



HM Revenue
& Customs

Research report

Simplifying Class 2 National Insurance Processes for the self employed

Qualitative research to explore customer
understanding of Class 2 NICs

Personal Tax Customer Design Team

November 2013

Behavioural Evidence & Insight Team

Simplifying Class 2 National Insurance Contributions for the self employed***About Personal Tax Customer Design Team)***

Personal Tax Customer Design Team works with colleagues in Personal Tax (PT) and across HMRC to help develop our approach to implementing the customer centric business strategy. We use customer insight to help PT design, deliver and operate services for individual customers which

- improve customer experience
- maximise tax yield
- ensure that those who need help get the support they need, when they need it

Personal Tax Customer Design Team also has a corporate role, to manage the relationship with the voluntary and community sector on behalf of HMRC

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Simplifying Class 2 National Insurance Contributions for the self employed

Research requirement (background to the project)

In 2011 the Office of Tax Simplification recommended that the Government review the Class 2 NICs processes for the self-employed and in particular look at collecting Class 2 NICs through the Self Assessment (SA) process.

Following informal discussions with self-employed customers, HMRC ran a 12 week consultation between July and October 2013 to understand the experience of the current Class 2 NICs processes and test the proposition of collecting Class 2 NICs alongside income tax and Class 4 NICs through the SA process.

To support this consultation HMRC commissioned external qualitative research to hear directly from a range of self-employed individuals.

Qualitative research was conducted amongst self-employed customers to get their thoughts on the current system and explore their knowledge gaps as well as their views on the proposed changes to the collection of Class 2 NICs, which involves collecting Class 2 NICs through the Self-Assessment process.

As HMRC is embarking on a transformation programme with the ambition to put more of its services online, the research also tested customer reactions to the idea of an individual online account that gives the individual opportunity to manage their national insurance affairs online.

When the research took place

The research took place during September 2013

Who did the work (research agency)

GfK NOP Social Research qualitative team

Method, Data and Tools used, Sample

A series of six focus groups, (each comprising of 6 customers) and 24 face to face in depth interviews were conducted amongst a range of self-employed customers.

As well as age, gender and socio-economic grade, the sample also took into account a range of professions and trades, the length of time they have been self-employed and the

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amount of profit they earned from self-employment to ensure a good spread of income levels.

In addition GfK researchers conducted in-depth telephone interviews with experts in the voluntary sector as well as agents, accountants and tax specialists to inform the main research phase.

The research took place across England, Scotland and Wales.

Main Findings

Summary of findings

- Awareness of Class 2 National Insurance Contribution is generally low and knowledge of the link with contributory benefits is even lower.
- The research process was an educational exercise for most, so views changed as customers became more informed.
- Most customers did not have much understanding of the current process. Once informed about it, they became concerned about the impact on pensions, particularly if they believed they had gaps in their contributions.
- Awareness of the Small Earnings Exception (SEE) is low and limited to those who have ever applied for one; knowledge of the consequences of applying for a SEE is even lower.
- The proposal for collecting Class 2 NICs through the Self-Assessment process was received positively by all. However, there were mixed views regarding the payment of Class 2 NICs in one lump sum. Established self-employed customers who tended to be confident about their business's cash-flow felt there would be no problems with paying £140 at the same time as their tax bill. Newly established or businesses with fluctuating incomes tended to favour monthly in year instalments as they saw smaller regular payments being easier to manage for them as they were not always able to tell when business would be busy or slow.
- Customers welcomed the idea of personalised online Tax and Pension accounts because it would allow them to interact with HMRC online and enable them to access relevant and bite sized information. They perceived this service would give them more control over planning for their future.

