contributory benefits and statutory payments should be determined by simple tests. Any reform of employee NICs onto an annual basis would entail changes to the existing tests. In considering such changes, there may be scope to make the tests more easily understandable than those currently in place (set out in Table 2.D in Chapter 2).

Objective 3: deliver fairer outcomes

4.16 Employees with similar circumstances should pay similar amounts of NICs and receive similar benefits. As set out in Box 2.A in Chapter 2 the current system does not treat employees equally. Those with earnings who fluctuate over the year, and those with multiple employments, may pay different amounts to those who do not. Reforming the assessment basis of NICs provides an opportunity to consider whether employees who earn the same amount can pay the same contributions – as above, changes to the assessment basis will be a key area to explore. In doing so, the Government will ensure it has a clear understanding of the number of earners likely to be affected and how they will be affected (see ‘challenge 2’ below).

4.17 The call for evidence also highlighted that some consider that the NICs treatment of the self-employed is unequal. The NICs rate for the self-employed is lower than for those in employment, reflecting the fact that the self-employed are eligible for fewer contributory benefits. Whilst the Government recognises these points, the primary focus of this work is an operational integration.

Objective 4: reduce administrative costs for government

4.18 Government’s administration of income tax, NICs and related benefits should be as efficient as possible. In developing detailed proposals for reform, the Government will be assessing whether they have the potential to reduce the administrative costs of the system. This is not just about HMRC’s regular in-year and year-end processes. There is also the potential for savings in HMRC’s compliance operations, if a simpler and better understood system leads to greater compliance. And any reforms to contributory benefit tests must enable an efficient administration by DWP.

4.19 Any reform will need to work with the introduction of PAYE Real Time Information, due to be introduced in 2013. Over time, Real Time Information should improve the accuracy of tax and National Insurance deductions.

4.20 Any changes to simplify the operation of tax and NICs will need to continue to enable student loan repayments and statutory payments, which depend upon the PAYE system, to operate successfully for employers, employees and government.

⁴ <http://www.hmrc.gov.uk/consultations/index.htm>

Challenges

4.21 The operation of income tax and NICs is complex, and any reform will take time to deliver. Stakeholders have raised concerns that the reform could have adverse impacts for employers and individuals if not developed with due care. There is work to be done to ensure reform is deliverable and that its benefits sufficiently outweigh the transitional costs of putting it in place. Only if the Government is convinced of this will reforms be implemented.

4.22 As with any tax reform of this scale, there will be challenges along the way. In some cases there will also be tension between the principles. The Government intends to debate the key trade-offs and challenges openly with stakeholders in order to get the balance right.

Challenge 1: delivering genuine simplification for businesses

4.23 Whilst it is clear that differences between income tax and NICs create complexity, the Government wants to work with employers to understand whether different options for integration, some of which were highlighted in the call for evidence, will really simplify the situation. For instance, it may be possible to go from two systems to one, but that one system may have additional complexity.

Challenge 2: the implications for individual earners

4.24 The Government recognises that reforming the operation of income tax and NICs has potentially significant consequences for individual earners across the country, in terms of their tax and NICs liability and their access to contributory benefits, including the State Pension.

4.25 In particular, any reform of NICs to an annual, cumulative and aggregated basis to match the income tax structure could mean a significant number of individuals would end up with a different NICs liability – some could pay more and others less. On the one hand, there are around nine million individuals in the UK who currently work less than a full year. Many of these individuals would pay less NICs if only one NICs threshold was applied each year. Some of these individuals might find their contributions record is affected, though they would be able to compensate by paying voluntary NICs. On the other hand, there are nearly three million individuals who work more than one job simultaneously. They would be likely to pay more NICs if only one NICs threshold were applied across multiple employments. Some of these individuals would find themselves eligible for contributory benefits for the first time. And there are over seven million individuals who have earnings that fluctuate across NICs thresholds within the year (e.g. through periods of overtime or irregular bonus payments). This final group could pay either less or more depending on the level and pattern of their earnings.

4.26 In addition, any steps to align the treatment of earnings will also affect individuals' liabilities, most notably any changes to the treatment of benefits in kind.

