Merging Income Tax and National Insurance

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National insurance is a tax on labour. Two taxes, in fact. Running three slightly different income tax systems is a century-old relic that should have no place in a modern, transparent tax system. National Insurance should be abolished in three phases:

1. **Transparency now.** First, at this year’s autumn statement, a transparency phase should be announced which requires the employer charge to be printed on pay-slips and changes the name of the employee and employer charges to ‘earnings tax’ and ‘wages tax’.

2. **Simplification in 2019.** Secondly, budget 2018 should announce a simplification phase which would align national insurance rules with income tax, removing most of the differences and coming into effect from 2019.

3. **Abolition in 2021.** Finally, budget 2020 should announce the full abolition of both charges from 2021, while raising income tax, effectively merging them into a single income tax. A transitional rate for those born before 1965 would ensure nobody pays more.

What’s wrong with national insurance?

1. **Complex.** National insurance means that income tax is split up into three charges (income tax, and both employer and employee national insurance) that are substantially the same but subtly different in many ways that add little value but introduce great complexity. Different rules for anything from the definition of earnings and whether or not someone counts as self-employed to whether it’s assessed on individuals or jobs and whether it’s assessed annually or weekly make the whole system labyrinthine.

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1 The Office for Tax Simplification’s recent consultation, “The closer alignment of income tax and national insurance” identified 84 “misalignments” between national insurance and income tax.
2. **Opaque.** All that complexity makes it harder to understand your tax affairs, clouding the financial connection between employee and employer and also between taxpayers and government. Importantly, national insurance is completely misnamed, which creates misunderstanding about what it does. It is in no way an insurance scheme but a tax on earnings and this is just as true of the employer charge as of the employee charge. It is relatively straight forward to add an employer’s contribution to a gross salary to calculate an employee’s true compensation. This is especially true as calculations are done by payroll software. But what purpose do the smokes and mirrors serve? Do we really want our tax system to be so complex that it is only practically navigable with computing software? The same goes for having to add up income tax, employee and employer national insurance to calculate true income tax level. Finally, the legal pretence that employers bear the economic burden of the employer charge lends weight to the myth that public expenditure can be financed by taxing abstract corporations rather than real individuals.

3. **Expensive.** All that complexity and opacity isn’t cheap. First, taxpayers have to employ three teams to administrate, process and monitor taxes on income instead of one. The cost of this duplication is likely to extend to hundreds of millions of pounds\(^2\). Secondly, there is the cost to business of payroll departments having to administrate the systems separately and procure more tax advice, either internally or externally. The scale of this is likely to be greater than the cost to HMRC. Thirdly, there are wider costs arising from the perception of complexity increasing levels of uncertainty relating to the impact of tax on economic activity.

**Pensions and older taxpayers**

People over the state pension age are currently exempt from the employee charge on earnings, but those earnings are nonetheless still liable for the employer charge. This means that on labour income, the current combined rate of 20 per cent income tax and 13.8 per cent employer national insurance works out to 29.7 per cent, just below the 30 per cent proposed merged rate in The Single Income Tax\(^3\). To ensure this group is not disadvantaged by the proposal, those enjoying the tax advantages of being above the state pension age at the time should have the option to be protected, paying a rate of 29.7 per cent on labour income and 20 per cent on other income within the basic rate band. This would apply to people born in 1965 or earlier if national insurance is merged with income tax in 2021.

Payments into pensions are currently exempt from income tax and, for employer contributions, national insurance. Employee contributions are liable. This would be simplified by using the rules which currently apply to income tax for the whole system, as part of the simplification phase.

**Employers and wages**

Employers should be required to state the employer charge and add that to gross pay to create a new total pay figure in the transparency phase, from 2018. In the simplification phase, from 2019, rules will be aligned as far as possible regarding matters such as the definition of earnings, deductibility of expenses and the annual calculation of the charge. Employer charge should continue to be assessed on a per-job basis to

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\(^2\) In 2006 KPMG’s *Administrative Burdens – HMRC Measurement Project* estimated the cost of the three most burdensome ‘information obligations’ relating to national insurance at £146 million.

