

Policy Report

Equalising National Insurance on Partnership Income: Revenue and Distributional Effects

September 2025

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Equalising National Insurance on Partnership Income:

Revenue and Distributional Effects

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This research was funded by the Nuffield Foundation (WEL/FR000023787) and the ESRC (ES/W001683/1). This work contains statistical data from HM Revenue and Customs (HMRC) which are Crown Copyright. The research data sets used may not exactly reproduce HMRC aggregates. The use of HMRC statistical data in this work does not imply the endorsement of HMRC in relation to the interpretation or analysis of the information.

This report models the introduction of an equivalent to Class 1 Secondary National Insurance Contributions (commonly known as ‘Employer NICs’) on partnership profits, which we refer to as ‘Partnership NICs’. We present novel statistics on the distribution of partnership profits in the UK and discuss how much revenue could be raised from our proposed reform. Our analysis draws on pseudonymised administrative data accessed via HMRC, which provides information on all taxpayers with partnership profits in the 2020 tax year.¹

Key Findings

- **The top 0.1% of UK taxpayers by total income received 46% of all partnership income in 2020**, compared with less than 5% of all employment income. This highlights the high concentration of partnership income relative to other forms of remuneration from work.
- **1800 partners in Kensington received over £1.8 billion in partnership income, exceeding the profits of all 65,000 partners in Wales and Northern Ireland combined.** Partnership income in Kensington was 1200 times higher than in Liverpool Walton (£1.5 million).
- **More than a quarter of UK partnership income went to taxpayers in just 12 constituencies, 11 of which are in London.** Constituencies at the bottom of the distribution are highly urbanised, and largely in the North of England.
- **Solicitors received one fifth (20%) of all partnership income, averaging over £300,000 each in partnership profits annually.** Partnership income is also particularly high in finance, exceeding an average of £600,000 per partner in some sectors.
- **Levying ‘Partnership NICs’ would raise an estimated £1.9 billion in 2026-27, after accounting for behavioural responses and interactions with other taxes.** Since Partnership NICs would be paid from pre-tax profits, the tax increase is smaller than the headline rate: for an additional rate taxpayer the marginal effective rate would rise by 6.9 percentage points.
- **98% of the revenue from the proposed reform would come from individuals in the top decile by total income.**
- **66% of current partners would have no tax to pay, due to the proposed Partnership Allowance and Partners’ Exempt Amount.**
- **Equalising the NICs treatment of partnership income with employment income would reduce economic distortions and be better for growth.** The revenue raised from the reform could then be used to cut other taxes or to fund public spending.

¹ Editorial note: all references to years in this report are based on tax years, giving the later year e.g., tax year 2019–20 is given as 2020.

1. Introduction

In a fair and efficient tax system, tax rates should not depend on how a taxpayer decides to work (Miller, 2018). While the UK Income Tax is designed with this principle in mind, our outdated National Insurance system leads to stark differences in how earnings are taxed according to their legal source. Gross employment income is subject to a headline rate of 15% for Class 1 Secondary National Insurance Contributions ('Employer NICs') yet no equivalent charge is applied to self-employment or partnership profits. The resulting tax wedge yields a significant advantage for earnings taken in the latter two forms, raising clear horizontal equity concerns and distorting taxpayers' decisions on how to work.

This report models the introduction of an equivalent to Employer NICs on partnership profits – which we refer to as 'Partnership NICs' – as a step towards equalising the tax treatment across different forms of income from work. While just one of many issues surrounding the taxation of work in the UK, the lack of an Employer NICs equivalent on partnership profits is a particularly conspicuous anomaly. The resulting wedge in effective tax rates is an accident of history rather than a conscious policy choice to favour unincorporated businesses over those that operate as a company. We take partnership profits as our focus for two key reasons.

First, there are many functional similarities between partnerships and companies, as the two main legal forms of multi-owner business in the UK. Despite these similarities, partnerships face significantly lower effective tax rates on their labour costs than companies, for no good reason. The tax privilege offered to partnerships results in economic distortions that are bad for productivity and growth. This wedge is driven almost entirely by the lack of (an equivalent to) Employer NICs on partnerships.

Second, the benefit of the current tax break for partnerships goes disproportionately to the highest earners. Partnership profits are among the most unequally distributed forms of remuneration in the UK, with nearly half (46%) accruing to the top 0.1% of the income distribution. We recommend that the effects of the reform on lower earners be mitigated via the introduction of a Partnership Allowance, equivalent to the existing Employment Allowance of £10,500 per employer for Employer NICs. This allowance would protect small partnerships from paying any additional tax (a typical two-person partnership would have to receive profits above £90,000 before any additional tax is due) whilst also reducing the impact for those above this level.

We estimate that the reform we propose would raise £1.9 billion per year, of which 98% would come from individuals within the top decile based on their total income. We take no position on what this additional revenue should be used for: it could be used to cut other taxes or to fund public spending. Purely by way of illustration, the revenue raised from the reform would be equivalent to around 1p on the Higher Rate of Income Tax that applies across all forms of income.

The report is structured as follows. First, we set out what a partnership is, the data we use to study partnerships, and the current recipients of partnership income. We then discuss how the disparity in taxation originated and why it has received relatively little attention to date, why it should be reformed, and what the revenue and distributional consequences of such a reform would be. A key advantage of our empirical approach lies in our use of HMRC administrative data covering the universe of taxpayers receiving partnership profits in the UK, which has not previously been used in policy modelling outside government.

2. What is a partnership?

A partnership is a form of business that consists of two or more owners, known as ‘partners’ or ‘members’, carrying out a trade with the aim of making a profit.² At the start of 2024, partnerships comprised more than 6% of the UK’s private sector businesses and were the third most common business type after sole proprietorships and limited companies. Despite their apparent similarities, partnerships and companies differ in several legal respects.

First, partnerships usually do not have an independent legal identity.³ This means that a partnership cannot directly own assets or enter into contracts; instead, these actions are formally carried out by one of the partners on behalf of the business. Second, partnerships do not usually offer limitation of liability to partners, which means that partners are liable for the debts of their business without any limitations.⁴ Finally, as we discuss below, there are substantial differences in the tax treatment of partnerships and companies, which follow from the separation of ownership highlighted above.

² Although the correct legal term is ‘partners’ in the context of general and limited partnerships and ‘members’ in the context of Limited Liability Partnerships (LLPs), we use partners to refer to both in this report.

³ LLPs are the exception to this rule, as they do have separate legal personality.

⁴ LLPs again provide an exception, as they offer limitation of liability to their members. Limited Partnerships also offer limitation of liability, but only to some partners (i.e. limited partners that do not participate in the management of the business).

Among business forms, partnerships have the advantage of being flexible structures offering privacy to their partners. This contrasts with companies, which have more detailed reporting requirements. Partnerships are also relatively simple to create and are subject to light regulation, though as noted previously, they typically come with the disadvantage of unlimited liability for partners. They are also less conducive to raising external finance, since borrowing must usually be in the name of individual partners, and to transferring a partner's interest in the business, since they do not have share capital (Roach, 2023). In practice, this means that partnerships are more common as structures for businesses providing professional services, such as solicitors, doctors, accountants and architects, although there are other industries (such as farming) where partnerships are also widely used.

Besides these functional differences, the most important distinction between companies and partnerships is their tax treatment. Companies are 'opaque' for tax purposes, meaning that they are treated as a separate tax unit from their owners. Companies are subject to Corporation Tax on profits as they arise in the company, and owners are then subject to Income Tax (at the lower dividend rate) on any profits they withdraw. By contrast, partnerships are 'transparent' for tax purposes, which means that partners are subject to Income Tax on the profits as they arise to the partnership, with no extra layer of taxation at the partnership level. As we explain in more detail below (Section 5.1), companies and partnerships are also treated very differently for NICs purposes, which results in a significant tax break for taxpayers remunerated through partnerships.

3. Data

We draw on administrative data from HMRC covering all UK resident taxpayers with partnership profits in the tax year ending April 2020, the most recent year with available data that did not occur during the COVID-19 pandemic. We observe all profits reported by these taxpayers on their self-assessment tax returns as well as information on their other income (with a breakdown by income type), location, and industry. To provide a comparison between the distributions of employment income and partnership profits, we use HMRC data covering all UK taxpayers who received employment income in 2020. In our descriptive analysis in Section 3 below, we present cash values as observed in the tax data, i.e. the figures shown correspond to the 2020 tax year. For our revenue modelling in Section 6, however, we update the data to 2027 using the Office for Budget Responsibility's (OBR's) annual series of past and forecasted earnings growth from the October 2024 Economic and Fiscal Outlook (OBR,

2024). This results in scaling up each taxpayer's partnership profits by approximately 22%.

