



HM Government

Abolishing Class 2 and reforming Class 4 National Insurance contributions: response to the consultation

December 2016



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1 Introduction

1.1 The self-employed currently pay two classes of National Insurance contributions (NICs): **Class 2 and Class 4**.

1.2 Class 2 NICs are flat-rate weekly contributions (£2.80 per week in 2016-17) and give access to contributory benefits for the self-employed. They are paid for every week or partial week of self-employment in a tax year, where the person's net profits (after deductions) for that tax year are equal to, or exceed, the Small Profits Threshold (SPT, £5,965 in 2016-17). Payment of Class 2 NICs is voluntary for those with profits below this level.

1.3 Class 4 NICs are payable at a rate of 9% on net profits between the Lower Profits Limit (LPL, £8,060 in 2016-17) and Upper Profits Limit (UPL, £43,000 in 2016-17) and 2% on net profits above the UPL. They do not currently give access to contributory benefits.

1.4 Budget 2016 confirmed that the government will abolish Class 2 NICs in April 2018. This represents a NICs cut, of, on average £134 a year. This commitment builds on recommendations from the Office for Tax Simplification,¹ who noted that the abolition of Class 2 NICs would be a worthwhile simplification of the self-employed NICs system.

1.5 Class 2 NICs give self-employed individuals access to the State Pension and other contributory benefits. Following the abolition of Class 2 NICs, new contributory benefit tests will be required to enable self-employed individuals to continue to gain access to the State Pension and other contributory benefits.

1.6 The government consulted on how this new test could operate between 9 December 2015 and 24 February 2016. 46 responses were received from individuals and organisations.² The government has carefully taken these responses into account before making its final decisions on the way to abolish Class 2 NICs.

1.7 This document confirms that:

- From 2018-19, **self-employed individuals will be able to gain access to contributory benefits based on a profits test in Class 4 NICs.** This will enable self-employed individuals to continue to gain access to the new State Pension, contributory Employment and Support Allowance (ESA) and Bereavement Support Payment (BSP). This will be a simpler and more transparent way of conferring access to contributory benefits. It means the self-employed will only have to pay one type of NICs.
- **A new zero-rate band will be introduced into Class 4 NICs on profits between the Small Profits Limit (SPL, which replaces the Class 2 SPT) and the Lower Profits Limit (LPL, £8,060 in 2016-17).** Class 4 NICs will be treated as having been paid on these profits. This means that everyone who was previously liable to pay Class 2 NICs based on their profits will be able to gain access to benefits through Class 4 NICs, whether paid or treated as paid. They will be able to gain a qualifying year for benefit entitlement purposes for each tax year in which their profits are above the SPL.³
- **The Standard Rate of Maternity Allowance (MA) for the self-employed will be accessed using Class 3 voluntary NICs.** This will ensure that women are able to access Maternity Allowance when they need it. This means that, for self-employed women, the NICs system will continue to determine the rate at which MA is paid in

¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/199183/05_ots_small_business_interim_report.pdf

² Annex A provides a summary of the consultation responses and the main themes and concerns raised.

³ The remainder of this document refers to the profits level at which someone is treated as having paid Class 4 NICs as the SPL.

a similar way as now. Access to MA for women who participate in the self-employed business of their spouse or civil partner will no longer be based on the spouse's/civil partner's NICs record.

- **As is currently the case, those with profits below the SPL will continue to be able to gain access to the new State Pension, through earnings subject to payment of Class 1 Primary (employee) NICs; through NICs credits; or through payment of Class 3 voluntary NICs.** The new State Pension rules mean that, between the ages of 16 and State Pension age (when NICs are payable), an individual could have up to 15 years without any NICs paid or NI credits recorded, and still be entitled to the full State Pension.⁴
- **The government will also enable self-employed individuals who (because of their profit levels) would not gain access to contributory ESA through Class 4 NICs to do so using Class 3 voluntary NICs.**
- Class 2 NICs abolition will see the **removal of the complex 'special rules' for various groups of Class 2 NICs payers.**
- **The Foster Carers National Insurance credit currently provides foster carers with access to the state pension. The government will upgrade this to a Class 1 credit, which provides access to contributory Jobseeker's Allowance and Employment and Support Allowance.** This will help maintain Foster Carers' access to these benefits.
- **Transitional arrangements will be introduced to enable individuals with low profits, share fishermen and volunteer development workers to rely on their contribution record in the years prior to Class 2 abolition for longer than usual when claiming contribution-based Jobseeker's Allowance and contributory Employment and Support Allowance.** The transitional arrangements will remain in place until 1 January 2022.

