

Technical Note: **Equalising tax rates across different types of income**

This technical note sets out how much revenue could be raised by reforms equalising the taxation of different sources of income. Table 1 provides estimates of the revenue and where in the income distribution the money is raised from. Below we describe the set of reforms considered, a brief rationale for why such reform might be desirable, and explain how the reform is modelled. For reforms to capital gains and to the taxation of partnerships we account for behavioural responses, with complete details provided in the linked separate reports. In other cases we provide static estimates which give an upper bound on the revenue that could be raised.¹

Throughout the note, revenue estimates were produced using administrative data from His Majesty's Revenue and Customs (HMRC) for the 2019-20 tax year, updated to the 2026-27 tax year. We update earned income and investment income by the Office for Budget Responsibility's (OBR's) outturn/forecast series of annual earnings and non-earnings income growth, respectively, which were published in the OBR's October 2024 Economic and Fiscal Outlook. For Capital Gains Tax (CGT), we update our estimates using the OBR's outturn/forecast series for CGT revenues, which was published in the OBR's March 2025 Economic and Fiscal Outlook. In each case we then model the effect of reform as the difference between the currently planned tax system for the 2026-27 tax year (policy baseline), and the counterfactual policy we describe.

1. Partnership Income

Reform: Applying Class 1 Employer National Insurance Contributions (NICs) to partnership profits ([Advani, Gazmuri-Barker, Lonsdale and Summers, 2025](#)).

Rationale: Partnership profits are a form of earnings that currently face a lower rate of NICs than employment income, largely due to the lack of an equivalent Class 1 Employer NICs charge. This encourages the use of partnerships relative to corporate structures, damaging growth by limiting the ability to raise external investment and raising horizontal equity concerns.

Policy assumptions: Partnerships would pay an equivalent of Employer NICs (currently 15%) on the amount of partnership profit they pay out to each partner, would have the tax base of partnership profits reduced equivalently (implying

¹ For completeness we note that we do not consider reforms to the taxation of dividends, since the combined Corporation Tax and dividend rates of Income Tax are already close to the rates of Class 1 National Insurance Contributions and main rates of Income Tax. There is also some uncertainty about what Corporation Tax rate would be appropriate to use.

that the effective increase in marginal tax rate for additional tax rate payers is 6.9pp), and would also receive a partnership allowance equivalent to the £10,500 Class 1 NICs employment allowance. Partners would still pay NICs at the Class 4 (and Class 2, when applicable) rates.

Modelling: We apply the Class 1 Employer NICs² schedule for each source of partnership profits that a taxpayer reports, i.e. treating profits independently when an individual is in multiple partnerships. Since Employer NICs is paid by the employer on top of the employee's salary, the equivalent charge to levy on partnership profits is $0.15/1.15 = 13.04\%$ and we apply this rate above the Secondary Threshold. We also model a £10,500 partnership allowance (equivalent to the Class 1 NICs employment allowance) for qualifying partnerships³ and allocate this in proportion to a partner's share of total profits at the partnership level, before deducting the relevant amount from their Employer NICs liability. Employer NICs payments by the partnership will decrease partners' taxable profits by the amount of the charge, reducing the tax base both for Employee NICs and Income Tax. We account for this by netting off the Employer NICs liability from taxable profits before calculating Employee NICs and modelling the subsequent reduction in a taxpayer's Income Tax liability. To calculate revenue from the reform, we determine Class 2⁴ and Class 4 NICs due on partnership income under the current regime and deduct this amount from a taxpayer's Class 2 and Class 4 NICs liabilities in the reform scenario. We also net off their reduction in Income Tax due.

2. Self-employment Income

Reform: Applying Class 1 National Insurance Contributions to self-employment profits.

Rationale: Self-employment profits are a form of earnings that currently face a lower rate of NICs than employment income. This encourages self-employment for tax reasons when it may not be economically efficient and raises horizontal equity concerns.

² We use Employee and Employer NICs to refer to Class 1 primary and secondary NICs, respectively.

³ We only apply a partnership allowance in cases where at least one partner in the partnership reports profits above the Secondary Threshold (£5,000).

⁴ Payment of Class 2 National Insurance was abolished from 6 April 2024 for taxpayers with self-employment and partnership income above £12,570. Those earning below that were unaffected by the abolition as those earning more than £6,725 (but less than £12,570) were already exempt but benefitting from NI credit, and those earning below £6,725 can continue to make voluntary payments to build up entitlements towards their state pension. We assume that taxpayers falling below this threshold continue to pay, though this has a negligible impact on our results.

Policy assumptions: Self-employed individuals would pay an equivalent of Employer NICs (currently 15%) and would have the tax base of trading profits reduced equivalently, to provide parity with incorporating and receiving the profits as employment income. They would also pay NICs at the Class 1 primary rates.

