

**Simplifying the National Insurance Processes for the Self Employed**  
**HM Revenue & Customs consultation**

**Response by the Low Incomes Tax Reform Group**

**1 Executive Summary**

- 1.1 We accept that collecting the Class 2 NIC **at the same time** as self assessment liabilities might reduce administration time for HM Revenue & Customs (HMRC) and also be simpler for some self employed taxpayers to manage.
- 1.2 But we do have major concerns that payment of Class 2 NIC in one instalment on 31 January after the year end will be difficult economically for some taxpayers, will potentially cause issues with claims for Universal Credit and will undoubtedly make claims for some other contributory benefits more troublesome.
- 1.3 Our recommendation is that the Class 2 NI be collected in one of two ways - either via the self assessment system in two instalments in January, in the year of assessment and 31 July, after the year of assessment or monthly as is the case now. This means that payments are made at broadly similar times to current payment dates.
- 1.4 We suggest that the thresholds for paying NI are aligned across Classes 1, 2 and 4.
- 1.5 Class 2 NI contributions are paid by many low income workers to protect their future benefits entitlement. On that basis, we cannot agree that the Small Earnings Exception (SEE) should become mandatory, nor can we agree that compulsory refunds of Class 2 NI be made.

- 1.6 We make suggestions at 4.10 below that we believe would both simplify the system and potentially improve the benefits position for current Class 2 contributors.

## **2 About LITRG**

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes.
- 2.2 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it - taxpayers, advisers and the authorities.

## **3 General Comments**

- 3.1 We are responding to this consultation with the specific interests of low-income workers in mind, many of whom may be unrepresented by agents. This group of workers may fall predominately into the category of workers described at point 1.6 in the Consultation Document, the very people who are likely to have more interactions with HMRC about their NIC as compared to other workers.
- 3.2 In principle we are in favour of simplifying our tax system, thus making it easier for low-income workers to make the best decisions for themselves.
- 3.3 The Consultation Document notes that some informal discussions have been held with self-employed workers resulting in the finding that the NI system is poorly understood. We would confirm that opinion and suggest that significant improvements are required to be made in notifying and educating taxpayers as to their rights and obligations as regards NICs. We would be willing to prepare documentation for this, if requested.
- 3.4 This lack of awareness is particularly acute with regard to Class 2 NI, where it appears that both the SEE and the prospective benefits available from paying those contributions are poorly understood.
- 3.5 It is disappointing to note that the current level of anticipated Class 2 debt equates to approximately three times the Class 2 NIC collected in 2012/13. HMRC appear to accept that much of this debt may not actually be due and it is even more disappointing that this Consultation Document makes no suggestion as to how the issue of ceasing self employment, claimed as one of the larger issues causing the discrepancy, may be addressed to make the figures more realistic in the future. Merely collecting the contributions in arrears will not affect the proportion of self employed people who fail to notify that self employment has ceased. Accordingly, as contributions are accrued until that notification is made, the debt figure will remain inflated.

- 3.6 We consider verifying the debt to be a very important point since Class 2 debts will shortly begin to be coded out, where possible. Establishing the correct level of debt is therefore crucial.
- 3.7 A number of Consultation Documents have been issued over summer 2013 that affect Class 2 NIC. We would request that any changes to the system are considered 'in the round' rather than on a piecemeal basis.

#### **4 Comments on Benefits**

##### **4.1 Universal Credit**

- 4.1.1 We note at point 4.12 of the Consultation Document that HMRC expect around 650,000 households with a self employed earner to receive Universal Credit. The Office for National Statistics showed there to be approximately 4 million self employed workers at June 2011, of whom approximately 1 million were part time workers. We understand that the figure may now be somewhat higher. Accordingly, based on the figures used in the Consultation Document, there is an expectation that 16% of self employed workers will claim Universal Credit. That is a very large proportion and any system needs to take care that the needs of this group are met, both in terms of enabling them easily to make payments and access benefits, where relevant.
- 4.1.2 Universal Credit requires self employed earners to report actual income/expenses on a monthly basis. The effect of the proposal in the Consultation Document would be to include additional costs in January each year.
- 4.1.3 Such a scheme does not work well for low income workers who may struggle to pay a large bill at one time, particularly so soon after Christmas.
- 4.1.4 In addition, it is possible that, particularly for workers with low profits in certain months of the year, this will interfere with the Minimum Income Floor, potentially creating 'losses' for Universal Credit that cannot be carried forward against future income and so prejudice the overall benefits payable to the person. This group of workers may well include many people setting out in self employment as well as those in trades that suffer a post-Christmas lull, for example construction trades.
- 4.1.5 We note that if their self assessment form were lodged early, taxpayers could start making payments towards their final liability. That is quite different from the current system, where payments may be taken by monthly direct debit, in that the taxpayer would be required to take action to physically make voluntary payment. We understand approximately 1.4 million self employed people currently pay their Class 2 NI by monthly direct debit. By our reckoning that means approximately £180M is collected in this way annually or somewhat over 50% of the Class 2 NI that is currently being collected.
- 4.1.6 While we have no further analysis of this figure, it seems likely that those individuals who might struggle to pay in two larger instalments have deliberately chosen to pay monthly. Removing that facility would be a backward step, especially as benefits are to be paid and calculated on a monthly basis. Indeed it is possible that with the advent of Universal Credit more people may choose to start paying bills monthly, including Class 2 NIC and also possibly their self assessment liabilities.