4. Who receives partnership income?

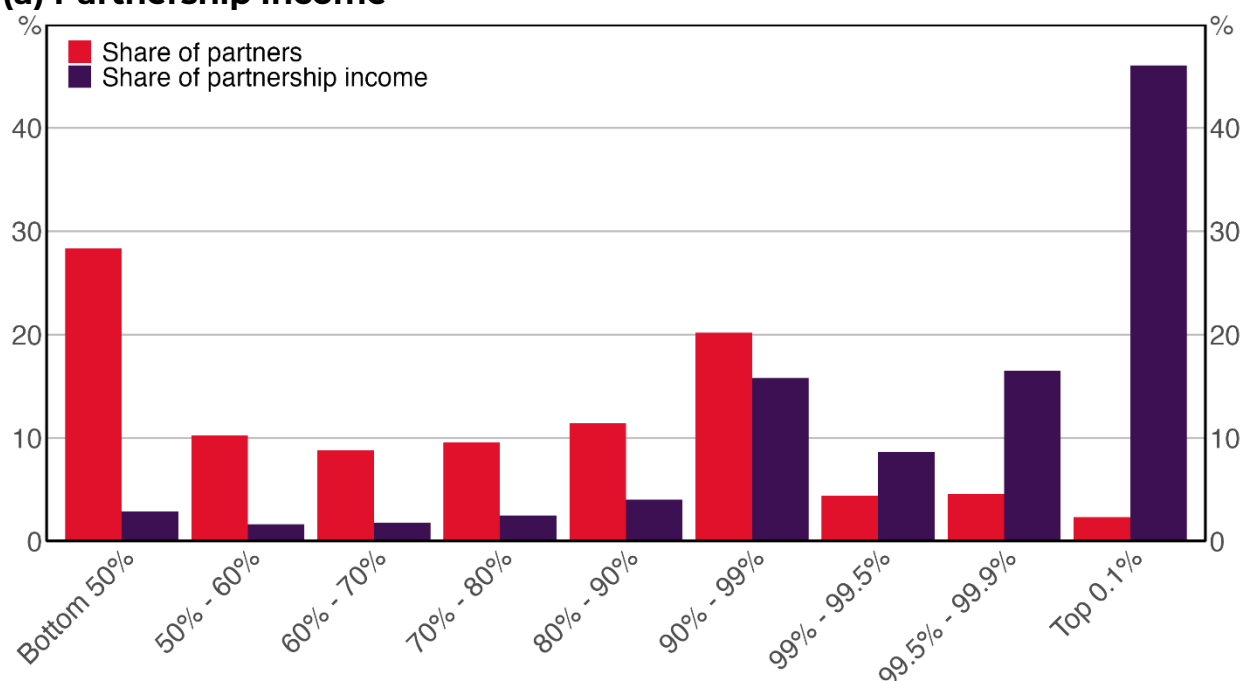
4.1 Income level

We begin by providing novel descriptive evidence on partnership income in the UK, looking first at how these profits are distributed along the income distribution. Figure 1a paints a striking picture of just how concentrated partnership income is: over 46% of all profits in 2020 were paid to individuals in the top 0.1% of the (overall) income distribution, despite this group accounting for only 2% of all partners. An additional 25% of partnership profits went to taxpayers in the next 0.9% of the distribution – bringing the share of partnership income going to individuals in the top 1% by total income to more than 70% – while 87% was received by the top decile. Although 28% of partners were in the bottom half of the income distribution (based on their total income), they received just 3% of all partnership income, which is almost 200 times less than the top 0.1% on a per-partner basis.

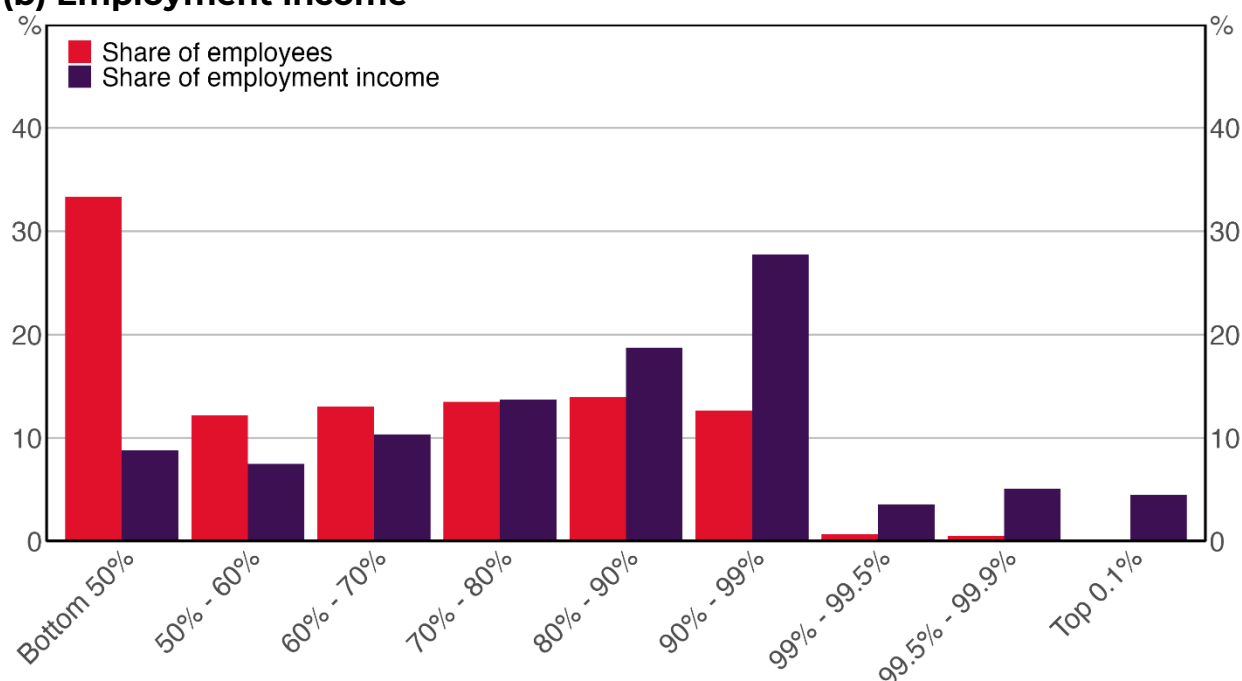
Comparing the distribution of partnership income to that of employment income provides a useful reference point. The share of employment income earned by taxpayers in the top 0.1% (by total income), for instance, was under 5% in 2020, or 10 times smaller than the corresponding share for partnership income. Employees in the top 1% and 10% of distribution of total income earned 13% and 41% of all employment income, respectively, while those in the bottom 50% earned 9%. Partnership income is significantly more skewed than employment income overall, highlighting that its favourable tax treatment in the current system overwhelmingly favours those with higher overall incomes.

Figure 1: Distributions of Partnership Income, Employment Income, and recipients by income group, 2020

