National Insurance credits and the single-tier pension

Summary

1. The National Insurance (NI) crediting system in the UK is comprehensive. It is a contributing factor in the progress towards having an equal proportion of women and men qualifying for a full basic State Pension; this is expected to happen in 2020[1].

2. However, the NI crediting system is highly complicated and there is a low level of awareness about some credits and eligibility for them is poorly understood. The take up rates suggest that some NI credits (for example Carer's Credits) are not achieving their stated aim of protecting the state pension position of individuals who take time out of paid employment due to caring responsibilities (these tend to be women).

3. Crediting arrangements under Universal Credit will represent a simplification of the eligibility aspect of the crediting system. All those in a household that is eligible for the benefit will automatically receive the same class of NI credit.

4. The implementation of the single-tier pension will further simplify the system because all credits will give the same state pension entitlement. There could also be a wider opportunity to simplify the system. A review of recording and operating systems is planned and this will aim to identify efficiencies that can be put in place. HMRC are also planning to review the delivery of deficiency notices in light of the introduction of the single-tier pension.

5. DWP are developing a Communications Strategy to ensure that the reforms to the state pension are communicated to the public in a timely and accurate manner. A component of this will be raising awareness about the NI credits which have been put in place to protect those who cannot work including due to caring responsibilities.

Background:

6. National Insurance (NI) credits are awarded to protect the state pension position and benefit entitlement of individuals who have a gap in their National Insurance record due to a range of specific circumstances. This can be due to unemployment or long term illness or because they are caring for a child or an adult with caring needs. As stated in the White Paper, *The single-tier pension: a simple foundation for saving*[2], the implementation of the single-tier pension would provide an opportunity to simplify the recording and operating systems for NI credits.

[1] Departmental modelling based on Great Britain.
[2] Department for Work and Pensions, 2013, *The single-tier pension: a simple foundation for saving*, Cm 8528, TSO.

7. During pre-legislative scrutiny of the draft Pensions Bill by the Work and Pensions Select Committee[3] a number of questions were asked about protecting the state pension position of those who are not working or whose earnings are low.

8. This paper provides a summary of information about NI credits and covers the current NI system, the range of credits that are available and what entitlement they confer. It goes on to cover the changes under Universal Credit which is being gradually rolled out and potential changes under single tier.

Section 1. The National Insurance System

9. The universal National Insurance system was introduced on 5 July 1948. Originally it was designed to be funded by flat-rate contributions with a 20 year transition period to allow those to build up before payments were made[4]. It rapidly became a pay as you go system so that each year's contributions were used to pay for the same year's benefits. However, it was and still is based on the principle that entitlement to benefits depends on prior contributions paid by employees, the self-employed and others. Until 1975, National Insurance contributions (NICs) were a flat-rate amount for everyone and records were kept by affixing special stamps to cards held by employers (with the exception of the earnings-related Graduated Retirement Benefit scheme which ran from 1961 to 1975). In 1975, contributions became earnings related and were collected along with Income Tax.

10. State benefits that are linked to the payment of NICs are known as 'contributory benefits' and these are as follows:
    - the basic State Pension;
    - the additional State Pension (since 2002 this has taken the form of the State Second Pension and between 1978 and 2002 it was the State Earnings-Related Pension Scheme or SERPS);
    - Jobseeker's Allowance - the contribution-based allowance;
    - Employment and Support Allowance - the contributory allowance;
    - Bereavement benefits - Bereavement Allowance, Bereavement Payment and Widowed Parent's Allowance; and
    - Incapacity Benefit.

11. NICs are paid into the National Insurance Fund (NIF) which is kept separate to revenue from general taxation. There are separate funds for Great Britain and Northern Ireland. The National Insurance Funds cannot be used to finance general Government spending but any NIF surplus is reinvested by the Commissioners for National Debt Reduction. It cannot therefore be redirected to fund short term benefit increases without affecting the deficit.

12. About 20 per cent of the NICs collected each year is used to fund the National Health Service (NHS). This money is deducted from the contributions before they reach the NI funds.