4.27 Before proceeding with any reform, the Government will ensure it has a clear understanding of the number of individuals likely to be affected and how they will be affected. The Government will explore the potential impacts of reforms with stakeholders to help inform our assessment of options. In assessing the costs and benefits of any proposed changes, the Government would also need to ensure that they are affordable.

Challenge 3: minimising transitional costs

4.28 Any reform will impose transitional costs for employers. The Government would like to work with employers to identify what these costs might be, and whether adopting a phased approach to implementation can reduce them. The Government recognises that employers are already facing changes due to the implementation of **Real Time Information**. Timing of income tax and NICs reform will allow Real Time Information to be in first.

4.29 The Government will also face transitional costs in making changes to systems operated by HMRC and DWP. Both departments are undergoing major change programmes to prepare for Real Time Information and the Universal Credit. Again, timing of income tax and NICs reform must allow for this. And more broadly, reforms must be affordable within public spending constraints.

Challenge 4: interplay with other reforms

4.30 There are a number of key interdependencies between reform of income tax and NICs and other reforms. It is important that these interplays are given due consideration as reform progresses. In particular:

- The Government has announced plans to introduce a new **Universal Credit** which will be designed to radically simplify the benefits system. Any reform of income tax and NICs will need to align with the Government's ambition that personal tax and welfare policies should make work pay.
- The Government has consulted on the introduction of a simpler and fairer **state pension**. Any new system will reward those who save for their retirement and be sustainable for future generations. Reform of the state pension has the potential to contribute to the simplification of the NICs system by removing the need for different NICs rates for those contracted out of the second state pension. Reform of the operation of NICs and of the state pension therefore must be progressed in parallel.

Challenge 5: interplay with contributory benefits

4.31 Chapter 2 explained that the NICs are a key element of the UK's social security system. Reforms must work not just from an operational perspective for HMRC and employers, but allow BIS and DWP to assess eligibility for contributory benefits and statutory payments. Reforms will also need to be consistent with the UK's obligations under EU law and the double contribution conventions.⁵

Conclusion

4.32 It was in recognition of these challenges that the Government intends to proceed with caution, fully taking into account the views of employers and the public. HMRC and HM Treasury began the process of reform with a call for evidence, and have now published this paper setting out next steps. They will establish a number of working groups with stakeholders to take work further. Depending on the results of the working groups, further rounds of consultation will proceed after Budget 2012. Chapter 5 sets out our engagement plan in greater detail.

⁵ The double contribution conventions are reciprocal agreements to enable UK residents to work overseas without completely losing benefit rights or being left without insurance, and for contributions paid in the UK to count in countries with similar systems of social insurance.

5

Engagement strategy

An indicative timetable for reform

5.1 As set out in *Tax policy making: a new approach*, the Government recognises the value of effective consultation, and of giving stakeholders clarity over its objectives, approach and timetable for reform.¹ Time must be allowed, at each stage of the process, for employers and other interested parties to play a role in developing and testing proposals.

5.2 As outlined in Chapter 4, there are major challenges to be overcome if reforms are to be implemented that will meet the Government's objectives. The full impacts and implications of reform must be understood if the right approach is to be taken. Due consideration must be given to overall policy design, to the need to amend legislation, systems changes for employers and government, and communication of changes to individuals.

5.3 Careful consideration needs to be given to the capacity of government and employers to make changes over and above the reforms already underway, in particular the move to Real Time Information of PAYE. Timing of reform will also depend on the progress made in reforming the state pension and other benefits, given the interactions set out in Chapter 4.

5.4 It is the Government's view that any significant reform of the operation of income tax and NICs will take two Parliaments to deliver. This will give sufficient time for issues of design to be resolved, legislation to be passed, and systems used by government and employers to be redesigned. It also gives a greater certainty that the other reforms discussed in Chapter 4 will be in place or on track, and the risks to delivery thereby reduced. Table 5.A sets out a high level timetable indicating the next steps for reform, including consultations. This should be considered indicative only, as there may be a number of options as to how to introduce reform in phases. The timetable will be confirmed at Budget 2012, following further work.

