Pointmaker

NICs: THE END SHOULD BE NIGH

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SUMMARY

- For decades voices irrespective of political hue have proposed the merger of National Insurance contributions (NICs) and Income Tax. Despite the rationale of simplification, transparency and fairness, it has yet to happen.
- The status quo is a detriment to democracy: the complexity and opacity of the tax system reduces the likelihood of the electorate appreciating (i) what their total tax burden is; and (ii) the size of any increase (or reduction).
- The catalyst for change could be the introduction of the new single-tier State Pension in 2016. It will be residency-based, replacing today's basic and second State Pensions – the last vestiges of the contributions-based principle for benefits entitlement. Thereafter, NICs will be unambiguously part of the broader tax take.
- The Government Actuary's Department (GAD) recently forecast that the National Insurance Fund (the Fund) will be exhausted by 2035-36.
- This paper suggests that Fund exhaustion could occur as soon as next year. The GAD's modelling assumes 2.4% for annual real earnings growth (i.e. growth over CPI): this is excessively optimistic. It is not supported by official historic data, and even the GAD has admitted its own concerns about this assumption.
- The Fund serves as a barometer for the sustainability of the State Pension. Given that exhaustion is inevitable (after taking into account the retreating State Pension age), the next generation should be advised that their State Pension will be, at best, derisory. Indeed, it would be prudent to plan around not receiving anything at all.
- Timing aside, with the Fund gone, there would be no justification for HMRC to continue to collect the insurance premium that is NICs.
- This would leave a huge shortfall in revenue: £110 billion was paid in employer and employee NICs in 2012-13. This paper describes how the revenue gap could be closed.
- This paper suggests four specific proposals for reform, as summarised overleaf.

FOUR PROPOSALS

Proposal 1: The introduction in 2016 of a new residency-based, rather than contributions-based, State Pension ends any justification for continuing with the complex National Insurance Scheme. It should be scrapped, along with NICs.

Proposal 2: Employee NICs and Income Tax on earnings should be replaced with a single Earnings Tax, ideally set at 32%, 42% and 47%, based upon today's Personal Allowance and three marginal Income Tax bands.

Proposal 3: HMRC should model the net effect of no longer collecting employer NICs receipts, offset by higher Corporation Tax, dividend tax, Earnings Tax and VAT receipts. Any projected shortfall should be made up by additional consumer taxes.

Proposal 4: The Chancellor should use the Autumn Statement to signal his intention to end NICs and introduce an Earnings Tax.

1. INTRODUCTION

In 2010, David Martin proposed that National Insurance Contributions (NICs) be merged with Income Tax.[1] He is not the first person to make such a proposal, nor is he the most recent, but his summary is as cogent as any:

"Coalition proposals for a universal flat-rate pension effectively remove the last justification for our National Insurance System. Whether we like it or not, the contributory principle underlying NICs will shortly be superfluous.[2] In any case, NICs are riddled with anomalies, complexity and a lack of cohesion. They can reward the profligate while penalising the thrifty. They can discourage saving. They can be unfair. They can impose high marginal rates on low earners. They have been used to disguise tax increases……The introduction of a universal state pension will provide the ideal opportunity to merge NICs and income tax."

Similar sentiments have been expressed by many other independent organisations and from across the political spectrum.

2. BROAD SUPPORT FOR THE END OF NATIONAL INSURANCE

The Mirrlees Review,[3] probably the most comprehensive appraisal of the UK's tax system in the last 35 years, is unequivocal: *"National Insurance is not a true social insurance scheme; it is just another tax on earnings, and the current system invites politicians to play games with NICs without acknowledging that these are essentially part of the taxation of labour income. The two systems need to be merged."*

Twenty years ago it was LibDem policy "*to abolish NICs and create an integrated tax on income*", and in 2006 the party called for a merger *"as the contributory principle becomes obsolete"*.

Labour has yet to declare a position although the Labour Uncut website, for example, has proposed that NICs and Income Tax be merged. Employee NICs predominately falls on the lower paid[4] so NICs' demise would provide an opportunity to introduce a more progressive, single, employment tax. Civitas has argued that National Insurance *"is no longer fit for purpose, which is why many observers think the most sensible option is to scrap it altogether",*[5] and more recently (July 2014) it too proposed that NICs and Income Tax be merged provided that it could happen equitably (and citing Mirrlees' report as a good starting point).