(a) Partnership Income



(b) Employment Income



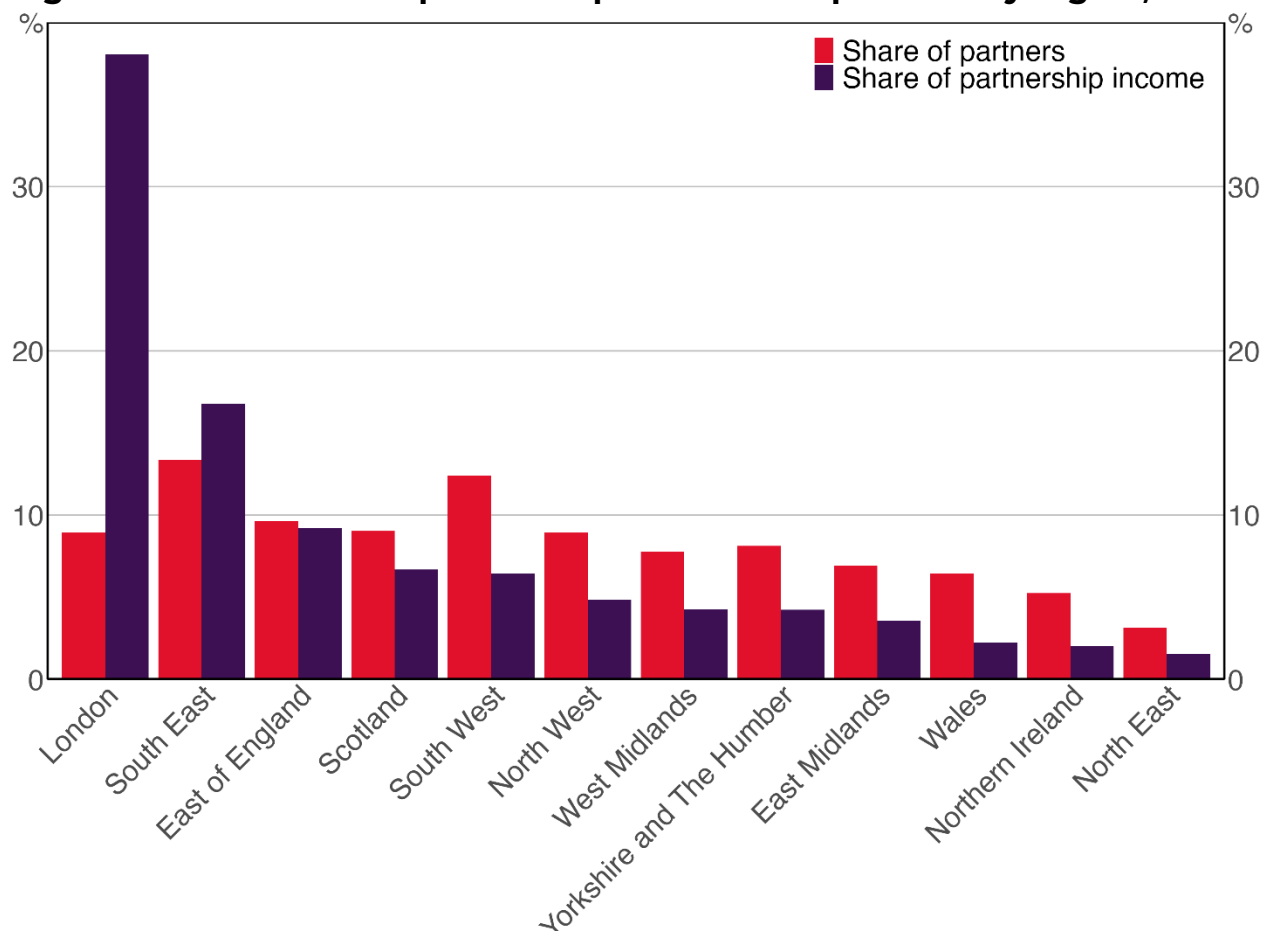
Notes: Panel (a) shows the share of partners and of partnership income across the distribution of total income. Panel (b) shows the share of employees and of employment income across the distribution of total income. Across the panel the number of observations are (a) N = 559,000, (b), N = 32,988,000.

Source: Authors' calculations based on HMRC administrative datasets.

4.2 Geography

A similar breakdown by geographic region shows that recipients of partnership income are highly concentrated in London (Figure 2). While the share of partners residing in the capital (9%) was lower than the city's share of the UK population (13%), Londoners received 38% of all partnership income in 2020. Given that the distribution of partners is relatively even across regions, this concentration implies sizeable geographic disparities in the amount of income received per partner. The South West, for instance, was home to almost 40% more partners than London yet received almost 85% less partnership income, amounting to an eightfold gap in income-per-partner. This ratio was even larger between London and Wales (12:1) and Northern Ireland (11:1). The South East is the only other UK region whose share of partners exceeded its share of partnership income received, yet mean income per partner was still three times lower than in London.

Figure 2: Distribution of partnership income and partners by region, 2020



Notes: Share of partners and of partnership income by region. Region defined by the International Territorial Level 1 (ITL1) subdivisions of the UK. N = 559,000.

Source: Authors' calculations based on HMRC administrative datasets.

Zooming in to the constituency level shows that these disparities exist even on a more local scale (Table 1). In 2020, just 1800 partners in Kensington received over £1.8 billion in partnership income, exceeding 5% of the national total and surpassing the profits of all 65,000 partners in Wales and Northern Ireland combined. Partnership income in Kensington was roughly 1200 times higher than in Liverpool Walton, the constituency with the lowest amount in the country (£1.5 million).

Even within London there are sizeable discrepancies between areas, with over 500 times more partnership income received by partners in Kensington than by those in Barking. More than a quarter of all UK partnership income went to taxpayers in just 12 constituencies, 11 of which are located in London. 50% of partnership income went to taxpayers in the top 10% of constituencies, while the bottom half of constituencies received just 13% of partnership income. Constituencies at the bottom of the distribution tend to be highly urbanised areas in the Midlands and the north of England (with the exception of Barking and Glasgow North East). This pattern can that be explained by considering the industries in which partners typically work, which we turn to next.

Table 1: Top 10 (left) and bottom 10 (right) constituencies by partnership income, 2020

Rank	Constituency	Total partnership income	Rank	Constituency	Total partnership income
1	Kensington	£1.8bn	1	Liverpool, Walton	£1.5m
2	Cities of London and Westminster	£1.2bn	2	Stoke-on-Trent Central	£2.8m
3	Hampstead and Kilburn	£1.1bn	3	Glasgow North East	£3.1m
4	Chelsea and Fulham	£1.1bn	4	Wolverhampton South East	£3.3m
5	Richmond Park	£0.6bn	5	Birmingham, Erdington	£3.4m
6	Wimbledon	£0.5bn	6	Nottingham North	£3.5m
7	Battersea	£0.5bn	7	Barking	£3.5m
8	Westminster North	£0.5bn	8	Sheffield, Brightside and Hillsborough	£3.6m
9	Esher and Walton	£0.4bn	9	Wolverhampton North East	£4.0m
10	Hornsey and Wood Green	£0.4bn	10	Preston	£4.0m

Notes: Parliamentary boundaries correspond to those in place in 2020, the tax year under consideration.

Source: Authors' calculations based on HMRC administrative datasets.

4.3 Industry

A key driver of the regional disparities observed in the preceding section is the geographic clustering of high-paying industries in the UK. Looking at the top 10 industries by aggregate partnership income shows that a significant share of these profits came from the UK's legal and financial sectors (Table 2), which are predominantly based in London and lead to a concentration of partners in the capital's affluent neighbourhoods. Solicitors alone receive one fifth (20%) of all partnership income, averaging over £300,000 in partnership profits annually.

While most industries in the top 10 had particularly high average partnership incomes (topping out at £675,000 per partner in some areas of finance), mixed farming stands out on this list due to its average profit level of just £16,000. As we discuss below, this low average income means that the majority of partners in this industry would be unaffected by the introduction of partnership NICs either because their incomes are below our proposed Partners' Exempt Amount of £5,000 or due to our proposed Partnership Allowance (see Section 5.4.2), which would act as a credit towards the first £10,500 of each partnership's NICs liability.

Table 2: Top 10 industries by partnership income, 2020

Rank	Industry	Total partnership income (share of all partnership income)	Income per partner (£)
1	Solicitors	£7.2bn (20%)	£316,000
2	Other activities auxiliary to financial services	£6.7bn (18%)	£675,000
3	General medical practice activities	£3.6bn (10%)	£118,000
4	Accounting, and auditing activities	£3.3bn (9%)	£246,000
5	Activities of patent and copyright agents; other legal activities	£1.6bn (4%)	£498,000
6	Mixed farming	£1.6bn (4%)	£16,000
7	Management consultancy activities	£1.0bn (3%)	£122,000
8	Fund management activities	£0.5bn (1%)	£609,000
9	Real estate agencies	£0.5bn (1%)	£98,000
10	Other engineering activities	£0.4bn (1%)	£98,000

Notes: Industry defined by 5-digit Standard Industrial Classification (SIC) code, as reported on partners' tax returns. If partners report inconsistent SIC codes for the same partnership, we take the modal SIC code within the partnership and assign this to all partners.

Source: Authors' calculations based on HMRC administrative datasets

The industry breakdown in Table 2 is also consistent with the concentration of deindustrialised, urban constituencies at the bottom of the ranking in Table 1 above, as these are areas with neither the high-paying professional service industries nor the agricultural activities that lead to geographic concentrations of partners.

5. Reforming the taxation of partnership income

5.1 The current tax break

Partnership profits are taxed on the individual partners on an arising basis.⁵ In other words, the partnership business is treated as 'transparent' for tax purposes, and the individual partners pay tax directly on their share of the partnership's profits. Specifically, partners are charged Income Tax at the standard rates of 20%, 40% or 45%, plus (for individuals above state pension age) Class 4 NICs at 6% on profits between £12,570 and £50,270 and 2% above that.⁶ This results in a marginal 'effective tax rate' of 47% (45% Income Tax plus 2% NICs) on partnership profits above £125,000. As we illustrate below, this rate is significantly lower than the effective rate paid by both employees *and* company owner-managers, resulting in a substantial 'tax break' for partners compared with other workers.