---

[3] House of Commons Work and Pensions Committee, April 2013, Fifth Report of Session 2012-13, *The Single-tier State Pension: Part 1 of the draft Pensions Bill*, HC 1000, TSO.
[4] Salter T, Bryans A., Redman C. and Hewitt M. (2009) *100 years of state pension: Learning from the past*, Oxford: Information Press Limited.

13. A summary of the thresholds and rates for the current NI system is shown in Table 1 below.

National Insurance Contributions for Individuals

14. Individuals are required to pay NICs if they are aged between 16 and State Pension age and are employed or self-employed, provided they earn over a certain level. Currently, employees who earn over the Primary Threshold of £149 per week (£7,755 per year in 2013/14) from a single employment are liable to pay Class 1 contributions. This is at a rate of 12 per cent of their earnings between the Primary Threshold and the Upper Earnings Limit (UEL) of £797 per week (£41,450 per year in 2013/14). All earnings above the UEL are subject to a rate of 2 per cent.

15. Employees who earn at or over the Lower Earnings Limit of £109 per week (£5,668 per year in 2013/14) but below the Primary Threshold are treated as having paid Class 1 NICs. This helps protect their entitlement to contributory benefits.

16. Self-employed individuals have to pay Class 2 contributions. However, those who earn below a set limit (£5,725 per year in 2013/14) can choose to apply for a Certificate of Small Earnings Exception and not pay any Class 2 NICs. The self-employed also pay Class 4 contributions if their taxable profits exceed the Lower Profits Limit (£7,755 per year in 2013/14). However, their Class 4 contributions do not count towards any contributory benefits.

National Insurance Contributions for Employers

17. Employers pay secondary Class 1 NICs for each employee who earns above the Secondary Threshold of £148 per week (£7,696 per year in 2013/14). These are paid at a rate of 13.8 per cent on earnings above the Secondary Threshold. The introduction of the Employer Allowance from April 2014 will allow most employers relief on the first £2,000 of their total NICs liability.

Contracting out of the additional State Pension

18. Employees can give up entitlement to the additional State Pension, in return for a broadly similar occupational pension and payment of a lower National Insurance (NI) rate for employer and employee. This is called contracting out and currently the employee pays Class 1 NICs on relevant earnings[5] at a rate reduced by 1.4 per cent. The employer rate for secondary contributions is reduced by 3.4 per cent. The additional State Pension will end in 2016 when single tier is implemented. This means contracting out will also end at that point and all employees and employers will pay the same rate of Class 1 National Insurance.

Reduced Rate Election

19. Until 1977 married women and widows could 'elect' to pay a reduced rate of Class 1 contributions when employed, and not to pay Class 2 contributions when self-employed. This meant they were not able to claim state pension based on their own contribution record but could claim on the record of their husband (or late husband). An individual with a Reduced Rate Election (RRE) usually cannot get NI credits.

[5] Earnings between the LEL and the Upper Accrual Point of £770 per week (£40,040 per year in 2013/14).

Voluntary National Insurance Contributions

20. There is also the facility for individuals to pay Voluntary Class 2 or Class 3 NICs (vNICs), subject to certain conditions and time limits, if they have gaps in their NI record. This could happen for a variety of reasons including a period spent outside the UK to work abroad, studying, doing volunteer work, being in prison or working but with low earnings.

Table 1. Summary of National Insurance rates

	Significance	**2013/14 rates and thresholds**	
		Weekly	Annual Equivalent
Class 1			
Lower earnings limit (LEL)	Earnings access point to the NI system	£109	£5,668
Secondary threshold	Earnings at which employer pays Class 1	£148	£7,696
Primary threshold	Earnings at which employee pays Class 1	£149	£7,755
Upper accrual point (UAP)	Earnings limit for employer contracted-out rebate	£770	£40,040
Upper earnings limit (UEL)	Earnings level at which the employee Class 1 rate lowers	£797	£41,450
Contribution rates			
Primary (employee)			
On earnings between the primary threshold and UEL			12%
On earnings above the UEL			2%
Secondary (employer)			
On all earnings above the secondary threshold			13.8%
Class 2			
Small earnings exception	Earnings limit below which the self-employed can apply not to pay Class 2		£5,725
Flat-rate contribution		£2.70	£140.40
Class 3			
Flat-rate contribution	Commonly known as Voluntary NICs	£13.55	£704.60
Class 4			
Lower profits limit (LPL)	Earnings level at which self-employed pays Class 4 NICs		£7,755
Upper profits limit (UPL)	Earnings level above which self-employed pay the lower Class 4 rate		£41,450
Contribution rate			
On profits between the LPL and UPL			9%
On profits above the UPL			2%