Table 5.A: Indicative timetable for reform

Date	Activity
Winter 2011/12	Working groups including key stakeholders develop detailed proposals on how reform can be achieved.
Budget 2012	High level options identified; timetable for consultation confirmed
Spring 2012	Stage 1 consultation seeks comments on the high level options for reform
Autumn 2012	Stage 2 consultation refines options and seeks comments on a narrower set of more detailed proposals
Budget 2013	Detail of reforms decided and announced
2013-15	Legislation drafted, consulted upon and then taken through Parliament
2015-17	Systems changes within government; employers prepare for new system
Around 2017	Reforms come into effect

¹ *Tax Policy Making*, HM Treasury and HMRC, June 2010

Work to Budget 2012

5.5 The next phase of work will bottom out the key issues identified in the call for evidence (Chapter 3) and explore options that have the potential to meet the Government's objectives and principles and overcome the challenges already identified (Chapter 4). Subject to the outcome of this work, at Budget 2012 the Government will provide an update on progress, including the timetable for further rounds of detailed and extensive consultation on any proposed options.

Focus of work

5.6 Given the complexity of the current system and the relationships between NICs, income tax and the benefits system, the initial focus will be to ensure that all issues and interplays have been identified. The issues identified by the call for evidence must be fully understood, including:

- the earnings basis that income tax and NICs are charged on;
- the NICs pay period;
- the treatment of internationally mobile employees;
- definitions of employment status for certain groups; and
- the NICs treatment of company directors.

5.7 HMRC and HM Treasury are now looking at these issues in detail, drawing upon the results of the call for evidence, the work of previous governments, and more recent work by the OTS and other third parties. HMRC will be conducting a survey of 1,500 small businesses to further develop the evidence base on employer burdens. This research will supplement the results of the call for evidence but be targeted at small employers. The survey will focus on:

- employer payroll processes, including which income tax and NICs processes are contracted out to agents, and how software use varies;
- difficulties with the current system, exploring which aspects of the current system are most difficult to operate or understand; and
- changes to the system, seeking views on which elements could be simplified and with what business impact.

5.8 In parallel, DWP, working with BIS, HMRC, and HM Treasury, will explore the potential for reforming the eligibility tests for contributory benefits and statutory payments in light of the options identified for NICs reform, whilst maintaining the contributory principle.

Stakeholder engagement and working groups

5.9 The Government is committed to giving employers and other interested parties a key role in developing and testing reforms:

- The Government has already brought together an informal group of stakeholders with a range of expertise to advise on policy development and our consultation approach. This group will continue to meet over the coming months.
- Several of HMRC's existing stakeholder forums have discussed the issue of income tax and NICs integration in recent months. These have included the Administrative Burdens Advisory Board, the Employment Consultation Forum, the Payroll Consultation Panel, the Taxpayer Data Standards Forum and the Charity Tax Forum. These groups will be kept up to date and given opportunities to provide input as work progresses. Details of these groups can be found on [the HMRC website](#).

- Officials have been holding separate meetings with key interest groups and will continue to do so. These will include the major business representative bodies, tax and payroll professional bodies and low incomes representative groups.

5.10 In addition, HMRC and HM Treasury will be establishing two technical working groups with stakeholders to look at some of the very key issues. These groups will focus on the earnings basis of income tax and NICs (what income tax and NICs are charged on) and operating NICs (how NICs are calculated and paid over the year). Table 5.B sets out the key issues the working groups will focus upon.