The Class 1 primary NICs ('Employee NICs') paid by employees on income up to £50,270 are 2 percentage points higher than the equivalent Class 4 NICs rate for partners (the rate is the same for income above this level). However, a much more significant advantage for partners compared with employees is that the partnership does not pay any equivalent of Employer NICs. Employers pay Employer NICs of 15p on top of every £1 of earnings paid to their employees, above £5,000 per employee (the 'Secondary Threshold') and an Employment Allowance of £10,500 per employer. Unlike Employee NICs, Employer NICs applies to all employees, including those above the state pension age.

Whilst Employer NICs are nominally paid by the employer, the cost is born to some extent by employees through lower wages. From a business perspective, for every £1 that the employer is willing to pay in total payroll cost, employees only receive 87p because the remainder (13p) is due in Employer NICs. By

⁵ Any investment income or capital gains arising to the partnership are also taxed at the partner level (in accordance with the partner's share of entitlement), with no taxation at the partnership level.

⁶ Technically NICs are charged on a weekly basis. For simplicity of presentation, we provide annualised equivalents.

contrast, there is no tax to pay at the partnership level on the income that partners receive, so for every £1 of profit that is 'paid' by the business to partners, the partners receive the full £1.

For top-earning partners, the lack of an equivalent to Employer NICs on partnerships results in an effective (marginal) tax break of 6.9pp on income above £125,000 (47% for partners versus 53.9% for employees). This is smaller than the headline rate of Employer NICs (15%) for two reasons. First, as above, the effective rate of Employer NICs is 13.04% rather than 15%, when expressed as a percentage of the employee's *gross* income (payroll cost). Second, Employer NICs reduce the *taxable* income on which Income Tax and Employee NICs is due, which mitigates their impact on the employee's overall effective rate. The absence of an equivalent charge for partnership income results in a larger effective (marginal) tax break for partners taxed at the Basic Rate and Higher Rate, of 9.6pp and 7.6pp respectively.

One might argue that this assessment of the 'tax break' received by partners compared with employees is not comparing like-with-like, because partnership profits are 'riskier' than an employee's salary. However, even leaving aside arguments about whether this element of risk can justify a lower tax rate (Miller, 2018), we note that the effective tax rates paid by top-earning partners are *also* lower than for than company owner-managers at equivalent levels of income. In other words, partners clearly benefit from a tax break even if other business owners – rather than employees – are thought to be the most relevant reference point.

The extent of the tax break for partners relative to company owner-managers depends on several factors. Unlike partners, company-owner managers face Corporation Tax on the profits of the business; they then pay Income Tax at the dividend rate when the net profits are distributed to them. Their effective tax rate therefore varies according to the rate of Corporation Tax paid on the profits and the tax band of the individual. Where Corporation Tax was paid at the main rate of 25%, and the owner-manager pays Income Tax on their dividends at the Additional Rate, their effective (marginal) tax rate is 54.5%, which is 7.5pp higher than for partners at the same level of income.⁷

Since they do not pay an equivalent to Employer NICs, partnerships also do not have an equivalent to the Employment Allowance. This allowance provides qualifying employers an annual credit of £10,500 against their total Employer

⁷ This assumes that Corporation Tax is fully economically incident on the owner-manager.

NICs liabilities.⁸ Together with the Secondary Threshold for Employer NICs (currently set at £5,000 per employee), this reduces the impact of Employer NICs on small employers and lower-earning employees. There are anti-avoidance rules to prevent employers from artificially splitting into multiple companies to multiply the benefit of the Employment Allowance, or from splitting employment contracts into several employments to multiply the benefit of the Secondary Threshold.

5.2 How did we get here?

The favourable NICs treatment of partnership profits has received relatively little attention for four reasons.

First, as partners are self-employed, it may seem natural that they are exempt from paying 'Employer' NICs. However, this is purely a naming convention and does not explain why the overall level of taxation should be lower for some forms of business than others.

Second, levying a tax on the partnership itself raises some administrative challenges given that partnerships are transparent and (generally) do not have their own 'legal personality'. However, we propose ways to overcome these obstacles below.⁹

Third, data on partnership profits are not broken out separately outside of administrative data. This means little has historically been known about who benefits, or the cost of the current relief.

Fourth, the tax advantage accorded to partnerships used to be smaller and came with more countervailing factors. Together this limited the significance of the disparity in terms of the revenue and distributional consequences.

Historically the tax advantage was lower because NICs rates were both lower than they are today and were capped at relatively modest levels. For example, in 1976 Employer NICs was only 8.5% and did not apply to earnings above £3,600 (equivalent to around £24,000 today) (IFS, 2021). This meant that the

⁸ Employers are unable to claim the Employment Allowance if their activities involve, wholly or mainly, the performance of 'functions which are of a public nature' (such as working for a council or services to the NHS). Limited companies are also ineligible for the allowance in cases where a company director is the only person paid above £5,000. Additionally, there are some restrictions on claiming the allowance in the case of persons employed by their family, and for NICs charged on work performed through a personal service company by the application of off-payroll working rules (NIC Act 2014, s. 2).

⁹ Adam and Loutzenhiser (2007) note that Canada solves this by simply charging self-employed individuals the equivalent to the combined employer and employee contribution to the Canada Pension Plan.

absolute tax advantage from the lack of an Employers NICs equivalent was at most £305 in savings, equivalent to around £2,000 today.

Lower NICs payments also historically came with a cost, since NICs also used to have a much stronger contributory principle. Originally, NICs were mandatory insurance payments that were overseen by the state but provided by private (non-profit) organisations, who administered health insurance for their members (Heller, 2008). Lower NICs for partners therefore came with a reduced entitlement to contributory benefits. The contributory principle has been gradually eroded since the publication of the Beveridge Report.¹⁰ As a result, there are currently only small differences in benefit entitlements for partners relative to other taxpayers, which cannot justify lower effective tax rates on partnership income.

Additionally, the NICs advantage from structuring a business as a partnership came with the inevitable drawback that the partners who managed the partnership ('general partners') faced unlimited liability for any debts of the business. This unlimited liability did not previously justify – and still does not justify – the difference in tax treatment. Nevertheless, it had the practical effect of dampening the appeal of partnerships as a way of structuring large businesses. The legal recognition of LLPs in 2001 removed this trade-off by offering a structure with the tax advantages of a partnership yet limited liability for all partners in the business. Unsurprisingly, LLPs have since become a popular business structure for certain types of large business, especially in the professional services industries.

5.3 The case for reform

The absence of any equivalent to Employer NICs on partnership profits gives rise to five key issues related to equity and/or efficiency in the current tax system.

5.3.1 Regressivity

First, it creates regressivity (vertical inequity), by giving a tax break whose benefits go largely to the well-off. As described in Section 3.2, partnership profits are very highly concentrated among individuals with high incomes. Within any partnership business that has both partners and employees, the partners are almost invariably the highest paid. The absence of some equivalent to Employer NICs is therefore regressive – both proportionally and in cash terms – relative to a neutral tax system. We quantify the distributional impacts of this in Section 7: the beneficiaries of the status quo are precisely those who lose from the reform we propose.

¹⁰ For details on the gradual erosion of the contributory principle see Adam and Loutzenhiser (2007).

5.3.2 Unfairness

Second, it creates horizontal inequity: individuals with otherwise similar pre-tax incomes are left with different incomes post-tax. Law firms provide the clearest example of this, since some are structured as companies and others as partnerships. A solicitor working as an employee of a company would have roughly £150,000 in net income if the business spent £300,000 employing them. The same solicitor working as a partner of a partnership and receiving the same £300,000 as partnership profits would instead have roughly £171,500 in net income. While there is disagreement about what level of progressivity a tax system should have, these arbitrary differences between otherwise similar people are more consistently perceived as unfair (Hvidberg, Kreiner, & Stantcheva, 2023).

5.3.3 Tax avoidance and complexity

Third, as well as being unfair, the fact that functionally similar work activities can lead to different tax treatment depending on whether they are done by a partner or an employee creates a strong incentive to reclassify individuals working within a partnership as partners to access more favourable tax treatment.

To avoid a loss of revenue, it has been necessary to develop anti-avoidance provisions to police this boundary. The effect is to make the system increasingly complex,¹¹ to create uncertainty for both the taxpayer and tax authority over how much tax is actually due,¹² to create substantial compliance and enforcement costs, and to still inevitably leave some avoidance. The pressure on these anti-avoidance rules would be significantly reduced (if not eliminated altogether) if the tax treatment of partners and employees were (more closely) aligned.

5.3.4 Economic inefficiency and growth

Fourth, the disparity in tax treatment of partnerships and companies creates inefficiencies that are damaging for growth. By advantaging partnerships over companies, the tax system will encourage some businesses to structure as

¹¹ See House of Common Treasury Committee, *Tax Simplification* (13 June 2023).