Modelling: We observe total self-employment income at the taxpayer level and apply Employer NICs at a rate of 13.04% above the Secondary Threshold (see explanation in Section 1 above for the 13.04% rate). For symmetry with employment income, we reduce taxable self-employment income by this Employer NICs amount and apply Employee NICs and Income Tax on the new reduced base. For revenue, we determine Class 2 and Class 4 NICs due on self-employment income under the current regime and deduct this amount from a taxpayer's Class 1 Employee and Employer NICs liability in the reform scenario, accounting for the reduction of Income Tax.

3. Property Income

Reform: Applying an equivalent of Class 1 National Insurance Contributions to property income.

Rationale: National Insurance is effectively an additional tax, but only applies to income from work, creating horizontal inequity between different sources of income.

Policy assumptions: Property income would face a higher income tax rate which implicitly 'tops up' the rate to be equivalent to income from employment. This applies to all property income, independent of whether the recipient is over the state pension age.

We do not include any adjustment for reintroducing a mortgage interest deduction. The current tax base for rental property overtaxes some landlords by not allowing them to fully offset the cost of financing. As a matter of policy design, the appropriate solution is an allowance for the opportunity cost of borrowing, rather than the only the cost for those with an outstanding mortgage on the property. We account for this as part of our Capital Gains Tax design (Section 7). If such an allowance were not introduced as part of CGT reform, there is some case for including it as part of reform to property taxation,⁵ and if this were done it would reduce the revenue.

⁵ The case here is not obvious, as an allowance only against property supports investment in property over and above investment in other assets (which would not have this allowance). Hence our preference for an allowance across all asset classes.

Modelling: We observe property income at the individual level and “stack” it on top of earned income to determine which band(s) this income falls into for calculating the equivalent liability under Class 1 NICs. We then apply an income tax ‘top-up’ to equalise the tax liabilities. The calculation is done in three steps.⁶

First, we calculate the equivalent NICs rates when applied on a grossed-up basis (we refer to these as the tax inclusive NICs rates). The grossed-up basis reflects the fact that while Class 1 NICs are calculated on an Employer NICs-free basis (e.g. on the salary, not the salary plus Employer NICs), we are going to top up income tax rates on the full income from property. This means that the equivalent Employer NICs rate will be 13.04% (15/1.15) and the equivalent Employee NICs rates will be 6.96% (8/1.15) and 1.74% (2/1.15).

The second step is to multiply the tax-inclusive Employer NICs rate (13.04%) by one *minus* the marginal tax rate of each taxpayer. This is to account for the fact that Employer NICs reduce the taxable profits of employers, so we need to adjust the rates to achieve full equalisation. This means that for taxpayers below the personal allowance (but above the Secondary threshold of £5,000) the rate should remain at 13.04%, but for basic rate taxpayers the equivalent tax rate should be 10.43% (13.04*0.80). For higher rate taxpayers the rate should be 7.82% (13.04*0.60), and for additional rate taxpayers it should be 7.17% (13.04*0.55).

The last step is to calculate the equivalent to the combined NICs liability (based on the tax inclusive NICs rates previously calculated) on different levels of property income. This would be 0% if below the Secondary threshold (£5,000), 13.04% if between the Secondary threshold and the Primary threshold (£5,000 to £12,570), 17.39% (10.43% plus 6.96%) if between the Primary threshold and the Upper earnings limit (£12,571 to £50,270), 9.56% (7.82% plus 1.74%) if between the Upper earnings limit and the additional rate threshold (£50,270 to £125,140), and 8.91% above this (7.17% plus 1.74%). These are the top-up rates that we apply to income from property to equalise their tax liability with employment income.

4. **Savings Income**

Reform: Applying an equivalent of Class 1 National Insurance Contributions to savings income outside of an ISA.

Rationale: National Insurance is effectively an additional tax, but only applies to income from work, creating horizontal inequity between different sources of income.

⁶ Our modelling of this reform is static. We note that, to the extent that higher tax rate leads some landlords to leave the industry and sell to owner-occupiers, this reduces revenue raised.

Policy assumptions: Taxable savings income – i.e. excluding savings income within an ISA, or equivalent product – would face a higher income tax rate which implicitly ‘tops up’ the rate to be equivalent to income from employment. This applies to all savings income, independent of whether the recipient is over the state pension age.

Modelling: Our approach to savings income follows that of property income, though we “stack” savings income on top of earned income and property income when working out the amount of National Insurance due.

5. Other Investment Income (excluding dividends)

Reform: Applying an equivalent of Class 1 National Insurance Contributions to other non-dividend invest income. This income class comprises largely of life insurance income and income from trusts and complex financial instruments.

Rationale: National Insurance is effectively an additional tax, but only applies to income from work, creating horizontal inequity between different sources of income.

Policy assumptions: Other taxable investment income would face a higher income tax rate which implicitly ‘tops up’ the rate to be equivalent to income from employment. This applies independent of whether the recipient is over the state pension age.

