Integrating the operation of income tax and National Insurance contributions

Working Group 1:  
Meeting 1  
15 December 2011

Attending

John Hampton  BT / CBI  
Helen Hargreaves  CIPP  
Sue Illingworth  Prudential / CIOT  
Anne Redston  King's College / ICAEW  
Chas Roy-Chowdhury  ACCA  
Michael Studham  Spurling Cannon  
Kate Upcraft  ISIS  
Peter McDonald  HMT (Chair)  
David McDowell  HMRC  
Mellannie Merrifield  HMRC  
Matt Ray  HMT  
Sam Tennakoon  HMRC

Background

HMT provided background to the project. In Budget 2011 the Government announced plans to consult on options to integrate the operation of income tax and National Insurance contributions (NICs). A Call for Evidence was issued in July and the results were published in November. This working group is to consider options to remove misalignments between the income tax and NICs treatment of earnings. The objectives are to reduce the burden on employers, improve transparency, improve fairness and reduce HMRC administrative costs. Parameters have been set, in particular that the contributory principle should be maintained, and NICs should not be applied to forms of income such as pensions, savings and dividends.

Terms of Reference

The Terms of Reference for the group were agreed. To encourage free and frank discussion the group was reminded of the importance of confidentiality. However, in line with the Government’s objectives on openness, a record of the meeting would be published. It was also acknowledged that the Group may on occasion need to refer to their members to canvas opinion on issues raised.

The Group agreed it was important to ensure that its work is sufficiently joined-up with the other Working Group.

Substantive discussion

HMT & HMRC set out their assessment of the state of misalignment between the earnings base of tax and NICs.

Points raised over the course of discussion included:

- **Business expenses**  
  - The Group identified that “mixed use” items were particularly complex.
Differences exist not only in the overall treatment of expenses but in the
treatment by type of expense.

The Group emphasised the importance of being clear about how a payment is
made – there are many different forms of payment and the manner in which the
payment is made will dictate the tax and NICs treatment.

The Group questioned the practical difference between the tax test of “wholly,
necessarily and exclusively” and the equivalent “specifically and distinct” test
for NICs (meaning that in practice the definition of a business expense is the
same for tax as NICs).

It was suggested that individuals are happy that they receive tax relief and it
does not occur to individuals that they should also receive NICs relief. There
was no clear view on whether relief in a NICS context should be offered.

- **Benefits-in-kind**
  - The Group pointed out that many of the tax valuation rules (that apply equally
to NICS) are out-dated and complex. There is a case for simplifying and
  bringing them up to date.
  - The Group felt that the £8,500 rule was still relevant and did not think that the
  aspiration of a higher personal allowance if delivered would remove the need
  for it. The group pointed out that lots of charitable organisations and overseas
  volunteers make use of the £8,500 threshold.
  - There was the view that pay-rolling is going to have to happen for some BIKs.

- **Pension contributions**
  - The Group felt that the rules were complex and that it did not make sense for
  NICS to be due on some pension contributions but not others – e.g. different
  NIC treatment afforded employer funded contributions and employee funded
  contributions. The Group did not understand why employee funded
  contributions were not exempt. The Group mentioned that complexity
  increased when salary was sacrificed in exchange for employer funded
  contributions given the need to use a notional pay figure for some but not all
  purposes. It was noted that complexity increased even further when multiple
  salary sacrifices were entered into.

- **Termination payments**
  - The Group acknowledged that the majority of the complication was driven by
  the tax rules, rather than the misalignment with NICs. The biggest difficulty
  was determining the nature of the various payments or components of a
  termination package.

  - The Group noted that imposing a NICS liability on genuine redundancy
  payments in the current economic climate would not be welcomed, even if
  was done in the spirit of tax/NICS alignment.

- **Pecuniary liabilities**
  - The Group said there was a lot of misalignment that drives complexity. The
  litany is complex; many people do not recognise pecuniary liabilities for what
  they are (again, this is more a tax problem than an alignment one).
  - The Group considered that this method of remunerating employees (i.e.
  paying their private bills) was more common that may be imagined. This was
  a particular issue for close company directors.

- **Payroll giving**
  - The Group thought that equivalent NICS relief should be given. The Group
  did not consider in detail the implications in relation to contributory benefit
  entitlement or the possible behavioural impacts.
• **Thresholds**
  - The Group thought it would be helpful to align the Primary Threshold and Secondary Threshold.
  - With regards to aligning the Primary Threshold and the Personal Allowance, the Group pointed out that the employer does not know whether the employee has reached their £10k allowance.

• **Salary sacrifice**
  - The Group felt that this area should be considered at as it can drive complexity.

• **Tips and gratuities**
  - The group thought that this was worthy of further work because “Operation Gourmet” had not resulted in total alignment – troncs’ being one of the issues that remain unaligned.

In conclusion, there was a recognition that considering aligning the tax and NICs earnings base is a worthwhile exercise. The Group agreed it was sensible to focus on the major points of misalignment. It should be borne in mind that by making the system simpler, the liabilities on employers and employees could change.

**Other points raised over the course of discussion**

• **Scottish variable tax rate**
  - The Group said that it was important to keep the possible of different tax rates existing when determining an employer NICs liability – e.g. employer based in England with employees living in both England and Scotland – particularly tricky for issues such as grossing up.

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1 Tronc - from the French *tronc des pauvres* meaning poor box. Used in the above context to mean a pooling of tips collected and later shared out between employees with no employer involvement.