¹² Both CBI and CIOT have listed certainty as the first principle that should guide tax policy (see CBI, *Business Tax Roadmap*, 2024; and CIOT, *The principles of tax policy*, written evidence submitted to the Treasury Committee inquiry into the fundamental principles of tax policy, January 2011, available [here](#)). While we do not necessarily endorse the primacy of certainty over other principles, it is clearly an important principle.

partnerships when – in the absence of the tax implications – they would otherwise prefer to have a corporate structure.¹³

One cost of this favourable tax position is the choice to structure as a partnership despite the higher cost of investment. Since partnerships are tax transparent, any profits are taxed immediately in the hands of the partners. This means reinvestment must be made from post-tax income. By contrast, a company pays Corporation Tax on its profits, but it can retain and reinvest those profits within the company without triggering any further tax for shareholders until a distribution is made. As a result, corporate structures benefit from a form of tax deferral, meaning a lower effective cost of investment than for partnerships. However, lower personal tax rates for partners (relative to employees) incentivise an organisational form that makes investment more costly.¹⁴

A second effect on efficiency is through misallocation of labour. By having a lower post-tax cost of providing the same remuneration, partnerships can offer higher pay than non-partnerships which are otherwise similar. This can distort which businesses individuals choose to work in, and even which industries they work in, since professional services industries can use partnership structures more easily than investment-heavy manufacturing.

A third effect is on competition. While there is natural variation in productivity, the tax differential gives partnerships an advantage over companies even when they are no more productive. Advantaging businesses which are in some cases otherwise less productive further worsens the allocative efficiency of both labour and capital, creating a drag on growth. It also incentivises existing companies to move to the partnership form in order to remain competitive, exacerbating the investment concerns.

5.3.5 Revenue loss

As we describe in the next Section, there is also substantial tax revenue foregone by government from not applying an equivalent of Employer NICs to partnership profits. This implies that other taxes are currently higher than they

¹³ The clearest example of this comes from the introduction of the Limited Liability Partnership (LLP) as a new form of business structure in the early 2000s. A large number of large professional service firms switched to using an LLP instead of either a company or another types of partnership, because doing so provided limited liability and separate legal personality like a company plus the favourable tax treatment of partnerships.

¹⁴ Up until 2014 partnerships often used a corporate partner to reduce the tax on reinvested profits, although these strategies implied further costs to create and manage, so were typically not worthwhile for smaller partnerships, creating a barrier to their growth. These tax planning strategies have been largely closed by the introduction of the mixed partnership rules in FA2014, implying an increase in the effective cost of investment by partnerships.

would otherwise need to be in order for the Government to raise the same amount of revenue, which entail their own costs in terms of financial cost and behavioural response. This consequence is underappreciated because one cannot draw a clear line to which specific alternative taxes are being used to pay for the tax advantage to partners, but it is present nevertheless.

5.4 Our reform proposal

5.4.1 Partnership NICs

To remove the distortions created by the absence of Employer NICs on partnership profits, we propose the introduction of 'Partnership NICs'.¹⁵ These would be an equivalent to Employer NICs applicable to partners' profits, with Income Tax and Class 4 NICs applied to post-Partnership NICs profit. As noted in Section 5.1, this closes almost all of the tax advantage to partnership profits over employment income, retaining only the 2pp gap in NICs rates charged between £12,570 and £50,270. The latter gap is worth a maximum of 'only' £754 per partner per year.

5.4.2 Allowances

Employer NICs currently have two allowances, and to ensure neutrality we propose to mimic the effect of both in the implementation of Partnership NICs.

Partners' Exempt Amount

The first allowance under Employee NICs is the £5,000 Secondary Threshold per employee, below which no Employer NICs are payable. This operates on a per employer, rather than per individual, basis. Someone with two different part-time employments therefore receives the benefit of two Secondary Thresholds, one for each employment. Although we believe this is an undesirable feature of the NICs regime that should be changed to align with the current treatment of the personal allowance under Income Tax, wider recommendations on reform of NICs are beyond the scope of this report.

Our proposal carries over the current rules for the Secondary Threshold when applying Partnership NICs. We refer to this allowance as the Partners' Exempt Amount. Consistent with the current rules for Employer NICs, this would be set at £5,000 and would apply to every different partnership from which an

¹⁵ The effect would be to more closely align the tax rate on partnership profits with employment income, moving them away from alignment with income for owner-managers. A well-designed tax system would have a single effective rate schedule, so there would be no question of what to align with. The UK is far from this system at the moment, and so a choice is necessary.

individual receives trading income, but subject to equivalent anti-avoidance rules to the aggregation of earning rules for Employer NICs.¹⁶

Partnership Allowance

The second allowance under Employer NICs is the £10,500 Employment Allowance. This operates on a per employer basis, subject to anti-avoidance rules that deny the benefit of multiple allowances when an individual is employed by connected companies.¹⁷ Given the lack of any equivalent to Employer NICs for sole traders, this allowance generally ensures that there are no immediate additional NICs costs from moving to a multi-owner company.

To achieve an equal NICs treatment, our proposal also incorporates a £10,500 allowance available per partnership, which we refer to as the Partnership Allowance. The Partnership Allowance should also be subject to similar anti-avoidance rules to those applying to the Employment Allowance to prevent the artificial fragmentation of partnerships to multiply the benefit of the Partnership Allowance.

There is a question as to whether the Partnership Allowance should be in addition to the Employment Allowance for a partnership which also has employees, or an extension of the Employment Allowance to also cover Partnership NICs. As we explain in Section 6.1, although the latter is necessary for neutrality, we think feasibility constraints for administration would currently only allow the former, despite conferring significant tax advantage over corporate form for small partnerships.

5.4.3 Implementation

Charging an equivalent of Employer NICs to partnership income requires some administrative considerations due to the tax transparency of partnerships. Neither Partnership NICs nor the Partnership Allowance can be administered directly at the partnership level, so must instead be applied at the partner level.

We recommend applying Partnership NICs as a “top-up” rate on partners’ Income Tax payments. To calculate the appropriate rate, we first note that the 15% rate of Employer NICs is applied on a tax-exclusive basis. This means that the 15% is calculated on the employee’s salary, but does not (considerations of economic incidence aside) reduce their salary, as it is paid by the employer. On

¹⁶ Regulations 15(1)(a) & (2) of the Social Security Contributions Regulations 2001. The rules require employers to aggregate an employee’s earnings if they hold different employments with the same employer or ‘associated employers’.

¹⁷ National Insurance Contributions Act, Section 3 and Schedule 1.

a more familiar tax-inclusive basis, Employer NICs should therefore be thought of as levied at a rate of 13.04% on the grossed-up salary (i.e. $0.15/1.15$).

In practice, however, the Partnership NICs charge will reduce taxable profits and lead to less Income Tax and Class 4 NICs due. For every £1 paid in Partnership NICs at 13.04%, the taxpayer will “save” the tax that they otherwise would have paid on this amount.¹⁸ To administer Partnership NICs at the individual level – i.e. through the partner’s personal Income Tax calculation – the appropriate charge applied to gross partnership profits is therefore not 13.04% but 13.04% multiplied by the share of income currently retained after Income Tax and Class 4 NICs.

This calculation leads to an effective ‘top-up’ rate of 6.9% on partnership profits taxed at the additional rate, 7.6% for those taxed at the higher rate, and 9.6% for those taxed at the basic rate.¹⁹ The regressive structure of this schedule reflects the fact that a flat rate reduction in profits before Income Tax and Class 4 NICs is proportionally a smaller post-tax reduction for those paying higher rates, since their Income Tax and Class 4 NICs bill is reduced by a greater amount.

We also propose that partnerships allocate the Partnership Allowance to their partners directly. In practice, this would involve an additional box on the partnership’s tax return where the partnership allocates the £10,500 amongst its partners, capped at the amount of the Partnership NICs paid by each individual. This information would be provided to the partners alongside their allocation of taxable profits, and they would claim their share of the allowance on their personal tax return. HMRC would then only need to ensure that the combined amount of tax credit claimed by the partners within each partnership does not exceed £10,500.²⁰

¹⁸ In a similar way, Employer NICs reduce taxable profits for a company, so the effective cost to a company of Employer NICs for a company paying 25% Corporation Tax is 9.78% ($13.04 \times 75\%$).

¹⁹ The share of marginal income retained by an additional rate taxpayer is 53% ($1 - 45\% - 2\%$), giving the Partnership NICs rate of $13.04 \times 53\% = 6.9\%$; the share retained by a higher rate taxpayer is 58% ($1 - 45\% - 2\%$), giving a Partnership NICs rate of $13.04 \times 58\% = 7.6\%$; the share retained by a basic rate taxpayer is 74% ($1 - 20\% - 6\%$), giving a Partnership NICs rate of $13.04 \times 74\% = 9.6\%$.

