



HM Revenue  
& Customs

# National Insurance: Simplifying the National Insurance Processes for the Self Employed

## **Summary of Responses** **17 December 2013**

# Contents

1	Foreword	1
2	Introduction	2
3	Responses	3
4	Next steps	4
5	List of stakeholders consulted	5

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# 1. Foreword

Self-employment enables a wide range of people to make a positive and fulfilling contribution to the economy, with self-employed individuals often playing a key role in driving growth by introducing new ideas and innovations.

The Government is keen to minimise the barriers that hinder those who want to start and run their own business. It recognises that complying with the tax system imposes costs, and is committed to creating a simple, transparent and fair tax system for all. We have already taken several steps towards this by setting up the Office of Tax Simplification (OTS), introducing simplified expenses and the cash basis accounting system for small businesses, and are committed to enabling individuals and businesses to engage with HMRC digitally.

In their 2012 Review of Small Business the OTS recommended that the Government review the National Insurance processes for the self-employed and, in particular, recommended collecting Class 2 National Insurance contributions (NICs) through the Self Assessment process. The Government agreed with this recommendation, and announced at Budget 2013 that HMRC would consult on this proposal.

This consultation sought your views on changes that will help improve processes and simplify the way that Class 2 National Insurance contributions are collected by HMRC. I would like to thank you for your support in this consultation.

David Gauke MP  
Exchequer Secretary to the Treasury  
17 December 2013

## 2. Introduction

### Background

1. In 2011 the Office of Tax Simplification recommended that the Government review the NICs processes for the self-employed as part of the Review of Small Business and, in particular, consider collecting Class 2 National Insurance Contributions (NICs) through the Self-Assessment (SA) process. Following this HMRC conducted some informal discussions with self-employed customers and conducted internal analysis of its Class 2 processes.
2. On 18 July 2013 HMRC published a consultation document, *Simplifying the National Insurance Processes for the Self-Employed*. This consultation looked at the option of collecting Class 2 NICs alongside Class 4 NICs and income tax through the SA process.
3. The consultation ran for 12 weeks until 9 October 2013. It was an opportunity for the self-employed, agents and accountants, the intermediary and representative groups and the general public to comment on whether collecting Class 2 NICs alongside income tax and Class 4 NICs would be simpler and reduce the administrative burden on the self-employed community. It was also an opportunity to put forward other ideas that might further simplify the collection of NICs from the self-employed.
4. Eight questions were asked through consultation. The consultation paper set out the current system and highlighted potential areas of complexity. In particular, it examined the Small Earnings Exception (SEE) and deferment processes. The consultation paper set out how the system might work if Class 2 NICs was collected through the SA process, examining the likely impacts and potential opportunity for a simplified system. Additionally, the consultation paper referenced the different rules that are applied to assess liability for Class 2 and Class 4 NICs and tested whether these differences were a source of complexity for the self-employed and agent community.
5. HMRC wishes to thank those who responded to the consultation and recognises the time and effort that went into the comments and contributions.

## 3. Responses

6. In total HMRC received 30 responses. In some cases it is not possible to determine if the response has come from a self-employed individual, or a member of the general public or if the person is part of a small or large business organisation. However, for ease of identifying the range HMRC has grouped them into 3 broad categories of respondents:
  - Self-employed individuals: 4 responses
  - Agent and accountancy practices: 14 responses
  - Advisory organisations and representative bodies: 12 responses
7. In terms of the depth of detail of each response, the range was from a few lines of general comment to a comprehensive and detailed commentary to each question and additional feedback on further ideas that may offer further simplification. From the total of 30 responses received, 19 responses provided answers directly in reply to the 8 questions posed in the consultation paper. Of these 19 responses, some provided replies to all 8 questions and some provided answers to just one or a few questions. For ease, comments that were submitted under different headings have been included under the question that they best addressed in this summary of responses.
8. During the course of this consultation, officials from HMRC met with some of these organisations to discuss the detail set out in the consultation paper prior to their formal response. These discussions were incredibly useful to discuss the proposal in more depth and any ideas for simplification. We thank the organisations for their time and commitment.
9. HMRC also commissioned GfK NOP to conduct qualitative research to hear directly from a range of self-employed people. Around 85 people took part in the research either through focus groups or in depth interviews. GfK NOP also conducted some expert interviews with agents and representative bodies. The research findings are published separately on HMRC's website.