Table 5.B: Working groups

Working group	Key areas of focus
1. The earnings basis of income tax and NICs	<ul style="list-style-type: none"> • Identifying the full range of misalignments between the tax & NICs treatment and definition of earnings. Particular focus to be given to the treatment of benefits in kind and business expenses • Considering the impact that these misalignments have on businesses and individuals • Exploring the desirability of removing these misalignments (both in isolation and as part of a package of changes) • Determining what may be necessary or helpful in order to facilitate the removal of misalignments • Working up options for implementation, in particular with a view to understanding their business impact
2. Operating NICs	<ul style="list-style-type: none"> • Considering options for making the operation of NICs more like tax, to facilitate an operational integration. The group will explore whether and how: <ul style="list-style-type: none"> ○ to operate NICs on an annual and cumulative basis ○ to aggregate NICs liability across employments • Exploring the costs and benefits to employers of such options • Identifying whether there are options for introducing such reform in phases in order to limit transitional costs for employers • Considering how reform can work for employer NICs as well as employee NICs

Source: HMRC / HM Treasury

5.11 The working groups will meet for the first time in December. Both will have terms of reference agreed at their first meeting. Officials will work with key stakeholder organisations to identify members. The priority will be to include a range of employers, including small businesses, to ensure that their perspectives are fully represented. Nominations should be sent to incometaxnics.simplification@hmtreasury.gsi.gov.uk by 22 November 2011.

5.12 The Government will [use a dedicated page on the Treasury website](#) and email distribution lists to provide regular updates on this work. To be added to the distribution list, or if you have any comments on the material set out in this paper, please contact incometaxnics.simplification@hmtreasury.gsi.gov.uk.



Contributors to the call for evidence

We are grateful to all those who responded to the call for evidence. Responses from individual members of the public are not listed here. We received responses from the following organisations, or individuals working for the following organisations:

Andrews Computer Services

Association of Accounting Technicians

Aviva plc

Baker Tilly

BDO

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Vale of Glamorgan Council
Warehouse Systems Group

B

Call for evidence: summary of responses by question

B.1 This annex provides a more detailed summary of the responses to the call for evidence. We received over 70 responses. Annex A sets out the list of respondents.

B.2 We received a good response from those who work in payroll: many of the submissions from large employers appear to have been written by the payroll departments, and we also received a number of responses from providers of payroll services and software.

B.3 We received very few submissions from small employers. We recognise that a number of the payroll and tax professionals who replied will have experience working with small employers. However, the summary below may not fully represent their perspective. As mentioned in Chapter 5, HMRC is to carry out some research focused on the issues affecting small employers.

Section 1: General Interest

1. The Government believes that integrating the operation of income tax and NICs may have the potential to remove distortions, reduce burdens on business and improve fairness. Do you have any comments on these objectives?

B.4 The majority of respondents welcomed these objectives and stated that they were broadly the right ones.

B.5 Most tax practitioners, payroll providers and large employers felt that complying with two separate systems was a burden for employers, and that greater operational integration had the potential to improve the situation. However, some felt that the burden could only truly be alleviated through a more radical approach, such as a complete merger of the two charges. Several highlighted that, for a lot of employers, the current system was not overly complex and they expressed concern at the transitional costs of any reform.

B.6 All types of respondent felt that the structure of National Insurance produced economic distortions and that it was generally not well understood by the public. There was less agreement over the third objective, improving fairness in the system, although this was primarily due to a lack of clarity among respondents on the scope of what Government is considering; several thought that NICs would be abolished completely, or extended to all forms of income, both of which were ruled out in the Budget announcement. Several respondents argued that NICs was not simply a tax and this must be recognised in seeking any changes to the system.

2. Of the differences between income tax and NICs listed in Table 1.A [of the call for evidence] (or any others that you consider important) which do you see as the most significant in terms of their impact on:

- a. economic distortions;
- b. burdens on employers;
- c. fairness?

Economic distortions

B.7 A number of respondents felt that the differences between income tax and NICs, and the structure and rate of NICs itself, produced economic distortions.

B.8 The most frequently cited distortion related to the earnings period basis for National Insurance. Respondents pointed out that individuals in multiple employments may pay less National Insurance than those with a single, full time employment, even if their overall annual earnings are the same. They argued this was distortionary.

B.9 A smaller number of submissions identified the following potential distortions:

- The fact that employee NICs are not charged on benefits in kind. Some respondents argued this encourages employers to pay their staff through non-cash means.
- The lower NICs rate for the self employed. Some respondents stated this provides an incentive for employers to engage individuals without a formal contract of employment or for employees to disguise their employed status.
- The existence of the employer contribution. Some respondents argued that, because it does not link directly to employees' contributory benefit entitlement, it is simply an additional tax on labour, but one less visible to the employee.