On the political right, the Conservative Party has not formally opined on the merger theme, but eminent thinkers such as John Redwood MP are taking an interest in it, under no illusions as to the implementation challenges. The TaxPayers' Alliance has long campaigned for merger, albeit that their primary objective is to lower the overall tax burden, rather than the pursuit of simplification and transparency.

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1 Abolish NICs: *Towards a more honest, fairer and simpler system*; David Martin, Centre for Policy Studies, 2010.

2 The new single-tier State Pension, to be introduced on 6th April 2016, will be residency-based.

3 Conducted by nine experts (including the Institute of Fiscal Studies), under the chairmanship of Nobel laureate Sir James Mirrlees. See Tax by Design; Oxford University Press, September 2011.

4 The Class 1A employee NICs rate is 12% of earnings between the Primary Threshold (£7,956 p.a.) and the Upper Earnings Limit (UEL, £41,865 p.a.), and 2% on the balance of earnings above the UEL (2014/15).

5 Civitas; Beyond Beveridge, by professorial research fellow Peter Saunders, 2013.

Finally, the Treasury's Office of Tax Simplification's (OTS) has recommended that the Government looks at reforming the structure of the UK tax system, citing the integration of Income Tax and NICs as one of the key areas requiring attention.[6] When reviewing the UK's tax reliefs, the OTS concluded that "*it has become apparent during our work that the mismatch between the* (National Insurance and Income Tax) *rules is a major cause of complexity*"[7] and it repeatedly identified issues that are "*another example of the general difficulties caused by differences between Income Tax and NIC rules….*"

3. RATIONALE

3.1 Simplification

Businesses would welcome the simplicity of a single Earnings Tax. National Insurance is a staggeringly complex system, with some 60 different categories into which employees may fall. Merging Income Tax and National Insurance offers the scope for substantial savings on administration costs for employers, because six different types of tax (four classes of employee NICs, employer NICs and Income Tax) would become one. The whole regime of NICs thresholds (Class 1 NICs for example has five thresholds)[8] with their different rates of NICs, depending upon category, would simply disappear. In addition, all tax-related bands could then be expressed on an annual basis; today NICs bands are expressed in terms of weekly income, whereas Income Tax bands use annual income.

Taxpayers would benefit from the reduction in government bureaucracy: the interfaces between HMRC and DWP would be simplified and in the longer term there would be IT cost savings.

3.2 Transparency

Combining NICs with Income Tax to become the single Earnings Tax would make the total tax burden on earnings more transparent, which can only be beneficial in a democratic society. It would be far more obvious, for example, that direct tax on earnings is not as progressive as would appear from today's rates of Income Tax (20%, 40% and 45%). Ignoring band differences (further discussed in section 6), simply adding today's 12% and 2% rates of NICs to Income Tax would produce Earnings Tax rates of 32%, 42% and 47%.

3.3 Fairness

The advent of the single Earnings Tax would provide an opportunity for a more informed public debate about what a "fair" differential should be between low and high earners, ideally ahead of the next general election. It would also reveal the iniquity of NICs in specific areas of policy, notably pensions.

(a) Tax relief on personal pension contributions

Tax relief on pension contributions *excludes* employees' NICs, so the relief differential between basic rate and higher rate taxpayers is 20%. If Earnings Tax were introduced, and relief were granted on it, then the differential would be a fairer 10%. This would represent a step towards addressing a fundamental conundrum: given that income tax is progressive, tax relief is inevitably regressive. (The final destination could be a single flat rate of relief, irrespective of the saver's taxpaying status.)

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[6] OTS; Small business tax review: Interim Report, March 2011. The recommendation to merge Income Tax and NICs was reiterated in the OTS's Final Report in 2012.

[7] OTS; Review of tax reliefs: Final report, March 2011.

[8] Lower Earnings Limit (LEL, £5,772 p.a.), Primary Threshold (PT, £7,956), Secondary Threshold (ST, £7,956), Upper Accrual Point (UAP, £40,040) and Upper Earnings Limit (UEL, £41,865).

