

Self-employed NICs consultation  
C/o Personal Tax team  
HM Treasury  
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25 February 2016

**Consultation on abolishing Class 2 National Insurance and introducing a contributory benefit test to Class 4 National Insurance for the self-employed**

The relationship between self-employment and social security has always been complex. The Social Security Advisory Committee (SSAC) published a review of the relationship in September 2014, [Social security provision and the self-employed](#), in which we noted the growth in self-employment in recent years. Of note was the changing composition of the self-employed, with more part-time workers, with increased numbers of women, greater disparity between the earnings of men and women, disparity of earnings between those working in London and those working elsewhere in the country; above all we noted a significant growth in low income self-employment and greater income volatility.

As a Committee, we support the contribution the self-employed make to economic activity, innovation and competitiveness. Equally, we are of the view that social security should not only support the broader economy but seek to mitigate the risks faced by those who wish to become entrepreneurs. As expressed in the foreword to our 2014 report: “Striking an appropriate balance between *de minimus* burden and *de maximus* risk mitigation is the challenge policy makers face.” (p.5)

The contributory principle lies at the historic heart of the social security system. National Insurance contributions (NICs) are made to the funding of social security and the National Health Service via National Insurance. Introduced in 1911, revised extensively during the inter-war period and reformed as part of the post war settlement in 1948, National Insurance represents, in essence, a tripartite contract between employee, employer and government. An appropriate number of contributions establish entitlement to a range of benefits as of right, related to a number of risks including unemployment, ill-health, bereavement, maternity, disability and retirement. Contribution conditions and qualifying rules are complicated and especially so for the self-employed. NICs now fall into a number of classes: Class 1, 2 and 3 (when paid) are credited to an individual’s National Insurance Account and this is used to establish eligibility for certain benefits and payments; Class 1A, 1B and Class 4 do not establish an individual’s entitlement but must nevertheless be paid if due.

The Committee is pleased to note, and we endorse, the government's commitment to ensuring that:

- "...the contributory principle is retained in the National Insurance system for self-employed people
- no-one loses access to the State Pension
- any changes to the benefit entitlement tests maintain access to Maternity Allowance."

The Committee is also sympathetic to the principle and objective of simplification of current National Insurance rules. However, the pursuit of simplification in one area may result in unintended complexity in another. Indeed there is serious risk that partial reform, of the kind proposed for this consultation, and in the absence of an overview of the social security needs of self-employed people and their dependents, will bring about unintended consequences and impacts. Moreover, the pursuit of simplification may conflict with the principles of entitlement and risk mitigation. The Committee would wish to be satisfied that the trade-off is balanced and proportionate. In this context we are disappointed at the absence of a published impact and equality statement to accompany these proposals. Moreover, the consultation document provides little empirical data to illustrate the consequences (both intended and unintended) for the various categories of self-employed worker.

In the absence of such data it is difficult to identify winners and losers and this is bound to have impaired the ability of many stakeholders to respond in an informed manner. In particular we have a particular concern for those who are engaged in what might be called 'pseudo-self-employment' (such as cleaners, care workers or construction workers) and for whom this form of self-employment is the only employment opportunity available and not (either) a life-style choice or a way 'to build a business'. Published analysis of how these proposals would impact on such workers compared to those doing similar/equivalent work under contracts of employment as employees has not been provided.

The Committee is not convinced that the proposal to abolish Class 2 contributions is the appropriate or logical response to the recommendations made by the Office of Tax Simplification (OTS) in its 2011 Report. Our view is that the OTS report was recommending a comprehensive review and simplification of the complex relationship between self-employment and social security: instead, this proposal is partial and restricted in scope but may (as a result) add to complexity. Indeed, as noted below the very timing of this proposal is questionable.

It is unclear if this proposal is the first (but indicative) reform/change in advance of a wider reform programme or a 'stand-alone' event: clarity of purpose and timetable would be good to know. Meanwhile the decision, effective from April 2015, that Class 2 NICs are to be paid through Self-Assessment alongside income tax and Class 4 NICs may be thought to have already contributed to some welcome simplification.