## 4.2 Entitlement to Other Benefits

- 4.2.1 We note that ESA operates on a 'benefit year', that is (almost) a calendar year basis. In order to be able to claim benefit, the individual has to have paid sufficient Class 2 contributions in the previous two tax years. It is suggested that to maintain this position, workers could pay their Class 2 early. Bearing in mind the proposal that the full amount of Class 2 be paid in a lump sum and that these individuals now find themselves claiming benefits just after Christmas, we do not think that is a practical solution. It is much more complex than the current situation.
- 4.2.2 There seem to us to be two other possible solutions: either realign the benefit year to 31 January or collect the Class 2 NI earlier. We would suggest that the full amount of NI is collected by 31 July following the year end by two instalments – one in the tax year and the other after the end of the tax year for those taxpayers who currently pay in two instalments, with those paying monthly remaining on the same basis as now.
- 4.2.3 Maternity allowance is based on having made sufficient contributions in the 66 weeks up to and including the week the baby is due. Although this allowance is paid to only a very small proportion of the self employed workforce, it is an essential benefit for those who claim it. We note the intention that this group should not be disadvantaged and would welcome the opportunity for further discussion on this point. Again we note that if the Class 2 NI were collected by 31 July following the end of the tax year, there would be little difference from the current system.
- 4.2.4 State pension entitlement would again be unchanged from the current position if all Class 2 NI were collected by 31 July after the tax year end.

### Responses to the Particular Questions raised

#### 4.3 ***Q1a Overall would collecting Class 2 NICs through the Self Assessment system be simpler?***

- 4.3.1 We can see that this would be much simpler for HMRC. But for low income workers, being forced to pay in lump sums is unhelpful. This is particularly the case because it is suggested it be collected at the same time as income tax and Class 4 NI, directly after Christmas.

#### 4.4 ***Q1b What benefits do you think this could bring to customers?***

- 4.4.1 For self employed workers who fall in and out of self employment/employment, this might remove some administration from them.
- 4.4.2 For HMRC, the SA form would have to be designed to capture the number of weeks in a year that the taxpayer was self employed. The comment at 3.5 of the Consultation Document that only start and finish dates would be needed is incorrect. As well as people moving in and out of employment, benefits may have been claimed during the period under review that would provide credits for some contributions. A system will be required to monitor these cases. It would be contrary to self assessment for HMRC to rely on an internal feed to confirm the number of weeks for which Class 2 NIC was due. Self assessment relies on the taxpayer being able to calculate their own liability: having the Class 2 liability outside this system would add unnecessary complexity.

4.4.3 Further, at 2.9 – 2.12 in the Consultation Document issues arising with deferment are discussed. Again we accept this topic is poorly understood. The changes being proposed here will have no effect on deferment unless the SA return is redesigned to capture all NI payments. We are also unclear as to how often overpayments of NI are refunded to individuals without a request being made. We would suggest that deferment is another area where more education/publicity might benefit both taxpayers and HMRC.

4.5 ***Q1c Do you see any drawbacks?***

4.5.1 The timing of the payment is an obvious disadvantage. Also, as noted above, because Class 2 payments are currently discrete from other payments, it is clear whether any payment is for NIC or for taxation, for example. Should arrears build up, disputes may arise as to which liability has been paid and which is outstanding. A clear policy on allocation of payments would be required. As Class 2 NI is currently paid earlier than self assessment liabilities, we would suggest that any payments made should be allocated first against Class 2 NI.

4.5.2 Removing the facility to pay monthly could be seriously detrimental to low income workers and we strongly recommend that facility is retained alongside any changes.

4.6 ***Q2 What do you consider will be the transitional challenges of moving from the current system to collecting Class 2 NICs through the SA system?***

4.6.1 The Consultation Document recognises that payment of Class 2 NI, the benefits associated with that payment, SEE and deferment are all poorly understood at the moment. One of the biggest challenges arising from any change will be the education of the self employed. Many self employed people do not have representation by a tax adviser/accountant so they will require clear information and active promotion of any new system.

4.6.2 This depends on the payment dates that are agreed. The proposal to move collection of all the Class 2 NIC until ten months after the end of the tax year will mean significant reductions in collection of NIC for a period. It also introduces some complexities in the claim for other benefits.

4.6.3 We also note the intention to change the interest/penalty regime for Class 2 NICs and trust this will be subject to full consultation in due course, particularly given the current high level of debt that is considered to be unsubstantiated.

