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National Insurance Contributions Bill

Bill No 79 of 2010-11

RESEARCH PAPER 10/76 17 November 2010

In its first Budget on 22 June 2010 the Coalition Government confirmed that the rates of National Insurance contributions (NICs) for employees, employers and the self-employed would rise by 1% from April 2011. This tax increase had been announced in two stages by the Labour Government in its Pre-Budget reports in December 2008 & 2009. The Coalition Government also stated that it would legislate to introduce a three year regional NICs 'Holiday' for new employers. Under the scheme new businesses may qualify for a deduction of up to £5,000 from the employer NICs that would normally be due, for each of the first ten employees they take on in their first year of business. However, new businesses in Greater London, the South East Region and the Eastern Region are specifically excluded from the scheme.

The purpose of the *National Insurance Bill 2010-11* is to implement these two measures. The Bill's second reading debate is set for 23 November 2010.

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Summary

National Insurance contributions (NICs) is the UK's second biggest tax after income tax, in terms of the amounts of money it raises for the Exchequer. In 2009/10 NICs raised £95.5 billion, which compares with receipts of £144.9 billion for income tax, £70.1 billion for VAT and £35.8 billion for corporation tax.[1]

In his March 2010 Budget the then Chancellor, Alistair Darling, confirmed that the rates of NICs for employees, employers and the self-employed would be increased by 1 percentage point from April 2011. Mr Darling had announced this tax increase in two stages, in his Pre-Budget statements in November 2008 and December 2009. In the March Budget Mr Darling also confirmed that the 'primary threshold' – the level of earnings at which employees become liable to pay the main rate of NICs – would be increased, to ensure that individuals earning less than £20,000 would not be worse off as a result of these rate increases.

During the 2010 General Election the Conservative Party proposed additional increases in NI thresholds for both employers and employees to mitigate the impact of the new higher NI rates. After the Election the new Conservative-Liberal Democrat Coalition Government announced that it would only implement the first of these measures – that is, a rise in NI threshold for employers – or 'secondary threshold' as it is called. In the Government's first Budget on 22 June, the Chancellor George Osborne confirmed that this threshold would rise by "£21 a week above indexation" while the increases in NI rates announced by the previous Government would go ahead.

In his June 2010 Budget the Chancellor also announced a new three-year scheme to relieve the NI costs to new businesses: "anyone who sets up a new business outside London, the south-east and the eastern region will be exempt from up to £5,000 of employer national insurance payments for each of the first 10 employees hired."[2] The scheme was launched on 6 September 2010: at this time the Government stated that the legislation to underpin the scheme would be included the forthcoming NICs Bill which would be required to set the new rates of NICs from April 2011.[3] The Government has estimated that 400,000 new businesses will benefit from the scheme, and the average benefit per business will be about £2,000.[4] However some commentators have raised doubts about whether the scheme may be too small financially and too complex administratively to be as successful as is hoped.

The *National Insurance Contributions Bill* [Bill 79 of 2010/11] was published on 14 October 2010. The Bill is relatively short - 15 clauses in all. It increases the rates of Class 1 NICs, paid by employees and employers on employee earnings, and Class 4 NICs, paid by the self-employed on their profits – and it provides for the regional NICs 'Holiday' for employers. It makes no changes to NI thresholds as this can be done by secondary legislation. It is estimated that the rise in NI rates will raise £9.02 billion in 2011/12, while the total cost of the NI holiday over its three-year lifetime will be £940 million.[5]

NICs are a reserved matter in Wales and Scotland, but an excepted matter for Northern Ireland. Northern Ireland has separate NI legislation equivalent to that made for the rest of the UK, so, where appropriate, the Bill either amends, or refers to, the equivalent NI legislation relating to NICs.

1 HM Revenue & Customs, *National Statistics: HMRC receipts*, October 2010
2 HC Deb 22 June 2010 c174, c177
3 HC Deb 6 September 2010 c1WS
4 *National Insurance Contributions Bill : Explanatory Notes Bill 79-EN*, October 2010 p15
5 *Explanatory Notes Bill 79-EN*, October 2010 p15

1 The structure of NICs

National Insurance benefits are funded by a system of compulsory contributions on earnings, paid by employees, employers and the self-employed. Most of the income from these contributions – NICs, for short – goes into the National Insurance Fund, kept separate from all other revenue raised by national taxes. The Fund is used exclusively to pay for these contributory benefits - which include contributions-based jobseeker's allowance, incapacity benefit, retirement pensions and bereavement benefits. The Fund operates on a 'pay as you go' basis: broadly speaking, this year's contributions pay for this year's benefits. One portion of NICs receipts do not go into the Fund, but go directly into the National Health Service.

It is projected that in 2010/11, NICs will raise just over £101 billion, of which £80 billion will go into the NI Fund and £21 billion will go to the NHS.[6]

NICs are divided into six classes:

- Class 1 contributions, which are paid by both employees and employers on the employee's earnings. The employee's share is known as the primary contribution, the employer's as the secondary contribution.

  Employees are liable for primary Class 1 NICs on earnings above the 'lower earnings limit' (LEL), set currently at £97 a week. A zero rate of NICs is charged on earnings above the LEL up to the primary threshold, set at £110 a week. The main rate of NICs, which is 11%, is charged on earnings above this threshold up to the 'upper earnings limit' (UEL), set at £844 per week. An additional rate of NICs set at 1% is charged on earnings above the UEL.

  Employers are liable to pay secondary Class 1 NICs at 12.8% on all employee earnings above secondary threshold, also set at £110 a week. No upper limit applies to employer NICs.

  There are arrangements for reducing the rates of both primary and secondary contributions where the employee has contracted out of the State Second Pension.

- Class 1A contributions are payable annually by employers on most taxable benefits in kind. They are payable by employers only. Class 1A contributions are payable at a rate of 12.8%.

- Class 1B contributions are payable annually by employers on items which are dealt with under a PAYE Settlement Agreement (PSA) for income tax – usually minor or irregular expenses and benefits. Class 1B contributions are payable at a rate of 12.8% on the value of the items included in the PSA and on the total tax payable by the employer under the PSA.

- Class 2 contributions are paid by the self-employed at a flat rate of £2.40 per week – a self-employed person can apply to be exempted from liability where earnings are below £5,075 per year. Class 2 contributions are paid either monthly or quarterly.

- Class 3 contributions are paid on a voluntary basis, at a flat rate of £12.05 per week, by people who fall outside the scope of Class 1 and Class 2 contributions.

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6 Government Actuary's Department, *Report … on the draft of the social security benefits up-rating Order 2009...*, January 2010 pp25-6

- Class 4 contributions are paid annually by the self-employed on profits that are immediately derived from a trade, profession or vocation and which are chargeable to income tax. Class 4 NICs are payable at a rate of 8% on profits between £5,715 and £43,875 and 1% of profits above £43,875.

The rates of NICs for employees and employers for 2010/11 are summarised below:[7]

Earnings[a] **£ per week**	**Employee (primary) NIC rate (per cent)[b]**	**Employer (secondary) NIC rate (per cent)[c]**
Below £97 (LEL)	0%	0%
£97 to £110 (PT/ST)	0%	0%
£110 to £844 (UEL)	11%	12.8%
Above £844	1%	12.8%

[a] *The limits are defined as LEL - lower earnings limit; PT - primary threshold; ST - secondary threshold; and UEL - upper earnings limit.*
[b] *The contracted-out rebate for primary contributions in 2010/11 is 1.6 per cent of earnings between the LEL and the upper accrual point (UAP) of £770 for contracted-out salary-related schemes (COSRS) and contracted-out money purchase schemes (COMPS).*
[c] *The contracted-out rebate for secondary contributions is 3.7 per cent of earnings between the LEL and UAP for COSRS and 1.4 per cent for COMPS. For COMPS, an additional age-related rebate is paid direct to the scheme following the end of the tax year.*

A glossary of some key terms for National Insurance and income tax is given in an appendix to this paper.

Further background on the National Insurance system is given in two Library standard notes:

- *National Insurance contributions : an introduction*, SN/BT/4517, 25 May 2010
- *National Insurance Fund: 1975-2010*, SN/SG/797, 14 June 2010

7 HM Treasury, *Budget 2010*, HC 451 March 2010 p124

2 Proposals to increase NICs

In the June 2010 Budget the Coalition Government confirmed that the rates of NICs on employees, employers and the self-employed would all rise by 1% from April 2011. This major tax increase has had a long history, as it was the Labour Government which first proposed putting up these rates in late 2008, along with related proposals to raise receipts from income tax. These plans were subject to considerable revision over the next two years, providing one theme to the 2010 General Election, before being amended again in the June 2010 Budget. A related issue which has given rise to much debate has been the broader pattern of person taxation – as efforts to compensate those on lower earnings for higher NICs rates have given rise to concerns about the lack of alignment between NICs and income tax. This section of the paper looks at the chronology of this debate, although readers new to this issue are advised that it is relatively complex, and they may prefer to focus on the subsequent analysis of the outcome to the June 2010 Budget and the Bill itself.

2.1 The 2008 Pre-Budget Report: increasing NICs rates

The proposal to increase rates of NICs by ½%

In his Pre-Budget statement on 24 November 2008 the then Chancellor Alistair Darling announced a series of tax increases for future years to "ensure sustainable finances in the medium term." He argued that he had chosen "those [measures] that are fairer and affect those who have done best out of the growth of the past decade" – specifically,

- a new higher rate of income tax on incomes over £150,000 from April 2011,
- the withdrawal of the personal allowance from those earning £100,000 or more from April 2010, and
- an increase by ½ per cent of "all rates of national insurance contributions for both employees and employers" from April 2011.

Mr Darling went on to say that, "to ensure that the [NI] increase does not fall on those with low or modest incomes, I have decided, at the same time, to raise the starting point for National Insurance to align it with that for income tax, so that no one on under £20,000 will pay any more national insurance contributions as a result."[8]

To grasp the significance of this last announcement, some history of the interaction between NICs and income tax in the wider scope of personal taxation is unavoidable.

Although there are broad similarities between the scope of income tax and NI, the structure of both these taxes has never been aligned. This has given rise to two serious problems. Businesses have complained about the administrative burden of administering two taxes on employee earnings, while economists have pointed out that taken together, the system gives rise to a perverse structure of marginal tax rates. First, employees have started to pay NI on earnings far below the level at which income tax is paid – making the collection of tax and NI by employers relatively complex. Second, although there has been a range of earnings over which employees have paid both the basic rate of tax and the main rate of NI, the upper limit for paying the main rate of NI has been *below* the point at which individuals start to pay the higher rate of income tax – the higher rate threshold. This has resulted in a 'kink' in the tax schedule.