(b) Employer pension contributions

Not all contributions to occupational pension schemes are equal in the eyes of the taxman: employer contributions attract NICs relief, whereas employee contributions do not. Thus, the 4.6 million self-employed are unable to benefit from corporate salary sacrifice schemes: the disappearance of NICs would put an end to this blatant tax arbitrage, conducted at taxpayers' expense (costing over £15 billion in 2012-13).[9] Ending NICs would also make the true value of employer-funded benefits more apparent and also, in respect of funded public service pensions (primarily the LGPS), their true cost to taxpayers. This latter should lead to a wider appreciation of the need to cut public spending and boost the effectiveness of public services.

4. THE POLITICAL VALUE OF MERGING TAXES: ELUSIVE

Notwithstanding the rationale triumvirate of simplification, transparency and fairness, and the widespread support for a single Earnings Tax, it has yet to happen. Why? The *status quo* is a detriment to democracy: the complexity and opacity of the tax system reduces the likelihood of the electorate appreciating (i) what their total tax burden is; and (ii) the size of any rise. An increase in National Insurance contributions, for example, is much harder to detect than an increase in the headline rates of Income Tax.

Reform is problematic for government as the political value of merging taxes is elusive. Were NICs and Income Tax to be combined, the sources of political capital would not be immediately obvious to much of the electorate (as opposed to businesses). Furthermore, implementation would not be straight forward (NICs and Income Tax are, for example, on separate computer systems); would the political return be worth the effort? The answer could depend upon whether politicians were able to see beyond the immediate practical challenges to identify, post-merger, what else could then be achieved.

Alternatively, the catalyst for action could be nothing more than the demise of an accounting curio: the National Insurance Fund.

5. THE NATIONAL INSURANCE FUND

5.1 Origins

The National Insurance Fund (the Fund) was established in 1948 as part of the infrastructure to support William Beveridge's recommendations for fixed rate benefit payments based upon flat rate contributions (used to determine entitlement to the basic State Pension), with minimal means testing.[10] Unfortunately, his core principles were soon undermined: some benefits payments were set too high relative to recipients' contributions, flat rate NICs were replaced by earnings-linked NICs (1960s) and increases in contribution-based benefits have long been under-indexed (to save money). Today's State Pension, the last vestige of the contributions-based principle, is to be replaced with a new single-tier arrangement in 2016: it will be residency-

9 HMRC; Table PEN 6: Cost of Registered Pension Scheme Tax Relief, February 2014. Note that NICs relief is a combination of NICs relief in respect of employers' contributions (cost c.£10 billion) and the saving for individuals from the employers contributions not being treated as part of their gross income, and thus not subject to employee NICs (cost c.£5 billion). This is further discussed in *Retirement saving incentives; the end of tax relief, and a new beginning*, Michael Johnson, CPS, April 2014.

10 Report to Parliament; Social Insurance and Allied Services, 1942.

based, putting an end to contributions-based benefits entitlement. Thereafter, NICs will be, unambiguously, part of the broader tax take.

5.2 The Fund: an extension of the Treasury

NICs are collected within the Fund, where they are ring-fenced for the purpose of meeting specific benefits on a pay-as-you-go (PAYG) basis, primarily State Pension payments, with roughly 19% of the total collected allocated to the National Health Service (2012–2013). Thus, the Fund is essentially a conduit for passing cash from today's workers to the older generation; it represents the cumulative surplus, and is solely invested in UK gilt-edged stock (i.e. debt). There are no other assets so, in essence, the Fund (or) is an accounting creation and merely an extension of the Treasury's balance sheet. Its proximity to the Treasury is reiterated by the Fund's eligibility for supplementary income from the Treasury, in the form of grants of up to 17% of benefit expenditure in any year.