### Key Themes

- Overall, there was strong support for reforming self-employed NICs with many responses indicating that reform would bring simplicity and reduced administration.
- Many accountants and agents were very supportive of the central proposal informing that it would provide certainty to their clients that all their tax and NICs affairs can be handled by their agent through the SA system.
- Feedback reported that a Direct Debit payment method is easy for customers and there was a lot of support to maintain the flexibility to make regular payments through-out the year, to spread the cost. It was considered that in-year payment flexibility supports customers who either have low or fluctuating profits to manage their payments through-out the year.

- A number of respondents welcomed reform of self-employed NICs and suggested reform beyond the OTS proposals to maximise the opportunity to simplify and reduce administration burdens for the self-employed community. Common suggestions put forward were that HMRC should consider either abolishing Class 2 NICs altogether or to merge Class 2 and Class 4 NICs into a single Class of NICs for the self-employed.

## Responses by Question.

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

15 responses in total received, as follows:

- Agent and accountancy practices: 6 responses
- Advisory organisations and representative bodies: 9 responses

10. Of the 15 responses received, 11 were supportive with the general consensus that collecting Class 2 NICs through SA would be simpler. As part of the simpler regime there was a strong preference to maintain some method of in-year payment to help self-employed people manage their payments. Several indicated a desire to retain a direct monthly facility though little positive feedback was received on the current billing system.

11. One respondent commented: *“As a payment on account system already operates for income tax and Class 4 NICs paid through self-assessment, we see no intrinsic difficulty in applying a similar payment on account process for Class 2 NICs, with any refund that is required made at the following 31 January.”*

12. Some respondents noted that whilst the collection of Class 2 NICs through the SA system aligned it with the collection of income tax and Class 4 NICs, it moved further away from the monthly ‘cash in – cash out’ basis on which UC claimants report.

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

15 Responses received in total, as follows:

- Individual self employed: 1
- Agent and accountancy practices: 6 responses
- Advisory organisations and representative bodies: 8 responses

13. A number of respondents mentioned expected benefits from the proposed change. These are summarised below.

**Administrative benefits:**

14. Overall it was considered that combining the collection processes would result in less administration, which would be simpler. In particular it was noted that removing the need for the Class 2 NICs deferment process, and administering the Self Employed Exception (SEE) and any under or over payments as part of the SA process had the potential of bringing significant benefits. Some cited that collecting Class 2 NICs through SA would mean fewer transactions with HMRC saving time and money for the self-employed.

15. Some thought it would be easier to deal with amounts due to HMRC (whether income tax or NI) through a single collection and recovery process.

*'De-registration would be self-assessed... errors in Class 2 payments could be identified automatically on electronic submission of self-assessment returns...'*

Another respondent suggested there would be greater certainty for those with lower profits as they would be paying the right amount of Class 2 NICs and further, that those with high employment income or any available exceptions from Class 2 NICs might be dealt with automatically.

16. Removing the need to forecast profits was seen as an advantage of the new system, with the decision about whether to opt in or opt out made after the level of profits are known and therefore removing any upfront administration activity. It was felt this would bring much greater certainty to self-employed customers and could act as a clearer reminder of the availability and consequences of an opt out facility.

17. **Class 2 debt:** It was noted that currently Class 2 NICs debt collection is separate to any debt collection activity for income tax and Class 4 NICs, thus adding to confusion. Combining Class 2 with any other SA debt collection was seen as beneficial.

18. **Role of agent:** Agents and accountants saw benefits of the proposal because it allowed them to take more control over their client's total tax and NICs obligations. One accountant recognised that the current system has no online portal and is not designed to include agents. The proposal was viewed favourably as it would give greater certainty to both the agent and the client that their total tax and NICs obligations were being dealt with at the same time.