Burdens on employers

B.10 The difference highlighted the most frequently by respondents was the different tax and NICs treatment of benefits in kind and expenses; for example, mileage payments, vouchers, and medical insurance. Respondents argued that this creates a burden by requiring employers to understand what each charge is applied to, and then follow a range of different in-year and end-year procedures. They perceived the process for benefits in kind as particularly confusing and burdensome.

B.11 The pay period basis for NICs was the second most common issue raised in submissions. Respondents argued that making retrospective amendments to NICs payments is difficult as a result of the finality of the pay period system. If errors occur, such as overpayments of NICs, these are time consuming to rectify. Other tasks are also made more difficult by needing to reference a specific pay period, such as reporting benefits in kind and expenses at the end of the year.

B.12 The different treatment of internationally mobile employees under income tax and NICs was a third issue highlighted by respondents, mainly large employers and tax practitioners. Further details are provided in the responses to questions 12 and 13.

B.13 A fourth issue, highlighted mainly by tax practitioners, was the different definitions of employment status for some groups under income tax and NICs. Respondents felt that having to interpret legislation to determine the employment status of certain occupations (such as entertainers) creates uncertainty for employers, as well as necessitating additional manual work when it comes to processing their NICs payments.

B.14 Many submissions highlighted distinct features of the NICs system itself as contributing to employer burdens, rather than the difference between NICs and income tax. A small number stated that identifying the appropriate NICs rate for each individual via the NICs category letters was time consuming, and a cause of mistakes when employees' letters changed. Other issues that were mentioned included; identifying the number of NICs thresholds and rates, and then explaining these to employees; the process for calculating Director's NICs, seen as confusing and often a cause of over or underpayments; and finally, the process for calculating statutory payments for NICs, and also the process for recovering these.

B.15 The evidence provided through the call for evidence suggests that these issues are not just a matter for the operation of payroll and tax compliance, but that they make a number of other aspects of business more difficult. These include making decisions on secondments or sending staff abroad, and determining remuneration or termination packages.

Fairness

B.16 Many submissions commented on the different amount of NICs paid by individuals, depending upon either the way they work (whether in one employment or in multiple employments), any fluctuations in their earnings over the year, or the way they are remunerated. The fact that individuals with similar levels of earnings can end up paying different amounts, and the fact that certain benefits in kind are not chargeable for employee's NICs, were both seen as unfair by some respondents.

B.17 A number of submissions also pointed out that the rate structure of NICs is regressive.

B.18 A few respondents discussed the contributory element of National Insurance. A small number argued that the weakening of the contributory principle, and the rise in means-tested benefits, was unwelcome. On the other hand, some respondents saw NICs as tax, and argued it would be more transparent to call it so.

3. What do you think are the most important steps that could be taken to reduce the effects on:

- a. economic distortions;**
- b. burdens on employers;**
- c. fairness?**

Economic distortions

B.19 The most common proposal was to move NICs to an annual, cumulative and aggregated basis to mirror income tax. Respondents argued that making NICs more like tax would make it more transparent and promote understanding.

B.20 A small number argued in favour of equalising the self employed and employee rate, as they thought this distorted individual (and employer) contract decisions. Several argued in favour of charging NICs on dividends, or undertaking some other form of action in order to reduce the practice whereby individuals pay themselves in dividends rather than drawing a salary.

B.21 Trade Unions, and a number of individuals, recommended strengthening the contributory element to NICs to provide a stronger a work incentive to individuals.

B.22 A few called for the complete abolition of the employer element of National Insurance, on a variety of grounds.

B.23 Two respondents argued that a NICs relief for payroll giving would help promote charitable contributions.

Burdens on employers

B.24 Many respondents argued that a complete merger would be necessary to meet this objective, although the majority recognised that this is not being considered by the Government.

B.25 The most common suggestion was moving NICs to an annual and cumulative basis, mirroring the system for income tax, although respondents were not sure how this could best be achieved.