5.3 The Fund: financial health

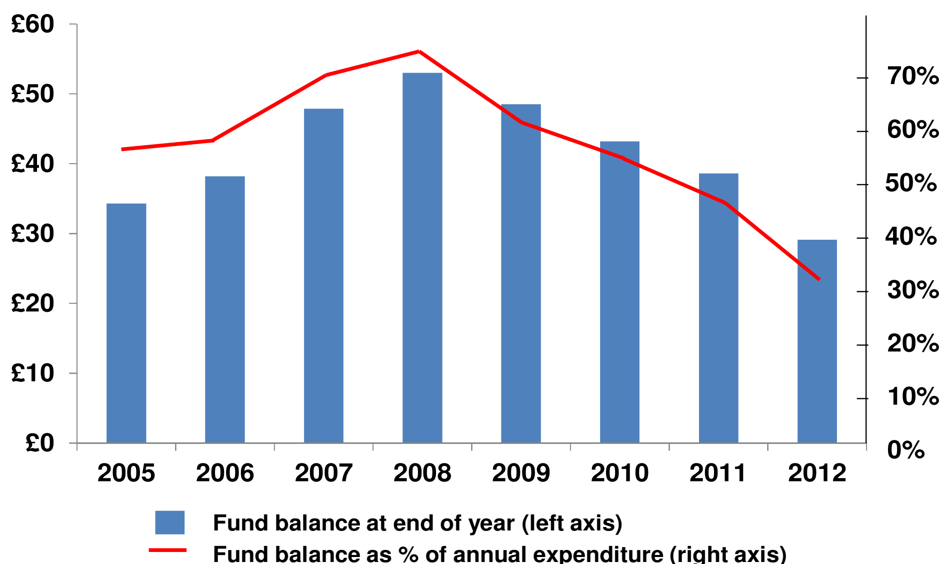
(a) In rapid decline

Recently the Fund has been rapidly shrinking, from £53 billion in 2008-09 to £29.1 billion in 2012-13. The Government Actuary's Department (GAD) has recommended that the minimum size necessary to ensure a reasonable working balance is 1/6th of annual benefit expenditure (17%): the Fund stood at over 70% of expenditure in 2008, but close to 30% in 2012; see Figure 1.

The Fund balance of £29.1 billion (March 2013) is in stark contrast to the GAD's 2005 review (conducted in 2009), which projected a balance of £103.3 billion for that year.[11] The £74.2 billion shortfall arose because contributions and investment income were £68.4 billion and £12.5 billion lower than expected, respectively, only slightly offset by £3.5 billion in lower benefit payments and some minor account restatements. Like everyone else the GAD did not foresee the financial crisis, but a gap as large as this

[11] GAD; Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2005, March 2010.

Figure 1: Fund balance (£ billion), and as a proportion of annual expenditure



Source: GAD; Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2010, Figure 1.1, July 2014.

between projection and outcome is a serious indication as to the Fund's frailty.

As an aside, it is worth noting that the Fund is essentially a captive gilts investor, akin to the Bank of England (which holds gilts as a result of quantitative easing). Consequently, because it contracted by £24 billion between April 2009 and April 2013 (down to £29 billion), an additional £24 billion of gilts would have been sold into the market (i.e. to external investors).

(b) Latest projections: startling

The GAD has recently published new financial projections for the Fund, out to 2075.[12] Crucially, these take into account the recent legislative changes, notably the Pensions Act of 2011, the introduction of the basic State Pension triple lock indexation,[13] and the Welfare Reform Act 2012.[14] A second set of projections also consider the implications of the Pensions Act 2014, which includes several cost-cutting measures:

- the introduction of the new single-tier State Pension, an increase in the number of qualifying years for a full pension to 35, and a minimum period of 10 qualifying years to receive any pension;
- the cessation of contracting-out and hence the ending of contracting-out rebates; and
- acceleration of the increase of State Pension age (SPA) to 67, between 2026 and 2028.

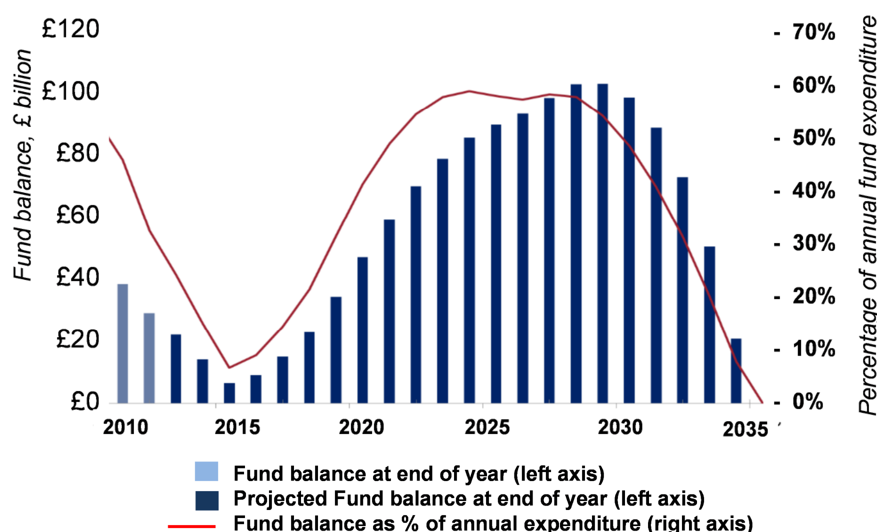
The GAD's base-case projections are startling because the Fund:

[12] GAD; Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2010, July 2014.

[13] The triple lock, introduced in April 2012, ensures that increases applied to the basic State Pension each year will be set as the minimum of 2.5%, average earnings growth or CPI growth over the previous year.

[14] The GAD's modelling therefore takes into account the increases in State Pension age to 66 for men and women, and reductions in Employment and Support Allowance and Jobseeker's Allowance.

Figure 2: Actual (to 2012) and projected Fund balance, and as a proportion of annual expenditure allowing for the Pensions Act 2014



Source: GAD; Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2010, Figure 1.6, July 2014.

- will likely need a Treasury grant during 2014-15, because its size is expected to fall below 1/6th of annual benefit expenditure; and
- it is projected to be exhausted in 2027-28, ignoring the changes in the Pensions Act 2014, and in 2035-36 if they are taken into account (i.e. the 2014 Act buys eight more years): see Figure 2.

(c) The earnings growth assumption: seriously suspect

The projections for Fund size suggest that 2015 marks a low point in its financial condition, but they are potentially seriously flawed. The GAD adopted the Office for Budget Responsibility's (OBR) long-term economic assumptions, a key one being for real earnings growth over the long-term: 2.4% per annum (over CPI). This is simply not credible: it is not supported by official historic data, and even the GAD has flagged its own concerns about using this OBR assumption.[15]

[15] In addition, it ignores one of Thomas Piketty's core conclusions, that over the long term (based upon empirical evidence) the rate of economic growth exceeds that for wage growth. Over the last 25 years, the UK's average GDP growth rate has been less than CPI plus 2.4% per annum, at CPI plus 2.2% p.a. Piketty may, or may not, be right, but for prudent modelling of the future, he should not be ignored. – Thomas Piketty; Capital in the Twenty-First Century, 2013.

(i) Official data

The Bank of England's latest Inflation Report (August 2014) reports robust employment growth (unemployment down to 6.5%) and, at 63.9%, the highest rate of labour force participation since 1991. On the other hand, it reports "*continued and unexpected weakness in wages*", as Table 1 shows.

Earnings have fallen by some 11% in real terms since just before the financial crisis, and since then the Bank of England has consistently over-forecast wage growth in its quarterly Inflation Reports. Minutes from the Bank's July 2014 meeting show that it is perplexed by the sharply contrasting labour market indicators. The Bank has offered a variety of explanations, including timing issues ("*stronger pay growth will arrive in due course….*") and a possible rise in effective labour market supply.[16]

According to the Office for National Statistics, annual nominal earnings growth was just 0.3% in the three months to May, well below the current inflation rate of 1.9%, and the Chartered Institute of Personnel and Development (CIPD)

[16] This is likely to reflect a combination of factors, including the phasing out of the default retirement age, changes to the State Pension age for women, benefit reforms and concerns about the adequacy of retirement provision (prompting older people back into work).

Table 1: Nominal inflation indicators (% change over prior year)

	Annual average over 2008-13	Q1 2014	Q2 2014	GAD forecasting assumption
Total average weekly earnings (AWE) growth	1.7%	2.0%	-0.1%	
CPI inflation	3.2%	1.7%	1.7%	
Wage growth less CPI inflation	-1.5%	0.3%	-1.8%	+2.4%

Source: Bank of England Inflation Report, Table 4.B, August 2014.

has expressed similar sentiments: "*weak real wage growth could be here to stay.*"[17]

Whatever the causes, weak earnings growth is not a recent phenomenon in the developed world. Over the last 40 years, for example, median earnings in the US have grown a mere 4% in real terms.[18] Given that UK employers are competing in the same global economy, it is unclear why the Bank would appear to be so surprised by poor wage growth (which, so far in 2014, is 1% weaker than expected).