8 HC Deb 24 November 2008 c496

By example, in 2007/08 income was taxed at three rates: a starting rate of 10% on the first £2,230 of taxable income (excluding the personal allowance), a basic rate of 22% on income up to £34,600, and a higher rate on income over this basic rate limit. NICs was charged at 11% on earnings from £100 to £670 and at 1% on earnings above this. Ignoring tax credits, the marginal rate of deduction faced by employees – combining income tax and NICs – was:[9]

Earnings (£ per week)	Marginal rate
£100 - £143	21%
£143 - £670	33%
£670 - £766	23%
Above £766	41%

In two Budgets – 1998 and 2007 – the then Chancellor, Gordon Brown, introduced proposals to simplify NI, and to simplify income tax: each reform package was designed to bring the two taxes into close alignment, though Mr Brown's controversial decision in 2007 to abolish the 10p starting rate of income tax threw these ambitions into some disarray. First, the 1998 Budget lead to the NI threshold being substantially increased over two years, to be fully aligned with the personal allowance in 2001. A new zero-rate of NICs was introduced for earnings between the old LEL and this new primary threshold, to protect the benefit entitlement of employees on low earnings.

Nine years on, Mr Brown proposed that the income tax schedule should be replaced from April 2008, with two rates set at 20% and 40%, instead of three rates set at 10%, 22%, and 40%. In addition, Mr Brown announced that the UEL would be aligned with the higher rate threshold over two years, by increasing the UEL by substantially more than the basic rate limit. However, concerns over the numbers of taxpayers who would lose out from this change lead to a major U-turn by Alistair Darling the following year. Some weeks after his 2008 Budget, on 13 May 2008 Mr Darling announced that the personal allowance would be increased by an *extra* £600 for that year: this move substantially reduced the numbers of taxpayers losing out, but meant that tax and NI were no longer aligned at the bottom of the income scale.

Returning to his 2008 Pre-Budget Report, Mr Darling was still dealing with the fallout from the 10p starting rate controversy. Initially Mr Darling had left it open whether the increase in the personal allowance introduced in May would be permanent. In his PBR statement he confirmed this would be the case, and that the personal allowance would go up *another* £145 from April 2009. This increase would also be permanent, even though inflation over the coming year was expected to be negative, boosting the real value of allowances and benefits. To ensure that higher rate taxpayers did not benefit from this effect, the basic rate limit would be frozen between April 2010 and April 2012.[10]

It is worth noting that the increase in NICs rates was projected to raise much more than the changes proposed to income tax. At the time it was estimated that the ½ percentage point rise in rates would raise just under £5.4bn in 2011/12, while the income tax increases on those with the highest incomes were projected to raise just under £2bn in the same year.[11]

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9 Taking account of the basic personal allowance – which is £5,225 for 2007-08 – employees are charged income tax at: 10% on earnings between £100 and £143 a week; 22% on earnings between £143 and £766 a week; and 40% on earnings above £766 a week.

10 Cm 7484 November 2008 p84 para 5.7

11 Cm 7484 November 2008 p10 (Table 1.2). For completeness, the increase in the primary threshold for employees, to cushion the impact of the rise in rates, was projected to cost £1.6bn in 2011/12. As noted below, the Government amended its income tax proposals in the 2009 Budget.

Arguably all of these changes to income tax and NICs were cast into the shade by Mr Darling's other proposal: a temporary cut in the standard rate of VAT – from 17½% to 15% – as a means to prevent the recession from worsening. As the Chancellor explained, the cut would last 13 months until 1 January 2010, "by which time we expect the recovery to be under way."[12]

Reaction to the proposed rate rise

Following Mr Darling's statement to the House, both the then Shadow Chancellor, George Osborne, and the Liberal Democrats Treasury spokesman, Vincent Cable, were dubious about the benefits of the VAT cut, and strongly critical of the decision to increase National Insurance in the medium term. Mr Osborne suggested that "borrowing money for a temporary cut [in VAT] when prices are already falling, and telling people that their taxes will go up to pay for it, is not much of stimulus. What will make a difference are the massive new taxes on ordinary incomes and jobs that are just around the corner … now we know at least one of those tax rises: national insurance, an income tax in all but name … [which represents] a precision-guided missile at the heart of the recovery." Dr Cable argued that what was required "alongside radical cuts in interest rates and radical action on bank lending, is a serious tax cut for the low paid":

> What I fail to see is how the economy receives a major stimulus from, for example, a £5 cut in the price of a £220 imported flat-screen television or a 50p cut in a £25 restaurant bill. Surely it would be much more sensible to put money directly in the pockets of low-paid workers by cutting their income tax, rather than offering them a pathetic £25 and, if they earn over £20,000 a year, the prospect of tax increases.[13]

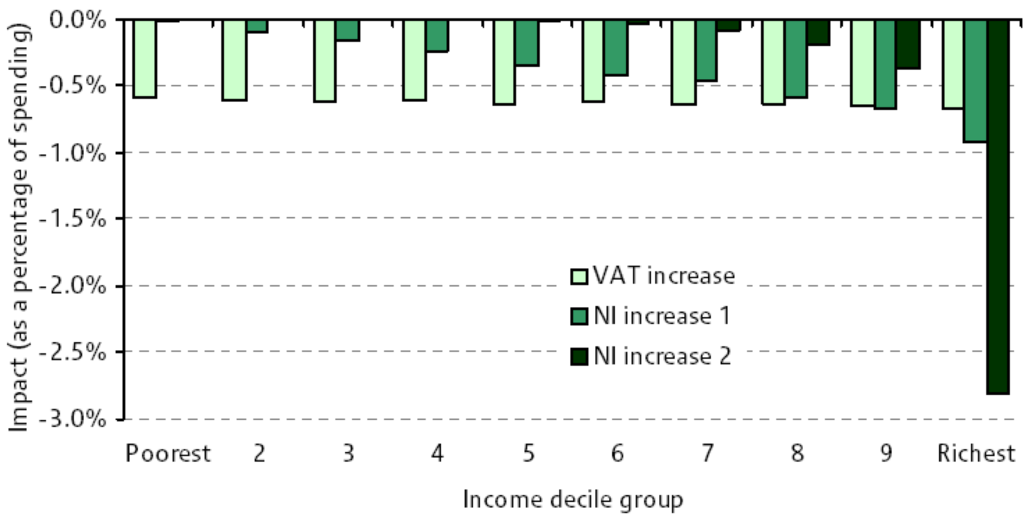
At the time of Mr Darling's statement it was widely reported that the Government had considered a higher standard rate of VAT – set at 18% – should be introduced after the end of the temporary cut. In January 2009 the Institute for Fiscal Studies considered the options for further tax cuts, and compared the case for raising VAT to that for additional increases in NICs. Notably the authors concluded that "further across the board increases" in NICs would be attractive if the Government wished to minimise the impact on poorer households, while avoiding very large tax rises on richer households: an extract from this analysis is reproduced below:

> Here we compare the distributional and economic impact of an increase in VAT (raising approximately £5 billion in 2011–12) with two different increases in NI raising the same amount … (1) an increase in the employers' and employees' rates of 0.5% each, both above and below the upper earnings limit (UEL); and (2) an increase in the additional rate of NI paid above the UEL from 1.5% to 6%. All three policies are in addition to the reforms of NI already announced in last November's PBR.
>
> Whilst all three policies would be expected to be progressive to some extent, the increase in the rate of VAT would be least progressive as it applies to all expenditure on standard rate goods, whilst the increase in the additional rate of National Insurance above the UEL would be expected to be most progressive as it only affects relatively high-earning individuals. Figure 10.3 confirms that this is the case. As a proportion of non-housing expenditure, Figure 10.3 shows a very progressive pattern for both NI reforms. For the 0.5 percentage point across-the-board increase (NI increase 1), average losses increase as one moves up the income distribution from close to 0% for the poorest decile to 0.9% for the richest. When the increase in NI applies only to the

[12] HC Deb 24 November 2008 c495
[13] HC Deb 24 November 2008 c508

additional rate paid above the UEL (NI increase 2), losses are negligible for the bottom six deciles and reach over 2.8% of expenditure for the top decile. For the increase in the standard rate of VAT, losses as a proportion of non-housing expenditure are slightly progressive, but not nearly as progressive as they are under either of the NI reforms. Those non-working or low-income households escaping the rise in NI are hit by the increase in VAT because, while their earnings are zero or very low, they are still spending on standard-rate goods.

Figure 10.3. Comparing losses from NI reforms and potential VAT increase (percentage of household expenditure)



Notes: Income deciles based on equivalised household net income using McClements equivalence scales. Net income is defined as private income minus income tax, National Insurance and council tax plus benefits and tax credits and is derived from the Family Resources Survey 2006–07. The Family Expenditure Survey significantly under-records expenditure on all goods and hence expenditure has been increased by a factor of 1.37 so that it matches National Accounts data. Expenditure on VATable goods is particularly underestimated and hence all VAT amounts have been increased by a factor of 1.410 so that estimated VAT revenue matches government revenue estimates. All direct tax and benefit changes are modelled using the Family Resources Survey, whilst all indirect tax changes are modelled using the Family Expenditure Survey.

Sources: Family Expenditure Survey 2005–06; Family Resources Survey 2006–07; National Accounts; HM Treasury, *Pre-Budget Report 2008*, November 2008 (http://www.hmtreasury. gov.uk/prebud_pbr08_repindex.htm); and authors' calculations.

Relying on large increases in the rate of National Insurance payable above the UEL therefore imposes significant costs on the top decile that may be deemed politically unpalatable.[14] Hence, if the government is concerned about minimising the impact of tax increases on poorer households, but not hitting richer ones too hard, it would seem that further across-the-board increases in National Insurance look attractive.[15]

In his March 2009 Budget Mr Darling modified his proposals for income tax increase on the highest incomes. First, the new higher rate on incomes over £150,000 would be set at 50%, rather than 45% as initially proposed, and would come in a year earlier, from April 2010. Second, the withdrawal of the personal allowance from those with incomes over £100,000 would be done by reducing the value of allowance by £1 for every £2 someone's income

[14] Note that, while the PBR 2008 announcement that the rate of income tax on earnings above £150,000 would rise to 45% from April 2011 was largely uncontroversial, that reform will affect only the top 1% of earners. This NI reform applies to the highest10% of earners.