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

16 Responses received in total, as follows:

- Individual self employed: 1
- Agent and accountancy practices: 6 responses
- Advisory organisations and representative bodies: 9 responses

19. **Financial impacts:** There was support to maintain the ability for customers to be able to pay Class 2 throughout the year if they wished to, to help with budgeting. Several felt if there was no in year payment facility the lump sum payments could be difficult for some people to pay, especially for those on low profits who may find small but regular payments easier to manage.

20. It was suggested that livestock farmers, in particular, would welcome the ability to be able to continue to pay their NICs on a regular basis which will help them to pay NICs even when profits are poor.

21. **Contributory benefit entitlement:** The consequence of the fiscal year and benefit year starting at different times may give rise to potential provisional payments of certain contributory benefits for those that make a claim for contributory benefits in January but have not completed their SA return. However, it was suggested filing an SA return before 31 December could be one way to negate this. One respondent suggested some form of self-certification as part of the SA process as another way of mitigation for Maternity Allowance.

22. **Link to Universal Credits:** It was suggested reducing the number of separate payments for NICs could reduce Universal Credit due to the monthly assessment basis if an in year payment facility was not retained.

23. **Administrative peaks:** People seeking help or advice in January may find it difficult as this is naturally a busy time for agents and HMRC as the SA deadline approaches.

**24. System impacts suggested by respondents:**

- It was suggested that the SA system will have to be able to distinguish contributory NICs from other payments and be able to replay this breakdown both internally and to the customer.
- It was also recognised that the SA system would need to be able to identify the number of weeks in a year an individual was self-employed to take account of any periods where Class 2 NICs is not liable, for example because they have ceased self-employment during the year.
- It was thought that bringing Class 2 into SA would increase the entries needed when filing in an SA return.



**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?

16 Responses received in total, as follows:

- Individual self employed: 1 response
- Agent and accountancy practices: 6 responses
- Advisory organisations and representative bodies: 9 responses

25. A range of transitional challenges were identified by respondents with the main one being timing of the cessation of existing payment arrangements. Some flagged the risk that individuals will omit payments or make duplicate payments. Some talked about the need for clear communications and the challenge of educating self-employed people with new rules, new processes and new habits to form particularly against a system that they have come to terms with.

26. Some asked that HMRC ensure that transition costs are minimised and that fresh administrative burdens do not arise with the new system.

27. Some respondents also commented on a potential 'transitional' gap in payments that may arise at the start of the new system and Class 2 NICs being paid at the end of the relevant tax year with self-assessment. This gap could potentially be around 21/22 months and may impact Government cash flow or benefit entitlement if in-year payment flexibility was not retained.

28. The following points were also raised:

- Ensuring those with low profits or losses do not automatically end up not paying Class 2 NICs and still have the opportunity to pay
- Working with clients to stop their present direct debit payments at the date of implementation – if any in year payment mechanism did not continue

**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?

18 Responses received in total, as follows:

- Individual self employed: 1 response
- Agent and accountancy practices: 6 responses
- Advisory organisations and representative bodies: 11 responses

29. Many respondents answered 'yes' to abolishing SEEs. Some respondents put forward concerns around this idea of removing the ability to pay Class 2 NICs below the SEE threshold. Protecting the contributory benefit entitlement of the low profit self-employed was identified as a consideration for some, particularly for those who have fluctuating profits and those with multiple jobs who earn an insufficient amount in an individual employment to obtain entitlement to contributory benefits.

30. It was noted that for some this would not be an issue as they may already have Class 1 NICs or NI credits. It was thought that those impacted may have to pay the higher amount of Class 3 NICs in order to protect their benefit entitlement if they could no longer pay Class 2 in-year when profits were low.

31. One representative body said that the SEE is poorly understood and rather than abandon the system, perhaps look to improve communication around SEEs to educate people.

**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?

18 Responses received in total, as follows:

- Individual self employed: 1 response
- Agent and accountancy practices: 7 responses
- Advisory organisations and representative bodies: 10 responses

32. This question explored whether the nature of activity that attracts a Class 2 NICs liability should be aligned with activity that attracts a Class 4 NICs liability. Some respondents understood this question to mean whether the Class 2 and Class 4 NICs thresholds should be aligned or whether Class 2 and Class 4 NICs should be merged. Any responses about thresholds or more fundamental changes to the self-employed NICs changes have been captured under Q6.