(ii) GAD's own concerns about the earnings growth assumption

In the GAD's penultimate review of the Fund (published in early 2010), it used assumptions for real earnings growth of 1.5% and 2% p.a. (over RPI: this is akin to 2.2% and 2.7% over CPI, respectively).[19] In the report, the GAD stated that "*over the last decade, average real earnings growth has fallen outside this range (at between 0.75% and 1% p.a.),"* i.e. lower than modelled. Furthermore the Department noted that: "*However, there have been similar periods of short-term lower earnings growth in the past and as yet there is no long-term track record of real earnings growth at this level….. If the recent level of average real earnings growth continues in future, then the impact of lower earnings growth on the progress of the Fund will be investigated in more detail at subsequent reviews."* This was nearly five years ago, and since then the rate of wage growth has continued to deteriorate.

To its credit, in the GAD's latest review of the National Insurance Fund (July 2014), further to its 2.4% base case for real earnings growth (over CPI), the GAD examines the consequences of using 0% (over CPI) out to 2020. Fund exhaustion is then expected in 2016! Given that wage growth in Q2 of 2014 was 1.8% *below* CPI, Fund exhaustion could be imminent.

5.4 Fund exhaustion: symbolism matters

Fund exhaustion, whenever it arises, would be of considerable symbolic significance. It would confirm that even with all the recent cost-saving measures (such as sending the SPA into rapid retreat) the forthcoming single-tier State Pension is unsustainable. Either benefits are further watered-down, or Generation Y,[20] in particular, will face rising taxes. This is unreasonable; Generation Y is already faced with unaffordable housing, college debts to repay, fragmented careers and earnings stagnation, and far thinner occupational pensions (DC, not DB, bar the public sector) than their baby boomer parents.[21] It is perhaps no surprise then that the 25-34 years old age group (i.e. core Generation Y) are the least likely to live in households in the top total wealth band. Conversely, only 4% of individuals aged 55-64 years (i.e. baby boomers), and 4% aged 65 or older, live in households in the lowest total wealth band.[22]

5.5 Time to accept reality

Treasury grants could be used to hide the reality of a dying Fund, but to what end? Treasury grants made over the next few years may even be repaid, but the GAD's modelling

[17] CIPD; Labour Market Outlook, August 2014.

[18] Economic Policy Institute: data covers 1973 to 2011. Since 2000, productivity has risen 23% while real hourly pay has essentially stagnated.

[19] Historically RPI has, on average, exceeded CPI by c.0.7%. See OBR; The long-run difference between RPI and CPI inflation; Ruth Miller, November 2011.

[20] Broadly, the under-35's, i.e. those born in the 1980's and 1990's.

[21] People born between 1946 and 1964.

[22] ONS; Chapter 2: Total Wealth, Wealth in Great Britain 2010-12, 15 May 2014.

suggests that this would be, ultimately, a futile exercise, such is the extent of the deficits forecast after 2030: irretrievable Fund exhaustion is inevitable.

With no Fund, there would be no remaining justification to continue to collect the insurance premium that is NICs. But to be clear the prospect of Fund exhaustion is not the primary reason for putting an end to our complex National Insurance scheme; that remains the introduction of the new single-tier State Pension in 2016 as identified by David Martin. Past accrued entitlement to state benefits via NICs should of course be preserved.

Proposal 1: The introduction in 2016 of a new residency-based, rather than contributions-based, State Pension ends any justification for continuing with the complex National Insurance scheme. It should be scrapped, along with NICs.

Putting an end to NICs and integrating whatever remains of the Fund back into the Treasury could be politically attractive. The Fund is a rare example of hypothecation of tax income for specific expenditure, generally unpopular amongst politicians because it reduces flexibility. In addition, if putting an end to NICs were to occur before Fund exhaustion, the risk of political embarrassment ("government incompetence") would be eliminated. But the end of NICs would, of course, leave a huge shortfall in revenue: £110 billion was paid in employer and employee NICs in 2012-13.