The evolution of NI credits

21. Before the universal NI scheme, people in insurable employment paid contributions to Approved Societies (e.g. private insurance companies or friendly societies) or to certain funds run by the Ministry of Health. Not all employment was insurable and insurance lapsed if there was a significant break in employment. In its first form the NI credit system was a "free insurance period" for individuals whose insurable employment ended. It was available for up to a maximum of two years after the employment ended and gave individuals access to the same benefits they would have got when they were employed.

22. Once the universal National Insurance scheme was opened in 1948, NI credits were given a value that was equivalent to a Class 1, 2 or Class 3 contribution. NI credits were originally available for limited circumstances e.g. for incapacity and unemployment.

23. The NI credits counted towards the same range of benefits as the contribution normally paid by the employee. Individuals had to have a recent link to insurable employment and have satisfied the contribution conditions for the associated benefit before they could receive it (for example, in order to receive Maternity Benefit, a pregnant woman must have at least 50 weeks of contributions of which 26 must have been in the preceding year).

24. When, in April 1975, NI contributions moved from being flat rate to earnings-related, Class 1 credits were given a value equivalent to a payment of weekly earnings at the LEL of the time. NI credits were then converted to a system of weekly credited earnings in 1987.

25. From 1975 16, 17 and 18 year olds were given credits if they stayed in full time education, approved training or apprenticeship to protect their state pension position. These credits were ended on 6 April 2010 because the reduction in the number of qualifying years required for a full basic State Pension at that time meant that they were no longer needed.

26. Individuals caring for a child below the age of 16 or someone with a long-term disability or illness with little or no earnings were not covered by crediting arrangements at that time. As a result women, who historically have been the main care givers, had significantly worse state pension outcomes compared to men. Home Responsibilities Protection (HRP) was brought in from 1978 to address this problem and from 2003 it was extended to foster caring. HRP reduced the number of qualifying years[6] that the individual needed to qualify for the full basic State Pension but could not reduce them below 20 qualifying years. It therefore helped to protect the basic State Pension position of people whose opportunities to work were limited because of caring responsibilities at home.

27. HRP was a prospective reform and therefore it only applied to those who met the qualifying conditions after it was brought in. It brought about a significant improvement in the number of women that were projected to reach State Pension age with a full basic State Pension. However, those eligible for HRP still needed at least five years of NI contributions to receive any basic State Pension; one of which

[6] In this note a 'qualifying year' is a tax year during which an individual has paid, has been treated as having paid or has been credited with enough National Insurance contributions to make that year qualify towards the State Pension.

had to be a paid year but the rest could be credited. It could be awarded for a maximum of 19 years which meant those caring for longer received only limited protection. HRP was replaced by a system of weekly credits in 2010 as part of wider State Pension reforms. There is now no limit on the number of years of credits that can be awarded.

28. NI credits are also available to low earning employees. Working Tax Credits were brought in from April 2003 to help provide a work incentive for those in low paid employment (for example it could help them meet the cost of childcare as that can be a barrier to work). Those on an income below the LEL, who are receiving Working Tax Credits, are eligible for NI credits to protect their basic State Pension and in certain cases their additional State Pension.

29. The Pensions Act 2007 reduced the number of qualifying years that men and women needed to get a full basic State Pension from 44 years for men and 39 years for women to 30 years for all. An individual could still contribute towards an increased amount of additional State Pension for their entire working life. Before the change in basic State Pension qualifying conditions, only a few years spent not paying NICs could have a large impact on state pension outcome. For a man, with a working life of 49 years (from 16 to 65), any more than 5 years out would have an impact; therefore it was important to ensure credits were available to cover all possible events that could justifiably interrupt employment, no matter how short. For example, a period of jury service or sick leave that crossed a tax year could result in a loss of two qualifying years. With the changes to the number of qualifying years that are required for a full pension and increases in the State Pension age more gaps can be absorbed without a negative impact on state pension outcome. In steady state, 35 years will be required for a full single-tier pension.

