One big hit: fixing national insurance for good

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Key findings

- The government plans to raise the employee national insurance threshold in April from £166 to £183 a week, equivalent to £9,500 a year, with an 'ultimate ambition' of £12,500 a year.
- This is welcome news for taxpayers, but implementing the entire change in one go would enable historic and substantial tax simplification as well as sending a powerful signal that work pays.
- Instead of raising the national insurance threshold to £9,500 this April and then gradually increasing it further to £12,500 over the following years, the government should delay the increase until next year but then increase it fully to £12,500 to match income tax, while also aligning the rules, stripping away the fiddly, needless differences between the two.
- A temporary 'multiple jobs relief' should also be introduced to ensure anyone who might otherwise be worse off from the transition is fully protected for five years.
- This package would only affect the timing of what the government intends to do anyway but would enable it to deliver desperately-needed tax simplification and shrink the UK's astonishingly long tax code.

One of the Conservative manifesto pledges during the 2019 general election promised a rise in the employee national insurance threshold to £9,500 this year, along with an 'ultimate ambition' to raise it further to £12,500, so that that amount of earnings 'is completely free of tax – which would put almost £500 per year in people's pockets'.

The TaxPayers' Alliance welcomed this commitment at the time the manifesto was launched[1]. It is right to reduce the tax that working people on low incomes pay. And the manifesto was right to be blunt about national insurance and call it what it is – tax.

That is why it is important that the government implements this pledge in the right way to maximise the benefit it can provide.

National insurance is a second income tax. It once operated as a hybrid insurance-tax system. But that is no longer the case. It is now just another tax on earnings. That is a problem and creates needless complexity in our tax system. Not only because it means there is not just one simple, clear number for someone's marginal tax rate, but also because the rules which govern it are slightly different, which creates an unnecessary headache for employers.

What expenses are deductible, how pensions contributions are treated, what counts as earnings and when it is assessed and calculated all differ between national insurance and income tax. All these matters should be aligned into a single set of rules. That is why the TaxPayers' Alliance has published detailed research into substantial tax reform that would eliminate the differences between national insurance and income tax, not least in *The Single Income Tax* and *How to abolish National Insurance*.

The problem is that the transition would leave some worse off as well as leaving others better off. Low-paid seasonal workers might gain from having an annual personal allowance instead of the weekly one which currently operates under national insurance, for example. But a low-paid worker with two part-time jobs might be worse off from only having one personal allowance instead of one for each job, as the rules for national insurance currently allow.

It is therefore important that a substantial tax cut in national insurance is implemented and timed in a way that counteracts as far as possible the negative side-effects of aligning it with income tax. Introducing a temporary relief applicable only to workers with existing multiple jobs could eliminate the possibility of anyone being worse off in the short term, protecting them while removing the complexity going forward.

[1] TaxPayers' Alliance, *TaxPayers' Alliance responds to Conservative Party manifesto launch*, 24 November 2019, www.taxpayersalliance.com/taxpayers_alliance_responds_to_conservative_party_manifesto_launch

Handling the rise in the employee national insurance threshold in the right way would mean that as well as the benefits of an overall tax cut in terms of strengthening economic incentives and improving people's purchasing power, it would also deliver an improved, simplified tax system by protecting taxpayers who might be worse off while magnifying the beneficial effects for those who would gain.

Additionally, the public awareness of a substantial tax cut would be enhanced by implementing it in one go rather than the staggered implementation of the personal allowance rise since 2010.

The government should therefore raise the employee national insurance threshold to £169 (instead of £183) a week in April, to retain its parity with the employer threshold and maximise the extent of the threshold increase which happens at the same time as aligning national insurance rules with income tax. It is unrealistic to expect this to be implemented this April, therefore it would be better to delay the rise (beyond £169 a week) until next year. But it should announce that from April next year, the employee national insurance threshold will be converted to a per-person, annual figure of £12,500, so that it aligns with the income tax personal allowance. Other rules such as pensions treatment should also be adjusted accordingly to eliminate differences.