How these changes will be made

1.8 Primary legislation is required to implement these reforms. This will be introduced in due course. Draft clauses are published alongside this document.

Scope of these changes

1.9 Social security is a transferred matter in Northern Ireland but generally mirrors the system that operates in Great Britain in terms of the range of benefits provided, the conditions of entitlement and the rates. The National Insurance system, however, is an excepted matter under Schedule 2 to the Northern Ireland Act 1998.

This document

1.10 Chapter 2 explains how Class 4 NICs will be reformed to enable the self-employed to gain access to contributory benefits. It describes how individuals with profits below the SPL – who will not be able to access benefits through Class 4 NICs – would be affected by this change and the arrangements the government intends to introduce to give them time to prepare for the forthcoming changes.

1.11 Chapter 3 describes the government's plans for Class 3 voluntary NICs to enable self-employed women to access the standard rate of MA on a similar basis as now and how women who participate in the self-employed business of their spouse or civil partner will be able to access MA. It also notes how payment of Class 3 voluntary NICs will in future help maintain

⁴ Subject to transitional rules that apply to individuals who paid or were credited with NICs before 2016/17.

access to contributory Employment and Support Allowance for the self-employed who will not qualify through Class 4 NICs.

1.12 Chapter 4 describes the government's planned approach for special groups of Class 2 NICs payers.

1.13 Chapter 5 notes the next steps that the government will take before it will abolish Class 2 NICs in April 2018. Finally, Annex A provides an overview of the issues and concerns raised in responses to the consultation, and Annex B lists the organisations who responded to the consultation.

Reforming Class 4 NICs to confer entitlement to contributory benefits

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2.1 This chapter confirms how contributory benefit tests based on profits in Class 4 National Insurance contributions (NICs) will work, and how this will determine access to contributory benefits for the self-employed. It sets out how self-employed individuals could be affected by these changes and what transitional arrangements will be provided.

2.2 Access to Maternity Allowance (MA) is challenging to facilitate through Class 4 NICs. Because of this, the government will introduce special provisions based on Class 3 voluntary NICs to maintain self-employed access to the standard rate of MA. This is discussed separately in Chapter 3.

The structure of Class 4 NICs from 2018-19

2.3 The consultation document set out a proposed approach for abolishing Class 2 NICs and introducing new contributory benefit tests based on Class 4 NICs.

2.4 This document confirms that, in April 2018, Class 4 will be reformed to confer entitlement to the new State Pension and other contributory benefits.

- The contribution conditions attached to the new State Pension and other contributory benefits will be changed to enable Class 4 NICs to count towards benefit entitlement.
- A new zero-rate band of Class 4 NICs will apply on annual profits between a threshold to be known as the Small Profits Limit (SPL) and the Lower Profits Limit (LPL, the point beyond which Class 4 NICs become payable).
- This means that self-employed individuals with annual profits at or over the SPL will be able to gain qualifying years (QYs) for benefit entitlement.
- The SPL will be aligned with the annual equivalent of the Lower Earnings Limit (LEL) in Class 1 employee NICs.