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Detailed Findings

- Understanding of Class 2 NICs and the National Insurance system
- Experience of the current Class 2 NICs processes and SA processes
- Reactions to collecting Class 2 NICs through the SA process
- Reactions to an individual online account

Understanding of Class 2 NICs and the National Insurance System

Awareness and understanding of the Contribution system is generally low, although there is some awareness that NICs payments can increase in ‘bands’ depending on how much customers earn. The research identified **three** main sources driving current awareness:

Informal channels/network

Advice from family, friends, other SE people

Previous experience as in PAYE

So aware of NICs but often bundle tax and NICs together

Family history/ culture of paying ‘the stamp’

So note that this is linked to NHS and Pension

- Informal channels where advice was sought from family, friends and other self - employed people who formed informal networks.
- Previous experience in Pay As You Earn (PAYE) where their payslips detailed their deductions but often NICs and tax were perceived to be bundled together.
- Family history and established culture of ‘paying the stamp’ and hearing about this when they were growing up.

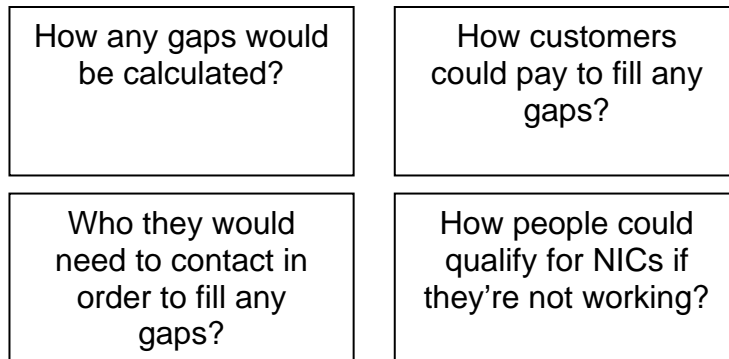
Only a small number of customers remembered being made aware of Class 2 NICs when registering as Self Employed with HMRC.

There was an impression amongst some that payment of Class 2 NICs was optional. They tended to be those who are new to self-employment, those with a Small Earning Exception (SEE) or who had come across information about SEE or those who are both self-employed and employed.

Whilst knowledge of self-employed NICs is low amongst nearly all customers, knowledge around NICs and the link to contributory benefits is even lower. While some made a link between Class 2 or ‘paying the stamp’ to NHS and pensions, there was very low awareness of how and how often Class 2 NICs was paid.

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Specifically, customers had the following questions around NICs and gaps in their contribution record:



Some customers recalled receiving a letter about their contribution gaps “out of the blue”. However, they were unclear what these were about so they tended to either ignore it or show it to someone else such as an accountant or a friend. Some reported paying it as they were worried and did not want to receive any more letters from HMRC.

The research process was an educational exercise for most, so views changed as they became more informed. Prior to being informed about contributions there was a sense that paying Class 2 NICs was important but they were not entirely sure why it had to be paid. Once they became more informed, it became very important because they realised that it was linked to their pension and their financial future.

“I know that I have to pay them [class 2 NICs], I pay by DD and I have for a long time and I know that’s it’s something I have to pay. I don’t really know why I’m paying it.”

(Female, aged 27, SE for 2-5 years, income up to £5,000)

“I’ve always paid it (NI.) It goes back to working full time and always paying NI...for your pension...I knew that’s what you’re building it up for...to go to the doctors and the dentist ...somebody told me that...I think it’s in my mind because of the age I am...I think for younger people starting up their own business, maybe it’s something they don’t really think about.”

(Male, 49, SE for 5+ years, income up to £5,000)

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Experience of the current Class 2 NICs processes and SA processes

Most customers did not have much understanding of the existing system for collecting Class 2 NICs. For many this was a passive experience where they responded to a twice yearly request for payments. Others had set up a direct debit (DD) when they registered as self-employed. It is worth noting that while DD was the preferred option amongst all, there was little motivation amongst twice-yearly payers to switch to DD. A common reason for this was ‘not getting around to doing it’.

Compared to the Self-Assessment process, there was low engagement with the current system for collecting Class 2 NICs. The table below summarises the current experience of both income tax and NICs.

