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United Kingdom – OTS Publishes Terms of Reference

by Colin Ben-Nathan, Steve Wade, and Rachel Beecroft, KPMG LLP, London (KPMG LLP in the United Kingdom is a KPMG International member firm)

The Office of Tax Simplification (OTS) in the U.K. has published its terms of reference for a review of the closer alignment of income tax and National Insurance Contributions (NIC – U.K. social security contributions).¹

Why This Matters

There are currently some significant differences in the way that income tax and NIC operate and how they are applied to various types of income. Furthermore, separate NIC systems apply to the employed and the self-employed, even though both are subject to income tax. These differences can lead to confusion over whether an item is subject to both tax and NIC and also to potential additional costs for employers in assessing this.

Any changes made to align the two taxes will affect all employers – including employers with international assignees – and for this reason the OTS has invited those who may be affected to contribute to the review. Guidance on how this may be done is provided at the end of this newsletter.

The OTS is part of HM Treasury in the U.K., but is a body set up to give the government independent advice on areas of tax legislation that may benefit from simplification and reform (for prior coverage, see [Flash International Executive Alert 2011-049](#), 11 March 2011). The OTS is due to publish a full review by the next Budget (March 2016). This is a further step in relation to recommendations made by the OTS in 2011 (see the aforementioned *Flash International Executive Alert*).

The Terms of Reference in Detail

The announcement of this review was made in the Summer Budget earlier this month and the terms of reference now set out the scope of the review. The aim of the review is “to build on the OTS’s earlier work and recommendations in this area and to understand the different stages of improving the alignment of the taxes.”²

In particular, the OTS will consider the following:

- “1. The case for change, including the distortions, burdens and costs associated with the current system.
2. The changes that could be introduced to bring the two systems closer together in relation to the taxation of earned income (for employers and employees) and the self-employed.
3. The costs, benefits and impacts of each step.
4. All forms of NIC charge, including employers’ NICs.

5. How any changes would fit with wider government policy/objectives, including:

- the system of determining entitlement to contributory benefits;
- Exchequer costs;
- burdens for business.”³

Significantly the OTS will not look at any extension of NICs to non-employment income, although it will consider “the base of the systems.”

KPMG Note

KPMG LLP (U.K.) understands “the base of the systems” to mean the income on which both income tax and NIC are paid with a view to mitigating any differences between the charges. We had anticipated that the tax and NIC treatment of termination payments was likely, therefore, to be high on the list for closer alignment and indeed, a consultation document on this topic was issued last week.⁴ Certain payments are, for example, currently exempt from income tax up to GBP 30,000, but exempt without limit from NIC.

Other possible areas for review include aligning the income tax “cumulative basis” and the NICs “pay period basis.” The cumulative basis means that for a tax year, the final tax charge is the same irrespective of whether the income is received evenly throughout the year or in just one month. The NIC charge, however, is different if the income is not received evenly. If change is recommended in this area, KPMG LLP (U.K.) anticipates a likelihood that NIC will be cumulative (i.e., looked at over the tax year as a whole) rather than income tax moved to a pay period basis (i.e., calculated on earnings paid, for example, in a month or a week).

The ending of salary sacrifice arrangements has also been a point of speculation ahead of a number of government U.K. budgets. This could also be looked at again, particularly as one of the areas the OTS is to consider is “the impact on any distortions to current taxpayer behaviour caused by the current system.”⁵

The OTS will also look at the impact of the differences between tax and NIC on “employment status.” In this regard, the OTS refers to its earlier work and states:

“The OTS’s...UK Competitiveness Review and Employment Status report both returned to the issue of IT/NIC alignment. Both reports reiterated the difficulties caused by the differing systems; closer alignment was seen as a way of improving competitiveness and as the main indirect way of ‘solving’ employment status problems. The impact of the employers’ NICs was seen a major issue in both cases.”⁶

In carrying out this review, the OTS will also consider the following matters which are relevant to employers:

- The likely effect on compliance burdens;
- Avoidance risks;
- The principles and design of HMRC’s Making Tax Easier reforms, including digital tax accounts, integrated reporting and payment;
- Fairness and consistency in treatment of taxpayers.”⁷

OTS will also consider the effect of any changes on taxpayers' and employers' understanding of the tax and NIC systems.

KPMG Note

The OTS must make a final report by Budget 2016, and although it will build on earlier work, the practical difficulties of aligning the two systems must not be overlooked. Whilst there is widespread agreement that if the tax and NIC system was being designed today, it would not look as it does today, there is far less agreement on how to transition to a new regime. It would be a very brave Chancellor who merged the two systems overnight at the start of a new tax year. It is clear, however, that there is a political will to do something and, therefore, there is a strong possibility that there will be several changes over the next few years. This is an area all employers will need to watch carefully.

If you wish to contribute to the debate, please do not hesitate to speak to your usual KPMG contact or any of the KPMG LLP (U.K.) contacts noted in the by-line to this newsletter or below. Alternatively the OTS has said that "anyone wishing to contribute to the review or arrange a meeting with the OTS team should email us at ots.gsi.gov.uk."⁸

Footnotes:

- 1 OTS, "[Alignment of Income Tax and National Insurance](#)" (July 2015).
- 2 Ibid.
- 3 Ibid.
- 4 See HM Revenue & Customs, "[Open consultation: Simplification of the tax and National Insurance treatment of termination payments](#)" (24 July 2015).
- 5 OTS, "[Alignment of Income Tax and National Insurance](#)" (July 2015).
- 6 Ibid.
- 7 Ibid.
- 8 Ibid.

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The information contained in this newsletter was submitted by the KPMG International member firm in the United Kingdom. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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