2.5 The existing and proposed systems are shown in Figures 2.A and 2.B.

Figure 2.A: The existing Class 2 and 4 NICs structure

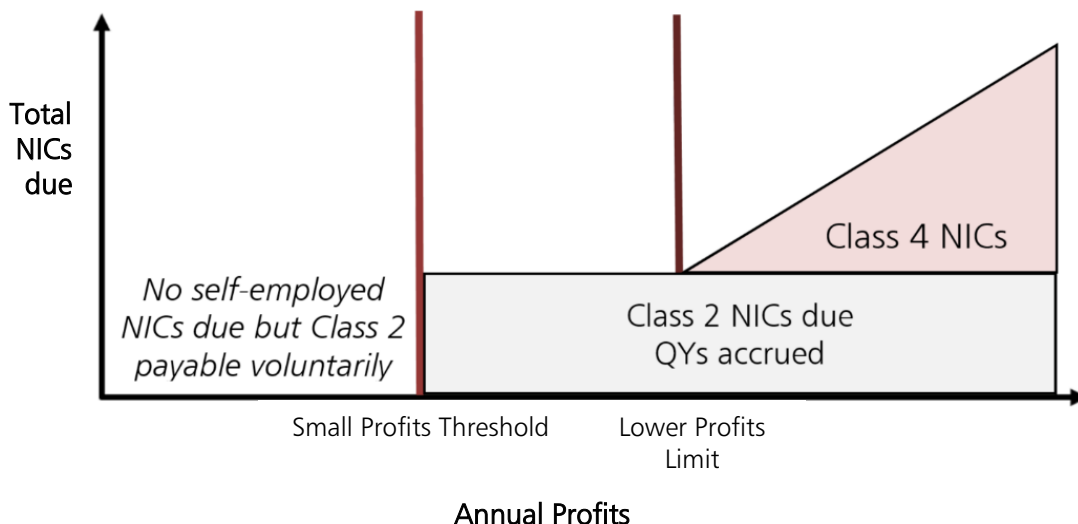
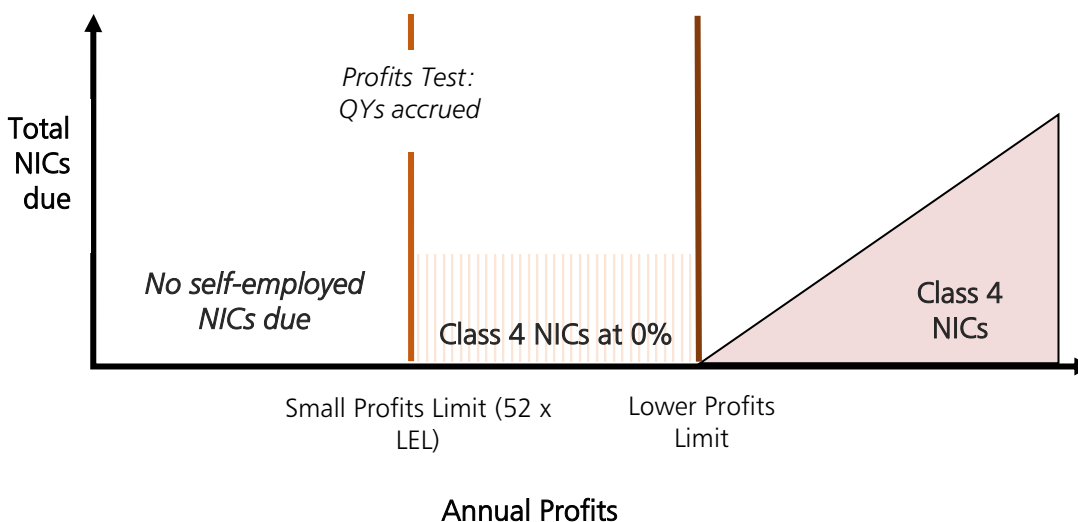


Figure 2.B: The proposed Class 4 NICs structure



(QY = Qualifying Year towards the State Pension)

2.6 This reform means that self-employed individuals will gain access to benefits if their profits are over the SPL, even though Class 4 NICs are only paid on profits over the LPL. This is consistent with the rules in place for employees, who are treated as having paid Class 1 NICs with earnings between the LEL and the Primary Threshold in an earnings period. By aligning the way in which employees and the self-employed gain access to benefits based on their earnings or profits, this reform also makes the NICs system simpler and more equitable for all.

The contributory benefit tests from 2018-19

2.7 From April 2018, the new contributory benefit tests for the self-employed will operate on the basis that annual profits at or above the SPL will confer **one qualifying year** towards benefit entitlement.¹ This does not apply to MA, for which access to the standard rate will be through a new set of rules based on payment of Class 3 voluntary NICs. This is addressed in Chapter 3.

2.8 Table 2.A sets out the current benefit tests for the self-employed (based on Class 2 NICs) and the approaches that will be taken following the introduction of a profits test into Class 4 NICs.

¹ Provided that any Class 4 NICs due are paid.

These changes are needed because of the move from a weekly charge to an annual charge based on profits.