On the other hand the conflation of NICs/tax for the self-employed may have unexpected and challenging consequences for them should they need to interact with the benefits system. Sometimes, the benefits system operates uncomfortably for those who have significant peaks and troughs of income and expenditure. The aggregation of Class 2 NICs with tax liabilities can create such an event. As Universal Credit rolls out and begins to embrace the larger population of the self-employed, this may very well become an issue to consider.

Although the government has not committed to a firm timetable for implementation, there are clear indications of a preference for changes coming into effect from April 2017. This may be premature bearing in mind the significant changes that the Government are proposing for the low income self-employed over the next few years. The Committee believes it may be prudent to delay these proposals pending the phasing out of Tax Credits, further roll-out and monitoring of Universal Credit, the introduction of conditionality for the self-employed, together with further maturing of the HMRC digitisation strategy.

There are also issues to address regarding the different calculation bases for Class 4 NICs and Universal Credit. We note that the Office for Tax Simplification has recently conducted a review of the relationship between NICs and the tax system but has yet to publish its report. We would recommend that government delays further progress with its current proposal to abolish NICs Class 2 pending publication and wide consideration of the OTS report.

Turning to the specific consultation questions, the Committee has the following observations and comments to offer.<sup>1</sup>

## **Chapter 2: A reformed Class 4 NICs and an annual profits test**

***Question 1: Do you think that the government should seek to maintain the existing level of access to contributory benefits? If so, how do you think this should be achieved?***

As the Committee argued in its 2014 report, we believe that the self-employed should be supported in their desire to become self-sufficient entrepreneurs; to that end contributory social security should seek to recognise and mitigate risk and in so doing promote a society which is inclusive, cohesive and mutually supportive. In the absence of risk mitigation measures afforded through social security it is possible that the prospect of pursuing a life of self-employment will become less attractive and in consequence the economy as a whole will suffer.

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<sup>1</sup> The Committee does not have the detailed knowledge required to offer an informed view on Chapter 5 (questions 11, 12 and 13).

In the absence of a satisfactory evidence base the Committee is concerned, given what it knows about the changing composition of the self-employed population (and in particular the growing numbers of women who are self-employed and their preponderance amongst those in the bottom quartile of the income distribution) that it will be the weakest and most vulnerable (for example women, those with disabilities and others on the margins of economic viability) who will be most affected by these proposals. A simple mechanism should be established and maintained to ensure that the particular risks faced by these categories of self-employed people are properly understood and mitigated.

***Question 2: This chapter explains the government's proposed approach – a profits test at the Small Profits Threshold in Class 4 NICs – and how this could work for self-employed people with profits above the Small Profits Threshold to determine entitlement to the State Pension, Bereavement Benefit and contributory Employment and Support Allowance. Noting the difference between this and the existing benefit entitlement rules (set out in Annex C), what are your views on this general approach?***

Our general reservations to one side, we welcome within the proposal that those earning below the Lower Profits Limit but above the Small Profits Threshold should receive NIC credits. However, what we know about the self-employed is that their income can vary (and be lumpy) over time and that they sometimes mix and match employment with self-employment. In these circumstances the calculation of contributions to be made would be complex and may be disadvantageous to the self-employed. For those earning below the Small Profits Threshold the prospect of having to make voluntary Class 3 contributions (as £14.10 per week compared with Voluntary Class 2 at £2.85 per week) does not look to be a good deal.

***Question 3: What are your views on the proposed contributory tests in Table 2.A? Can you suggest any alternative contributory tests based on annual profits for: a. State Pension? b. Bereavement Support Payment? c. Employment and Support Allowance?***

We do not have specific observations to make about the contribution test for the State Pension, but are concerned at what appears to be a doubling of the contribution requirements for Bereavement Benefits (up from 26 weeks of Class 2 to 1 qualifying year in Class 4). We do not see the rationale for this. In addition we are concerned that higher rates of fatal industrial injuries in several self-employed occupations (farming, forestry, fishing and construction for example) may be significant when assessing the impact of this proposed change.<sup>2</sup>

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<sup>2</sup> See: <http://www.hse.gov.uk/statistics/pdf/fatalinjuries.pdf>

**Question 4: To what extent do you think that people – and self-employed people in particular – are sufficiently aware of the existing provisions in the NICs system that currently protect entitlement to the State Pension and Bereavement Benefits, namely NI credits and Class 3 voluntary NICs?**

We find this to be a complex and challenging area requiring details and sometimes arcane knowledge; we believe that understanding of these complex issues is not widely shared. Of particular concern is the low proportion of self-employed workers (especially those at the lower end of the income distribution) who engage (or can afford to engage) knowledgeable professional advisors. Our 2013 report on [Communications in the benefits system](#) provided extensive evidence about low levels of understanding about social security in the broadest sense.

