Should different ways of working be taxed differently?

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The tax system penalizes employment

Tax due on a job generating £40,000, 2017–18

- **Employee**
  - **Income tax**
  - **Employee NICs (12%)**
  - **Employer NICs (13.8%)**
  - **Total Tax Due**: £12,146

- **Self-employed**
  - **Income tax**
  - **Self-employed NICs (9%)**
  - **Total Tax Due**: £8,713

- **Owner-manager**
  - **Corporation tax**
  - **Dividend tax**
  - **Total Tax Due**: £7,358

Should different ways of working be taxed differently? © Institute for Fiscal Studies
Why are tax differentials a problem?

Fairness: similar individuals doing similar work can be taxed very differently

Efficiency: individuals’ choices are distorted

Public finances: more individuals running their own business means lower government revenues

- HMRC estimates that in 2016–17:
  - £5.1 billion forgone through lower self-employed NICs
  - £6.0 billion forgone through lower taxes on company owner-managers
The tax system penalizes employment

Tax due on a job generating £40,000, 2017–18, including abolition of Class 2 NICs, Class 4 NICs to 11% & dividend allowance cut

- Employer NICs (13.8%): £12,146
- Employee NICs (12%): £9,202 (+£471)
- Self-employed NICs (9%)
- Income tax
- Dividend tax
- Corporation tax

Notes: For illustration, the abolition of class 2 NICs, Class 4 NICs to 11% and cut to dividend allowance are shown as if introduced in the 2017-18 system.
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Mind the gap: NICs much higher for employees than self-employed

National Insurance Contributions schedule, 2017–18

Notes: For illustration, the abolition of class 2 NICs and Class 4 NICs rates at 11% are shown as if introduced in the 2017-18 system. Employee schedule includes employer NICs.
Argument 1: Lower NICs reflect lower access to publicly-funded benefits

The self-employed get very similar state benefits to employees
- From April 2016 both accrue same rights to single tier state pension
- Self-employed don’t get contribution-based JSA ...
- or statutory parental benefits
  - but can access Maternity Allowance

The NICs advantage is far bigger than differences in benefit entitlements
- Differences in benefits could justify less than 1 ppt difference in rates
Argument 2: Lower rates are necessary to compensate for lack of employment rights

Self-employed don’t get employment rights such as holiday & sick pay

Employment rights are a transfer from employers to their employees, not a benefit given to employees by the government

- Make employment more attractive to the employee – higher tax offsets this
- Make employment less attractive to the employer – higher tax reinforces this

There is no net benefit to employment for tax to offset

Employment rights can be seen as part of remuneration package
Argument 3: Lower rates reward risk taking & entrepreneurship

Difficulty & risk associated with running a business do not in themselves justify favourable tax treatment

What is it that we want to support?
- Innovation, start-ups, investment, those on low incomes ...

Across-the-board lower rates are the best policy response to what?
- They are poorly targeted
- And come at cost of creating boundaries in tax system

There are better ways