[15] *The IFS Green Budget*, January 2009 pp 205-6

exceeded the limit, until completely withdrawn.[16] Both changes boosted the expected receipts from these measures: the new 50% rate was estimated to raise a *further* £1.81bn in 2011/12, and the full withdrawal of the personal allowance would raise an extra £180m in the same year.[17]

2.2 The 2009 Pre-Budget Report: a further rise in NICs rates

In his Pre-Budget statement on 9 December 2009 the then Chancellor, Alistair Darling, announced a further increase in the rates of NI from April 2011:

> Our priority is to protect those services that are absolutely essential to the health of our society and the strength of our economy: the health service, which is crucial for our well-being; the police force, which is crucial for our safety; and our schools, which are crucial for our future. I am determined that we will protect improvements in those front-line services, on which millions of people rely. That cannot be done without a further difficult decision. I intend to increase all employer, employee and self-employed rates of national insurance by a further half pence from April 2011. But to protect those on modest incomes, I have also decided to raise the starting point from which national insurance is payable, and no-one earning less than £20,000 will pay more contributions as a result. This will raise £3 billion a year from 2011-12.[18]

As Mr Darling had predicted a year before, RPI inflation had been negative in the year up to September 2009: the rates and thresholds for income tax and NICs for the 2010/11 year would all be frozen, providing individuals with a small real-terms benefit. In his 2008 PBR Mr Darling had stated that to take account of this, the basic rate threshold would continue to be frozen for the next year – 2011/12. In this statement Mr Darling made another long-term proposal: that “in April 2012 I have decided to freeze the point at which people start to pay income tax at 40% for one year.”[19] It is worth underlining that Mr Darling specifically referred to the higher rate threshold – in effect, the interplay between the personal allowance and the basic rate limit – leaving open the question of what both of these would be come 2012/13.

In response to the statement the then Shadow Chancellor, George Osborne, was critical of the rise in NI rates, referring to it as “a higher tax on jobs”, while the Liberal Democrats spokesman, Dr Vincent Cable, suggested that tax rise would not be used to reduce the deficit: “any worker earning more than £7,000 a year will pay 32 per cent. marginal income tax and 12 per cent. national insurance contributions. All the money raised in additional tax will go to public spending, and none will be used to pay down the borrowing requirement and the deficit.”[20] Business groups were also critical: the *Financial Times* quoted Richard Lambert, director of the CBI, as saying, “the Chancellor has made a serious mistake imposing an extra jobs tax at a time when the economic recovery will still be fragile.”[21]

The *Pre-Budget Report* noted that to protect those on earnings under £20,000, the primary threshold would rise by £570, a measure which would cost £1.48bn in 2011/12. By comparison, the 0.5 percentage point rise in NI rates on employees, employers and the self-employed would raise £4.64bn in the same year.[22]

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16 Initially it had been proposed to withdraw the allowance in two-stages, for incomes over £100,000 and over £140,000. This was strongly criticised at the time for creating, in effect, two 60% income bands, over certain income ranges, and very strong incentives for individuals to avoid these high rates.

17 *Budget 2009* HC 407 April 2009 p153 (Table A1 : items 43 & 44)

18 HC Deb 9 December 2009 c370

19 HC Deb 9 December 2009 c368

20 HC Deb 9 December 2009 c373, c377

21 “Employers fume at ‘attack on jobs’”, *Financial Times*, 10 December 2009

22 Cm 7747 December 2009 p173 (Table B4)

In their initial response to Mr Darling's statement, the Institute for Fiscal Studies focused largely on the Chancellor's difficult balance between restoring the public finances and supporting the economic recovery, though in a presentation on the personal tax and benefit changes, one IFS researcher suggested that if employers decided to cut wages in response to higher NI, the higher primary threshold would help employees earning up to just £14,000, rather than £20,000.[23] The IFS expanded on this point in a discussion of the options for raising tax revenue in their *Green Budget* published in February 2010:

> In the long run, the economic and distributional impact of changes to employee and employer NI should be identical, as they are essentially the same tax: they both impose a wedge between the employer's cost of employing someone and the amount the employee actually receives. Therefore, if it is the case that rises in employee NICs are fully incident on employees (meaning that it is employees who ultimately bear the burden of the tax through lower net wages), then rises in employer NICs must also be fully incident on employees, but this time through lower gross wages in the long run. If this is the case, then a given percentage point rise in employer NI will lead to a smaller increase in tax revenues than a given percentage point rise in employee NI, as the former leads to lower wages, which would reduce revenues on income tax and NICs.[24]

Other commentators raised concerns that the rise in NI rates could hit the recovery, and there were press reports that some Treasury officials would have preferred a rise in VAT to raise government revenues.[25] In a debate on taxation in the Lords some weeks after the PBR, Lord Goodhart, argued that "employers' NICs are a tax on employment and should not be increased during a time of recession." He went on to argue that a wider reform in NICs was overdue:

> Most people think that NICs go into a pool that will pay for their pensions on their retirement. That is not the case. NICs do not go into a reservoir; they go into a pipe that sprays out money for current pensions. Recent increases in NICs should have been introduced as increases in income tax. They have been introduced as increases in NICs simply to conceal from the public the fact that the Government are reneging on their promises not to increase income tax. When the time arose, they should have said that it was no longer possible to stick to that promise. At the very least, employees' NICs should be paid on the whole of the employee's income. There should be no ceiling. Even so, NICs mean that more tax is payable on earned income than on investment income. That is not desirable, and it may be worth considering that employees' NICs should be absorbed into income tax, at least for those under retirement age.[26]

In a short debate in the Lords at this time, the then Secretary of State, Lord Mandelson, argued that "previous experience indicates that rises in NICs need not choke off employment: contributions rose in 2003, also by 1 per cent, but employment went on rising. This increase is timed for 2011, when the UK economy is expected to be growing steadily and can afford it."[27]

However, business groups continued to lobby against this measure: in the run-up to the Budget in March, the CBI, the Institute of Directors, the British Chambers of Commerce and a number of other organisations launched a campaign for the 1% rise to be reversed, on the

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[23] David Phillips, "Personal tax and benefit changes", *IFS Pre-Budget Report 2009 briefing*, December 2009

[24] "Chapter 7: Options for fiscal tightening: tax increases and benefit cuts", in *IFS Green Budget 2010*, February 2010 p144 (footnote 15)

[25] For example, "Treasury fears tax rise could end up making deficit worse", *Independent*, 12 December 2009

[26] HL Deb 28 January 2010 c1530

[27] HL Deb 21 January 2010 c1099

grounds that it would "discourage companies of all sizes from taking on staff at a critical point in our economic recovery."[28] Alongside this, the centre-right think tank Policy Exchange published some analysis of the impact of possible tax raising measures on the economy. It argued that putting up employer NI rates would be "one of the worst possible taxes to raise", in part because employers might find it hard to pass on the cost in lower wages:

> Under circumstances where wage growth is already very low it might be particularly difficult for employers' to cut wages further in response to a rise in employers' NIC, and so the key effect might be raised costs of employment, resulting in greater unemployment.[29]

Nevertheless Mr Darling confirmed the rise in both employer and employee NI rates in his Budget speech on 24 March, noting, "on taxes … I have been guided by our values of fairness and the need not to undermine the recovery. The one penny increase in the main rate of national insurance contributions will not affect anyone earning under £20,000 a year; nor will it come into effect until April next year, by which time I expect that the recovery will be stronger and more secure."[30]

2.3 The 2010 General Election: debating the impact of NICs on jobs

Manifesto proposals for NICs

The proposed increase in NICs proved to be one of the themes to the General Election campaign. One of the measures in the Conservative Party's manifesto was to increase NI thresholds for both employees and employers:

> **Cut government waste to stop Labour's jobs tax**
> Labour are planning to increase National Insurance in 2011. Anyone earning over £20,000 will pay more tax, and employers will pay more tax on all jobs paid over £5,700. This jobs tax, which will hit small businesses especially hard, will kill off the recovery. Experts predict it will cost 57,000 jobs in small and medium-sized businesses alone.
>
> At the same time, Labour will not take action to cut waste in government. They have identified £11 billion pounds of waste, but they do not plan to start dealing with it until April 2011. So Labour will continue wasting money while putting up taxes on working people. We will act immediately to cut government waste so we can stop the most damaging part of the National Insurance rise for employers and for anyone earning under £35,000.
>
> We will make the following changes in April 2011, relative to Labour's plans:
> - raise the primary threshold for National Insurance by £24 a week and raise the Upper Earnings Limit by £29 a week; and,
> - raise the secondary threshold at which employers start paying National Insurance by £21 a week.
>
> Seven out of ten working people – those earning between £7,100 and £45,400 – and almost every employer will save up to £150 a year per person compared to under

[28] British Chambers of Commerce press notice, *Business coalition: 'say no to employer NICs increase'*, 1 March 2010; see also, "Business coalition battles £7bn 'tax on jobs'", *Financial Times*, 1 March 2010 & "Business oppose national insurance rise", *Financial Times*, 10 April 2010

[29] Policy Exchange, *Taxation, Growth & Employment*, March 2010 p8

[30] HC Deb 24 March 2010 c255

> Labour. Lower earners will get the greatest benefit as a percentage of their earnings. Nobody will be worse off as a result of these changes.[31]

The party had published details some days before the official start to the campaign, arguing that it could fund higher NI thresholds by ‘cutting waste’ in public spending by £6 billion.[32] The IFS estimated that these changes would cost £5.6 billion a year; this compared with the £6.3 billion which the Treasury had estimated the Labour Government’s NI measures would raise. In the longer term the cost might be lower – about £4.3 billion – if, as the IFS expected, employers passed on the cut in employers’ NI in the form of higher earnings. In their commentary the IFS went on to observe that both Labour and Conservative proposals would result in a more complex tax structure, and in the latter case, might affect individuals’ incentives to increase their earnings:

> What does the proposal imply for the structure of earnings taxation? In its 2007 Budget, the current Government announced a set of reforms that would have led to a significantly simpler Income Tax and NI contributions schedule. The personal allowance (the amount of income you can receive before you start to pay income tax), and the employee and employer’s NI thresholds were to be aligned, as were the Higher Rate Threshold (the amount of income you can have before you start to pay the 40% rate of income tax) and the NI UEL. Including the impact of employers' NI on the cost of employing someone, the marginal tax rate would have been 0% for about the first £5,700 of income, 39% between £5,700 and about £44,000, and 48% above this. The Government’s subsequent reforms, combined with their proposed changes to NI, have moved us far from this simple structure, as we discussed in our analysis of last year's Pre Budget Report.
>
> The Conservative Party's proposals would add to, rather than remove, these complexities, because the higher-rate threshold and the NI UEL would no longer be aligned. This would mean a combined income tax and NI rate (again including employers’ NI) that goes from about 40% below the higher rate threshold, to 58% between the higher rate threshold and the new higher NI UEL, before falling back to 49%. There seems no sensible reason for such a complex rate structure. It is also noteworthy that the combination of the Government’s and the Conservative Party’s proposed reforms would mean that the first £1,800 of earnings above the income tax personal allowance would face a combined income tax and NI rate of 20%, very similar to the combined rate of 21% that existed before the abolition of the 10p income tax band (these two rates ignore employer NI; including employer NI, both rates are 30%).
>
> The Conservative proposal may also affect people's working decisions. Compared with the Government’s proposals, by raising the point at which NI contributions first become payable, it increases the attractiveness of working relative to not working (although losses in housing and council tax benefits will offset much of this for some poor households). But those facing the new combined 58% rate will face weaker incentives to increase their earnings. Compared with the current NI system, both the Government’s and the Conservative Party’s plans will mean that all workers above the new primary threshold will face weaker incentives to earn more, thanks to the rise in the rates of NI.[33]

The Labour Party’s manifesto simply confirmed the forthcoming NI rate rise, noting, that this would “not happen until next year, once growth is firmly established” and that as “no-one earning under £20,000, or any pensioners will pay more”, this measure would be “fairer than

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31 *Invitation to join the Government of Britain: the Conservative Manifesto*, April 2010 pp8-9

32 Conservative Party press notice, *We will stop Labour's damaging NIC increase*, 29 March 2010

33 IFS press notice, *Conservatives plan to cut public spending to cut National Insurance*, 29 March 2010

alternative options like VAT."[34] In their manifesto the Liberal Democrats stated that, "while it will be impossible to remove the Government's tax rises while the deficit is so huge, the increase in National Insurance Contributions is a damaging tax on jobs and an unfair tax on employees, so when resources allow we would seek to reverse it."[35]

Increases in NICs rates – a 'tax on jobs'?