**Question 5: Do you agree that the government should align voluntary contributions (i.e. by making Class 3 the only voluntary NICs payment) for the new State Pension for employees and the self-employed? Please give reasons.**

All other things being equal, we believe that the treatment of the employed and self-employed should be comparable – reflecting the increasingly complex and fluid nature of the labour market in which people can occupy both status positions simultaneously or move between one and the other as economic circumstances demand. Our key concern is that Voluntary Contributions are (now) set at a much higher rate (£14.10 per week) than NIC Class 2 (£2.85 per week). For those on very low income we find the prospect of making voluntary Class 3 contributions to be most unlikely. As a result these people (and in the absence of data we do not know their number) would be excluded from a range of contributory benefits.

Moreover, we think the time limit of six years for the retrospective payment of contributions (helping to make good a contribution record) may be too short for many as their businesses mature to financial sustainability. With an increase to 35 years in the contributions record for State Pension this may become a significant consideration. The implications of auto-enrolment also need to be factored into the assessment of proposed changes to NICs.

**Question 6: Do you think the government should continue to enable individuals who have not made a contribution via sufficient self-employed profits to access: a. Bereavement Support Payment? b. Contributory Employment and Support Allowance?**

The Committee has recently published a report on [Bereavement Benefit Reform](#) and we welcome the government's commitment to simplifications and in particular the extension of entitlement to those under 45. The government affirmed a commitment to the contributory principle in respect of bereavement benefits, has liberalised entitlement rules and we see no reason for that principle not to apply to the self-employed. The security and confidence about income that comes from entitlement to bereavement benefits is particularly important to those recently bereaved and therefore at their most vulnerable.

***Question 7: Do you agree that the government should consider facilitating this access through Class 3 voluntary contributions?***

The principle of being able to make voluntary contributions is important and should be upheld. However, there is a problem. Since 2002 the cost of Class 3 contributions has increased and diverged significantly from current Class 2 rates. The level of Class 3 contributions may act as a serious barrier/impediment to voluntary contribution and thereby increase the numbers without entitlement to benefits. It would have been helpful to have had data on the number/rate of voluntary contributions over time (especially among those on the lowest incomes). If numbers have declined this would suggest that high cost voluntary contributions are not attractive or feasible for those otherwise not covered by current Class 2. It may also be necessary to consider the role of Class 3 contributions as a deduction under Universal Credit.

**Chapter 3: Access to Maternity Allowance**

***Question 8: Do you have any comments on the approaches proposed for Maternity Allowance in chapter 3? Do you have any preferences for an approach based on:***

- a. A profits test with optional payment of Class 3 NICs during the 13 week test period (to protect those with low profits or who have no recent profits)***
- b. Estimated earnings during the 13 week test period***
- c. (For participating spouses only) The conditions of the existing employment test only***

We note the complexity of the options and therefore are inclined to observe that the proposed 'work around' is no less (and possibly more) complicated than the existing arrangements. We also suspect that it will be difficult and not always accurate to determine profits with respect to any 13 week period because we know that self-employed income (and offset costs/expenses) can be 'lumpy and variable' (ie fluctuate in both value and frequency).

***Question 9: Can you suggest any alternatives?***

We would argue that the existing arrangements are not changed unless implications and consequences are properly understood.

**Chapter 4: Self-employed people with multiple sources of earnings**

***Question 10: Do you have any comments on the proposals to provide for individuals moving into and out of self-employed within the tax year, who may be less able to achieve annual profits at the Small Profits Threshold?***

No – beyond noting that this is complex but important. We have previously noted the challenges that this and closely related issues present as Universal Credit is rolled out.

Social Security Advisory Committee  
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