6. PLUGGING THE REVENUE GAP, POST-NICS

6.1 A big hole

NICs are expected to produce £110 billion in 2014-15, as £64 billion from employers, £43 billion from employees and £3 billion from the self- and non-employed, some 18% of total forecast tax receipts (£606 billion).[23] Post-NICs, this would have to be sourced from elsewhere (net of some £15 billion in NICs reliefs in respect of pension contributions).

6.2 Personal tax

(a) Replacing employee NICs

Following NICs' demise, it would seem logical to simply increase today's basic, higher and additional rates of Income Tax to 32%, 42% and 47%, respectively, to cover the tax shortfall. Unfortunately, NICs' lowest band is not

[23] HM Treasury; Budget 2014, Table D.3, March 2014 and ONS; UK National Accounts, The Blue Book, 2013, Table 5.2.4S, and HMRC. The three other largest contributors to the Exchequer are expected to be £166 billion from Income Tax (27%), £111 billion in VAT (18%), £47 billion in excise duties (8%) and £41 billion from Corporation Tax (7%).

Table 2: Class 1 NICs deductions from employees' pay (2014-2015)

	Earning band, £ per annum			
Category	**£5,772 to £7,956**	**£7,956 to £40,040**	**£40,040 to £41,865**	**Above £41,865**
A	0%	12%	12%	2%
B	0%	5.85%	5.85%	2%
C	N/A	N/A	N/A	N/A
D	1.4% rebate	10.6%	12%	2%
E	0%	5.85%	5.85%	2%
J	0%	2%	2%	2%
L	1.4% rebate	2%	2%	2%

identical to that for Income Tax; Class 1A employee NICs commences at the Primary Threshold (£7,956 p.a.), whereas the basic rate of Income Tax commences at the Personal Allowance, current £10,000. Additional complications are reflected in Table 2, namely the existence of NICs rebates, and multiple rates of NICs, depending upon earnings band and category.

Consequently precisely replicating today's Income Tax bands for the new Earnings Tax would produce small groups of "winners" and "losers". It may be necessary to (initially) preserve some different categories although some will disappear with the end of contracting out in 2016. An alternative approach would be to set the new Personal Allowance at the level of the national minimum wage (£13,520 from October 2014), so that anyone earning less would not pay any earnings-related tax at all. This would be consistent with the current direction of travel for the Personal Allowance – David Cameron recently signalled an intention to lift it to £12,500 by 2020.[24] The Earning Tax's bands and rates would then have to be fitted around this; a juggling act for the Treasury, ideally introducing new bands that would be simple to remember (for example, a higher rate Earnings Tax threshold of £42,000 rather than £41,865). Crucially, the new bands should not mask an underlying increase in the total earnings-related tax burden.

Proposal 2: Employee NICs and Income Tax on earnings should be replaced with a single Earnings Tax, ideally set at 32%, 42% and 47%, based upon today's Personal Allowance and three marginal Income Tax bands.

(b) Tax on other sources of personal income

National Insurance is a tax on earnings: income derived from state and private pensions, capital gains, property, savings and dividends are, for example, all NICs-exempt. A discussion as to how these should be taxed, were Earnings Tax to be introduced, is beyond the scope of this paper.

6.3 Company tax

(a) How to replace employer NICs?

In 2012-13, HMRC collected £61 billion (at 13.8%) in employer NICs, and £41 billion from Corporation Tax. Raising the headline rate of Corporation Tax to make up for the loss of employer NICs is not recommended. The main rate of Corporation Tax has been falling in recent years, from 28% in 2010 to 20% from April 2015, and this has helped encourage businesses to employ more people and improve Britain's competitiveness. In addition, the recent wave of so-called "tax inversions" sweeping across corporate US illustrates the risk of high company taxes.[25]

(b) HMRC's Computable General Equilibrium (CGE) model

HMRC has been developing a CGE model to assess the dynamic macroeconomic effects, and subsequent Exchequer revenue effects, of a major policy change. Its strength is in modelling the long-term economic effects of policies rather than short-term economic fluctuations. Similar models are used by the Congressional Budget Office in the US.

[24] Conservative Party Conference, Birmingham, September 2014.

[25] A tax inversion occurs when a company merges with a foreign one and, in the process, reincorporates abroad. Such mergers have many motives, but often one of them is to take advantage of the more favourable tax treatment offered by other nations.