Recent Changes to NI credits

30. The Pensions Act 2007 brought in a number of reforms including some to the NI credit system in response to the fact that only around 35 per cent of women were reaching State Pension age with a full basic State Pension compared to around 85 per cent of men. The reforms aimed to improve the position for those who took time out of the workplace due to caring responsibilities.

31. As mentioned above, the Act replaced HRP with a system of weekly credits. Since April 2010 a parent receiving Child Benefit for a child under 12 has automatically received Class 3 and Earnings Factor credits. It was estimated that this would lead to an extra 780,000 women and an extra 30,000 men getting access to the State Second Pension from 2010. Also, from 2011, if a parent receiving Child Benefit was getting a qualifying year by paying NICs through employment a family member could receive the NI credit for looking after a child under the age of 12. This extended NI credits to family members, such as grandparents.

32. The Pensions Act 2007 also brought in the new Carer’s Credit for those caring for disabled people for at least 20 hours a week from April 2010. This is a Class 3 and Earnings Factor credit. This meant that around 70,000 extra carers a year could access the basic State Pension and around 110,000 more women and 50,000 more men gained access to the State Second Pension in 2010. Similarly to when HRP

was first brought in these reforms were solely prospective so only those who reached State Pension age after 6 April 2010 could benefit.

33. On 7 January 2013 the Child Benefit rules changed, affecting households with members who earn over certain limits. The amount of Child Benefit paid starts to taper when an individual income is over £50,000, with it reaching a zero award at an income of £60,000. For those currently receiving Child Benefit, their entitlement to Class 3 and Earnings Factor credits will not be affected, even if they receive no Child Benefit (due to payments being stopped or it being recouped through the tax system). New parents with a high income must still complete a Child Benefit form in order to get the credits even if they expect to get a zero award.

34. On 29 April 2013 the roll out of Universal Credit started. The pathfinder is starting in a limited number of Job Centres, so it will be a number of years before the changes to the NI credit system under Universal Credit are fully implemented. The changes are discussed in Section 5 but the credit has been listed in Table 4 for completeness.

35. The NI crediting system has been expanded and modified over time to cover a wide range of circumstances (see Section 3 and Table 4).

Section 2. Classes of National Insurance credit

36. NI credits are typically linked to receipt of a benefit but some others are available for certain activities. There are two main classes that are available:
    - Class 1 credits - which count towards the basic State Pension, bereavement benefits[7] and some of the other state benefits listed above; and
    - Class 3 credits - which count towards the basic State Pension and bereavement benefits only.

37. An individual can have a qualifying year on their NI record that is based solely on NI credits; they can also be combined with paid contributions to make a full qualifying year. For example, if an individual worked for the first 40 weeks of a tax year and paid Class 1 NICs but then lost their job and claimed Jobseeker's Allowance, NI credits could cover the final 12 weeks in the tax year to make it a full qualifying year.

38. As stated, both of these classes of credits count towards the basic State Pension. In the current system, a qualifying year is worth 1/30th of the basic State Pension. In 2013/14 it is worth 1/30th of £110.15 or £3.67 of state pension per week.

39. In addition to Class 1 and Class 3 credits, some individuals are awarded Earnings Factor credits. These are for those who have caring responsibilities or long-term incapacity. These Earnings Factor credits give rise to an amount of State Second

[7] The Bereavement Support Payment will replace the current suite of Bereavement Benefits. It has the qualifying criteria that the deceased needs to have at least one year of paid NI contributions. The contributions in that year must total more than 25 times the weekly LEL of £109 (£2,725). NI credits cannot be used to meet this condition but once the condition is met they can protect entitlement.