The Conservative proposals gathered considerable attention after a number of senior businessmen signed an open letter to the *Daily Telegraph*, supporting the party's plans on the grounds that, "cutting government waste won't endanger the recovery – but putting up national insurance will."[36] In response, the Labour Party took the position that this threatened essential public services – as Ed Balls, then Education Secretary, was quoted in the *Financial Times*, "a tax freeze on this scale can only be paid for by drastic cuts to frontline services or by unfair rises in other taxes like VAT."[37] David Cameron and Gordon Brown made similar claims at Prime Minister's questions on 7 April: Mr Cameron argued that the Prime Minister had "made the decision to introduce a jobs tax which will kill the recovery." Mr Brown's rejoinder was that there was a "clear choice" – to put up national insurance "and therefore protect our schools, our hospitals and our policing" or rescind this tax rise and put those services at risk.[38]

However, as the IFS noted at this time, the amounts of money at stake were relatively minor, given the much bigger questions that all three parties had failed to answer over their plans to tackle the public deficit:

> The parties are all aiming to deliver at least two-thirds of their fiscal tightening through spending cuts rather than tax increases, and have not announced any measures to cut welfare spending substantially. When the last Conservative government required a significant fiscal tightening in the early 1990s they aimed to split the burden roughly 50:50 between tax increases and spending cuts. This might suggest that all the parties are overambitious in the amount they think they can squeeze out of public services. Whoever forms the next government, that points to greater reliance on tax increases and welfare cuts after the election than the parties are willing to admit to beforehand.[39]

Reviewing the IFS' presentation, Larry Elliott, the *Guardian*'s economics editor, was more blunt. He argued that irrespective of the outcome of the election, a substantial increase in VAT, alongside rises in NI rates, was inevitable:

> Finally, some home truths. Three weeks into an election campaign that has plumbed new depths of fatuity, somebody told it the way it is. Sadly, that person was not Gordon Brown, David Cameron or Nick Clegg, but Robert Chote, the director of the Institute for Fiscal Studies …
>
> Bluntly, the plague-on-all-your-houses message was threefold. First, they are lying to you (although the IFS would never use such intemperate language). The real choice facing the electorate is not whether wasteful spending should be cut by £6bn this year

34 *The Labour Party Manifesto 2010*, April 2010 p1:4

35 Liberal Democrats, *Liberal Democrat Manifesto 2010*, April 2010 p97

36 "Letter: Business supports George Osborne's national insurance cut", Daily Telegraph, 31 March 2010

37 "Labour on the back foot over NI rise", *Financial Times*, 6 April 2010; see also, "Labour to mount fightback over national insurance", *Guardian*, 8 April 2010

38 HC Deb 7 April 2010 c963

39 *IFS Election Briefing 2010 Summary*, 27 Apri 2010 p14. A similar case was made by the financial consultancy group Fathom Consulting: "NI contributions row an 'irrelevance'", *Financial Times*, 4 May 2010

> to avoid increases in national insurance contributions. That is sound and fury, signifying nothing. Instead, the choice is between four years of draconian spending restraint under Labour or the Lib Dems not seen since 1976-1980, when the International Monetary Fund imposed an austerity programme on the Callaghan government as the price of supporting sterling, or five years of cuts under the Tories that would be unprecedented in the entire postwar era. Second, the chances of any of the parties taking the axe to public spending in this way are strictly for the birds. …
>
> As a result, the IFS has a third and final message. Since the parties are being wildly optimistic about what they are likely to achieve through spending restraint, something else has got to give: either an increase in taxes or a cut in benefits. Making the poor carry the burden will be a hard sell for two reasons: they didn't cause the crisis, and the gap between rich and poor is already wider than it was when Labour came to power in 1997. So higher taxes it will almost certainly be. It doesn't take a genius to work out which tax it is going to be. There is a gorilla in the room and it is called VAT. When this phoney election war is over, it will go up.[40]

Echoing these points Philippe Legrain writing in the *Financial Times* argued that raising NICs was not the best way to raising revenue at this time:

> None of the parties has spelt out how they would cut the deficit. Since their various proposals will scarcely dent it, whoever wins the election will have to implement further tax rises and spending cuts.
>
> Is raising NICs a good first step, though? Hardly. With unemployment high and incomes squeezed, it is staggering that Labour wants to raise taxes on labour. Hitting ordinary voters' main source of income is hardly progressive. Worse, it will harm the recovery by raising the cost of labour and penalising effort. That will crimp pay, cost jobs and discourage working - limiting the tax take and raising benefit spending. NICs and income tax inflate the cost of employing the average worker by half, according to the OECD, while a single person on two-thirds of average wages faces a marginal tax rate of more than 40 per cent. Hiking taxes on hard work is perverse.
>
> While the Conservatives are right to oppose a "tax on jobs", Labour and the Lib Dems are right to question George Osborne's scarcely credible claim that nebulous "efficiency savings" will cover the revenue shortfall. But that does not make rescinding the NIC rise "unaffordable". It just means the parties need to find better ways to raise extra revenue.[41]

For his part, the author recommended taxing on carbon emissions, reforms to encourage people to retire later (such as raising the retirement age), and a new tax on land values.

The *Financial Times*' economics editor, Chris Giles, noted that there was general consensus among economists that labour taxes hit employment, as they increased the 'wedge' between the employer's costs of taking someone one, and that person's take home pay – but that this generally quite small:

> The phrase "tax wedge" is not something that crops up regularly, but economists agree that it is crucial to an understanding of the long-run effect of taxation on labour markets, jobs and unemployment. It is a measure of the difference between labour costs to the employer and the corresponding net take-home pay of the employee. Employers care about the former, while employees worry about the latter. The reason

40 "Gorilla in the room of this phoney war: a rise in VAT", *Guardian*, 28 April 2010
41 "Tax land or cabon emissions, but not hard work", *Financial Times*, 9 April 2010

> why the tax wedge is so important is that it can be used to estimate the effects of all sorts of taxes on jobs, whether they are formally levied on companies, like employers' national insurance, or employees, like income tax. In its annual report, "Taxing wages", the Organisation for Economic Co-operation and Development says it puts most emphasis on the tax wedge when looking at the effects of income tax or national insurance on employment.
>
> Economists tend not to worry too much about who pays the tax bill to government but about the effect that taxation has. All of Britain's big taxes are likely to reduce jobs because they make an hour of work less attractive to employees and more expensive to employers. To the extent that value added tax reduces the quantity of goods and services someone can buy from an hour of work, rises in VAT also reduce the availability of labour because some people will choose to do something else. But because most employees have little alternative to working for a livelihood, economists expect these labour taxes to be borne by employees in lower wages rather than by the owners of companies.
>
> The literature on the effect of the tax wedge is large and disputed, but one regular finding is that the big employment taxes have a statistically significant, but small, effect on jobs. [An article in the *Economic Journal* which appeared in 2007[42]] … aimed to look at the impact of competition on unemployment but, to distinguish its effects from other things such as taxation, it estimated the effects of all forms of tax. It was based on international evidence from 1986 to 2000. The authors were pleased that their findings were consistent with those of Stephen Nickell of Nuffield College, Oxford, Britain's most renowned labour economist. Labour's national insurance rise lifts the total employment tax - or tax wedge - by 0.7 percentage points compared with the Conservative plans, giving an estimated jobless rise on his methods of 22,000.[43]

More recently in October 2009 the Federation of Small Businesses published research it had commissioned from the Centre for Economics and Business Research, which suggested that a 1% rise in NI rates would reduce employment by SMEs by 57,000.[44] On its 2010 Election 'Factcheck' blog, Channel 4 News commented that extrapolating this estimate across the economy predicted job losses of about 100,000.[45]

Writing for BBC news the commentator Michael Blastland suggested that while the political debate on this measure was overdone, the distributional impact of this change was still important:

> It's the story of the election campaign so far - whether or not to raise National Insurance by 1%. In fact, the figures show what is at stake here is a relatively trifling amount of money … In some contexts, £6bn makes a big difference. In others, rather less. So are the accusations on both sides on the right planet in terms of proportion? In this case, the £6bn falls within the typical margin of error on Treasury forecasting. Economic growth and tax revenues could easily turn out far more, or far less, than this…

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42 Rachel Griffith, Rupert Harrison, Gareth Macartney, "Product Market Reforms, Labour Market Institutions and Unemployment", *The Economic Journal*, Volume 117, Number 519 (March 2007), pp. C142-C166

43 "Why politicians should beware bold tax claims", *Financial Times*, 14 April 2010

44 FSB News Release PR 2009 56, *Taxing small businesses will cause deeper unemployment, FSB warns*, 28 October 2009; CEBR, *Small business tax increases – do the economic costs outweigh the fiscal gains? - Final Report for the Federation of Small Businesses*, October 2009

45 "Will NI rise cost hundreds of thousands of jobs?", *Channel 4 News Factcheck blog*, 7 April 2010