²⁰ HMRC already needs to link partnerships and partners’ tax returns to ensure consistency between amount reported at the partnership and partner levels. For example, to ensure that all profits are attributed to the partners and included in their individual tax returns, and that losses are not over-claimed by partners. This also occurs with other tax credits, such as tax credits for foreign taxes paid on the partnership’s profits.

5.4.4 Impact

Unlike general increases in taxation, the behavioural consequences of responses to our proposed reform are largely positive. The reform would make operating a partnership less attractive relative to operating a company, and would limit the tax benefit from being a partner rather than an employee within a partnership. Both of these would improve allocative efficiency and enhance growth, through undoing the consequences described in Section 5.3.4. A neutral tax system would neither incentivise nor disincentivise particular ways of working or of organising a business, and our reform moves the system in that direction.

Any negative behavioural consequences of reform must be weighed against revenue neutral alternatives. Holding all else constant, increasing the overall level of taxation on partnership income would likely have some negative impacts on labour supply and/or investment by partners, although the magnitude of this is uncertain. But any evaluation of this effect cannot look at this in isolation. Instead the effect must be compared with the effects from any alternative reform, if revenue were otherwise raised elsewhere, or against the negative effect from not reducing another tax in a revenue neutral way.

6. Revenue estimates

6.1 Data and modelling approach

To produce revenue estimates for 2026-27, we uprate partnership profits in the 2020 data in line with the OBR's annual outturn and forecasted wage growth series from 2020 to 2027. We model baseline revenue under the current policy regime for 2027 by applying the Class 4 NICs rules outlined above to each taxpayers' aggregate (uprated) partnership profits. In the rare case where a partner also reports self-employment income, we account for the uprated amount in the aggregate base and scale down their Class 4 liability by the share of partnership income in this base, to approximate the contribution of partnership profits to their baseline Class 4 liability.

To model revenue under the reform scenario, we assume that the Class 1 NICs rules discussed previously will remain unchanged in 2027, namely that Employer NICs will be payable on employment income at a flat rate of 15% above the £5,000 Secondary Threshold (implying an equivalent rate of 13.04% on partnership profits above this amount). After netting off the Partners Exempt Amount (equivalent to Secondary Threshold), we apply this rate to the

updated profits from each individual source of partnership profits and aggregate the result at the individual level. We then deduct each partner's entitlement to the Partnership Allowance discussed below to determine their final Partnership NICs liability.²¹ Importantly, we then subtract the liability from partners' taxable incomes and model the subsequent reduction in Income Tax and Class 4 NICs, which we account for in our final revenue calculations.

We propose a Partnership Allowance modelled after the Employment Allowance currently available for Employer NICs, which provides firms with £10,500 of tax relief against their aggregate NICs bill. As partnerships with employees already benefit from the Employment Allowance, there is a policy question as to whether one should: 1) extend any part of their unused allowance to the Partnership NICs liabilities (with no benefit to the partners when the £10,500 is already used up), or 2) offer separate allowances to partners and employees, such that partnerships with employees receive two (non-transferable) allowances. While a neutral tax system would call for the former, it is our understanding that information linking employees of partnerships to the relevant partners is not currently collected by HMRC, limiting the feasibility of this approach in practice. Given this data limitation, we are also unable to discuss the distributional consequences of one option relative to the other.

Both for reasons of practicality and to avoid advocating for a policy that we are unable to adequately model, we recommend implementing a separate allowance for partners, although our stance may be different if the necessary data were collected and made available. In practice, we apply the allowance in proportion to a partner's share of total profits in their partnership. We note that having a separate allowance for partners has the effect of limiting the impact of our proposed reform for small partnerships, as a typical two-partner case would need to earn over £90,000 in profits (i.e. at least £45,000/person) before they are liable to pay any Partnership NICs.

6.2 Static revenue estimate

We estimate that applying Partnership NICs would raise £2.4 billion on a static basis for the 2027 tax year (Table 3). This number corresponds to £4.5 billion from directly applying an equivalent to Employer NICs, partially offset by a £2.1 billion reduction in Income Tax and Class 4 NICs receipts among those affected

²¹ While NICs on employment income are calculated each pay period, our modelling of Partnership NICs performs this calculation on an annual basis. This choice is due to data limitations, as we only observe a taxpayer's annual profits with no further breakdown over the course of the tax year. However, Class 4 NICs on partnership income are currently paid at the end of the tax year on the entirety of the partner's profits, so there is precedent for introducing Partnership NICs in this way.

Table 3: Static revenue estimates

1) Partnership NICs	2) Reduction in Income Tax	3) Reduction in Class 4 NICs	Total Revenue (1 + 2 + 3)
+ £4.5 billion	- £2.1 billion	- £0.1 billion	+ £2.4 billion

Source: Authors' calculations based on HMRC administrative datasets.

Notes: Numbers do not sum due to rounding.

by the reform. Our headline scenario accounts for the proposed £10,500 Partnership Allowance, which would cost an estimated £0.6 billion while implying that fewer than 200,000 of the roughly 457,000 partners with profits above the Partners' Exempt Amount are liable to pay Partnership NICs. This is because, as noted above, revenue will only come from taxpayers in partnerships with sufficiently high profits. Together, the Partners' Exempt Amount and Partnership Allowance ensure that 66% of current partners would have no additional tax due.

6.3 Accounting for behavioural response

6.3.1 Elasticity

In an ideal world, we would estimate the behavioural response for each potential margin separately and aggregate across responses to obtain an overall behavioural estimate. In doing so, we could identify the margins most relevant to the reform at hand and provide a clearer picture of exactly how different behaviours translate into lower revenue. This would allow a quantitative examination the trade-offs in policy design that affect the feasibility of some types of response. Unfortunately, the existing evidence base does not allow us to construct a credible set of “micro-elasticities” covering the relevant behavioural margins here, limiting the feasibility of this approach. We instead draw on the wealth of existing literature on the overall elasticity of taxable income (ETI) to inform our behavioural estimate.

The ETI aims to summarise all margins of behavioural response into a single parameter that captures how taxable income varies with a tax change. This includes both real responses as well as planning responses. The ETI has been estimated extensively by economists across different settings in recent decades and a consensus has emerged on a range of plausible ETIs for high earners. Saez, Slemrod, and Giertz (2012) note that the “best available estimates” of the ETI for high earners span from 0.12 to 0.40, and take the approximate midpoint of 0.25 for their work. Browne and Phillips (2017) estimate an ETI of between 0.1 and 0.2 for top income recipients in the UK, in

response to the introduction of the Additional Rate of Income Tax in 2010—contextually this is the most similar to our setting. In a recent paper, Kleven et al. (2025) study a reduction in Denmark’s top marginal income tax rate and estimate an ETI of 0.2 in the short-run, rising to 0.49 in the long run once accounting for job switching.

We provide post-behavioural estimates for a range of possible elasticities, from 0 to 0.5. The zero elasticity is merely for reference, since we think it highly unlikely that there is no response. The 0.5 elasticity, as an approximation of Kleven et al. (2025), is likely to overestimate the elasticity relevant within the Budget forecast window considered by the OBR.²²

The central elasticity estimate of 0.25 is higher than the labour supply elasticity of 0.125 used by the OBR in their costing for the October 2024 changes to Employer NICs. That these elasticities are different is not in itself surprising for at least two reasons. First, the population affected by our proposed Partnership NICs is systematically different to that affected by the previous change: partners have much higher incomes on average, and are largely focused on a relatively small number of industries.

Second, the ETI covers a broader range of possible responses than merely labour supply changes. Saez, Slemrod and Giertz (2012) find that for high-income taxpayers, “there is no compelling evidence” of labour supply responses. Instead, “in all cases, the response is either due to short-term retiming or income shifting.” Partners and partnerships are ordinarily very limited in their options for retiming. However, one consequence of losing the current tax advantage is that many partners may instead become employees, opening up standard routes for retiming, such as through pension contributions. Some partnerships will instead choose to structure as corporates, creating additional scope for deferral. For small partnerships, incorporation potentially also allows access to the lower tax rate on distributed profits where the profit was taxed at a lower rate than the Corporation Tax main rate. Since this advantage applies only to smaller partnerships, who (as we show in Section 7) contribute a relatively small share of the revenue, the impact of this is likely to be limited.