\(^3\) [http://2020tax.org](http://2020tax.org)
avoid introducing uncertainty to employers. Finally, at the abolition phase, from 2021, employers should be required to recalculate gross pay to include what would have been the employer charge, which would be abolished. The amount employers pay and employees receive should be unaffected by this change, but there would be a one-off administrative requirement to implement them and a permanent, on-going reduction in administration by no longer having to manage three tax payments on employees’ incomes instead of one.

**People with multiple and fluctuating incomes**

Because the tax free allowance for national insurance is applied per job rather than per person, people with multiple incomes may pay more when national insurance takes the same “per person” rule as income tax as part of the simplification phase. There is no good reason, however, for the tax system to encourage people away from full time employment and into taking multiple jobs with tax incentives. Replacing the 20, 13.8 and 12 per cent with a single 30 per cent rate would mean that the overwhelming majority are better off.

Similar principles apply to people whose incomes fluctuate around the upper earnings limit (£827 a week in 2016-17), because national insurance is assessed weekly rather than annually. Because earnings above the limit are taxed at 2 per cent while that below is taxed at the higher 12 per cent rate, fluctuation reduces liability. However, people whose incomes fluctuate around the thresholds for payment of national insurance (£155 or £156 a week in 2016-17) would benefit because the rate is higher above the threshold than below it.

**Dividends, savings and royalties**

This note only relates to earnings, subject to national insurance. However, these types of earnings would also be relevant to implementing a single income tax. A transitional rate of 20 per cent on such income should be available on basic rate income if it was earned before the date of the announcement of merging the taxes and of a fixed nature. Dividends and their recipients, by contrast, would substantially benefit from other single income tax proposals relating to corporate taxes, so no transitional measures would be needed.

**Contributory benefits**

National insurance is used to determine eligibility for the contributory payments of job seeker’s allowance, employment and support allowance, bereavement benefits and maternity allowance. These payments should be abolished, removing the need for a system to monitor contributions. The means-tested payments would continue to pay those on lower incomes who qualify.

**Complexity**

Capital gains tax and, in particular, corporation tax together account for much of the ever-growing complexity of our tax system. That shouldn’t be surprising. As the global economy becomes ever more sophisticated, complex and transnational, a tax system designed for largely closed, national economies needs constant patches and updates to keep it functioning.
## Schedule for full merger to 30p Single Income Tax

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| Autumn Statement    | 1. Announce a 5-year plan for abolition.  
| 2016                | 2. Launch a consultation on requiring the employer charge to be stated on payslips, including a new “true” total pay which includes the employer charge.  
|                     | 3. Immediately introduce new, honest names: “earnings tax” (for the employee charge) and “wages tax” (employer charge).                  |
| Budget 2017         | 1. Cut both charges to 11 per cent (currently 12 and 13.8 per cent)  
|                     | 2. Announce a further cut to 10 per cent to take effect in 2019.  
|                     | 3. Raise the self-employed rate to 10 per cent while abolishing the weekly charge.  
|                     | 4. Announce the simplification phase with a consultation to iron out anomalies.  
|                     | 5. Legislate to include employer charges and “true” total pay on payslips, to take effect in 2018.  
|                     | 6. Abolish the £100,000 personal allowance limit for income tax and the 45p additional rate.                                            |
| Budget 2018         | 1. Legislate for simplification phase, to come into effect in 2019.  
|                     | 2. Transparent payslips to take effect, including “true” pay total.                                                                   |
| Budget 2019         | 1. Simplification phase to take effect, including raising allowances to match income tax.  
|                     | 2. Cut both main rates to 10 per cent.  
|                     | 3. Abolish the class 1 and class 4 additional rates of 2 per cent.                                                                      |
| Budget 2020         | Legislate for the abolition of both charges, to take effect in 2021.                                                                      |
| Budget 2021         | Abolish both charges, raise basic rate of income tax from 20 to 30 per cent.                                                               |