Multiple jobs relief

Taxpayers already working multiple jobs at the time of the announcement could be entitled to a tax relief to ensure they do not lose out from the change from 'per job' to a 'per person' assessment. The relief entitle the worker to continue to apply the existing 'per job' threshold to second (and further multiple) jobs, less the value of the increase in the general threshold.

For example, if the national insurance threshold is raised to £12,500 a year from the current level of around £8,650, then the multiple job relief on the second job would be reduced by the same amount. The worker with two jobs is entitled to a total of around £17,300 of earnings before paying national insurance. This would remain unchanged because the relief on the second job would fall to £4,800 as the general threshold rose to £12,500. If the worker earns £8,650 from each job, the £3,850 excess in the second job would not be caught under the new scheme because the worker would still have the same amount of unused 'per person' threshold under the new system.

Because the relief would only be open to people with existing multiple jobs, over time the numbers eligible would naturally diminish as people changed jobs. However, a 'sunset clause' limiting the relief for perhaps five years would put a time-limit on the extra complexity it creates while giving people a fair amount of time to adjust to the new rules and take advantage of the larger allowance with a single job.

Fiscal impact

The government has announced a rise from £166 to £183 a week from next year, which HMRC figures suggest will be worth £2.6 billion in 2020-21 and £2.7 billion in 2021-22. If the government effectively delays the change by only raising the employee threshold to £169 this year (the same rise which is planned for the employer threshold) and implements a £12,500 annualised charge instead, it would be worth substantially more. The equivalent rise under the current rules and HMRC numbers suggest a value of around £0.5 billion in 2020-21 and around £11.8 billion in 2021-22.

Case studies

Earners with two jobs

The most extreme example of a two-job worker who would lose money from changing the national insurance 'per job' rule to match the income tax 'per person' rule is a worker with two part-time jobs, each paying £166 a week. This worker currently pays no national insurance, because £166 a week is the threshold for each job. Because the worker's annual income from both jobs is £17,311, income tax at 20 per cent on the £4,811 above the £12,500 personal allowance is payable, a total of £963. If the national insurance threshold was applied to the person rather than the job, the worker would have to pay £1,039 national insurance, the same as someone with a single employer earning the same total income.

But if the threshold for national insurance is raised to £12,500 at the same time as it is made 'per person' like income tax, then the national insurance bill would be £577. Conversely, the worker with a single employer earning the same total income would also pay that amount, too, saving £461.

Minimum wage workers

A worker with two part-time jobs earning the national minimum wage, working 7 hours a day, each for two and a half days a week, earns just under £144 a week from each job. This worker currently pays no national insurance, because £166 a week is the threshold for each job. Because the worker's annual income from both jobs is £14,983, income tax at 20 per cent on the £2,483 above the £12,500 personal allowance is payable, a total of £497. If the national insurance threshold was applied to the person rather than the job, the worker would have to pay £759 national insurance, the same as someone with a single employer earning the same total income.

But if the threshold for national insurance is raised to £12,500 at the same time as it is made 'per person' like income tax, then the national insurance bill would be £298 (those who already in this situation would still pay nothing due to the multiple jobs relief, of course. This would only apply to new cases). Conversely, the worker with a single employer earning the same total income would also pay that amount, too, saving £461.

Seasonal workers

A seasonal worker who can find work paying £600 a week for nine months of the year currently pays £2,037 a year in national insurance. A worker who earns £450 a week year-round earns the same £23,464 annual total income but only pays £1,777. Changing the national insurance 'per week' assessment period to an annual one so that it aligns with income tax would mean that both would only pay £1,777. But if the threshold for national insurance is raised to £12,500 at the same time as it is made an annual charge like income tax, then the national insurance bill for either of these two examples would be £1,316. The seasonal worker's tax bill would be cut by £721 a year while the year-round worker earning the same annual income would enjoy a tax cut of £461.