In addition to the elasticity, a key determinant of the behavioural response to a tax reform is the percent change in the retention rate, i.e. the share of income that one keeps after taxes. As described in Section 5.4, the introduction of Partnership NICs leads to an increase in marginal rates of 6.9-9.6pp, lower for

²² We are not asserting here any primacy for the forecast window. In general, policy should certainly be concerned with long run impacts even when they occur outside of this window. In this specific case, the wider economic impacts are likely to be positive relative to any revenue neutral counterfactual, as we discuss in Section 5.4.4.

those with higher current marginal rates. Across the population of affected partners, we estimate that the average retention rate would go from 58.6% to 53.5% on a static basis, i.e. a decline of 5.1 percentage points, or 8.7%.

We do not account for wider dynamic effects in our estimates. In Section 5.4.4 we highlight that such effects are likely to be positive relative to a revenue neutral counterfactual. In the absence of revenue neutrality, they would likely be negative, albeit less negative than alternatives because of the efficiency gains from removing distortions. Nevertheless, given the relatively small number of people affected by the reform, these effects would be modest whether the reform were revenue neutral or not, and therefore may not meet the OBR materiality condition for being included in dynamic scoring.

6.3.2 Results

We present our behavioural estimates for the range of plausible elasticities in Table 4 below. We assume that the reduction in taxable income in response to the reform corresponds to income that would have been taxed, on average, at a rate of $(1 - \text{retention rate})$, i.e. 46.5%.

Using the central elasticity from Saez, Slemrod and Giertz (2012), we estimate the proposed reform would raise £1.9 billion. This implies a reduction of 20% in revenue relative to the static costing. To give a sense of scale, it is roughly equivalent to increasing the higher rate of income tax from 40% to 41%, though the latter change would affect roughly 7 million individuals, rather than the 190,000 affected by the introduction of Partnership NICs.

Table 4: post-behavioural revenue estimates:

Elasticity	Revenue	% change from static estimates
0.0	£2.4bn	0%
0.1	£2.2bn	-8%
0.2	£2.0bn	-16%
0.25	£1.9bn	-20%
0.3	£1.8bn	-24%
0.4	£1.6bn	-32%
0.5	£1.5bn	-40%

Source: Authors' calculations based on HMRC administrative datasets.

7. Distributional effects

7.1 Modelling assumptions

Underlying our distributional analysis is the assumption that Partnership NICs would be fully borne by partners. In the case of payroll taxes on employers, there is some debate over the share which is incident on the employees (through lower wages) versus the share that is incident on the employer (through lower profits).²³ In the case of partnership profits this is more straightforward: since the partnership is transparent, there is no distinction between labour income paid to the partner and profit made by the business, so the cost will necessarily be passed through to the partners.

The distributional analysis is done assuming zero behavioural response, since there is no clear way to assign responses across the characteristics set out. To the extent that some individuals do respond, we also note that this response is not costless, and so we would anyway not want to entirely remove it from the distributional effect.

7.2 Income level

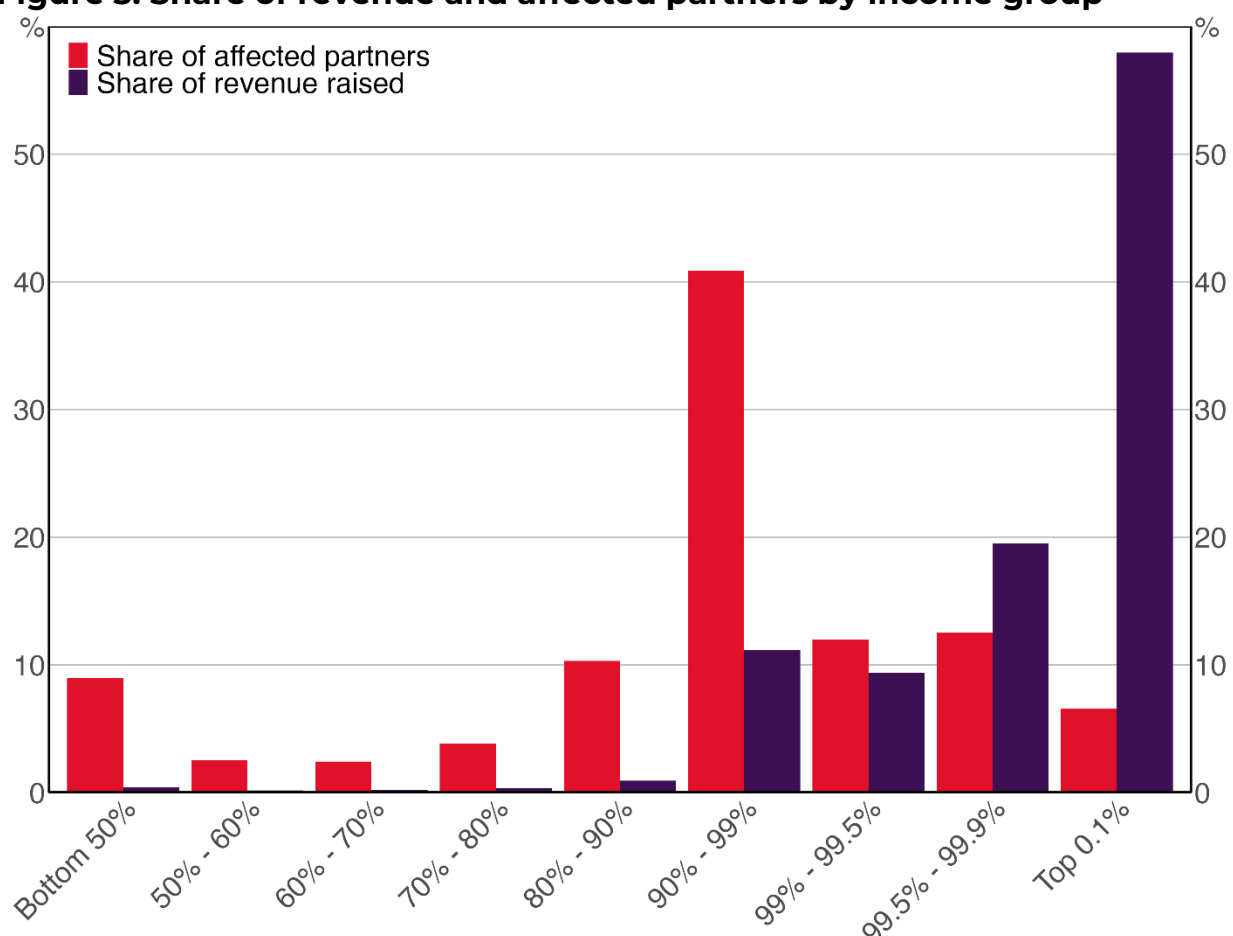
Revenue from the introduction of Partnership NICs is even more concentrated than partnership income (Figure 3). This is for two reasons. First, partners with profits below the Partners' Annual Exempt amount do not pay any Partnership NICs. Second, the Partnership Allowance removes over half of remaining partners from the reform's impact.

Almost all (98%) of the revenue from the proposed reform would come from individuals in the top decile by total income, with 58% from the top 0.1% alone. Together, partners in the top decile of total income would account for over 70% of all taxpayers affected by the reform.

On the other hand, those in the bottom 50% of the distribution of total income – who comprise nearly a 30% of all partners – make up just 9% of the affected population and would contribute less than 0.4% of total revenue. In some cases the inclusion of these partners comes because the other partners in their partnership have too low an income for the partnership to qualify for the Partnership Allowance: a plausible behavioural response would be for partnership profit to adjust to ensure the partnership qualifies for the allowance, further reducing the share of these low-income partners.

²³ In principle some of the incidence may also be on consumers if firms can pass through the costs into higher prices, but there is much less evidence on this. In industries where partnerships compete with non-partnerships, their ability to raise prices is likely to be limited.

Figure 3: Share of revenue and affected partners by income group



Notes: Share of affected partners and of revenue across the distribution of total income. N = 191,000.