B.26 The second most frequent suggestion was aligning the definition and treatment of earnings and expenses for NICs with employment income for tax (including benefits in kind, expenses, and termination payments), and a simplification of the systems used to process and report both forms of income.

B.27 Respondents frequently recommended simplifying the system for processing benefits in kind, but there were differences in opinion on how this might be achieved. Some argued in favour of HMRC making greater efforts to enable the payrolling of benefits in kind to remove the need for the end year processes; but broadly equal numbers argued against this, in some cases viewing payrolling benefits in kind as more difficult for employers.

B.28 Several respondents argued that the special rates for certain groups (such as those contracted out of the State Pension) should be abolished, as they create administrative difficulties for payroll operators.

B.29 Tax practitioners argued that the collection and penalty regimes should be the same for both income tax and NICs to prevent employers having to understand and comply with two separate systems.

B.30 Several respondents, primarily large employers and tax practitioners, recommended aligning the rules and procedures for internationally mobile employees. (see the summary of answers to questions 12 and 13 for more detail).

B.31 A few respondents argued that aligning the NICs primary and secondary thresholds would be helpful, although they did not provide details on how this would reduce administrative burdens in practice.

B.32 Three respondents argued for a review of the cases where employment status is different for income tax and NICs.¹

B.33 A few submissions argued in favour of abolishing the employer contributions, although they recognised the considerable fiscal implications of such a move.

Fairness

B.34 Many submissions argued that moving NICs to an annual, cumulative and aggregated system would address the current disparities in treatment.

B.35 A few felt that NICs should have a more progressive rate structure.

B.36 A few also argued in favour of levying Class 1 NICs on benefits in kind, to ensure that individuals do not avoid NICs through being paid in benefits in kind rather than salary.

¹ Under the Social Security (Categorisation of Earners) Regulations 1978, some occupations are deemed 'employed' for NICs purposes even if they are self employed for income tax

Section 2: Employers and Payroll Professionals

B.37 This section focused on gathering evidence on employer burdens. As noted, most of the comments came from larger organisations and tax professionals and not small employers.

B.38 In general, answers suggest that the most time consuming parts of the payroll process is the familiarisation with the different sets of NICs and income tax rules, and the time taken to perform the actual calculations themselves. Explaining the system to employees is also difficult.

B.39 However, examples of specific areas of difficulty varied quite widely, seemingly reflecting a number of factors; differences in the sophistication of the payroll software used by respondents; the different circumstances and remuneration packages experienced by respondents; and the degree of outsourcing of payroll tasks, with some employers choosing to outsource the more difficult payroll tasks.

General

4. Under the current system, how much staff time and/or other resource is required to carry out income tax and NICs processes? Please give a score on a scale from 1 to 5 where 1 is only a small amount of time/resource and 5 is a great deal of time/resource for each of the following:

- a) Familiarisation: understanding HMRC's requirements, legislation and guidance.
- b) Retrieval of information: obtaining the information required to run a PAYE payroll.
- c) Record keeping: maintaining the records needed for income and NICs purposes e.g. keeping copies of returns/letters where necessary.
- d) Calculation: calculating and checking income tax and NICs due (including in-year and end of year processes).
- e) Provision of information to HMRC: reporting of information to HMRC e.g. P45s for new employees.
- f) Provision of information to employees: reporting and providing information to employees e.g. year end P60s.
- g) Payment of liabilities: paying income tax and NICs to HMRC.

B.40 Employers, payroll providers and tax practitioners provided the majority of responses to this question. Each task scored an average of 3 or above in terms of time consuming/resource intensiveness. Only payment of liabilities scored below at 2.8. The mean for each question was also 3.

B.41 Familiarisation was rated as the most time consuming task, with an average of 3.7; calculation scored the same (3.7), followed by provision of information to employees (3.5). Retrieval of information, provision of information to HMRC, and record keeping were rated as less time consuming, scoring 3.1, 3.1, and 3 respectively.

B.42 There was only a small difference between the ratings given by each group. Payroll providers, and large employers, generally gave slightly lower responses for each task than the average, whereas tax practitioners tended to give slightly higher ratings. But the difference was not significant.

