Self-employed earners, etc: restructuring of contributions
Consultation on draft clauses for Finance Bill 2017
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 We welcome the opportunity to comment on the draft clauses in relation to the abolition of Class 2 National Insurance (NI) contributions. LITRG previously responded[1] to the consultation on 'The Abolition of Class 2 National Insurance: Introducing a benefit test into Class 4 National Insurance for the self-employed'.

1.2 While we welcome simplification of the NI processes for the self-employed, we remain deeply concerned that those on the lowest incomes may find that funding voluntary Class 3 NI contributions is completely beyond their reach, causing them to require means-tested state support in the future instead of support to which they have contributed. The cost of Class 3 NI contributions is around five times that of Class 2 contributions – that is a very significant increase for those on the lowest incomes who were, up to now, prepared to pay voluntarily towards the cost of future state benefits. Furthermore, and crucially these people are the least likely to be able to afford professional tax advice.

1.3 We strongly recommend that a lower rate of Class 3 contribution be introduced so that self-employed earners with profits below the small profits limit can continue to build up a contributions record at low cost. In addition, straightforward guidance must be provided to help them understand the consequences of choices they make now in relation to payment of NI contributions.

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[1] http://www.litrg.org.uk/sites/default/files/files/160222-LITRG-response-Class-4-NI-benefits-FINAL.pdf

CHARTERED INSTITUTE OF TAXATION
1st Floor, Artillery House, 11-19 Artillery Row,
London, SW1P 1RT

Tel: +44 (0)20 7340 0550
Fax: +44 (0)20 7340 0559
E-mail: litrg@ciot.org.uk
www.litrg.org.uk

1.4 Communication of these changes will be very important and must be available in a range of media, not solely digital. Clear and detailed guidance will be required especially in explaining how Class 3 NI contributions can be made and understanding the new state pension contributions rules.

1.5 We are very pleased that the start date has been delayed to 6 April 2018 from the date originally proposed of 6 April 2017. Nevertheless, we remain concerned that the timeframe is far too short to provide adequate communication of such a wholesale change to the way welfare benefits for self-employed people are funded by their NI contributions. This communication is all the more crucial since many self-employed people are already confused about changes to the way that Class 2 NI contributions are paid.[2]

1.6 The government's response[3] to the consultation regarding these proposals states that 'The Foster Carers National Insurance credit currently provides foster carers with access to the state pension. The government will upgrade this to a Class 1 credit, which provides access to contributory JobSeeker's Allowance and Employment and Support Allowance.' Our understanding was that shared lives carers and some other carers are also entitled to the carers credit. We look forward to confirmation that these other groups will similarly see their credit upgraded to a Class 1 credit.

1.7 We have huge concerns about how payment of voluntary Class 3 contributions may interact with claims for universal credit and recommend this be clarified quickly.

1.8 It is not at all clear how or when any Class 3 NI contributions payable by an expectant mother might be offset against her Class 4 NI liability. It is important that the regulations relating to this are issued quickly, enabling proper consultation.

1.9 Clause 10 provides some transitional relief to self-employed earners who claim contributory Employment and Support Allowance (ESA). We remain concerned, though, that if the correct communications are not put in place, few people will be aware of this protection and understand their entitlement.

2 About Us

2.1 The 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

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[2] From the tax year 2015/16, Class 2 NI contributions are payable on 31 January following the end of the relevant year of assessment rather than earlier and on a more frequent (often monthly) basis as was previously the case.

[3] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/573606/abolishing_class_2_NICs_response_web.pdf; page 4

the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 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 welcome simplification of the NI processes for the self-employed. In particular, we welcome the introduction of NI credits, placing low-income self-employed people on the same footing as low-income employed earners.

3.2 It would be helpful for the proposed rates of Class 3 and Class 4 NI to be published as soon as possible so that self-employed taxpayers on low incomes can plan their financial affairs.

3.3 We remain deeply concerned that self-employed earners with profits below the small profits limit, who can currently opt to secure a contributions record by paying Class 2 contributions at £2.85 a week, will in future be required to pay Class 3 contributions to secure the same benefits. At £14.10 a week the cost to them will increase fivefold. That is a significant increase for those on the lowest incomes who are currently prepared to pay voluntarily towards the cost of future state benefits. These people are the least likely to be able to afford professional tax advice.

3.4 In order to maintain the existing cost of access to contributory benefits for self-employed earners on very low incomes, we recommend that a lower rate of Class 3 contributions be introduced at a rate similar to the outgoing Class 2, payable voluntarily by earners (whether employed or self-employed) with earnings below the lower earnings limit (if employed) or small profits threshold (if self-employed). That would reduce the risk of those earners being dependent on means-tested benefits in retirement if they were unable to build up entitlement to the state retirement pension because of the vastly increased cost of making their own contributions after April 2018.