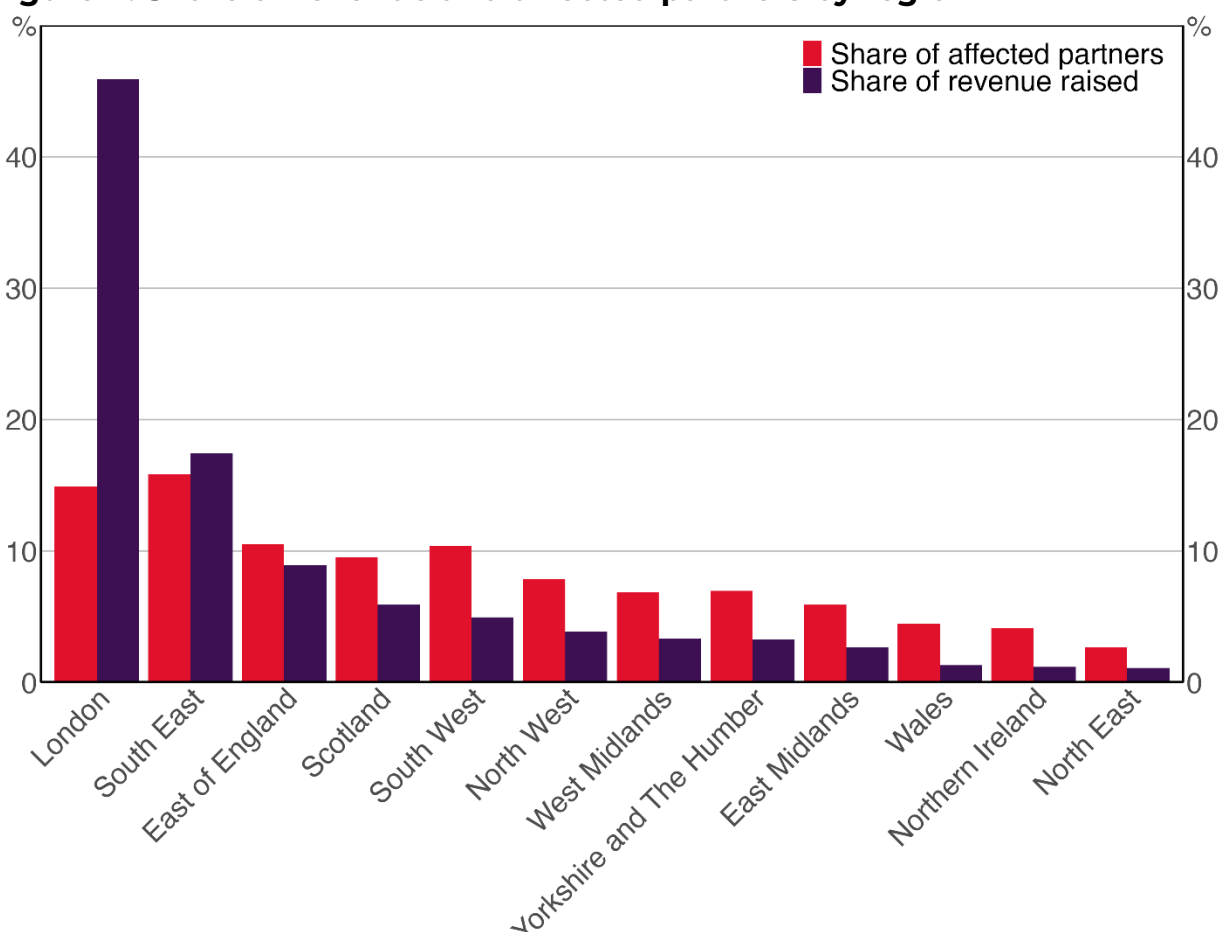
Source: Authors' calculations based on HMRC administrative datasets.

7.3 Geography

Given that average profits are far higher in London than in any other part of the UK, it follows that London's share of static revenues (46%) exceeds its share of partnership income under our proposed reform (Figure 4). Aside from London and the South East, all other UK regions have lower revenue shares than their respective shares of partnership income shown in Section 4.

Similar patterns can also be observed when looking at shares of taxpayers affected by the reform: London is strongly overrepresented relative to its population of partners, while the opposite is true for regions such as Wales and Northern Ireland. The damped effect of the reform in areas outside of London and the South East is driven by the Partnership Allowance for partners working in agriculture specifically, whose incomes tend to be low enough that they would not have any Partnership NICs to pay after the reform.

Figure 4: Share of revenue and affected partners by region



Note: Share of partners and of partnership income by region. Region defined by the International Territorial Level 1 (ITL1) subdivisions of the UK. N = 191,000.

Source: Authors' calculations based on HMRC administrative datasets.

7.4 Industry

As the revenue from the proposed reform is concentrated at the top of the income distribution, it is no surprise that the legal and financial sectors – which report the largest shares of partnership profits and have particularly high pay per-partner – are the industries that would be impacted most heavily. Solicitors alone, for instance, account for roughly 25% of static revenue, while 23% comes from partners working in other activities auxiliary to financial services (Table 5). Nearly all solicitors (95%) would incur Partnership NICs liability, reflecting the fact that most law firms operating as partnerships have total profits exceeding the Partnership Allowance and profit-share per partner exceeding the £5000 Partners Exempt Amount.

Table 5: Impact of reform by industry

Rank	Industry	Total revenue raised	Share of partners liable
1	Solicitors	£580m	95%
2	Other activities auxiliary to financial services	£550m	77%
3	Accounting, and auditing activities	£260m	78%
4	General medical practice activities	£250m	96%
5	Activities of patent and copyright agents; other legal activities	£130m	86%
6	Management consultancy activities	£80m	43%
7	Fund management activities	£40m	88%
8	Mixed farming	£40m	24%
9	Real estate agencies	£40m	59%
10	Other engineering activities	£30m	62%

Notes: Industry defined by 5-digit Standard Industrial Classification (SIC) code, as reported on partners' tax returns. If partners report inconsistent SIC codes for the same partnership, we take the modal SIC code within the partnership and assign this to all partners. Revenue figures rounded to nearest £10m. Industries ranked according to unrounded revenue figures.

Source: Authors' calculations based on HMRC administrative datasets

By contrast, although farmers account for 17% of all partners, only 2% of revenue (£40 million) comes from this group. The combined effect of the Partnership Allowance and Partners Exempt Amount means that over three quarters of farming partners (76%) would pay no additional tax as a result of the reform.²⁴ This is because partners would only pay any Partnership NICs if the partnership generated profits exceeding at least £90,000, and even then the tax would only be due on profits exceeding this amount.²⁵ We estimate that amongst all impacted farmers, the *average* tax increase would be £1600 per partner, but most would pay less than this.

96% of General Practitioners (GPs) working as partners would pay additional NICs as a result of the reform. As with solicitors, this reflects the fact that most GP partnerships have total profits exceeding the Partnership Allowance and profit-share per partner exceeding the £5000 Partners Exempt Amount. *If* the

²⁴ Some low-income farmers are affected in our modelling because they do not qualify for the Partnership Allowance, due to being the only partner in the partnership earning above the Partners' Exempt Amount. We estimate that an *additional* 8% of farming partners would be taken out of the reform's scope if the allowance were made available to these partners, bringing the share of impacted farmers to 16%.

²⁵ This threshold is higher for partnerships with more than two partners. For example, a partnership with four partners dividing their profits equal shares would need to have total profits exceeding £100,000 before paying any Partnership NICs.

Government wished to avoid reducing the net pay of GPs, then the approximately 10% of revenue that comes from this group could be ‘recycled’ back to GPs as an adjustment to their funding settlement. In that case, the net revenue from the reform would be reduced to approximately £1.7 billion. We take no position on this issue, or more generally on the use of any revenue raised.

8. Conclusion

Partnerships provide a flexible, lightly regulated structure which can sometimes be a more appropriate means to carry out business than a company. However, their prevalence comes not only from these legal/regulatory differences, but from the tax advantage they provide, particularly when a business has a large highly-paid workforce. Partnership profits are taxed as a form of self-employment income, meaning that they currently lack any equivalent of Employer NICs. This creates an effective marginal tax benefit of between 6.9pp and 9.6pp, depending on the current income tax rate of the recipient.

Since most UK data sources do not separately report partnership income, it has historically not been possible to quantify who receives partnership income, nor to understand the magnitude of the tax foregone. Using anonymised administrative tax data we find that partnership income is highly concentrated. Almost half (46%) goes to people in the top 0.1% (around 50,000 people) by total income. More than half (57%) goes to people in London and the South East, though less than a quarter of partners (23%) are based in these regions.

This tax advantage has only grown in recent years, as Employer NICs have risen. We highlight the costs of this in terms of (i) regressivity, (ii) unequal treatment of otherwise similar individuals, (iii) incentives to reclassify individuals working within a partnership as partners to reduce the tax owed, (iv) reduced economic efficiency and growth, and (v) revenue forgone.

We propose the introduction of ‘Partnership NICs’, which are applied as a tax on the profits of partners to account for the lack of Employer NICs. This entails a tax rate of between 9.6% and 6.9% applied to partnership profits, lower for partners with high marginal income tax rates. Alongside this we propose allowances at both the individual and partnership level, again mirroring the treatment of earnings for Employer NICs.

Our proposed reform would raise almost £2bn after accounting for behavioural responses. At present, this is revenue that is effectively being

funded by higher taxes on others. Put differently, for any given size of state, the choice not to levy Partnership NICs amounts to a choice to apply higher taxes elsewhere, with all the costs that entails. Considering the wider negative consequences of that choice for fairness and for growth, this seems hard to justify.

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