Pension which in 2013/14 is worth £1.75[8] per week per full tax year that the individual receives the credit. This is equivalent to the accrual rate for those paying the full rate of Class 1 NICs on earnings of £15,000, which ensures that caring contributions or long-term incapacity are valued the same as paid contributions at that level.

Table 2. Summary of National Insurance credit classes

	Basic State Pension	**Bereavement benefits**	**Other contributory state benefits**	**Additional State Pension**
Class 1	✓	✓	✓	✗
Class 3	✓	✓	✗	✗
Earnings Factor	✗	✗	✗	✓

40. If an individual has enough paid contributions (Class 1 or Class 2 contributions) in a tax year they will take precedence over a possible award of credits (see Table 3).

Table 3. Summary of the hierarchy of National Insurance contributions and credits in terms of whether they are paid or awarded.

Hierarchy
Class 1 and 2 contributions
Class 1 credits
Class 3 credits
Class 3 contributions

Section 3. Types of National Insurance credit

41. There is a wide range of different circumstances that give rise to an award of NI credits and the current list is summarised in Table 4. The table also contains information on the class of credit awarded for an activity, the conditions that must be met and whether the award is automatic.

[8] The State Second Pension calculation changed so that accruals from April 2012 are based on a flat-rate amount for earnings below £15,000 (in 2013/14 prices) or those that have been credited. Earnings-related accruals continue to be provided on earnings above £15,000.

Table 4. Summary of National Insurance credits

Circumstances	Type of Credit	Counts towards the State Second Pension	Main conditions to meet	Automatic award
Caring for a child	Class 3	Yes	Receiving child benefit for a child under 12 (even if their Child Benefit award is zero due to a high-earning spouse).	Yes
Foster parents	Class 3	Yes	Approved foster carers or kinship carers.	No
Family member caring for a child (Specified Adult Childcare credits)	Class 3	No	Adult family members who care for a child under 12 to whom they are related (e.g. grandparent), usually when their parents are working. Parent or main carer must be receiving Child Benefit and have a qualifying year through means other than receiving credits linked to their Child Benefit.	No
Caring (Carer's Credit)	Class 3	Yes	Caring for one or more disabled person for at least 20 hours a week but not receiving Carer's Allowance.	No
Caring	Class 1	Yes	Receiving Carer's Allowance. Class 3 protection is also available for the 12 weeks before and after receipt of Carer's Allowance.	Yes
Maternity, Paternity or Adoption pay period	Class 1	No	Receiving maternity allowance, statutory maternity pay, additional statutory paternity pay or statutory adoption pay. It is only awarded if they do not make a full qualifying year through other means.	Yes if in receipt of Maternity Allowance otherwise – application required
Incapacity for work	Class 1	No	Receiving statutory sick pay or Unemployability Supplement.	Yes
Incapacity for work	Class 1	Yes with some conditions	Receiving Incapacity Benefit, Severe Disablement Allowance or satisfies the entitlement conditions for the benefit apart from the contribution conditions. Or receives Income Support on incapacity for work grounds.	Yes
Limited capability for work	Class 1	Yes with some conditions	Receiving contribution-based or income-related Employment and Support Allowance, or satisfies the entitlement conditions for the benefit apart from the income-related and contribution conditions.	Yes
Limited capability for work	Class 3	Yes with some conditions	Receiving Universal Credit and not receiving Employment and Support Allowance nor any other benefit for which Class 1 credits are awarded.	Yes