5. Which aspects of the current income tax and NICs process work well for your business?

B.43 Responses to this question varied quite widely, again seemingly reflecting the different experiences of PAYE among respondents, and also differing interpretations of 'NICs process.'

B.44 Many respondents stated that the PAYE system worked well most of the time, but only provided they had the sufficient resource and expertise to operate the payroll. Specific processes cited, in no particular order, were;

- Electronic data Interchange (HMRC's online data exchange service for employers);
- Online payments (the online payment facility for PAYE and other types of tax);
- Dispensations (a notice exempting the employer from reporting expenses and benefits in kind at the end of the year);
- PAYE Settlement Agreements (a facility for reporting some types of irregular or unusual benefits in kind and expenses in a single payment).

6. Do you carry out income tax and NICs obligations together? Are there any elements you carry out separately?

B.45 Around ten respondents stated that all obligations were carried out together. However, the majority of those who answered this question highlighted processes which required separate consideration for income tax and NICs; expenses and benefits in kind; end of year processes (class 1A NICs, P11D forms); termination payments; statutory payments; share scheme awards; and payment of in-patriates and expatriates.

7. What effect do differences between income tax and NICs have on wider payroll processes such as expenses and benefits, statutory payments and student loans deductions?

B.46 Only a small number of respondents stated that the differences had no impact on wider payroll processes. Some felt that software could handle some of the differences if it were sufficiently sophisticated.

B.47 However, the majority of those who answered this question identified benefits in kind and expenses as the area most affected by the differences between income tax and NICs. They perceived the different treatment of certain items, and the separate processes for reporting them to HMRC, as unduly complex. Respondents also identified processing termination payments, and calculating statutory payments according to income tax and NICs pay periods, as issues affected by the different PAYE processes.

B.48 Many respondents commented that the differences between income tax and NICs made the overall payroll process much more time consuming and resource intensive. The burden is not just following separate processes, including any additional manual work, but the initial process of understanding the separate rules. Operating PAYE was perceived as requiring a high degree of specialist, technical knowledge which some employers could not handle.

B.49 Explaining tax and NICs payments to employees was also frequently cited as forming part of the burden.

8. Which of the differences between income tax and NICs are dealt with largely automatically by payroll software and which require significant manual working? Where manual working is required how straight forward is this?

B.50 Respondents provided similar examples to those provided for questions 6 and 7, stating that the differences between income tax and NICs often necessitated additional manual working.

B.51 Almost no respondents reported calculating the cash salary manually. The items reported as necessitating manual work, in no particular order, were;

- In year and end-year processes for expenses and benefits in kind
- Reporting contracted out earnings for those in final salary schemes
- Processing Director's NICs
- Payments to employees that covered multiple pay periods, and paying annual payments such as bonuses

- Calculating and paying NICs for those working abroad for part of the year
- Payments of awards to employees in share schemes

B.52 Respondents were not always clear about whether the manual work was required during or at the end of the year. However, as in previous answers, submissions highlighted the difficulty of the end-year processes for benefits in kind as a key burden. Payroll software was capable of generating the returns in some cases, but staff were seen to be heavily involved in determining which figures needed to go on each.

B.53 As in previous answers, respondents commented that the manual work itself is only part of the burden. It is the time taken prior to any calculation/payment which is the more time consuming element; the time taken to understand the separate procedures and identify the liability of each employee. A number of respondents argued that even if software handled all of the differences between income tax and NICs, the benefit of greater alignment would be the increase in employer understanding on what it was they were processing.

Issues and Errors

9. Are there particular issues that occur in the calculation of income tax and NICs?

B.54 The answers to this question mainly related either to the pay-period basis of NICs or to the special NICs rules for certain groups.

B.55 The pay period system for NICs was perceived as too rigid to handle ‘real-life’ scenarios. Respondents argued that the finality of each period’s calculation, in comparison to the withholding system for income tax, makes correcting mistakes more difficult. Examples included recovering over or underpayments, or adjusting rebates when employees opt out of pension schemes retrospectively.