Table 2.A: Current and future entitlement tests for contributory benefits

Benefit	Current entitlement tests	Class 4 profits test
New State Pension (from April 2016)	For those contributing for the first time under the new system, 35 x qualifying years ² are required to be entitled to the full amount on reaching State Pension age (a minimum of 10 qualifying years is needed to be entitled to any State Pension). Transitional rules will apply to individuals with NICs and NI credits under the old system.	<u>No change</u> required to the existing qualifying year rules
Bereavement Support Payment (from April 2017)	25 weeks of Class 2 contributions in any one tax year	1 qualifying year in any past year
Contributory Employment and Support Allowance	26 weeks x Class 1 and/or Class 2 NICs in one of the previous two tax years and 50 weeks x Class 1 or Class 2 NICs or Class 1 NI credits during both of the previous two tax years ³	1 qualifying year in one of the past 2 last recorded tax years and 1 qualifying year or 50 Class 1 NI contributions or credits in both of the previous two tax years

2.9 Class 2 NICs paid in respect of any tax year prior to their abolition in 2018 will continue to count towards benefit entitlement. For instance, a qualifying year comprised of Class 2 NICs paid in 2017-18 will still count towards an individual's State Pension.

Impact on the self-employed who have profits under the SPL

2.10 Self-employed individuals with profits below the SPL are currently able to pay Class 2 NICs voluntarily to gain access to the new State Pension and other contributory benefits. This will no longer be possible once Class 2 NICs have been abolished. Many responses to the consultation raised the benefit position of those with profits under the SPL as a concern (see Annex A for more information). Responses noted in particular that the cost of a Class 3 contribution (£14.10 per week in 2016-17) is greater than the corresponding value of a voluntary Class 2 contribution (£2.80 per week in 2016-17) for those wishing to gain access to the State Pension via payment of voluntary NICs.

2.11 This section explains how this group would be affected by the abolition of Class 2 NICs in April 2018 in relation to the following benefits:

- New State Pension
- Contributory Employment and Support Allowance (ESA)
- Bereavement Support Payment (BSP)

2.12 The government wants to ensure that self-employed individuals who have profits below the SPL can continue to gain access to the new **State Pension**. There is already protection in the NICs system for these individuals to do this:

- government analysis suggests that in 2018-19, around 77%⁴ of all self-employed individuals expected to have profits below the SPL will see their State Pension record

² 52 x NICs of any class, NI credits or combinations of these, would be required to gain a qualifying year.

³ The previous two tax years which immediately precede the beginning of the benefit year in which a claim is made (a benefit year roughly equates to a calendar year).

⁴ This is based on HMRC forecasts. This figure also includes those who have already achieved the maximum number of qualifying years towards the State Pension.

protected by NI contributions from employment alongside self-employment, by NI credits or will already have a full State Pension record⁵

- the remainder will still be able to pay Class 3 voluntary NICs to gain access to the new State Pension for those years in which their profits were below the SPL. Class 3 NICs can usually be paid for up to six years after the year in which an individual did not achieve a qualifying year. Individuals are able to check their National Insurance record on their Personal Tax Account (via GOV.UK) before deciding whether to pay Class 3 voluntary NICs⁶
- an individual needs 35 years of NICs and/or NI credits to qualify for the full rate of the new State Pension. NICs are currently payable by those aged between 16 and State Pension age, which means that an individual could have up to 15 years of gaps in their National Insurance record without their State Pension award being affected
- the median duration of self-employment is between six and ten years.⁷ This means that those with profits below the SPL are unlikely to rely solely on their profits for their entire working lives

2.13 Analysis suggests that those expected to pay Class 3 NICs in any one year following the abolition of Class 2 would represent only 5% of those with profits below the SPL in 2018-19, and around 2% of all self-employed individuals who may have self-employment profits.⁸

Box 2.A: The self-employed and the new State Pension

The new State Pension allows self-employed individuals to gain a greater amount of State Pension than they were able to in the past. Under the old system, Class 2 NICs counted towards the basic State Pension (a maximum of £119.30 a week in 2016-17, for 30 years of contributions). However, Class 2 NICs did not count for the earnings-related additional State Pension. This meant that in general, each qualifying year based on Class 2 NICs in the 'old' system would only have been worth £3.98 of State Pension per week every year.