> Does the NI differences matter at all? As a sign of further things to come, maybe, although even long-term differences in tax and spend between the parties are smaller than people often think. As an issue of principle or ideology, like fairness or freedom? Possibly, though not many principles have died on this scale. Is it an important detail about where the burden should fall? Certainly.
>
> For example, Antoine Bozio of the Institute for Fiscal Studies, has written that the cost of a tax like NI isn't always met in the way people expect. "What if the company simply lowers the worker's wage by the amount of the tax?" he asked. "Then the tax isn't really being paid for by the company at all - it's being paid for by the worker, through lower wages. So the company hands over the money but the worker is made worse off." Is this what really happens in practice? Study after study suggests that it is, he wrote. Labour might not be any happier either way. For though this argument suggests that the party should be off the hook of taxing jobs, would it enjoy any better the accusation of lumping the whole burden on workers? So details matter. But it's a characteristic of politics to throw in the kitchen sink and claim that not just these but everything - the whole economy - is at stake.[46]

2.4 The June 2010 Budget: increasing the employers' NI threshold

In the agreement underpinning the Coalition, published on 21 May, the new Government set out a number of tax measures, which combined some of the elements from each of the parties' manifestoes. The most striking tax measure in the Liberal Democrat manifesto had been the proposal to set the personal income tax allowance at £10,000 – an increase of over £3,500 at an annual cost of about £16 billion.[47] The Coalition agreement made this a long-term goal, funded, in part, by sacrificing Conservative proposals for an additional increase in the NI threshold for employees:

> We will increase the personal allowance for income tax to help lower and middle income earners. We will announce in the first Budget a substantial increase in the personal allowance from April 2011, with the benefits focused on those with lower and middle incomes. This will be funded with the money that would have been used to pay for the increase in employee National Insurance thresholds proposed by the Conservative Party, as well as revenues from increases in Capital Gains Tax rates for non-business assets as described below. The increase in employer National Insurance thresholds proposed by the Conservatives will go ahead in order to stop the planned jobs tax.
>
> We will further increase the personal allowance to £10,000, making real terms steps each year towards meeting this as a longer-term policy objective. We will prioritise this over other tax cuts, including cuts to Inheritance Tax.[48]

One important thing to note is that the Liberal Democrats had initially proposed that the benefit of the higher personal allowance would be given to *all taxpayers*. In its response to the Coalition agreement, the IFS suggested the Government could meet their commitment while cutting the basic rate limit to ensure only basic rate taxpayers benefited from the higher allowance:

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46 "National Insurance: how to get the rise in proportion", *BBC News online*, 8 April 2010

47 *Liberal Democrat Manifesto*, April 2010 p13,p100; IFS, *Election Briefing Note: Taxes and benefits – the parties plans*, April 2010 p32

48 HM Government, *The Coalition: our programme for government*, May 2010 p30

> We might choose to read something into the promise that the benefits of the rise in the income tax personal allowance would be "focused on those with lower and middle incomes". This would certainly not have been the case with the increase in the personal allowance proposed by the Liberal Democrats, which would have benefitted all those with incomes below £100,000. It is not clear what is meant by this phrasing, but it is possible that the Government would reduce the basic rate limit (i.e. the band of income over which someone pays basic-rate tax) to remove all of the gains of a higher personal allowance from higher-rate taxpayers. This would mirror exactly the form of the changes to employee National Insurance proposed in the Conservative manifesto. In effect, the Conservative Party could forgo its manifesto proposal to cut employee National Insurance bills by £150 a year (while changing the Upper Earnings Limit to remove the benefits from higher-rate taxpayers) in order to fund a £150 a year cut in income tax bills (with a change to the basic-rate threshold to remove the benefits from higher-rate taxpayers).
>
> If that is how they wanted to structure the change, this could take the income tax personal allowance in April 2011 close to around £7,300 (having incorporated the usual rise in line with inflation and the cut pre-announced by the last government) from its current £6,475, and would cost slightly more than the Conservative Party"s proposed change to employee National Insurance (which we think would have cost around £2.5 billion). Of course, the new Government may wish to extend some benefits of the increased personal allowance to higher-rate taxpayers (which could cost more, or mean a smaller rise in the personal allowance). On the other hand, it says it will have additional revenues from CGT and possibly air passenger duty reforms which it could spend on a larger increase in the personal allowance.[49]

The Coalition Government presented its first Budget on 22 June. In his Budget speech the Chancellor George Osborne confirmed that although NI rates would rise from April 2011, the employers' NI threshold would be increased to mitigate the impact of this change on employers:

> It is my deeply held belief that a genuine and long-lasting economic recovery must have its foundations in the private sector. That is where the jobs will come from, and we will do absolutely everything to support their creation. We argued that imposing a jobs tax was the last thing that Britain needed in a recovery, and the businesses of the country agreed with us, so we will adopt a different approach. We will make it cheaper for companies to employ people. From April 2011, the threshold at which employers start to pay national insurance will rise by £21 a week above indexation. The cost of hiring people on incomes lower than £20,000 will be less than it is today; and in one move we will have lifted 650,000 employees out of this tax altogether.[50]

Mr Osborne also announced a £1,000 rise in the personal allowance from April 2011:

> In the current system, everyone under the age of 65 is eligible for a tax-free personal allowance of £6,475. That means that many thousands of people have their income taken away from them in tax, only to have to apply to get it back in benefits. That does not reward work. So today I can announce that we will increase the personal allowance by £1,000 in April. People will be able to earn £7,475 before they have to start paying income tax, 23 million people who are basic-rate taxpayers will each gain by up to £170 a year, and 880,000 of the lowest-income taxpayers will be taken out of tax altogether. Higher-rate taxpayers will not benefit from the change, and the higher-rate income tax threshold will have to remain frozen until 2013-14. Our long-term objective

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[49] IFS press release, *Some initial thoughts on the Tory / Lib Dem coalition agreement*, 12 May 2010
[50] HC Deb 22 June 2010 c174

> remains to increase the personal allowance to £10,000, as set out in the coalition agreement, and we will take real steps towards achieving that objective during the rest of this Parliament.[51]

The Budget report did not give details of other allowances and thresholds for 2011/12, though it confirmed that the basic rate limit and upper earnings limit would be adjusted so that higher rate taxpayers would not benefit from the new personal allowance:

> To ensure that support will be focused on those on low and middle incomes the Government will reduce the level of the basic rate limit. The National Insurance Upper Earnings/Profit Limit will also be reduced to keep it aligned with the income tax higher rate threshold. Based on current Retail Prices Index (RPI) forecasts the basic rate limit will be reduced by £2,500 and the higher rate threshold by £1,650 below plans the Government inherited. Exact figures will be confirmed in the autumn. These changes will mean that higher rate-taxpayers will not benefit from this measure.[52]

To date no further details have been given, though it is now known that the Retail Prices Index (RPI) measure of inflation in the year to September 2010 was 4.6%.[53] In the past allowances and thresholds for the coming tax year have been announced at the time of the Pre Budget Report (PBR), which has generally been in late November or early December. This year it is anticipated that the Chancellor will make a financial statement on 29 November. This was mentioned in a letter the Chancellor sent to the Treasury Committee last month, in relation to the Government's wider reform in its fiscal policy, which includes the establishment of the Office for Budget Responsibility and doing away with a formal PBR in future years.[54]

One other uncertainty relates to the inflation measure which may be used. At present when allowances and thresholds for income tax and NI are uprated, this is in line with the RPI measure of inflation. Indeed, it is a statutory requirement – the 'Rooker-Wise' amendment – for the main income tax allowances and thresholds to rise in line each year with RPI unless Parliament determines otherwise. In the June 2010 Budget the Government announced that it would use the Consumer Price Index (CPI) for the price indexation of benefits and tax credits in future years, and that it was "reviewing how the CPI can be used for the indexation of taxes and duties while protecting revenues."[55] The choice between inflation measures may have significant revenue implications; notably, the annual rate of CPI in the year to September 2010 was 3.1%, while RPI was 4.6%.[56]

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51 HC Deb 22 June 2010 c179

52 HC 61 June 2010 p32 paras 1.93-4

53 Office of National Statistics press notice, *Inflation: CPI inflation 3.1%, RPI 4.6%*, 12 October 2010

54 Letter from the Chancellor to the Chairman of the Treasury Committee, *Letter regarding his announcements on the Office for Budget Responsibility*, 12 October 2010

55 HC 61 June 2010 para 1.106

56 The Budget report showed that switching to CPI for benefits, tax credits and public service pensions could raise £5.84bn by 2014/15: HC 61 June 2010 p40 (Table 2.1: item 22).

3 The Regional Employer NI Holiday

3.1 The June 2010 Budget

In his Budget speech on 23 June, the Chancellor also announced a regional employer NICs holiday for new businesses, to come in from September – as one of a series of measures to rebalance the economy, and promote job creation "in all parts of the country, including Wales and Scotland":

> We will shortly announce a new tax scheme to help create new businesses in those regions where the private sector is not nearly strong enough. For the next three years, anyone who sets up a new business outside London, the south-east and the eastern region will be exempt from up to £5,000 of employer national insurance payments for each of the first 10 employees hired. We aim to have the scheme up and running by September, but any qualifying new business set up from today will also receive help. The Treasury estimates that some 400,000 new businesses will benefit, ensuring all parts of our country contribute to a more balanced and sustainable economic future.[57]

Details of the scheme were given in the Budget report, which estimated that it would cost £940m in total over its three year lifespan:

> The Government's strategy to support private sector enterprise in all parts of the UK aims:
>
> - to encourage the creation of private sector jobs in regions reliant on public sector employment, through reducing the cost to new businesses of employing staff. **The Government will shortly announce details of a scheme to help new businesses in targeted areas of the UK that need it most. During a three year qualifying period, new businesses which start up in these areas will get a substantial reduction in their employer National Insurance Contributions (NICs).**
>
>   Within the qualifying period, these employers will not have to pay the first £5,000 of Class 1 employer NICs due in the first twelve months of employment. This will apply for each of the first 10 employees hired in the first year of business and operate in selected countries and regions.[58] Subject to meeting **the necessary legal requirements, the scheme is intended to start no later than September 2010. Any new business set up from 22 June 2010 which meets the criteria set out in the forthcoming announcement will benefit from the scheme.**[59]

Alongside the Budget report the Government published details of how it had arrived at producing cost/yield estimates for its Budget measures – something governments have not done in the past.[60] The process involves making a 'static costing' – the difference between

[57] HC Deb 22 June 2010 cc176-7

[58] The measure would apply in Scotland, Northern Ireland and Wales, and the following English regions: the North West, North East, Yorkshire and Humber, West Midlands, East Midlands and South West.

[59] HC 61 June 2010 p30. The cost is projected to be £50 in 2010/11, £320m in 2011/12, £390m in 2012/13, and £180m in 20131/14 (Table 2.1 : item 10).

[60] HM Treasury, *Budget 2010 policy costings*, June 2010. This is available at: http://collections.europarchive.org/tna/20100623144040/http://www.hm-treasury.gov.uk/d/junebudget_costings.pdf

applying the pre-Budget and Budget tax or benefit regimes to the relevant post-Budget base data – before estimating the direct behavioural effects of the change. This is the way in which individuals and businesses change their actions as a result of a policy change, and may involved changes to related taxes or benefits.

