

# NICs Code: Design Options Paper

## Introduction

**1.1** In March 2016 the OTS issued a report on the closer alignment of income tax and national insurance contributions (NICs) and made a number of recommendations (see March Report <sup>1</sup> pages 8 to 13). These included moving employees' NICs to an annual, cumulative and aggregated basis (ACA) across all employments and self-employments.<sup>2</sup> The Government asked the OTS to explore the implications of this, leading to a further report in October 2016. This note is published simultaneously with the further report and elaborates on one aspect of the process which would be required to deliver ACA: a NICs code.

**1.2** Employers, through the operation of PAYE, are integral to the collection of employees' NICs. With ACA they will need to know whether all or part of the Primary Threshold is available to an employee. For income tax the PAYE IT code acknowledges an employee's other activities, facilitating the deduction of an appropriate amount of income tax. A NICs code would have a similar purpose, ensuring that the NICs collected through PAYE in one employment takes account of earnings in other employments.<sup>3</sup>

**1.3** The March 2016 Report considered whether NIC code information could be included within a combined IT and NICs code or if a dedicated NICs code would be needed.<sup>4</sup> In principle a single code would be preferable but at the present time we thought a separate NICs code would be needed: a single code would be complex because the IT code takes account of income which is not subject to NICs, the IT and NICs thresholds are different and, at present the definition of employed earnings is not the same for IT and NICs. It is conceivable that reforms could mean a single composite code would be possible; it is also possible that in due course automation and modernisation of the whole PAYE/NIC process may render codes obsolete but that will clearly take some considerable time.

**1.4** We propose a NICs code which replicates the function of the PAYE/IT code but adopts a different format. This note provides further detailed explanation of the alternative ways a dedicated NICs code could be designed, as part of an annual and aggregated NICs system.

**1.5** This note also considers whether underpayments of NICs should be collected through the PAYE/IT code or the new NICs code, concluding that it would be preferable to use the PAYE/IT code.

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<sup>1</sup> <https://www.gov.uk/government/publications/closer-alignment-of-income-tax-and-national-insurance-contributions>

<sup>2</sup> The arguments for aligning the basis for determining employees' NICs and the options for achieving this are set out on pages 66 to 74 of the March Report.

<sup>3</sup> March Report page 71

<sup>4</sup> March Report pages 74-75

## A dedicated NICs code

1.6 NICs would be calculated cumulatively and aggregated across all employments in the same way as income tax. Employees would continue to have a NICs Primary Threshold ('NICs free' pay) and Upper Earnings Limit, but these would be applied across their total earnings from all of their employments for the whole of the tax year. In effect, the annual Primary Threshold would operate in the same way as the Personal Allowance for income tax, providing a 'NICs-free' allowance for the year.

1.7 A dedicated NICs code would run in parallel to the PAYE/IT code. PAYE/IT codes would continue to operate as they do currently. There are two options for the design of a dedicated NICs code:<sup>5</sup>

- 1 a NICs code that replicates the function and format of the PAYE/IT code
- 2 a NICs code that replicates the function of the PAYE/IT code but adopts a different format

### NIC code design A: replicating the function and format of the PAYE/IT code

1.8 In this model HMRC would use as far as possible codes and letters as used for PAYE/IT codes. For example, a person with a Primary Threshold of £8,060 would have a NICs code of 806L.

1.9 This would have the advantage of having a familiar concept and format to the PAYE/IT code, making it easy to understand for those who are already familiar with PAYE/IT codes. A major disadvantage is likely to be that in looking so similar to the PAYE/IT code, there is a risk of the two being confused, with a NICs code used to calculate an employee's income tax or a PAYE/IT code used to calculate and employee's NICs.

### NIC code design B: replicating the function but not format of the PAYE/IT code

1.10 An alternative approach might be for the NICs code to perform like a PAYE/IT code but to look different. The code could have a different alphanumeric format. For example, a standard suffix NICs code might show **all** the digits in the code, rather than be truncated by one digit like the PAYE/IT code and also have different suffix letters to taxpayer/IT. A person with a Primary Threshold of £8,060 might have a NICs code of 8060A. The number is the amount of NICs free pay and the letter represents information about the rate at which NICs are to be charged. In this example "A" represents the standard rate of NICs (as with the table letters currently used by employers to determine the correct NICs rate for each employee). Table 1.A provides examples of how specific NICs codes could look under this model, alongside the existing PAYE/IT codes.

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<sup>5</sup> A potential third option would be a different approach which apportions the NICs thresholds. Instead of expressing NICs codes in the form of NICs free pay (as in options A and B) a code could be expressed in the form of a percentage. This percentage would be applied to each of the thresholds (for example the Primary Threshold and Upper Earnings Limit) and thereby apportion thresholds across an individual's multiple employments. Although this would have the advantage of being clearly distinct from the PAYE/IT code it would lack the flexibility that options A and B bring and we have not pursued it.