Under the new State Pension, all contribution years after 6 April 2016 will add a year of new State Pension in the same way for all classes of NICs and credits. That is 1/35 of the full amount for each post-2016 year. The full new State Pension is £155.65 a week in 2016-17, for 35 years of contributions. Therefore, a qualifying year gained under the new system, including those by self-employed individuals, is worth £4.45 of State Pension per week. As a result, it will be possible for self-employed individuals to gain a much higher State Pension (with 35 years of any NI contributions) under the new State Pension system, than they could in the previous system (with 30 years of Class 2 NICs).

2.14 Class 3 NICs are voluntary payments of NICs. They currently confer access to the State Pension; they do not currently confer access to contributory ESA or Bereavement Support Payment (BSP). In view of concerns raised specifically about ESA access, **the government will introduce provisions to enable individuals to pay Class 3 voluntary NICs to maintain access to contributory ESA** (see next chapter).

2.15 From its introduction in April 2017, entitlement to BSP will be based on a test of having paid Class 2 NICs for 25 weeks in a single tax year. Following the abolition of Class 2, the

⁵ NI credits are available to individuals in certain circumstances and help to protect their future entitlement to contributory benefits. More information is available here: <https://www.gov.uk/national-insurance-credits/overview>.

⁶ More information is available on how to check your National Insurance record is available here: <https://www.gov.uk/check-national-insurance-record>

⁷ Department for Work and Pensions analysis

⁸ This is based on HMRC forecasts showing that there will be over 5 million self-employed individuals who may be liable to NICs in 2018-19.

government will amend the rule to align with an annual Class 4 profits test. From 2018-19, a single qualifying year of Class 1 or Class 4 NICs will be required in order to gain entitlement to BSP. The introduction of a test based on Class 4 NICs is not expected to have any measurable impact on overall BSP entitlement: for an individual to not be entitled to BSP, they would need to have paid insufficient NICs in all previous tax years in their working life. While the government does not therefore intend to introduce any additional specific provisions into the NICs system in relation to this, it will continue to monitor the impact of this change.

2.16 The consultation document stated that the government was considering introducing special provision for self-employed individuals with profits below the SPL who have multiple sources of earnings or who moved into and out of self-employment within the tax year. However, the existing provisions that would protect an individual's access to the State Pension (as outlined above), and the new provisions that will protect access to contributory ESA, mean that no additional facility is required to protect self-employed access to contributory benefits. All options here would have been complex for individuals and HMRC to administer. The government does not wish to reintroduce unnecessary complexity into a reformed and simplified self-employed NICs system.

Transitional arrangements

2.17 The government will introduce transitional arrangements to enable individuals with profits below the SPL, share fishermen and volunteer development workers to rely on their contribution record in the years prior to Class 2 abolition for longer than usual when claiming contribution-based Jobseeker's Allowance and contributory ESA. The transitional arrangements will remain in place until 1 January 2022.

Maintaining voluntary contributions for Maternity Allowance and contributory Employment and Support Allowance

3

3.1 This chapter considers the consultation responses to the proposals for a new earnings test for self-employed women claiming Maternity Allowance (MA), and how to maintain access to MA for women who participate in the business of their self-employed spouse or civil partner. It confirms how the government intends to proceed in light of those responses.

3.2 This chapter also sets out the government’s intentions for maintaining access to contributory Employment and Support Allowance (ESA) for those who do not meet the new Class 4 National Insurance contributions (NICs) requirements.

Maternity Allowance

3.3 For self-employed women, entitlement to MA is currently based on an employment test and an earnings test, the latter of which involves payment of Class 2 NICs. Unlike entitlement to the new State Pension or (from April 2017) Bereavement and Support Payment (BSP), these Class 2 NICs must be paid in respect of weeks falling within a prescribed period of 66 weeks immediately preceding the week the baby is due, known as the test period, in order to gain entitlement to the standard rate of MA. For women who participate in the business of their self-employed spouse or civil partner, access to MA is, in part, determined by the Class 2 NICs record of their spouse or civil partner.

3.4 The earnings test for self-employed women is based on payment of Class 2 NICs; sufficient payment of Class 2 NICs confers entitlement to MA paid at the standard rate. Self-employed women who have not paid sufficient Class 2 NICs are entitled to MA at the lower rate, provided they meet the employment test. Access to MA for women who participate in the self-employed business of their spouse or civil partner is also based on the spouse’s or civil partner’s Class 2 NICs record. **Table 3.A** sets out the current rules for MA entitlement.