33. In general there was support given to the idea of aligning the liability to pay Class 2 NICs with the liability to pay Class 4 NICs.

One accountancy practice commented:

*“... life would be simpler for taxpayers and agents if liability to pay Class 2 and Class 4 were aligned. Time spent understanding the subtle differences between liability for Class 2 and liability for Class 4 is wasted time.”*

One organisation noted that there may be a small number of people who may be operating for example, a property business, and with no Class 1 NICs or NI credits, who may potentially lose out on contributory benefits if their liability for Class 2 is removed and voluntary Class 3 NICs may have to be arranged for this group.

34. One respondent suggested maintaining the differences in rules between Class 2 and Class 4 NICs – HMRC already have distinctions in place to determine Class 4 liability, and maybe using a simple tick box in the SA return so that individuals can properly be excluded from Class 2 payment, if appropriate.

35. Overall, there was consensus that the current difference is not desirable and some change will help simplify NICs in this area, although the current different implications of the two classes or the potential loss of benefit entitlement for those who may not therefore have a Class 2 liability, should be noted.

**Q5) What groups might be excluded from paying Class 2 NICs if liability to pay Class 2 NICs is aligned with the current Class 4 rules?**

13 Responses received in total, as follows:

- Individual self employed: 1 response
- Agent and accountancy practices: 5 responses
- Advisory organisations and representative bodies: 7 responses

36. The consultation paper stated a couple of groups here and respondents mentioned some other groups, for example, those with carer responsibilities and some part time workers. It was also mentioned that some people with fluctuating profits or those with a mix of employed and self-employed income may be excluded.

**Q6)** Do you have other ideas that might deliver further simplification for the collection of NICs from the self-employed?

15 Responses received in total, as follows:

- Individual self employed: 1 response
- Agent and accountancy practices: 6 responses
- Advisory organisations and representative bodies: 8 responses

37. In response to this question a majority of respondents said the scope of the consultation should go further with the general consensus being that having both Class 2 and Class 4 NICs for the self-employed adds complexity.

38. The main suggestion put forward here was to abolish Class 2 NICs and reflect this in the amount of Class 4 liability. Some organisations gave detailed analysis of how this could work. Below are some suggestions put forward:

**Abolish one or both classes:**

- Abolish Class 4 and set the level of Class 2 to a point that combines both Classes
- Abolish Class 2 and make Class 4 contributory – perhaps with a zero per cent liability for those below the Class 4 lower limit or who make a loss. It was mentioned that the combined amount may cause people difficulty in paying but acknowledged that people usually manage to pay their Class 2 to protect benefit entitlement.
- There was an appetite from some respondents to abolish NICs altogether and consequently raise income tax. However, there was not much detail put forward in how this might work.

**Merge Class 2 with Class 4 NICs:**

- A number suggested merging of Class 2 and Class 4 into one Class of NICs would reduce costs and improve clarity. One respondent suggested the combined charge should be based on the level of NICs imposed on those in employment and any loss relief for NICs can be automatically carried forward and off set against future NICs liability.

**Aligning Thresholds:**

- It was suggested that the Government should take this opportunity to align certain employee/employer and self-employed thresholds and provide more education/publicity on how the current system operates in particular, around deferment.
- Another suggestion was the Government considers aligning the benefits that might be claimed as a result of payment of Class 2 and Class 4 NICs with those that may be claimed by payment of Class 1 NICs.

- Another small change idea put forward was to align the definition of ‘profits’ for the SEE with ‘taxable profits’ on the SA return and avoid confusing references to ‘accounting profits’.