B.56 The second area related to the special NICs arrangements for certain groups. The rules for NICs aggregation, the contracted out rebate, and the system for Director’s NICs, were all mentioned as the cause of mistakes (such as overpayments) which were difficult to correct.

10. How often is it necessary to correct income tax or NICs calculations and which are the most time consuming to correct?

B.57 Only five responses stated that NICs required correcting regularly. The majority of those who answered this question stated that NICs required correcting only infrequently, provided the operator had a sufficient understanding of the system to begin with. However, this was strongly qualified with statements on about the acute difficulty of correcting NICs once errors had been identified.

Software

11. Do you have any comments about difficulties in designing or using software resulting from the differences identified in Table 1.A *[of the call for evidence]* (or any others that you consider important)?

B.58 Only a few respondents answered this question. Of those who did, responses suggest that software design is complicated by the differences between the two systems, as it is partly driven by the volume of data it holds; so the different thresholds and rates do contribute to a more complex design.

B.59 Some respondents believed that this complexity is partly responsible for the high price of software. Simplifying the system should, they argued, drive down the price as it becomes less complex to design.

B.60 Many respondents used this question as an opportunity to highlight the cost of updating payroll software. They pointed out that this reform would mean purchasing potentially costly new programs.

International

12. What do you see as the main differences between income tax and NICs in relation to employees you have who work internationally?

B.61 Large employers and tax practitioners provided the most evidence on this question. They perceived the difference in treatment for those working internationally to be significant, and argued the NICs rules were difficult to understand. Liability for income tax is based upon residence, ordinary residence or domicile in the UK; liability for Class 1 NICs is linked to the nature of the employment and a range of other factors, such as the length of assignment and the country in which the employment is held. This means in-patriates may be on the payroll for income tax but not for NICs; and expatriates may be liable for NICs but not for (UK) income tax.

B.62 In addition to the rules on taxing salaries, respondents highlighted the different income tax and NICs rules for non-salary items such as expenses and bonuses.

13. Which of the differences outlined in question 12 are dealt with largely automatically by payroll software and which require significant manual working? Where manual working is required how straightforward is this?

B.63 The majority of respondents stated that their payroll software was not able to automate NICs for those who worked internationally and that they managed the process manually for at least part of the time. However, some responses suggested that the manual work itself constitutes only part of the burden.

B.64 Respondents reported that the process for determining NICs liability for those who move in and out of the country was unduly complex in comparison to the system for income tax, as it depends upon a much wider range of factors. They argued that the legislation was very unclear, causing a high degree of uncertainty for employers, as well as causing errors in calculations.

B.65 Dealing with separate HMRC processes was also cumbersome at times, with delays in certain processes such as the *appendix 7b NIC Settlement Return*. Finally, respondents highlighted the financial cost for employers of seeking legal advice and outsourcing this aspect of the payroll to specialists.

B.66 Most of those who answered this question felt that there was scope for greater alignment between income tax and NICs in this area. Most thought that the definitions of 'ordinary resident' and 'resident' should be the same for both charges, and more generally, that the regulations for NICs should be rewritten to make them clearer. Some argued that the rules should be fully aligned, including introducing a double tax relief for NICs, but most thought a more minimalist approach would suffice.

Interaction with other reforms

14. Do you have any views on how the introduction of Real Time Information may affect the cost and benefits of income tax and NICs integration?

B.67 Of those who answered this question (around a third of all respondents) many argued that the introduction of Real Time Information broadly supports the operational integration of income tax and NICs. Some argued that if successful, the improved information returns to HMRC will enable an annual and cumulative system for NICs, and allow more processing of benefits in kind through the payroll. Others saw alignment as a necessary precondition for Real Time Information, to reduce the administrative burden of filing monthly returns by merging the reporting requirements for both charges.

B.68 Despite this, many respondents expressed concerns about the impact on employers of implementing two significant PAYE reforms in a short timeframe. Several argued that HMRC should consider introducing the two reforms together to reduce the transitional costs for employers, but others were content with the staggered approach to allow employers and HMRC to adjust to Real Time Information.

B.69 A number of respondents used this question to express wider scepticism over the benefits and deliverability of Real Time Information.

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