	Income Tax	Class 2 NICs
Process	<ul style="list-style-type: none"> • Headache • Stressful • Complex • Books and expenses • Get accountant involved if possible 	<ul style="list-style-type: none"> • Low engagement • DD and rolling • Pay when bill appears
Amount	<ul style="list-style-type: none"> • Variable 	<ul style="list-style-type: none"> • Standard and low
Consequences	<ul style="list-style-type: none"> • Penalty • Interest 	<ul style="list-style-type: none"> • “What consequences?” • Option to opt out
	HIGH PRIORITY AND ENGAGEMENT	LOW PRIORITY AND ENGAGEMENT

However, once informed, there were very strong feelings about enabling people to make an informed choice regarding opting in or out of Class 2 NICs.

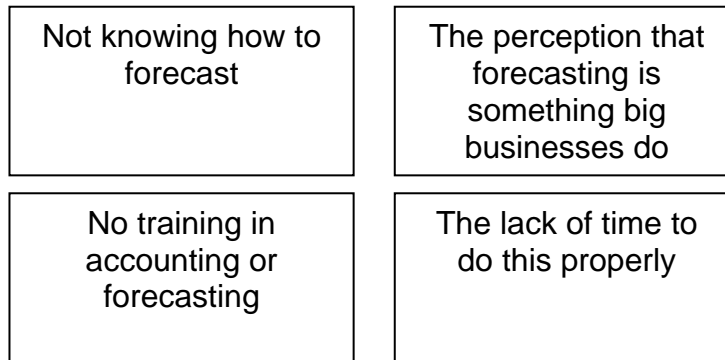
They felt it counter-intuitive not to have any encouragement to pay contributions to their pension. While they expected to be prompted and encouraged to pay Class 2 NICs, they also expected to be told why it is important to pay.

“If they made it clear what you’re paying, what that payment is for...everybody would want to pay that, if there was a clear understanding...I don’t think anybody would not want to.”

(Group, aged 24 – 63, Part year SE, medium-low income)

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Under the current system it is necessary to **forecast** profits in order to apply for SEE and self-employed customers reported that they do not find this easy to do, particularly as fluctuating incomes can make this challenging. Other reasons for their dislike of forecasting include:



“I think it’s strange to forecast something, especially when you’re talking about such a small amount of money and you’re starting out and you become a self-employed person you don’t have a clue how much you’re going to make ...I don’t think a lot of people are thinking along these lines of forecasting ahead.”

(Female, aged 27, income up to £5,000, SE for 2-5 years)

Generally, customers tended to know about SEE only if they currently have one. While awareness of SEE is low, awareness of the **consequences** of applying for a SEE is even lower. Some SEE certificate holders had not spotted that their benefit entitlements could be affected as a result of having an SEE. Once this was pointed out to them it left many feeling angry about this and worried about their future finances.

“They [HMRC] should still make you aware that this will affect you in the future...and your contributions.”

(Female, aged 45, SE for 2-5 years, income up to £5,000)

Those who were also PAYE assumed that they paid enough Class 1 so they believed there were no consequences for them while holding a SEE certificate. However, a small number were aware of the consequences and they had opted out because they felt it would be a temporary situation while their business was getting established and making more money. They saw it as a way to financially support their business getting established with a view to paying additional contributions once their business was generating enough profit.

Those without a SEE certificate, who could potentially be eligible to apply for one, were mostly pleased that they had not known about it as they were not sure they would have

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known about the consequences at the time and did not want to opt out of paying towards their pension.

In general, there were mixed views on SEE and opting out of Class 2 NICs and many felt that there should not be an opt-out option. They felt that the consequences suggest that Class 2 NICs is an important payment and by offering an opt-out there is a danger that many will be left without a pension or access to much needed benefits.

“Class 2 is not a vast amount, why is it not compulsory so you can guarantee your benefits?...so at least you are making some contribution.”

(Group aged 30 – 58 Established SE medium/low income)

“It would be better if they said everyone needs to make national insurance contributions in order to get their state pension.