**Other:**

- A further suggestion was made that liability for NICs should be changed from weekly earnings to annual earnings – similar to the annual earnings period rules that apply to directors

**Q7) Are there any direct or indirect equality impacts from any of the changes discussed in this document?**

11 Responses received in total, as follows:

- Individual self employed: 1 response
- Agent and accountancy practices: 3 responses
- Advisory organisations and representative bodies: 7 responses

39. Some respondents did not identify any impacts other than those already highlighted in the consultation paper.

40. Here are some other areas of impact put forward for consideration:

- Abolishing Class 2 NICs liability below a certain level of earnings could result in impact on those with parental responsibilities who work part-time (particularly those who work part-time to fit in with parental and caring responsibilities) other carers and foster carers. Also it could impact those in volatile business sectors with fluctuating profits, such as farmers.
- Members of some religious orders are unable to own shares or carry insurance except where it is a legal requirement to do so. As a result they may be more at risk of suffering uninsured losses, which in turn makes them more likely to suffer trading losses than other self-employed businesses.
- One organisation advised that the proportion of people with disabilities who are self-employed is significantly higher than that of the population as a whole so any proposals may impact them.
- There was a suggestion that some low income earners are compelled to work self-employed because work engagers are not prepared to offer flexible contract terms which meet their health needs and limitations, or they work part time or on low incomes for reasons connected to their physical or mental health. These groups may be impacted if the ability to pay Class 2 below the SEE threshold was removed
- In contrast, another organisation commented that if HMRC followed their suggestion, to merge Class 2 and Class 4 NICs and make all self-employed pay NICs by direct debit and use the SA system to reconcile and adjust contributions, then this system will remove all the adverse impacts.

**Q8)** Do you have any comments or suggestions on the indicative impacts identified in the table of impacts?

8 Responses received in total, as follows:

- Agent and accountancy practices: 4 responses
- Advisory organisations and representative bodies: 4 responses

41. Some feedback here suggested that the long term savings to HMRC will outweigh the cost involved to introduce change, especially if HMRC can produce easy to use IT solutions.
42. There was a desire for more clarity around economic impacts in terms of the cost to the Exchequer, any possible reduction in public revenue and any impact on those with fluctuating profits.
43. One organisation suggested to convert bi-annual SA payments into monthly direct debit so as to reduce the impact on low earners.
44. Another organisation commented that moving to an annual approach for Class 2 NIC liability should greatly reduce the level of uncertainty and be conducive to a more true Class 2 debt figure. It was also suggested administering more state benefits through self-assessment will help encourage those operating in the informal economy to engage with HMRC through completing a tax return.
45. Some respondents commented that some people who are able to manage the current system with relative ease may not experience any reduction in administrative burden. Also, it was mentioned that cross Government work should be consistent.
46. A question was raised about how payments will be allocated particularly if an individual could not pay the full amount of income tax and Class 2 and Class 4 NICs.
47. There was also acknowledgment that if HMRC intends to continue with special rules for share fishermen, mariners and marine development workers, as referred to in paragraph 3.15 of the consultation paper any added complexity would be undesirable.

## 4. Next steps

This consultation on simplifying the self-employed NICs process combined with recent research has presented some useful insights on how collecting Class 2 NICs through SA might work in practice and how this can be delivered in a way that makes life easier for the self-employed. There was much support for collecting Class 2 NICs through SA, because of the benefits that a stream-lined process will give and it was also acknowledged that many find the flexibility of in-year payment options helpful.

Additionally we had many respondents who argued that the scope of this consultation did not go far enough and that Government could consider more fundamental changes to the Class 2 and Class 4 NICs system.

In light of the range, particularly in some areas that went beyond the scope of this consultation, HMRC will consider these in detail and give an update at Budget 2014.

## Annex A: List of stakeholders consulted

HMRC received 4 responses from individuals and the following organisations:

BDO LLP  
Chronicle Accountants Ltd  
Crown Tax Affairs  
David Marshall Associates Chartered Accountants  
Deloitte LLP  
FreeAgent Central Ltd  
Gibson Booth Insolvency  
Harold Smith Chartered Accountants  
K P Bonney & Co LLP  
Nabarro Poole Ltd  
RJK Accounts  
Sila Accountancy Services  
Tom Connolly Accountants  
Whitefield Tax Ltd

Administrative Burdens Advisory Board  
Association of Accounting Technicians  
Association of Taxation Technicians  
CentreForum  
Chartered Institute of Taxation  
Incorporated Society of Musicians  
Institute of Chartered Accountants in England and Wales  
Low Income Tax Reform Group  
National Farmers' Union  
Professional Contractors Group  
TaxAid  
The Society of Professional Accountants