3.5 Liability to Class 4 NI will operate on a tax year basis rather than a week-by-week basis. This means that someone who is self-employed for only part of a tax year may find themselves earning enough on an annualised basis to reach the small profits limit, and so obtain Class 4 credits, but have insufficient profits for the actual period of self-employment falling in the tax year. As these Class 4 credits provide access to several state benefits we recommend that credits are available for both the first and last year of self-employment if profits are sufficient on a pro-rated annualised basis.

3.6 We are pleased that the government has recognised that a simple, affordable system must be put in place to enable self-employed women to claim the higher rate of maternity allowance. While the cost of paying for such entitlement has increased slightly from the current position for those on the lowest incomes,[4] we recognise that these proposals still provide some financial security for the expectant mother. Communication of these proposals is essential, well in advance of the changes being introduced, so that women understand the system.

3.7 Special communications must be sent to those who currently pay special rates of Class 2 NI so that they understand the changes being made. Share fishermen, in particular, may need further guidance in relation to the availability of universal credit if they are unable to work.

3.8 We are unsure as to how the payment of voluntary NI contributions interacts with the operation of the Minimum Income Floor (MIF) for universal credit purposes. Our understanding is that the MIF takes account of notional NI – but on what basis is that notional figure calculated? This may be of particular relevance to a pregnant lady who is required to pay voluntary Class 3 contributions to receive maternity benefits at the higher rate but whose income may have fallen so that she is subject to MIF.

3.9 We are aware that certain people resident overseas are eligible to pay Class 2 NI contributions to secure a UK state pension. For those individuals the cost of Class 3 NI contributions will be considerably higher than the Class 2 NI they pay at present. While we appreciate that social security agreements are negotiated on a country-by-country basis, it seems anomalous that for some individuals the level of their state pension is fixed at the time that it is first paid with no subsequent increase, while others benefit from the 'normal' increase. With the increased international mobility of individuals and the increased costs of purchasing such benefits, we think this is something to be reconsidered when such social security agreements are being negotiated.

4 Comments on draft legislation

4.1 Where two sets of provisions have been presented, one for GB and one for Northern Ireland, we have restricted our comments to the former.

[4] Should the woman earn sufficient profits that she pays Class 4 NI, then the cost of the contributions she makes will be set against that Class 4 liability meaning that there is no net cost to her.

4.2 ***Clause 1 Abolition of Class 2 contributions etc***

4.2.1 Draft clause 1(4) should read "….Class 2 contributions for **2017-18** or any earlier tax year", rather than "…..Class 2 contributions for 201718 or any earlier tax year".

4.3 ***Clause 2 Late paid Class 2 contributions***

4.3.1 We are unclear as to the rate that such late paid contributions will be required to be paid.

4.4 ***Clause 3 Class 4 contributions: small profits limit: Great Britain***

4.4.1 We note that relevant profits is as defined in S15 SSBCA 1992. Broadly that is the taxable profits for the trade or profession for the relevant year. We assume, but would like it clarified, that it is the profit after any loss relief has been given. This could mean that an individual might lose the benefit of Class 4 NI credits for two years where a loss is made in one year. For example, if Mr A incurred a loss for 2019/20, he would receive no Class 4 NI credits for that year. If he now makes a small profit for 2020/21 it would entitle him to Class 4 NI credits; the carried forward loss might remove that eligibility to credits.

4.5 ***Clause 5 Class 3 contributions: Great Britain***

4.5.1 In subsection 3(a)(ii) replace 201718 with **2017-18**.

4.6 ***Clause 7 Maternity allowance***

4.6.1 We note that the self-employed woman must be 'engaged in employment as a self-employed earner' at the time of claim or before the time of the claim. We seek assurance that shared lives carers would satisfy this condition.

4.6.2 In subsection 4 (1D) replace selfemployed with self-employed.

4.6.3 In subsection 13, we note that the new rules will take effect from claims intimated from 29 April 2018. It would be easier for people to understand if that date coincided with the start of the tax year (6 April).

4.7 ***Clause 9 Employment and Support Allowance***

4.7.1 New subparagraph 2C requires that where the claimant is relying on credits for their Class 4 NI contributions they need to file the relevant tax return by the due date. We suggest some discretion needs to be available here – the fact that the individual is claiming ESA implies that they may require support and may be unable to deal with their tax affairs.

4.7.2 New subparagraph 4 confirms that the employed earner need only have earned 50 times the lower earnings limit whereas the self-employed earner has to earn 52 times the lower earnings limit in order to obtain Class 4 NI credits that would provide them with the same benefit entitlement. We consider this to be unfair.

LITRG
30 January 2017