In the case of the NI Holiday, the static Exchequer impact was estimated to be £900m over the lifetime of the scheme. The department went on to note that it was 'difficult to quantify' the behavioural impact of the policy, but put it at an extra cost of £40m over the life of the scheme, bringing the total cost to £940m.[61]

3.2 Initial reactions to the Budget

Initial reactions to the Budget focused on other aspects of the Chancellor's speech, although the potential impact of the scheme was discussed when the Treasury Committee took evidence on the Budget. Alan Clarke at BNP Paribas observed that if successful, the scheme was a "good idea" while John Whiting at the Chartered Institute of Taxation commented it was a "worthwhile experiment"; by contrast Robert Chote at the IFS suggested it might be "a little too complicated to offer the best value for money."

An extract from these exchanges is reproduced below:

> **Q124 David Rutley:** The need for a stronger private sector-led recovery is implicit in the Budget, but I have been interested in your views particularly on the strength of the package of measures in the Budget that will help SMEs generate jobs, particularly in the regions.
> **Mr Clarke:** One particularly encouraging measure, I think, was the tax incentive to hire outside of the South East. If it is successful, yes, that was a very good idea. In terms of small- and medium-sized businesses, it is just coming back to the question of the banks and their lending. I am a bit worried by the latest Bank of England Credit Conditions Survey which is showing that the availability of lending that lenders expect over the next three months is going down. If the bank levy means that banks try to minimise the size of their balance sheets, they may lend less and it is not the big firms that are going to suffer most, it is the SMEs, so that would be a concern at the back of my mind.
>
> **Mr Whiting:** The national insurance holiday idea is certainly a worthwhile experiment for the small, new business with new employees. There are other things, no doubt, which could be done. There is a certain amount of concern about the reduction in the annual investment allowance, the 100% allowance, which is obviously of particular significance to small- and medium-sized businesses, although the proposed £25,000 limit will certainly cover an awful lot of small businesses. It is the medium business that perhaps falls into the potential £25,000-100,000 investment level in that there will be less allowances for them.
>
> **Mr Chote:** On the NICs holiday, it will obviously be interesting to see how that performs, an exemption from one year to the next, first 10 employees hired, first year of trading by businesses that have been set up in the last three years outside three particular regions of the country, up to a maximum of £5,000. I remember reading about simpler, flatter tax systems a while ago and that is not, I think, a move in that direction.

[61] *Budget 2010 policy costings*, June 2010 pp 21-22

> **Q125 David Rutley:** So your concern is about complexity.
> **Mr Chote:** It is complex and it is estimated to cost less than £1 billion. If you are trying to protect employment, the case for providing support for start-ups relative to existing businesses that are feeling under pressure to let people go, it is not necessarily the best allocation of support.
>
> **Q126 David Rutley:** Do you think that it should have been capped to businesses of a certain size? What would your preference have been to take it forward?
> **Mr Chote:** You can push it in different areas if you want to make it more or less expensive. To what extent that sort of measure in terms of its size and magnitude is going to make a large material difference is unclear and depends a bit on what your actual objectives are for the policy to achieve. This may be a little too complicated to offer the best value for money.
>
> **Mr Whiting:** Yes. I view it as a bit of an experiment that needs evaluating after it has been in place for a little while.[62]

At its next evidence session the Committee asked Edward Troup from the Treasury whether the Holiday would be too complex and open to abuse:

> **Q135 Chair [Andrew Tyrie]:** Do you agree with Robert Chote's conclusion that the NICs changes are complex and may be too complicated to offer best value for money? …
> **Mr Troup:** I was interested in Mr Chote's comments. Inevitably any measure which attempts to target has a degree of complexity about it. Although we have not published the details of these they are going to be designed in a light-touch way, it is going to be fairly straightforward, effectively self-certification, and it is going to operate quite simply by new businesses not having to pay the NICs for their first 10 employees for the first year. It is not as straightforward as a simple NICs cut but I think it will work quite smoothly.
>
> **Q136 Chair:** Do you think it is going to have any supply side impact?
> **Mr Troup:** What is clear and if you look at what is said in the Budget is that it is going to encourage new businesses. It is £5,000. Talking in the billions that we normally talk about here it is easy to regard anything less than a few million as insignificant but for small new businesses it is a significant amount of money. We do hear from businesses going from the stage of being the self-employed individual to taking on employees that the burden of PAYE and NICs is a significant threshold, so we do expect businesses to be encouraged and respond.
>
> **Q137 Chair:** Is this more than a gesture then?
> **Mr Troup:** Definitely so.
>
> **Q138 Chair:** Robert Chote is wrong on that as well?
> **Mr Troup:** I am not quite sure what the word "gesture" means. It is certainly something which gives effect to a commitment made in the coalition agreement and in the manifesto and it will benefit 400,000 businesses and about 800,000 employees.

[62] Treasury Committee, *First report: The June 2010 Budget*, 20 July 2010 HC 350 2010-11 Ev17-18

Q139 Andrea Leadsom: I just wanted to ask a particular question about that. I have met a number of small business people who say that this measure will simply encourage them to keep recycling their business to take advantage of it. What consideration have you given to the unintended consequences of this type of gaming?
Mr Troup: I am afraid my excellent colleagues in HMRC are on to that one. There will be provisions in the legislation to stop simply recycling, so stopping your business, packing up for a week and then pretending you have got a new business. I cannot say there will not be any avoidance because unfortunately there seems to be avoidance of absolutely every tax there is, but I think we are fairly confident that it will go to the businesses who are genuinely new businesses and this will not be something where people spend their time closing down their businesses and reopening them to get the benefit.

Q140 Chair: For those of us who have been on the circuit a while it sounds like another case of triumph of hope over experience if I may say so.
Mr Troup: I look forward to sitting here in a year or two's time and seeing how it has gone.[63]

3.3 Formal launch and debate over its potential impact

On 27 August HM Revenue & Customs published further details, as well as draft legislation. An overview of the NI 'Holiday', as it is called, was provided in a technical note:

> The Regional Employer National Insurance contributions Holiday for New Businesses (the Holiday) … will last from the date of the Emergency Budget on 22 June 2010 until 5 September 2013. The Holiday will target help on certain 'new businesses' who are also employers and who start up outside Greater London, the South East and the Eastern regions of the UK.
>
> New businesses will be able to make National Insurance contributions (NICs) savings under the Holiday from earnings paid to employees on or after 6 September 2010. The Holiday will operate by allowing a deduction against the amount of Class 1 NICs that an employer is required to pay to HMRC each month or each quarter. With two main modifications, new businesses that were started between 22 June 2010 (the date of the Chancellor's Emergency Budget) and the 5 September 2010 will benefit to the same extent as a new businesses started on or after 6 September 2010 provided they satisfy the eligibility tests.
>
> For the first ten qualifying employees that a new business employs in its first year of business, following start up, it will be entitled to an individual Holiday for each of those employees. The Holiday period for each employee will last for the shorter of the employee's first year of employment or the time left until the Holiday scheme ends on 5 September 2013.
>
> The Holiday will apply to all relevant earnings paid to a qualifying employee during the first year of the employee's employment but there will be a maximum saving of £5,000 in employer NICs in respect of each employee. The Holiday will be administered as a de minimis State Aid. New businesses wishing to enjoy a Holiday will need to make an application to HMRC when

[63] HC 350 2010-11 Ev20-21

> they engage their first employee. Full guidance will be available on the Business Link website for those interested in applying …
>
> The Holiday will be entirely voluntary and will enable qualifying new businesses that choose to participate to reduce the amount of secondary (employer) NICs liability that they would otherwise have to pay over to HMRC. If a new business does not wish to participate in the Holiday scheme it will be required to meet its employer NICs liabilities in full in the same way as any other employer.[64]

The note also gave more details of exactly which regions across the UK were *excluded* from the scheme:

> The Holiday is not available to new businesses where the principal place at which the new business is carried on when it starts is in the excluded regions. The three excluded regions are:
> **- Greater London**
> **- The Eastern Region** comprising:
> (a) The counties of Bedford, Cambridgeshire, Central Bedfordshire, Essex, Hertfordshire, Norfolk and Suffolk.
> (b) The non-metropolitan districts of Luton, Peterborough, Southend-on-Sea and Thurrock.
> - **The South East Region** comprising:
> (a) The counties of Buckinghamshire, East Sussex, Hampshire, the Isle of Wight, Kent, Oxfordshire, Surrey and West Sussex.
> (b) The non-metropolitan districts of Bracknell Forest, Brighton and Hove, Medway, Milton Keynes, Portsmouth, Reading, Slough, Southampton, West Berkshire, Windsor and Maidenhead and Wokingham.

There has been some criticism of this aspect of the Holiday.[65] The Federation of Small Businesses has argued that the scheme should cover the whole UK, as well as including existing businesses, rather than just start-ups.[66] In a piece on the scheme the *AccountingWeb* site quoted one practitioner arguing that the exclusion of very deprived boroughs in the South East was unfair and would limit its impact: "the Government is denying invaluable NICs savings to many of the businesses that would need them the most … restricting the scheme offering by geography rather than by need is too rough a criterion."[67] In answer to recent PQs, the Government has emphasized that, in its view, it would be impractical to use the scheme to pinpoint smaller areas within these regions which are relatively less well-off:

> **Caroline Dinenage:** To ask the Chancellor of the Exchequer what his policy is on extending National Insurance exemptions on new jobs to areas of the South East which have low levels of employment and high levels of social deprivation.
>
> **Mr Gauke:** The regional employer national insurance contributions holiday for new businesses is targeted on countries and regions within the UK where reliance on public

[64] HMRC, *Regional employer National Insurance contributions Holiday for New Businesses - Technical Note, Draft Legislation and Explanatory Notes*, 27 August 2010 pp4-5. At present this is available on the department's site

[65] For example, Gavin Shuker MP put down an EDM critical that the scheme excludes the Greater South East area (EDM 537 of 2010-11, 19 July 2010); 5 Members have signed this to date.