(Female, 44, SE for less than 2 years, income up to £5,000)

“I’m not seeing the point [in opting out]...I wouldn’t even consider it”

(Group aged 30 – 58 Established SE medium/low income)

However some still wanted to retain an opt-out for those on low profits driven by a belief that choice should always be offered. It was felt that this choice was important because it could be financially valuable for the newly self-employed, those pursuing a passion or a hobby or those who have other pension provision.

“...I like the fact you can choose to opt out...I would rather have it say at this point you are paying or opting out, not choosing to not pay...I still thinks that leaves a little bit of room for confusion”

(Female, 44, SE for less than 2 years, income up to £5,000)

There was a strong belief that choice should be presented with the consequences so that it is a truly informed choice.

The research demonstrated low awareness and understanding of **deferral**. Once deferral was explained many questioned the feasibility of someone being self-employed and earning £42k+ a year from employment.

This scenario did not resonate with them and they felt disengaged from the process as it did not apply to their financial circumstances. Moreover, there was confusion among some PAYE customers regarding the obligation to pay Class 2 as they assumed they only had an

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obligation to pay Class 1. One specific insight around the word 'deferment' is that it was negatively interpreted in some parts of the country to mean 'delaying'. This did not sit well with those who dislike debt and feared being in arrears.

Reactions to collecting Class 2 NICs through the SA process

All customers were shown an overview of the new proposed system whereby Class 2 NICs would be aligned with the SA process. They were generally all positive about it, especially those customers who had spontaneously suggested alignment with Self-Assessment and therefore were pleased that the new proposed system met this need.

Established businesses with high or medium profits did not foresee any problems with the requirement to pay a lump sum of £140 along with their tax bill by the end of January as they were confident they could pay this.

"The lump sum is good if you can afford it"

(Group aged 30 – 58, Established SE, medium/low income)

However, there was some resistance regarding payment of £140 in one go in January amongst newly established businesses or those with fluctuating incomes. This group of customers could foresee cash-flow issues in January, particularly if October – December were lean months for their business. This left them concerned that they might not be able to pay the bill and therefore wanted to be able to continue with monthly instalments, to enable small, manageable payments.

"...it all makes perfect sense...but I would be more panicked about money coming all out...I would have to think about that during the year...if there was an option whereby it could be split over the next 12 months (tax and NIC)."

(Female, aged 27, income up to £5,000, SE for 2-5 years)

"If I have a slow month...I would worry not being able to pay it...I would prefer to have it paid and out the way...it's the way I work things...I would rather pay it up front and if anything went wrong I know where I was and that it was paid."

(Female, 41, SE for less than 2 years, income from SE up to £5000 and income from PAYE up to £10,000)

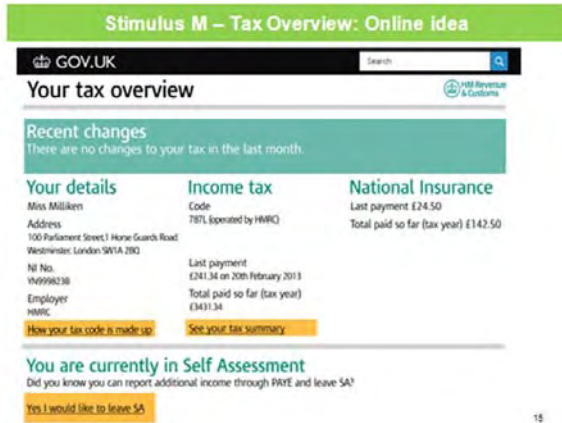
Ideally customers would like to know about the move to the new system well in advance to enable them to plan for the payments. Some envisaged depositing monthly instalments of Class 2 NICs to a private account so that they could build up the money incrementally and pay the bill along with their tax in January.

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“I don’t mind if there are changes...it wouldn’t make a massive difference, it would make a difference if I had to change the way I paid it (does not want to pay a lump sum)”

(Female, aged 27, income up to £5,000, SE for 2-5 years)

Reactions to an individual online account



Customers were shown some concepts as part of HMRC’s digital strategy. The Tax Overview concept was very positively received by all because of its element of personalisation for the customer.