4.6.4 The timetable for further consultation appears to be quite rushed: we trust that full consideration will be given to the responses to this consultation before the next round takes place (possibly later this year).

4.7 ***Q3 Would complete abolition of the SEE process and removing liability to pay Class 2 NICs from people who have profits below the SEE limit be simpler than the current system? What benefits could this bring and do you see any drawbacks?***

4.7.1 We accept that the SEE is poorly understood and also sympathise with taxpayers who might believe that if their profits were below £5,725, no payments of Class 2 would actually be necessary. Rather

than abandon a system, perhaps a one page leaflet made available to all self employed people at registration would fill this 'education gap'.

- 4.7.2 We note that 60% of individuals paying Class 2 NI with profits below the SEE limit also have earnings from employment that are above the lower earnings limit (and so are credited or pay Class 1 NI). Nevertheless this leaves 40% of those in this category choosing to pay Class 2 NI and securing benefits by doing so. This is a very sizeable minority.
- 4.7.3 We accept that removing the SEE process entirely would benefit HMRC significantly, by removing a great deal of administration. But some self-employed earners with profits below the SEE (for example a considerable number of foster carers and shared lives carers) will want to secure their entitlement to benefits by paying Class 2 contributions and the facility for them to do so voluntarily must remain. This facility would be removed if the SEE were removed and automatic refund of Class 2 NI resulted.
- 4.7.4 In order to make this process as simple as possible, we consider it may make sense to remove the time-apportionment method for determining eligibility for SEE. If the lower earnings limit for paying Class 2 NI were aligned with the primary threshold, as suggested below, this removal would cause much less penalty.
- 4.7.5 We propose that where Class 2 NIC continues to be collected in two instalments that these are in January in the year of assessment and July following the year of assessment but we consider it crucial that for low income taxpayers the facility to make monthly payments remains.
- 4.8 ***Q4 Would aligning the liability to pay Class 2 with the liability to pay Class 4 NICs be a simpler system for the majority of self-employed individuals? What benefits could this bring and do you see any drawbacks?***
- 4.8.1 There are three related points here that we respond to separately below.
- 4.8.2 First, we would be in favour of changing the threshold when Class 2 becomes payable to mirror that used for Class 4 and the primary threshold for Class 1 NICs, but conditional upon the understanding that Class 2 NICs are credited to Class 2 earners who earn between the lower earnings limit and the primary threshold.
- 4.8.3 Second, while we can see significant benefits for HMRC in aligning the payment dates for Class 2 and Class 4 NICs through the SA system, we have severe reservations about 'lumping' all the Class 2 contributions into a single payment to be made just after Christmas. Apart from the effect on Universal Credit, discussed above, we suggest that this is an insensitive time to ask low paid workers for additional cash.
- 4.8.4 Finally, we would be in favour of defining liability for Class 2 and Class 4 NI in the same way.
- 4.9 ***Q5 What groups might be excluded from paying Class 2 NICs if liability to pay Class 2 NICs aligned with the current Class 4 rules?***
- 4.9.1 We consider aligning rules in this way might exclude foster carers and shared lives carers, for example, as well as those identified in the Consultation Document.

- 4.9.2 We note the intention to continue with special rules for share fishermen, mariners and marine development workers, for example. Any added complexity is undesirable.
- 4.10 ***Q6 Do you have other ideas that might deliver further simplification for the collection of NICs from the self-employed?***
- 4.10.1 If the rules for liability for Classes 2 and 4 NICs are aligned, we would suggest that at some point Class 2 should be subsumed into Class 4, albeit we would anticipate further consultation on any such new rules.
- 4.10.2 We suggest you might consider the option we raised at point 3.8.2 above, that is aligning the threshold for payment of Class 2 NI with that of Class 4 NI, but allowing credit for Class 2 NI between the lower earnings limit and primary threshold. This might be paid for by a small increase to Class 4 NI.
- 4.10.3 Another suggestion might be to align the benefits that might be claimed as a result of payment of Class 2 and 4 NI contributions with those that may be claimed by payment of Class 1 NI contributions. Again this potential increase in benefits might be paid for by a small increase in the rate of Class 4 NI.
- 4.11 ***Q7 Are there any direct or indirect equality impacts from any of the changes discussed in this document?***
- 4.11.1 The Consultation Document has identified the need to protect pregnant taxpayers.
- 4.11.2 It does seem that the proposal to collect all payments in January would discriminate against any low earning taxpayers.
- 4.11.3 We understand that the proportion of people with disabilities who are self employed is significantly higher than that of the population as a whole. Accordingly, their interests require to be protected. Any failure to do so could lead to a challenge under equality legislation or human rights law.
- 4.12 ***Q8 Do you have any comments or suggestions on the indicative impacts identified in the table of impacts?***

No.

LITRG

9 October 2013