[66] FSB press notice PR 2010/38, *Business confidence still fragile for small businesses, say FSB*, 20 July 2010

[67] "Regional NIC holiday for start-ups kicks off", *AccountingWeb*, 3 September 2010

> sector employment is highest. For practical reasons the Government have no plans to introduce national insurance contribution exemptions for smaller geographical units.[68]

In its impact assessment of the Holiday, the Treasury noted that the choice of eligible regions had been based "on those that have the greatest reliance on public sector employment. ONS statistics show that the average of public sector employment in London, the South East and East is lower than all other UK regions and that labour productivity is also higher in these regions based on the most recent data.[69]" It went on to explain that a *nationwide* scheme had been considered and that this "would make around 300,000 extra new businesses eligible each year and increase the cost of the policy by around £600m." However, "to ensure affordability and to meet the Governments goal of assisting private sector enterprise in regions most reliant on the public sector, this option is not favoured." The decision to set a £5,000 cap on the maximum benefit per employee had been made to "to limit the incentive for abuse of the scheme and to control the cost of the policy. The cap level will only impact where a business engages new employees who earn more than £45,000 in a year, and the number of employees to whom this will apply is expected to be relatively small."[70]

The Holiday was launched on 6 September.[71] To operate the scheme the department has exercised its general statutory powers for the "collection and management" of revenue[72] – as the launch date was well before the legislation for the scheme was presented to Parliament. The explanatory notes to the Bill comment on this decision as follows:

> The Commissioners [of HMRC] have satisfied themselves that this is an arrangement which will cost less (thus increasing net yield) than collecting employer NICs until Royal Assent of the Bill and then refunding them.
>
> This is on the basis that:
>
> - Ministers made a statement of what the scheme entailed, specified which people could expect to benefit from the scheme, and stated the intention to legislate with retrospective effect back to the implementation date; and
> - HMRC published draft provisions to accompany the statement.
>
> The Budget notes included a statement that made it clear to those taking up the Holiday in advance of Royal Assent that it was subject to the successful passage of the legislation and that, if the Bill was not passed or the legislation relating to the Holiday was substantially altered, they would have to pay to HMRC any employer NICs withheld by 19 April 2011.[73]

Following the launch some commentators have questioned whether the Holiday will be as effective as the Government hopes. In a piece on the TUC 'Touchstone' blog, Richard Exell suggested that the scheme had had insufficient publicity, and was likely to cover employees who would have been recruited anyway, a phenomenon known as 'deadweight':

> With the abolition of the Future Jobs Fund and unemployment likely to start rising again soon we need all the positive employment measures available, and the NIC holiday will do some good. Unfortunately, I find it hard to believe it'll create 60,000 jobs or be taken up by 400,000 businesses … It might be argued that the new scheme is

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68 HC Deb 10 November 2010 c359W. see also, HC Deb 1 November 2010 c664W

69 ONS (http://www.statistics.gov.uk/downloads/theme_compendia/RegionalSnapshot/directory.pdf)

70 HM Revenue & Customs, *Impact Assessment of the Regional Employer National Insurance Contributions Holiday for New Businesses*, 23 September 2010 p4

71 HC Deb 6 September 2010 c1WS; HM Treasury press notice 40/10, 6 September 2010

72 under sections 5 and 9 of the *Commissioners for Revenue and Customs Act 2005*

73 *National Insurance Contributions Bill : Explanatory Notes Bill 79-EN*, October 2010 p4

> going to be more effective because it isn't restricted to long-term unemployed people. Provided it's adequately advertised (which hasn't happened so far) more employers might get to hear about it this time. But reaching and influencing employers is much more difficult than the new government seems to imagine and this scheme will inevitably have a good deal of deadweight – a lot of the businesses that claim the holiday would have been recruiting in any case.[74]

Mr Exell also mentioned the limited success of an NI holiday scheme which operated in the late 1990s. Under the scheme, which was launched in April 1996, employers were able to claim a full National Insurance rebate on employer contributions for up to a year after taking on someone who had been unemployed for two years or more. It was originally expected that 130,000 people a year would be helped by the scheme but take-up was much lower than expected. Expenditure was rapidly reduced before the scheme was closed down completely from April 1999 except for holidays that were already in place.

In a survey of employers' attitudes to the scheme published by the Department for Social Security in 1998,[75] the author found that awareness of the scheme was low, and for those who knew of its existence, the tax benefit did not compensate for a number of disadvantages: such as the logistical problems of making a claim for the NI rebate, the strict eligibility requirements, and the difficulty of finding suitable recruits among the long-term unemployed:

> This research found that responses to the scheme were very positive overall, and there was a strong feeling among employers that it was worth the effort to apply for the NIC Holiday if they recruited an eligible employee. The NIC Holiday encouraged employers to invite long-term applicants to job interviews when they might otherwise have been omitted from the recruitment process, and, for some employers, it tipped the balance in favour of the unemployed person (but only if the unemployed candidate was otherwise suitable for the job, in terms of skills, qualifications and experience).
>
> Employers disagreed, however, with the idea of recruiting long-term unemployed people in order to claim the NIC Holiday – they felt that the NIC Holiday savings would not override the fact that they were not getting someone who was right for the job. For employers, the NIC Holiday appeared to be a bonus for recruiting a long-term unemployed person, rather than an incentive for so doing.
>
> Employers also offered suggestions that they felt could improve the operation of the NIC Holiday. These included a sliding scale of NIC Holidays based on the length of the person's period of unemployment, reducing the two-year unemployment requirement to between six and 18 months, and making the scheme automatic for an employer who has recruited a long-term unemployed person rather than the employer having to apply for the Holiday.
>
> Employers also suggested a number of new features, apart from the NIC Holiday, to make the recruitment of long-term unemployed people more attractive and involve less risk to them. The first was a 'work trial' period, so that the employer could get a better idea of what the potential employee is like in the job, and the second was to give long-term unemployed recruits customised training to raise their skills, rather than employers reducing their standards. In addition to these ideas, employers also suggested greater financial assistance, measures to help them tap into pools of long-

74 "National Insurance Contributions 'holiday' starts", *Touchstone blog*, 6 September 2010

75 Dawn Snape, *Recruiting Long-Term Unemployed People : Department of Social Security Research Report No. 76*, 1998 pix. Available at: http://collections.europarchive.org/tna/20091009180345/http://research.dwp.gov.uk/asd/asd5/rrep076.pdf

> term unemployed jobseekers, and improving the recruitment-related skills of long-term unemployed people.
>
> Despite this favourable attitude, however, there was felt to be a lack of awareness of the NIC Holiday among large proportions of employers. Even when employers were aware of it, the information was often not shared with the relevant staff; for example, payroll staff may have heard of the NIC Holiday but not told the staff involved in recruitment. In addition, employers lacked a clear understanding of how the scheme operated, which precluded some from taking part. Thus employers also suggested increased and more effective marketing of the scheme, which would highlight its benefits and make it clear that participation is 'hassle-free'.[76]

David Heaton, deputy chairman of the Institute of Chartered Accountants' Tax Faculty, suggested that "some of the lessons" from the old NI scheme had been learned, but he remained doubtful that the new NI Holiday would be a success:

> Under the new NIC holiday, the recruits need not be from among the long-term unemployed, who were sometimes in that position precisely because they would not ordinarily have the skills and attitudes that employers needed, so that is one hindrance removed. The new scheme is also unlikely to appeal to large businesses, as it is limited to the first 10 recruits in a new business, although it is not clear what will in fact count as a 'new' business, and large employers might be able to find a way to qualify for some of their business units by spinning them off. Anti-avoidance rules in this area are inevitable.
>
> The savings have a headline cap of £50,000 spread over 10 employees at £5,000 each. £5,000 represents earnings of about £45,000 at current not contracted out rates, and about £43,000 next year, so it has to be questioned how many new businesses will be paying all of their first 10 recruits anywhere near the figures quoted (except perhaps the spin-out businesses suggested above). Will it really be worthwhile to jump through all the inevitable hoops? Is that desirable or sensible? …
>
> The 'new' NIC holiday will clearly differ from the 'old' one, so my pessimism might be totally misplaced (I hope that is the case), but even if the idea is neat and simple in concept, it is unlikely ever to be worth £50,000 to any business. Once we factor in the inevitable pages of legislative paranoia that will accompany the new relief to ensure that it is not abused by employers, and the form-filling and double-checking that the qualification and audit criteria entail, and the internal cost at HMRC to publicise, manage and police the scheme, we may see the new going the same way as the old, maybe even to a similar timescale. Waking the dead is rarely a fruitful exercise.[77]

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76 John Atkinson (Institute for Employment Studies), *Employer Perspectives on the Recruitment, Retention and Advancement of Low-pay, Low-status Employees*, Prime Minister's Strategy Unit, July 2003 pp 49-50

77 "Editorial: Waking the dead", *ICAEW TAXline*, August 2010 p5

4 Summary of Exchequer impact

The table below summaries the Exchequer impact of the changes to both NICs and income tax from April 2001 and beyond:

Summary of Exchequer impact (£ million: positive figures are a yield, negative are a cost)

National insurance	**2011/12**	**2012/13**	**2013/14**
Increase main employee NICs rate by 1% from 2011/12 (a)	+3,660	+3,780	+3,990
Increase additional employee NICs rate by 1% from 2011/12 (a)	+580	+610	+640
Increase employer NICs rate by 1% from 2011/12 (a)	+4,500	+4,670	+4,940
Increase main self-employed NICs rate by 1% from 2011/12 (a)	+240	+250	+250
Increase additional self-employed NICs rate by 1% from 2011/12 (a)	+40	+40	+40
Align the NICs primary threshold with baseline personal allowance from 2011/12 (a) (c)	-1,510	-1,650	-1,800
Increase NICs primary threshold in 2011/12 (a)	-1,420	-1,440	-1,590
Employer NICs: increase threshold in 2011/12 (b)	-3,130	-3,150	-3,510
Employer NICs: relief for new businesses in targeted regions from September 2010 (b)	-320	-390	-180
Income tax	**2011/12**	**2012/13**	**2013/14**
Personal allowance: increase by £1,000 in 2011/12 with adjustments to basic rate limit and upper earnings limit (b)	-3,490	-3,700	-3.770
Freeze basic rate limit in 2011/12 (a)	+410	+850	+870
Freeze higher rate threshold in 2012/13 (a)	0	+380	+850
Freeze basic rate limit in 2013/14 (b)	0	0	+320

Notes: (a) announced in March 2010 Budget or before
(b) announced in June 2010 Budget
(c) In PBR 2008 the Labour Government stated it would realign the NI primary threshold with the personal allowance by April 2011. The two had become unaligned by the decision in May 2008 to substantially increase this allowance as compensation for the abolition of the 10p starting rate. In turn this decision was superceded by the increase in the primary threshold announced in PBR2009 and the £1,000 rise in the personal allowance announced in the June 2010 Budget.

Source: HC 61, June 2010 p40 (Table 2.1: items 10-13), p55 (Table 2.4 items a-i)

All told in 2011/12, the changes to NICs will raise £2.64 billion, while changes to income tax will cost £3.08 billion.