HMRC's model has now been satisfactorily peer-reviewed,[26] and in 2013 it was used to drive a report analysing the net cost of the Coalition's company tax cuts over the period 2010-2015.[27] It should be set a similar task, to forecast the impact of ending employer NICs, taking into account the subsequent increases in:

- Earnings Tax receipts. Companies would be under huge pressure to raise wages, were employer NICs to end (which would be welcomed by politicians as well as by employees);
- VAT receipts (higher wages would lead to more consumption);
- Corporation Tax receipts. Company profits would most likely rise because not all savings arising from the end of employer NICs would find their way into the wage bill;
- dividend tax receipts (company profits having increased); and
- tax receipts in general, following any increase in investment (companies would have more cash available were employer NICs to end).

If the model (or some human intervention) were to conclude that the aforementioned additional tax receipts would be insufficient to make up for the loss of employer NICs receipts, then some additional consumer taxes should be considered.

Proposal 3: HMRC should model the net effect of no longer collecting employer NICs receipts, offset by higher Corporation Tax, dividend tax, Earnings Tax and VAT receipts. Any projected shortfall should be made up by additional consumer taxes.

(c) Should companies pay any tax?

Ending employer NICs would be consistent with Gregory Mankiw's observation that companies are more like tax collecting conduits than taxpayers.[28] The burden of taxes on business is ultimately borne by people: perhaps their contribution to support the government should be based upon how much of the economy's output of goods and services they enjoy? *In extremis*, perhaps we should gradually put an end Corporation Tax altogether, replacing it with consumer taxes?

As an aside, such an arrangement would put an end to the futility of paying for two Houses of Parliament to debate and legislate for tax-raising powers, only to be thwarted by an army of expensive tax consultants in the employ of corporate Britain. Amazon, for example, paid a mere £2.4 million in UK Corporation Tax (on 2012's UK sales of £4.2 billion). In October 2012, Starbucks told HMRC that its British arm was loss-making, yet told its investors that its British subsidiary was profitable. While this does raise serious moral and ethical issues, we should not lose sight of Mankiw's sentiments.

6.4 Communicating the changes

The introduction of a single Earnings Tax could be a communications challenge *par excellence.* There would be considerable scope for mis-interpretation (perhaps assisted by both the media and the parliamentary Opposition), particularly by the elderly – and

[26] https://www.gov.uk/government/publications/computable-general-equilibrium-cge-modelling

[27] HM Treasury; Analysis of the Dynamic Effects of Corporation Tax Changes, December 2013.

[28] Mankiw was George W. Bush's former chairman of the Council of Economic Advisors and currently an economics professor at Harvard.

any government is particularly sensitive to the pensioner vote. It would be important to focus people on cashflow as it affects them, rather than rates of tax and thresholds.

Crucially, the reform should not be used as an opportunity to increase overall tax. A pre-implementation communications strategy would help improve public understanding; it could, for example, include the interim renaming of NICs as Earnings Tax, along the lines proposed by Ben Gummer MP in a 10-minute rule bill (February 2014). In addition, the NICs and Income Tax thresholds could be unified prior to replacing them with a single Earnings Tax. More could also be done to make employees aware of the content of their wage slips and P60s (which already show how much NICs and Income Tax they paid).

6.5 Timing

The forthcoming 2014 Autumn Statement (3 December) presents the ideal opportunity for the Chancellor to flag an intention to end NICs. With a general election then imminent, there would be insufficient time for implementation, and hence the Chancellor would have no obligation to commit to a timetable. He could, however, flag up other potential areas for reform that could follow the end of NICs, notably concerning the whole gamut of tax reliefs (including retirement saving incentives) and the welfare and benefits framework.

Proposal 4: The Chancellor should use the Autumn Statement to signal his intention to end NICs and introduce an Earnings Tax.

7. CONCLUSION

The National Insurance Fund is essentially a conduit for passing NICs from today's workers to the older generation in the form of the State Pension. Fund exhaustion is inevitable, merely confirming what we already know, namely that today's workers are passing too much to today's pensioners, given the relative sizes of the two populations. This problem is only going to get worse, as the population ages. Sending the State Pension age into retreat is intended to address this, but too late to save the Fund.

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