Why the focus on individuals running their own businesses?

Backdrop: self-employed & company owner-managers account for 40% of growth in workforce since 2008

Lower taxes for these groups imply impact on 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
• Revenues losses increasing as business population grows

Raises issues of fairness ...

• Similar individuals get very different tax rates

... and economic efficiency

• Tax differences distort choices
The tax system penalizes employment

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

- **Employee**
  - **Income tax** (not shown)
  - **Employee NICs** (12%)
  - **Employer NICs** (13.8%)
  - **Total**: £12,146

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

- **Owner-manager**
  - **Dividend tax**
  - **Corporation tax**
  - **Total**: £7,358
Other ways to reduce taxes if running your own business

Split income with a spouse

More scope to deduct work-related expenses from income

Tax avoidance (legal) or evasion (illegal)
- HMRC estimates 30% of self-employed tax returns understate the amount of tax due

Retaining earnings in a company can bring even more benefits
Self-employed NICs changes

Increase main rate of Class 4 NICs
• Currently main rate of 9% of profit
• Main rate increase to 10% in April 2018, and to 11% in April 2019
  – Raises £600m in 2020-21
• Rate on profits above Upper Profits Limit remains at 2%

Abolish Class 2 NICs from April 2018
• Flat rate of £2.85 per week in 2017-18
• Abolition announced Budget 2016
  – Costs £400m in 2020-21
Self-employed NICs

<table>
<thead>
<tr>
<th>Annual NICs liability</th>
<th>£0</th>
<th>£1,000</th>
<th>£2,000</th>
<th>£3,000</th>
<th>£4,000</th>
<th>£5,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual profit</td>
<td>£0</td>
<td>£10,000</td>
<td>£20,000</td>
<td>£30,000</td>
<td>£40,000</td>
<td>£50,000</td>
</tr>
</tbody>
</table>

- **Actual 2017-18**
- **With 2018 & 2019 reforms implemented**

Actual 2017-18:
- £0 profit: £0 NICs
- £10,000 profit: £15,570 NICs
- £50,000 profit: £589 NICs

With 2018 & 2019 reforms implemented:
- £0 profit: £0 NICs
- £10,000 profit: £15,570 NICs
- £50,000 profit: £589 NICs

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Distributional effects of NICs changes
Average gain/loss among households with self-employment income

Note: Decile groups of whole population. Assumes reforms implemented in 2017-18
The self-employed get very similar state benefits to employees

- From April 2016 both accrue same rights to single tier state pension
- Contribution-based JSA & statutory parental benefits are the only differences

The NICs advantage is far bigger than differences in benefit entitlements

New consultation on parental benefits for the self-employed

Lower employment rights don’t justify lower tax rates
Dividend tax change

Summer Budget 2015: introduce dividend allowance & increase rates

- New dividend allowance of £5,000 introduced in 2016-17
- Alongside increases in marginal dividend tax rates of 7.5ppt
  - Overall tax rise of £2.0bn
- Incentive for many to bring dividends forward
  - Overall, paid £800m less as result
  - HMRC analysis: 1/7th of that saving went to 100 individuals, who, on average, withdrew £30m of dividends from companies

Budget 2017: reduce dividend allowance

- From £5,000 to £2,000 from 2018-19
  - Raises £825m in 2020-21
- Tax rise if dividend income >£2,000 and total income >£13,500
Loss from reducing dividend allowance to £2k
For individual with dividends >£5,000 and total income >£16,500

Note: Assumes implemented in 2017-18.
Before & after reforms

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

- **£12,146**
  - Employee NICs
  - Employers NICs
  - Income Tax
  - Self-employed NICs
- **£8,713**
  - Income Tax
  - Self-employed NICs
  - Dividend tax
- **£7,358**
  - Corporation Tax
  - Owner-manager
- **£12,146**
  - Employee NICs
  - Employers NICs
  - Income Tax
  - Self-employed NICs
- **£9,202**
  - Income Tax
  - Self-employed NICs
  - Owner-manager
- **£7,583**
  - Corporation Tax
  - Owner-manager

Actual system vs. System with: no Class 2 NICs; 11% main rate class 4 NICs; £2,000 dividend allowance.
Effect of changes on incentives

March 2017 Budget changes have a fairly small effect

- Reduces incentives to switch from employment to self-employment
- Difference between self-employed and owner-managers depends on income level
- Increase incentive for owner-managers to take income as capital gains
- Reduces incentives to work and invest
- Incentives to save in shares (outside pensions & ISAs) reduced
Moving towards alignment is a step in the right direction

Differences in tax rates across legal form are costly, inefficient and unfair
- Not justified by differences in state benefits or employment rights
- Poor way to encourage entrepreneurship

This is a small step towards aligning tax rates across legal forms

But this is a tax rise, with associated disadvantages

And don’t forget the tax base
- Money invested in a business should be tax deductable
Business Rates revaluation coming in April

Long-run impact on average bill

London
South East
East Midlands
South West
East
West Midlands
Yorkshire & the Humber
North West
North East

See https://www.ifs.org.uk/publications/8962
More money to ease business rates transition

New cap on bill increases for those getting small business relief
  - Cost: £20-25m a year

£305m to councils to fund extra discretionary business rates relief for those seeing bill increases
  - Money across four years, front-loaded

One-off £1,000 discount for most pubs in 2017-18
  - Cost: £25m
Summary

2ppt increase in main rate of self-employed NICs
• +£600m in 2020-21

Reduction in dividend tax allowance from £5,000 to £2,000
• +£825m in 2020-21

Money to ease business rates revaluation
• Small cost as tightly targeted at losers & pubs

Amount to fairly small changes to tax system
• Albeit ones that will have a large impact on some people