To put these in some context, the proposed increase in the standard rate of VAT from 17.5% to 20% from 4 January 2011 is expected to raise £12.1 billion in 2011/12. These figures compare with the budget deficit which is forecast to be £149 billion in 2010/11. This is forecast to fall to £37 billion by 2014/15 (and to £20 billion by 2015/16). The majority of the fiscal tightening comes through spending cuts: roughly £80 billion in spending cuts and £30 billion of tax increases by 2014/15.[78]

5 The Bill: summary of clauses

The *National Insurance Contributions Bill* (Bill 79 of 2010/11) was printed on 14 October, along with explanatory notes prepared by HM Revenue & Customs.

Part 1 : Clauses 1-3
Increases in rates

For employees the main rate and the additional rate of Class 1 NICs are set by s8(2)(a) and (b) of the *Social Security Contributions and Benefits Act (SSCBA) 1992*. **Clause 1(1)** of the Bill amends these provisions, to increase the main rate from 11% to 12%, and the additional rate from 1% to 2%.

For employers, the main rate of Class 1 NICs is set by s9(2) of *SSCBA 1992*: **Clause 1(2)** amends this to increase the rate from 12.8% to 13.8%.

The Bill only changes the *rates* of NI from April 2011 – although the Government is committed to increasing the *thresholds* for both employees and employers at this time. These limits are set by regulation, under s5(1) of *SSCBA 1992*.

For the self-employed the main rate and the additional rate of Class 4 NICs are set by s15(3ZA)(a) and (b) of *SSCBA 1992*. **Clause 2(1)** amends these provisions, to increase the main rate from 8% to 9%, and the additional rate from 1% to 2%.

The Treasury has limited discretion to amend NI rates by Order, rather than primary legislation, under ss143 & 145 of *SSCBA 1992*; for example, the primary and secondary rates of Class 1 NICs can be increased by up to 0.25 percentage points. The main rate of Class 4 NICs may be increased by Order as well, though in this case, the legislation simply sets a maximum upper limit for the rate under s143(4)(b) of *SSCBA 1992*. At present this is 8.25%; **clause 2(2)** sets it at 9.25%

Both clauses make provision for these rate increases in the equivalent Northern Ireland legislation – the *Social Security Contributions and Benefits (Northern Ireland) Act 1992*.

One significant fraction of NI receipts go to the NHS, rather than into the NI Fund. The formula for calculating this allocation is set by s162 of *SSCBA 1992*. By way of an example, the main rate of primary contributions is 8% - and of this, a fraction equivalent to a rate of 2.05% goes to the health budget. In additional, *all* of the receipts of the 1% additional rate on earnings above the upper earnings limit go to the NHS.

The 1% additional rate paid by both employees and the self-employed was introduced in April 2003. In the 2002 Budget the then Chancellor, Gordon Brown, announced a substantial increase in health spending, through an 1 percentage point increase in the existing rates of NI paid by employers, employees and the self-employed, *and* the introduction of an additional rate on employee earnings and self-employed profits, set at 1%, on earnings and profits above the upper earnings/profits limit. The NHS funding formula was amended so that receipts from all these rate increases went to the NHS.[79] **Clause 3** amends this formula

[78] More details are given in, *Government borrowing, debt and debt interest payments: historical statistics and forecasts*, Library standard note SN/EP/5745, 2 November 2010

[79] For details see, *The National Insurance Contributions Bill*, Library Research paper 02/32, 8 May 2002

– so that only 50% of the receipts of the additional NI rates go to the NHS. In effect this means that the extra receipts from the new higher additional rates will go into the NI Fund.

Part 2 : Clauses 4-11
Regional secondary contributions holiday for new businesses

Clause 4 sets the scope of the NI holiday for new businesses, setting three conditions for eligibility:

- a person, or a number of persons in a partnership, must have started a new business during "the relevant period", defined in **clause 4(4)** as from 22 June 2010 to 5 September 2010.
- the principal place where the new business is carried on cannot be in one of the "excluded regions", defined in **clause 4(5)** as "Greater London, the South East Region and the Eastern Region".
- the new business employs one or more "qualifying employees".

Those areas excluded from the scheme are set out in more detail in **clause 11**, which defines or gives signposts to the terms used in this part of the Bill; in this context,

- the South East Region means
  (a) the counties of Buckinghamshire, East Sussex, Hampshire, the Isle of Wight, Kent, Oxfordshire, Surrey and West Sussex, and
  (b) the non-metropolitan districts of Bracknell Forest, Brighton and Hove, Medway, Milton Keynes, Portsmouth, Reading, Slough, Southampton, West Berkshire, Windsor and Maidenhead and Wokingham.

- the Eastern Region means:
  (a) the counties of Bedford, Cambridgeshire, Central Bedfordshire, Essex, Hertfordshire, Norfolk and Suffolk, and
  (b) the non-metropolitan districts of Luton, Peterborough, Southend-on-Sea and Thurrock.

Clause 5 defines what is meant by "starting a new business" for the purposes of the scheme, with a view to excluding existing businesses that might otherwise qualify for relief by having stopped operations for a short time or by being restructured. So, **clause 5(2)(a)** specifies that a business is not 'new', if the person or partnership involved had operated another business up to six months before which carried out all the same or most of the same activities. **Clause 5(2)(b)** & **5(3**) also exclude new businesses that have been established as "a result of a transfer": where all or most of an existing business' activities have been passed from one person to another by arrangement. **Clause 5(4)** extends this to cover situations where a partnership is restructured into individual businesses, or a partnership is created from an existing business or another partnership of a different composition. Similarly **clause 5(5)** extends this test to situations where a person or partnership starts a business by exercising rights, previously agreed, to takeover part or all of an existing concern. The explanatory notes to the Bill give a series of examples of how these exclusions would work in practice. **Clause 5(6)** specifies that qualifying businesses may include a trade, a profession, a vocation, a property business or an investment business.

Clause 6 specifies what a "qualifying employee" is under the scheme: first, they must have been taken on by the new business in its first year of operation, and second, the person or partnership running the new business must be responsible for paying secondary Class 1 NICs on their earnings. **Clause 6(2)** limits the scope of the NI Holiday to the first ten qualifying employees only. **Clause 6(4)** defines the length of the NI Holiday for each qualifying employee. The holiday can begin, at the earliest, from 6 September 2010, last for no more than a year, and end, at the latest, on 5 September 2013. The explanatory notes give a worked example of the scheme:

- A new business (sole trader) commenced trading on 6 August 2010 which falls within the relevant period. The principal place at which the new business is carried out when it starts up is not in an excluded region. The first ten employees engaged between 6 August 2010 and 5 August 2011 (the initial period) will qualify for the Holiday.
- The first employee is engaged on 28 August 2010. Earnings paid to that employee between 6 September 2010 and 5 September 2011 (the Holiday period) will be eligible for the Holiday.
- The second employee is engaged on 30 September 2010. Earnings paid to that employee between 30 September 2010 and 29 September 2011 (the Holiday period) will be eligible for the Holiday.
- The third employee is engaged on 10 September 2011. As the employee's start date is outside the first year of business (the initial period) the new business is not eligible to claim the Holiday for this employee.
- The second employee leaves the new business in January 2011 and rejoins it in July 2011. The new business can resume the Holiday for this qualifying employee until the end of his original Holiday period which ends on 29 September 2011.

Clause 7 specifies the amount that new businesses may claim on behalf of qualifying employees. Under **clause 7(3)** businesses may not claim relief on earnings if, during the year for which they are making a claim, they move into any one of the 'excluded regions'. **Clause 7(4)** caps the total amount that may be claimed for each qualifying employee at £5,000.

Clause 8 sets out the mechanism for businesses obtaining relief – either by deducting the appropriate amount when paying NICs to HMRC, or by claiming a refund after the fact. **Clause 8(3)** requires businesses to make an application to HMRC, to ensure no claim falls foul of the EU rules on state aid. In brief, this form of targeted aid is subject to a de minimis test, allowing grants of €200,000 over 3 years – but lower limits apply to businesses in certain sectors (road transport, agriculture, fisheries and aquaculture). Under **clause 8(4)** no claim for a refund in respect of a qualifying employee will be considered if they are made over 4 years after the last deduction could have been made in respect of that person.

Clause 9 places requirements on businesses to retain relevant records for at least 3 years after they have used the holiday. **Clause 10** sets out an anti-avoidance rule, stating that persons or partnerships will not qualify if they have entered "avoidance arrangements" that have, in essence, misrepresented their establishing a 'new' business so as to exploit this tax relief.

Clause 11, as noted, provides further definitions of the terms used in this part of the Bill.

Part 3 : Clauses 12-15
General

These clauses set out the abbreviations used in the Act, the commencement of each part, the Bill's territorial extent and its short title. While the increase in NI rates provided for under Part 1 comes into force on 6 April 2011, the remainder of the Act comes into force on the date of Royal Assent.

Appendix: Glossary of terms

National Insurance

Class 1 contributions	These are contributions paid by employees and employers on earnings that exceed the primary and secondary thresholds (which are set at the same level).
Primary Threshold	The primary threshold is the point at which employees begin to pay National Insurance contributions.
Secondary Threshold	The secondary threshold is the point at which employers begin to pay National Insurance contributions.
Lower Earnings Limit	Historically the lower earnings limit was both the point at which a liability to pay National Insurance contributions arose and the point at which entitlement to contributory benefit began. In 2001 the point at which contribution liability arises was changed to a new earnings threshold, which was initially aligned with the income tax personal allowance. Despite this change, the lower earnings limit retains its contributory benefit purpose.
Upper Earnings Limit	Historically the upper earnings limit was the point at which a liability to pay primary Class 1 contributions ended. In 2003 an additional Class 1 contribution liability on earnings in excess of the upper earnings limit was introduced and it became the point at which liability for Class 1 contributions at the main primary percentage ceased.

Income tax

Personal allowance	The amount of annual income every individual may receive free of tax. The allowance is deducted from a person's income before their liability to income tax is calculated. Two age-related additions are made to the allowance for the elderly. For 2010/11 the basic personal allowance is set at £6,475.
Basic rate limit	The band of taxable income which is liable to tax at the basic rate, which is currently 20%. Taxable income excludes personal allowances. Taxable income above this limit is liable to tax at the higher rate, which is currently 40%. For 2010/11 the basic rate limit is set at £37,400.
Higher rate threshold	The point at which individuals become liable to pay tax at the higher rate on their gross income. For individuals in receipt of the basic personal allowance, it is the sum of the personal allowance and the basic rate limit.
Higher rate limit	The band of taxable income which is liable to tax at the higher rate. Taxable income above this limit is liable to tax at the additional rate, which is currently 50%. For 2010/11 the higher rate limit is set at £150,000.

Further details on direct tax rates and allowances are given in *Direct taxes: rates and allowances 2010/11*, Library Research paper 10/29, 26 March 2010