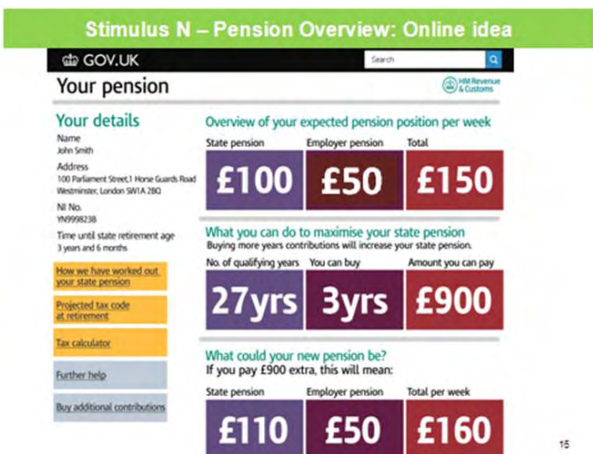
Customers liked the idea of having information about their tax online. This was particularly the case for those who like to manage banking online. They felt that it would be useful to have an easy to access up-to-date portal detailing their information.

There was also some appetite for a space to record on-going financial details that could provide a forecast of Class 4 NICs. Customers welcomed the opportunity for relevant personalised information and the opportunity to interact with the portal/application e.g. allowing them to insert figures and get a forecast of their profit.

“It would be very useful because it’s unique to you, it’s all your information on that page, you’re not having to phone up and wait in a queue to speak to someone...it’s all there for you to see...that would appeal to me.”

(Female, 44, SE for less than 2 years, income up to £5,000)

“It’s simple...I think if that was for self-employed people, I would want to see what benefits you’ve received and impact on tax. I assume it wouldn’t have any impact on NI ...there should be something about company pension.”



(Male, 57, SE for Less than 2 years, £12,000 +)

The Pension Overview concept was also very positively received by most customers. They were very keen to view information about their pension, and this was driven by a current lack of understanding around how the state pension is calculated and the relationship between Class 2 NICs and pension entitlement.

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Those less keen on this information were those who were generally not interested in engaging in information about their pension and they tended to be younger people, those financially unable to consider putting money aside for later in life or those who were cynical about the provision of state pension. Those customers keen on the idea felt that this would give them more control and some felt that this could help them plan their financial future a lot better. (The figures in the concept above are for illustrative purposes only)

“I love that idea...you just don’t have an idea really; you get a letter once in a blue moon. To see it like that and be able to click online and see where you are in terms of paying your pension, I really love that. Tax calculator, I like that...just so that I know where I am in regards to whether I need to opt out and where I’m at or where I need to be if I’m able to pay in more.”

(Female, 41, SE for less than 2 years, income from SE up to £5000 and income from PAYE up to £10,000)

“I’m desperate to see something like this that is personal to me.”

(Female, 44, SE for less than 2 years, income up to £5,000)

“That makes sense because I’ve never seen anything like that before, I don’t know how much state pension I would get... because it’s something you need to do for a long time... so if it was easily accessible it would be better.”

(Female, aged 27, income up to £5,000, SE for 2-5 years)

This research sought to understand awareness and understanding of the current Class 2 NICs system amongst self-employed customers and ascertain their views on the proposed changes. Following the qualitative research, it is clear that while engagement with the current process is low because of a lack of knowledge, the proposed changes present a good opportunity to improve engagement levels if customers are informed of the relevance and importance of paying Class 2 NICs as well as the consequences of not paying.

The research also highlighted that there is a positive attitude towards collecting Class 2 NICs through the Self-Assessment process, with a desire among some customers to retain in-year payments.

This research also tested customer reactions to the idea of an individual online account that gives the individual opportunity to manage their National Insurance affairs on line. This was very positively received by all and the findings should support HMRC as it embarks on a transformation programme with the ambition to put more of its services online.