Circumstances	Type of Credit	Counts towards the State Second Pension	Main conditions to meet	Automatic award
Working and getting Working Tax Credit with the disability element	Class 1	No	Receiving Working Tax Credit which includes an award of the disability element. If self employed they must have a Small Earnings Exception Certificate.	Yes
Working and getting Working Tax Credit	Class 3	No	Receiving Working Tax Credits. If self employed they must have a Small Earnings Exception Certificate.	Yes
Unemployed	Class 1	No	Receiving Jobseeker's Allowance or satisfies the entitlement conditions for the benefit but not the contribution conditions.	Yes
Universal Credit	Class 3	No	Eligible for Universal Credit (UC). This will not be affected by the amount of UC they receive.	Yes
On a training course	Class 1	No	On an approved full-time (more than 20 hours) course that is less than one year in duration. This does not include GCSE, A level or equivalent courses and should not be part of an individual's job. There are special rules for disabled people.	Yes for Government sponsored courses. If not written application
On jury service	Class 1	No	Individuals who attend court and have earnings lower than the LEL or are unemployed. The self employed do not get these credits.	No
Wrongly imprisoned	Class 1	No	For periods of imprisonment where a conviction is quashed.	No
Armed forces spouse or civil partner	Class 1	No	Spouse or civil partner of a member of Her Majesty's Armed forces on an accompanied assignment outside the UK.	No
Male approaching the age of 65 (auto credits)	Class 1	No	Men aged between women's State Pension age and 65 who are not working or earning enough to get qualifying year. A self-employed man needs a Small Earnings Exception Certificate. They must live in the UK for at least 183 days a year. This credit is being phased out as male and female State Pension ages equalise.	Yes
Aged 16-18 (starting credits)	Class 3	No	For the years in which a person was 16, 17 and 18. These credits were ended on 6 April 2010.	Yes

Section 4. Take up of National Insurance credits

42. As indicated in Table 4, some NI credits are automatically registered on an individual’s NI record through receipt of a relevant benefit. Whereas, there are other types of credit that the eligible individual has to apply for because there is no automatic means to establish the individual’s eligibility for the credit.

43. The number of applications for some of the other NI credits that have to be claimed has been lower than expected. The reforms to the NI credit system in the Pensions Act 2007 were expected too extend access to the basic State Pension to 20,000 people in 2010 due to the introduction of the Carer’s Credit. However, in May 2013 around 4,700 individuals were receiving Carer’s Credits and there had been fewer than 8,000 applications in the 3 years since the credit was introduced. This credit is not awarded automatically and has to be applied for by writing to the Carer’s Allowance Unit of the Department for Work and Pensions. Poor awareness of the credit may explain why the take up is lower than modelled.

44. This point can be further illustrated by looking at the take up of other NI credits that must be claimed: 601 applications were processed in 2012/13 for Armed forces spouse or civil partner credits, 13 applications were processed in 2012/13 for Miscarriage of Justice credits and there were 101 applications in the 2011/12 tax year for credits for a family member caring for a child. The first two of these cover quite unusual circumstances so the low case load is not unexpected. However, the coverage of the family member caring credit might be improved by better awareness and a simpler application process.

Section 5. National Insurance credits under Universal Credit

45. The Universal Credit (UC) pilot started on 29 April 2013 with a trial in the Greater Manchester and Cheshire region. The national rollout will follow and is expected to be almost complete by the time the single-tier pension is introduced.

46. Universal Credit will simplify the Welfare System by replacing the following benefits with one monthly payment:
    - JobSeeker’s Allowance (income based);
    - Employment and Support Allowance (income related);
    - Income Support;
    - Working Tax Credits;
    - Child Tax Credits; and
    - Housing Benefit.

47. Under UC all eligible claimants will be credited with Class 3 NI credits and in a joint claim both members of the couple will be awarded the credit. This will protect their entitlement to both the basic State Pension and Bereavements Benefits. It will not give rise to any State Second Pension or other contributory benefits entitlement.

48. UC aims to support individuals back into work so benefit payments will be reduced gradually as they earn more from paid employment. However, claimants will continue to be awarded NI credits for as long as they are eligible for a penny of UC. If an individual starts to earn over the Lower Earnings Limit in a single job they will

be treated as if they had paid Class 1 NICs and if they start to earn over the Primary Threshold they will be liable to pay Class 1 NICs.

49. Similarly, if claimants are in receipt of both UC and another benefit that gives them a Class 1 NI credit, the Class 1 credit will be applied to the individual's NI record and will take precedence over the Class 3 credit from UC (See Table 3).

50. Self-employed UC claimants will be liable to pay Class 2 NICs unless they have a Small Earnings Exemption Certificate even when they are receiving UC payments.

51. If a claimant does not uphold the 'Claimant Commitment' and receives a sanction they will lose their benefit for a set period of time. However, they will not lose their NI credits for that period as this would punish them twice.

