

# TAX BRIEFING NOTE

## NATIONAL INSURANCE

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DECEMBER 2017

### What is it?

National insurance is a collection of taxes on earned income and provides the second largest receipts after income tax, delivering HM Treasury almost a fifth of the total. It was introduced by the National Insurance Act 1911 as a contributory system of payments linked to benefits but, with the exception of a handful of minor maternity and bereavement benefits, this link now largely only exists in the form of accounting fictions.

National insurance is split into employer and employee contributions. It is levied weekly instead of annually, on a per-job instead of per-person basis. Both charges are levied on employee pension contributions but neither are on employer contributions. Definitions of employment status and allowable expenses vary slightly between income tax and national insurance due to the different legal basis of the two charges.

A separate lower earnings limit exists beneath the lower thresholds for payment. People earning above this level are treated as if they had paid national insurance for the purposes of benefits eligibility even if they have not paid any national insurance contributions.

The employee charge is 12 per cent up to an upper earnings limit, above which the rate is 2 per cent, while the employer rate is charged at 13.8 per cent with no threshold. Self-employed pay a lower rate of 9 per cent employee contributions and a weekly contribution (which is being abolished from April 2018) but are exempt from employer contributions. A separate system operates for share fishermen and some women who married before April 1977 are entitled to a special, lower rate of 5.85 per cent.

### What's the problem with it?

Like any income tax, national insurance weakens incentives to engage in productive economic activity. In some cases and for some people, it makes the difference between an activity being worthwhile or not. This means that some jobs and promotions are not sought by workers, and some are not created by employers because some investments are not made in the first place. This leads to lower employment, lower incomes and lower productivity. The difference between taxes on consumption and taxes on income is that the income taxes also hit investment, which makes them disproportionately damaging to the economy. More directly, they reduce the amount of money workers and investors have to spend on what they value for themselves and their families.

National insurance contributions are effectively a pair of duplicate income tax systems. This creates a bloated tax code which leads to inflated numbers of planning and avoidance agents and compliance officials to monitor and understand the system on behalf of taxpayers and HMRC. Economically, the employer charge operates as another income tax on workers because labour markets reflect the charge through adjusting wages. In the short term, however, before changes are passed through to wages, changes operate as a business tax on employers. This means that some tax (and wages) are hidden from employees, making it harder for employees to understand what their full compensation and tax liabilities are.

## What should be done?

1. All taxes on income (including national insurance, capital gains tax and corporation tax) should be replaced over time with a single tax on all income at a single rate of 30 per cent.
2. In the meantime:
  - a. National insurance should be renamed immediately to reflect its genuine tax function.
  - b. Rules on the basis of the charges and expenses and earnings definitions should be aligned with those which apply to income tax.
  - c. Both rates should be cut first to 11 per cent and then 10 per cent.
  - d. The starting age for employee national insurance should be raised from 16 to at least 26.

## Additional information

The TaxPayers' Alliance has campaigned vigorously to abolish national insurance for many years. In addition to numerous opinion pieces and press comments, we also undertook the following activity:

2011 *Abolish National Insurance* report was published and the key recommendation was to abolish national insurance.<sup>1</sup>

2012 *The Single Income Tax* recommended a comprehensive overhaul of the tax system including abolishing national insurance. Produced by the 2020 Tax Commission, a joint project with the Institute of Directors, the report explored the history, economics, politics and ethics of tax reform and recommended replacing all taxes on income with a single tax.<sup>2</sup>

*How to abolish National Insurance* explored in detail how to abolish national insurance as part of a plan to introduce a single income tax to ensure that all taxpayers, including pensioners, could be better off with a well-designed reform.<sup>3</sup>

2013 Our giant payslip stunt illustrated the full effect on payslips of national insurance. It was unveiled on College Green, Westminster.

2015 *What are you really paying?* video explained the effect of national insurance with a cartoon and simple language.

12016 *Merging Income Tax and National Insurance* urged the chancellor to abolish national insurance in his autumn statement.<sup>4</sup>

2017 *Fees, loans and tax* is a forthcoming report which will recommend raising the starting rate on employee national insurance instead of loosening repayment terms on student loans.

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<sup>1</sup> Meakin, R., *Abolish National Insurance*, TaxPayers' Alliance, 2011, [https://d3n8a8pro7vhmx.cloudfront.net/taxpayersalliance/pages/6809/attachments/original/1478013137/NI\\_Income\\_Tax\\_merger.pdf](https://d3n8a8pro7vhmx.cloudfront.net/taxpayersalliance/pages/6809/attachments/original/1478013137/NI_Income_Tax_merger.pdf)

<sup>2</sup> Heath et al, *The Single Income Tax*, 2020 Tax Commission, 2012, [www.2020tax.org/#report](http://www.2020tax.org/#report)

<sup>3</sup> Meakin, R., *How to abolish National Insurance*, TaxPayers' Alliance, 2012, [https://d3n8a8pro7vhmx.cloudfront.net/taxpayersalliance/pages/3305/attachments/original/1489138957/How\\_to\\_Abolish\\_National\\_Insurance\\_formatted.pdf?1489138957](https://d3n8a8pro7vhmx.cloudfront.net/taxpayersalliance/pages/3305/attachments/original/1489138957/How_to_Abolish_National_Insurance_formatted.pdf?1489138957)

<sup>4</sup> Meakin, R., *Merging Income Tax and National Insurance*, TaxPayers' Alliance, 2016, [https://d3n8a8pro7vhmx.cloudfront.net/taxpayersalliance/pages/6809/attachments/original/1478013137/NI\\_Income\\_Tax\\_merger.pdf?1478013137](https://d3n8a8pro7vhmx.cloudfront.net/taxpayersalliance/pages/6809/attachments/original/1478013137/NI_Income_Tax_merger.pdf?1478013137)