Integrating the operation of income tax and National Insurance contributions

Working Group 2:
Meeting 1
14 December 2011

Attending

Peter Arrowsmith  ICAEW / NI Consultancy
John Black  Midland HR
James Collings  PCG Ltd
Norman Green  BCS / Logica
Helen Harvey  Nannytax payroll bureaux
David Heaton  ICAEW / Baker Tilly
Chris Hind  BCC / Frontier Software
Jackie Petherbridge  FSB / The Payroll Practice
Steve Wade  CBI / KPMG

Simon Carr  HMRC
Simon Manclark  HMRC (Chair)
Elizabeth Morgan  HMT
Matt Ray  HMT
Sam Tennakoon  HMRC

Background

HMT provided the 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 make the calculation and operation of NICs more like income tax. The objectives are to improve fairness, reduce the burden on employers, reduce distortions in the economy, improve transparency and reduce HMRC admin costs. Parameters have been set such that the contributory principle should be maintained, and NICs should not be applied to forms of income such as pensions, savings and dividends.

The ambition is that high level options will be identified by Budget 2012.

Terms of Reference and confidentiality

The draft Terms of Reference 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 canvass opinion on issues raised.

Operation of NICs

A concern was raised about employers having to report all earnings even if they were always at a level at which neither PAYE nor NICs were due. HMRC said that under RTI this would be
the case anyway. HMRC also confirmed that an employer would not have to register with HMRC (to open a PAYE scheme) if their employees were paid below the LEL and had no other income (P46 process statement A or B checked), as is the case now.

The group was positive about the opportunity to reform the system to meet the stated objectives, and it was suggested that any proposal for change be measured against each of those objectives to ensure that any change would improve the system and reduce burdens.

**Annual & Cumulative & Aggregated (ACA)**

HMRC introduced paper WG2(1) and explained what ACA would mean in practice.

Class 1 primary (employee) NICs are currently charged in each employment in isolation once earnings reach the weekly primary threshold (or equivalent if the person is paid other than weekly) and assessed in each earnings period individually i.e. non-cumulatively. The proposal is Class 1 primary NICs will be charged on an annual basis of assessment, with earnings aggregated across employments against a single set of annual thresholds. Like tax, National Insurance (NI) deductions would be calculated each payday on a cumulative basis which means that previous pay and deductions would be taken into account when calculating the NI deduction for the current pay period.

HMRC explained that with an ACA system it would be necessary to have NICs codes and explained what a combined tax and NICs code may potentially look like in practice e.g. 747L/722L. The following points were made in discussion:

- employers might very easily reverse the part of the code related to tax and the part for NICs if they look alike
- NI Category Letters could form part of the NI element of the code
- there could be problems with the code where the employee had several employments and we would need to consider what the code would look like for this scenario.

HMRC agreed to bear this in mind when considering a combined code.

An alternative to the proposed design of a NICs code was put forward. It would not have to look or work exactly like a tax code, instead it could be structured in a way that informs the employer as to what percentage of the tax and NI thresholds should be applied to earnings. For example a code of 30N would imply that the employer would give 30% of the allowances to the employee.

At present there were two calculation methods being considered for tax and NICs – a combined calculation within which the tax and NICs systems are overlaid and where they overlap the percentage rate is combined. But the tax and NI would have to be split out at the end of the payroll process so that, for example, the employee’s payslip would show tax and NI deductions as separate figures.

The alternative to this would be to run two calculations in parallel. This would result in the NI and tax deductions being visible through the calculation. The group considered this calculation method to be preferable because of the need for tax and NI to be shown separately at the end of the process.

The treatment of expats was raised but the view arrived at was that there would be no change for this sector and existing issues would simply remain. HMRC added that they will be testing international issues with the expat forum in more detail.

The group also suggested aligning the NI Primary Threshold and the PAYE Personal Allowance. Doing so would enable HMRC to ‘start with’ a single code and HMRC could issue any new codes just for the tax side. The group stated that by not aligning the proposed system would not makes things simpler, and that there are other changes HMRC could make to neutralise the effect. HMRC noted that aligning thresholds was an area already highlighted
by the Call for Evidence, but that the Government is committed to raising the income tax Personal Allowance to £10,000 and that any alignment in future would need to be affordable. If PAYE and NIC could not be aligned it was suggested that the employer and employee NICs thresholds should be aligned, to reduce the employer burden.

This was on the assumption that employer NICs would continue to be calculated like employee NICs, but the group’s view was that adoption of ACA could make this difficult, as it would be necessary to have extra rules to allocate employer liability fairly across the aggregated earnings. The group expressed concerns that any change should relieve burdens, but this might not be achieved if new, separate rules for employer contributions had to be created and that it may not make sense to create a system that was merely different but not less burdensome for employers and HMRC.

ACA could result in employment patterns changing, as currently individuals may be inclined to take on two part-time jobs to minimise NICs deductions, and is also partly driven by the benefit system where it is not financially beneficial to work full-time.

**Annual & Cumulative - not aggregated**

HMRC introduced paper WG2(2).

HMRC explained how Annual and Cumulative not aggregated across employments would work in practice.

The Annual and Cumulative charge would be assessed cumulatively (and separately) for each employment (unlike ACA) for the whole of the tax year, or for the length of the employment if less than a year with NI thresholds adjusted pro-rata.

Where employment commences during the tax year pay and deductions from any previous employments would not be taken into account by the new employer, nor would any details of other employments be sought (similar to ACA and the existing P46 procedures for tax). Also, no P45/leaver statement would be provided to the employee if the employee ceased employment during the tax year.

NI would simply be calculated without reference to other employments or other income in that tax year, on an annual, or pro-rata basis.

This was viewed by the group as being somewhat of a halfway house and potentially too complex and that it would not address the fairness issue. With this method employees with concurrent employments would benefit from the NI Primary Thresholds in both (say) employments. The view was made that ACA is the more complex option but would be fairer. Also, the introduction of shorter periods of assessments (for joiners/leavers) would require new rules and processes for both HMRC and employers and therefore increase complexity. However, it was agreed that this option could be retained (as a stepping-stone option) and revisited as the project develops. Concerns were again expressed that adoption of this change would not put NICs onto the same basis as PAYE, so the rules might just be different rather than simpler.

**Next meeting – areas for discussion**

The following areas were proposed:

- Alternative method of producing a NICs code (as a percentage of an allowance). HMRC agreed to consider the proposal made from the group and come back with comments.

- Employer NICs. This would also include related areas which are currently based on employers NICs, such as student loans and statutory payments.
Date of next meeting

17 January 2012