52. UC claimants who receive the limited capacity for work (LCW), limited capacity for work-related activity (LCWRA) or carer element of the benefit may receive Earnings Factor credits on top of their Class 3 NI credit. In a joint claim the Earnings Factor credits will only be given to the individual in receipt of the relevant element not both members of the household. This is a temporary measure to protect their access to the additional State Pension until it is closed in April 2016 and replaced with the single-tier pension.

53. By simplifying the welfare system UC will also streamline the NI crediting system. Instead of there being six benefits with different eligibility conditions for the two classes of NI credits or no eligibility at all; all individuals eligible for a penny of UC will get a Class 3 credit.

Impacts

54. The crediting arrangements under UC will increase the coverage of the basic State Pension by bringing in members of around 800,000 households (once it is fully rolled out) because they will start to receive a Class 3 credit automatically. These are individuals who are currently earning below the LEL and are eligible for Income Support, Child Tax Credit or Housing Benefit and therefore would not have received any NI credits or have liability for NI contributions. This also includes people such as carers on Income Support who are eligible for a credit now, but have to apply or rely on their benefit processor informing HMRC of their eligibility for the NI credit.

55. In addition, in steady state it is estimated that 100,000 UC households will gain access to the state pension because the non-working partner of those previously claiming Working Tax Credit will start to get a Class 3 credit.

56. Individuals who have multiple part-time jobs, none of which pay more than the Lower earnings limit (£109 per week in 2013/14), can get access to Class 3 credits under UC if their household income means they are eligible for UC. This will protect their basic State Pension position.

57. In steady state, it is estimated that around 2.7 million households will receive a Class 3 NI credit in place of the Class 1 credit that the claimant would have received under the legacy benefit system (legacy benefits are those that UC is replacing). This includes those who would have received income-related JobSeeker's Allowance

Section 6. National Insurance credits under the single-tier pension system

58. Under the proposals set out in the current Pensions Bill, from 6 April 2016 those reaching State Pension age will do so in the single-tier state pension system. The single tier will be a flat-rate pension set above the basic level of means-tested support (Pension Credit standard minimum guarantee, £145.40 in 2013/14).

59. A key objective of reform is to move to a simpler pension system that gives people clarity over what their State Pension will be worth when they retire. It has been designed to ensure that people of working age have a solid foundation for saving. The new state pension system has also been designed to cost no more overall to ensure that there is no additional burden for the younger generations who will be paying for the pension of those over State Pension age.

60. In steady state, 35 qualifying years of NI contributions or credits will be required to receive the full single-tier pension. There will be a minimum qualifying year period of no more than ten years. This means that a set number of years of contributions is required before any single-tier pension is payable. Those with fewer than 35 qualifying years but above the minimum qualifying period will get a proportionally smaller amount. For example, someone with 25 years would get 25/35th of the full single-tier pension.

61. Departmental modelling indicates that by the mid-2030s over 80 per cent of pensioners will qualify for the full single-tier pension, rising to around 85 per cent by 2040. This modelling is based on full take up of Child Benefit credits but does not include Carer’s Credits, UC credits or payment of vNICs. As crediting arrangements will be taken forward to protect the single-tier pension position of those who cannot work (and vNICs will still be available) it may in fact be a slight underestimation of the number of individuals who will receive a full single-tier pension.

62. During the transition from the current system individuals who have been contracted out of the additional State Pension during their working lives will have a deduction applied during the calculation of their state pension. This deduction reflects the fact that, whilst they were contracted out, they paid lower NICs and their employer received a National Insurance rebate to fund their workplace pension. The deduction is broadly equivalent in value to the workplace pension the rebate funded. This adjustment for contracting out is consistent with the rules of the existing pension

system. More information can be found in the *Single-tier Pension Technical Note* which is available on the GOV.uk website[9].

63. If in 2016 the amount of state pension an individual could become entitled to is lower than the full single-tier pension, they can increase the prospective value of their state pension by gaining further qualifying years up until they reach State Pension age. Even if an individual is no longer in paid employment they may still gain qualifying years if they are carrying out activities or in circumstances that attract an award of NI credits. Individuals may also use NI credits to meet the minimum qualifying period requirement.