Modelling: Our approach to other investment income follows that of property income and savings income, though we “stack” savings income on top of earned income, property income, and dividend income when working out the amount of National Insurance due.

6. Removing the NICs exemption for pension-age individuals

Reform: Applying Class 1 National Insurance Contributions to earnings for individuals who are over the state pension age, and therefore currently no longer liable to it.

Rationale: NICs are a form of tax on income, with payment not closely linked to any entitlements, removing the original rationale for exempting pension-age individuals.

Policy assumptions: Earned income (under the current tax base) would continue to have NICs applied to it when individuals pass the state pension age.

Modelling: We observe employment income, partnership income, and self-employment income as well as taxpayer age. We proceed by calculating Class 1 Employee NICs (for employees) and Class 2/4 NICs (for self-employed and

partners) under the status quo system for taxpayers above the state pension age. Revenue would be larger if this reform were combined with the reforms to National Insurance Contributions for partnership and self-employment income.

7. Capital Gains

Reform: Introduce an investment allowance for the ‘normal rate of return’, equalise the marginal rate on gains with the marginal rate on income, remove death uplift and apply rebasing on arrival and deemed disposal on departure ([Advani, Lonsdale and Summers, 2024](#)).

Rationale: The current CGT regime is needlessly complex, inefficient, and unfair, providing opportunities for tax avoidance while damaging investment and growth. Reforms to CGT *rates* announced at Budget 2024 will not fix these problems, although they change the revenue effects relative to previous work.

Policy assumptions: The CGT base on existing realisations would be reduced by an investment allowance equal to the ‘normal rate of return’ but gains in excess of this would be taxed at individuals’ marginal income tax rates. Accrued gains which currently are exempted because the asset is transferred at death would instead be carried over to the recipient of the asset, to be taxable when the recipient disposes of the asset. Accrued gains which are currently exempted because they are disposed of only once the holder leaves the UK would be taxable on departure if they exceed a threshold of £1 million, with easements for temporary emigrants (see [Advani, Poux and Summers, 2024](#)). Conversely, gains that were accrued when a taxpayer was not UK resident, and which are subsequently realised after arriving in the UK, would be exempt from taxation.

Modelling: The counterfactual tax regime is as described [Advani, Lonsdale and Summers \(2024\)](#). In this note we compute the difference between revenue under the counterfactual regime and under an updated policy baseline. The updated baseline accounts for reforms made in October 2024, which raised Capital Gains Tax rates on most asset categories. We have a representative sample of taxpayers disposing of assets in the 2019-2020 tax year at the asset level and apply the new rates to work out an individual’s (static) liability under the new regime. We combine this with our previous analysis of the counterfactual regime to work out revenue raised at the individual level. Our final estimate accounts for behavioural response following the same methodology outlined in [Advani, Lonsdale and Summers \(2024\)](#). Our original policy package included carried interest in the CGT base. From 2026-27, carried interest will be taxed under Income Tax, subject to a “multiplier” that reduces taxable profits by 27.5%. In light of this, we provide estimates with and without equalising taxes on carried interest.

Table 1: Revenue and distributional estimates of reform by tax base

	Total revenue	Share of revenue from									Analysis type
		Bottom 50%	50% - 60%	60% - 70%	70% - 80%	80% - 90%	90% - 99%	99% - 99.5%	99.5% - 99.9%	Top 0.1%	
Partnership Income	£1.9bn	0.40%	0.16%	0.19%	0.33%	0.92%	11.14%	9.38%	19.53%	57.94%	Behavioural
Self-employment income	£5.8bn	17.92%	10.69%	12.84%	16.25%	17.62%	15.60%	2.06%	3.30%	3.72%	Static
Property Income	£3.2bn	5.16%	6.54%	8.49%	12.46%	20.35%	36.59%	3.81%	4.30%	2.30%	Static
Savings Income	£0.6bn	3.79%	2.61%	4.32%	6.58%	11.36%	31.02%	6.43%	11.80%	22.09%	Static
Other Investment Income (excl. dividends)	£0.5bn	3.01%	2.60%	3.10%	5.95%	9.34%	28.61%	6.52%	13.54%	27.31%	Static
Removing the NICs exemption for pension age individuals	£3.0bn	3.90%	10.27%	13.40%	15.49%	19.39%	29.44%	2.97%	3.11%	2.04%	Static
Capital Gains (+ Carried interest)	£11.3bn (£11.8bn with carry)	3.93%	1.64%	1.46%	1.98%	4.99%	32.73%	11.75%	19.33%	22.19%	Behavioural

Note: This table reports estimated revenue from reforms to the tax treatment of different sources of remuneration, as set out above. 'Analysis type' reports whether the reform described accounts for behavioural responses or is a purely static estimate. In the latter case, the revenue estimates should be thought of as an upper bound, since responses to reform would reduce the revenue ultimately raised. Distributional estimates in the last row are for capital gains and carried interest combined.