**Table 1.A: Examples of codes that could be used under NIC code design B**

Scenario	PAYE/IT code	NICs code
Full Personal Allowance and Primary Threshold – sole employment	1100L	8060A
No allowances - earnings below UEL	BR (Basic Rate - 20%)	MR (Main Rate - 12%)
No allowances – known by HMRC that earnings at or above UEL in other employment	D0 (40%)	AR (Additional Rate - 2%)
No allowances – for example a payment made after leaving employment	OT (zero T) operated non-cumulatively, also known as the Week 1/ Month 1 (W1/M1) basis	0A (zero A) W1/M1
Two jobs – full allowance applied to first job, employee then takes on second concurrent employment	1100L	8060A
First job	BR (20%)	MR (12%)
Second job		
Allowance split evenly over two jobs – same earnings in both and totalling below PT (£11,000)	550T 550L	4030AT 4030A
The T suffix is used in certain circumstances. In this case because there are two sources of income and the allowance has been divided.		
Full Personal Allowance – sole employment but previous earnings unknown	1100L W1/M1(week 1 month 1)	8060A W1/M1(week 1 month 1)
K code – no allowances and income ‘increased’ by an amount to recover additional tax due	e.g. K123	K123A
Not taxable/Not NICable	NT	NN

**1.11 Recommendation** Option B would be the best model for designing a NICs code – though the final design might differ from the examples in the table. It would have the advantage of using concepts familiar from PAYE/IT codes, making it easy to understand for those who are already familiar with PAYE/IT codes. But it would also look sufficiently different such that there would be a limited risk of the two being confused.

## Using codes to deal with income tax and NICs underpayments

**1.12** An annual and aggregated system of NICs will in some cases give rise to an employee NICs over- or underpayment. This is because NICs deductions made in the year would become, like PAYE/IT, provisional payments subject to an end-year reconciliation process. Deductions may not ultimately match the total NICs due figure when the year as a whole is reconciled, for example, where an employee has a number of changes in circumstance during the year.

**1.13** At present, only income tax is reconciled at year-end, and whilst this is a largely automated process a sizeable portion of reconciled cases require some form of manual intervention. Thus the prospect of introducing annual reconciliation for NICs will appear as a potentially significant extra burden for HMRC. However, as we have mentioned in our report, HMRC’s Making Tax Digital programme could help reduce this additional burden and facilitate these changes.

**1.14** Under ACA, overpayments would be repaid by HMRC in the same way as those for income tax. If the year-end reconciliation finds that NICs have been overpaid, it will either be repaid or off-set against any other underpayment.

**1.15** There are two possible approaches to collect underpayments in the process known as 'coding out'. Either the NICs code or the PAYE/IT code could be adjusted. Table 1.B sets out the advantages and disadvantages of using either the PAYE/IT or NICs code to do this.

**1.16** There is a protection for taxpayers in that total deductions from the PAYE/IT code cannot exceed 50% of a person's gross income. Existing NIC protections would be removed and a NICs underpayment in the PAYE/IT code would be subject to the same protection as is currently applied to tax. Assuming that ACA NICs and annual PAYE/IT will generate largely correlated under or over payments, the size of sums which need to be coded out is likely to increase and so the 50% limit may be reached more frequently.

**Table 1.B: Advantages and Disadvantages of using the NICS code and PAYE/IT code to collect underpayments**

Option for collecting NICs underpayments	Code out through the PAYE/IT code (the PAYE/IT code would be adjusted to collect the NIC underpayment)	Code out through the NICs code (the NIC code would be adjusted to collect the NIC underpayment)
<b>Advantages</b>	<p>If the PAYE/IT code were used to deal with NICs underpayments, the NICs code would only need to be used for current year adjustments, for example if the Primary Threshold was split over two jobs.</p> <p>It would also reduce the need for an employee coding notification to have to explain adjustments to two codes, because the PAYE/IT code would contain all the adjustments.</p>	<p>The NICs code would deal with all NICs adjustments. This would include any earned income where employee NICs had not been deducted at source (for example benefits in kind) but also where a fixed amount of money is required (for example a NICs underpayment from a previous year).</p>
<b>Disadvantages</b>	<p>For some individuals the PAYE/IT code would contain more information and, therefore, more volatile and harder for employees and employers to understand.</p> <p>The fact that underpayments of NICs would be collected as income tax may lead to confusion, and not be transparent.</p> <p>The 50 % limit would be at greater risk of being breached, requiring HMRC to take alternative collection activity.</p> <p>The NICs that somebody paid as part of their tax code would need to be estimated and reflected on their National Insurance record.</p>	<p>For some individuals the NICs code would contain more information, and therefore be harder for employees and employers to understand.</p> <p>Very large adjustments might be necessary for those who are paid above the annual upper earnings limit, because the rate is only 2%.</p> <p>For example, for an additional rate NICs payer with a NICs underpayment of £500 the adjustment to the code would be <math>500 \div 2\% = 25,000</math>.</p> <p>As the Primary Threshold is currently £8,060 then the amount of NICs free pay would be -£16940. HMRC would have to apply a large negative code (similar to the PAYE/IT K code) for a relatively small amount of underpayment.</p> <p>The NI Code could look like K16940A</p>

## Conclusion

1.17 The advantages and disadvantages of using the NICs code or PAYE/IT code to collect NICs underpayments are reasonably balanced. More research should be conducted to establish which approach would be easier for employees to understand, taking into account potential changes to personal tax accounts.