Simplicity

64. Under the single-tier pension all NI credits will give rise to the same amount of state pension. A full year of credits will give rise to 1/35th of the full rate of the single-tier pension. An individual will continue to be able to combine NI credits with paid contributions in a tax year to make a full qualifying year.

65. There will be no need for Earnings Factor Credits because there will be no earnings-related additional State Pension (known as the State Second Pension) under the single-tier system. As the Minister for Pensions said during his evidence session[10] in front of the Work and Pensions Select Committee “In our World, a credit is a credit is a credit.”

Impacts

66. Under the single-tier pension, Class 1 and Class 3 credits will give rise to more state pension than in the current system. Currently a qualifying year gained from these credits is worth 1/30th of the full basic State Pension (£3.67 in 2013/14) and under single tier it will be 1/35th of the full single-tier rate (using the illustrative single-tier amount of £144 this is £4.11).

67. Currently some benefits and activities, such as caring for a child under the age of 12 or a sick or disabled person, also give rise to Earnings Factor credits which are worth £1.75 a week. Altogether, individuals credited for these activities get access to a maximum of £5.42 (£3.67+£1.75 in 2013/14) per week in state pension. However, adding further complexity to the current system, only the first 30 years of NI credits are worth £5.42 in state pension and then all extra years are worth only £1.75. Under the single-tier system all years are worth the same as shown above because Earnings Factor credits will not be available when the additional State Pension ends.

68. Also the policy for the annual increase (uprating) of the state pension has to be factored into this picture. Under single-tier a larger amount of pension will be increased in line with the average increase in earnings (using the illustrative figures for the full single-tier pension and the 2013/14 level of the basic State Pension this is £144 compared to £110.15). Under the current system the additional State Pension is increased in line with price inflation and historically this has been a less generous method of uprating.

---

9 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/181233/single-tier-pension-transition-technical-note.pdf

10 House of Commons Work and Pensions Committee, April 2013, Fifth Report of Session 2012-2013, *The Single-tier State Pension: Part 1 of the draft Pensions Bill*, HC 1000, TSO.

69. All of these factors make it very difficult to carry out a direct comparison between the situation for those solely relying on NI credits in the current system and under single-tier. Also, it would be unusual for someone to solely rely on NI credits for their eligibility for state pension. Since October 2012, all those over the age of 22 and earning over the threshold will be automatically enrolled into a work place pension scheme that meets a minimum quality standard. Those under the age of 22 or earning below the threshold can choose to opt in to the same pension that an employer is using for automatic enrolment.

70. The removal of Earnings Factor credits is a consequence of the simplification of the state pension system, which aims to help people understand what they will receive in retirement so they can take action to provide any extra retirement income they want. The proposed single-tier pension system has been welcomed by stakeholders and the simplification it will lead to has been praised.

Next Steps

71. The planned review of NI credit recording and operating systems will aim to identify efficiencies that can be put in place. DWP are also working on a customer-focused Communications Strategy for the new pension system and this will include crediting arrangements. We have already consulted with interested parties, including the adviser community. We are carrying out fieldwork over this summer which will focus on how best to communicate the changes and how to tailor information for different audiences. We are working with partners such as Age UK, the Money Advice Service and the Pensions Advisory Service.

72. State Pension statements will be the vehicle to provide customers with more personalised information about how they are affected by the single-tier reforms. Following the implementation of the single-tier pension, State Pension statements will give estimates of an individual's single-tier state pension position. From Royal Assent of the Pensions Bill, although statements cannot give estimates of single-tier pension at this point, the accompanying leaflet will provide simple information about single tier including information on how those affected by transition can build further qualifying years by working longer, making voluntary contributions or engaging in activities that attract an award of NI credits.

73. HMRC are also planning to review the delivery of deficiency notices in light of the introduction of the single-tier pension. Deficiency notices are sent out by HMRC that informs people they may have a shortfall in their National Insurance contributions and they are currently suspended for people who reach State Pension age on or after 6 April 2016.