Table 3.A: Current entitlement tests for Maternity Allowance

What type of MA claimant	Current entitlement rules
Self-employed women	<p>“<u>Employment test</u>”: The claimant must have been self-employed for any part of the week, in at least 26 of the 66 weeks immediately preceding the week the baby is due (this 66 week period is known as “the test period”).</p> <p>“<u>Earnings test</u>”: The claimant must have paid Class 2 NICs for at least 13 weeks in the test period to receive the standard rate of MA (currently £139.58 per week, paid for up to 39 weeks). A lower rate of MA (£27 per week, paid for up to 39 weeks) may be paid to self-employed women who have not paid Class 2 NICs for 13 weeks of the test period.</p>

<p>Women participating in the self-employed business of their spouse or civil partner</p>	<p>“Employment test”: The claimant must have taken part in the business for any part of the week in at least 26 weeks of the test period.</p> <p>“Earnings test”: The claimant will receive the lower rate of MA (£27 per week, paid for up to 14 weeks) if her self-employed spouse or civil partner has paid Class 2 NICs in respect of the same 26 weeks during which the claimant participated in the business.</p>
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3.5 Following the abolition of Class 2 NICs, a new earnings test will be required for self-employed women. This is set out below.

The earnings test for self-employed Maternity Allowance claimants from 2018-19

3.6 The consultation document proposed two approaches for a new earnings test for self-employed MA claimants:

- an earnings test based on a profits test in Class 4 NICs, with the option to pay voluntary Class 3 NICs where the woman’s profits were not sufficient or they had not yet been assessed in the relevant tax year
- an earnings test based on self-declared estimated earnings over 13 weeks during the test period. These estimated earnings would be averaged and used to determine the rate of MA payable

3.7 Consultation responses on these proposals were clear that the replacement earnings test for self-employed access to MA should be simple, easy to understand and not disadvantage self-employed women. The government has taken these comments on board in deciding whether and how to proceed with the options proposed in the consultation.

3.8 As a result of the government’s consideration of the responses it has decided not to adopt either approach set out in the consultation. This is because it has become clear from those responses that neither approach meets the main criteria of simplification and both potentially exacerbate complexities within the existing MA system, for the reasons explained below.

3.9 The **first approach** (option 1 in the consultation document) – was a profits test based on Class 4 NICs. Although there was support for this option from some, it was also seen by some as continuing the existing complexities for self-employed women and potentially adding to them by introducing a two-fold approach to accessing standard rate MA. This is because under this approach, self-employed women would need to first show whether they meet a Class 4 profits test and, where they did not meet that test, they would then need to make voluntary payments of Class 3 NICs in order to access the standard rate of MA. Additionally, respondents consistently raised the issue that the cost of the Class 3 NICs must not be substantially greater than the Class 2 NICs that are currently paid, especially for those women whose businesses are new or do not have a high level of earnings.

3.10 The government also acknowledges that this approach – based on self-assessment returns submitted in the January after the end of the tax year – could result in the rules applying differently to women with similar levels of profits, depending upon when in the year their baby was due. This is because the test period during which a woman would be required to meet the Class 4 profits test, would be determined by the baby’s due date. Consequently, not all women would have filed a self-assessment return covering 13 weeks during their test period at the time they claimed MA. These women would be required to go through the extra step of paying voluntary Class 3 NICs even though their profits, once assessed, may have been sufficient for them to access the standard rate of MA. Conversely, women who, at the time they claimed MA, had filed a self-assessment return covering 13 weeks during their test period

and who met the Class 4 profits test, would be eligible for the standard rate of MA with no further action required.

3.11 The **second approach** (option 2 in the consultation document) – was an earnings test based on estimated earnings over a 13 week period during the test period. The government acknowledges concerns raised in a number of responses that it would be too complex, too easily misunderstood, difficult to administer, and could lead to fraud and error. It also does not easily accommodate the fluctuating nature of many self-employed businesses where work and earnings are not uniform.

3.12 The need to maintain simplicity is a core objective for the government and was also consistently raised by consultation responses. The government also believes that all self-employed women should be treated consistently by the rules that determine access to MA, for fairness and simplicity.

3.13 For these reasons, and after taking into account the responses received during the consultation, the government has decided to pursue a variant of the first option that does not involve Class 4 NICs at all. **The government plans to adopt an earnings test in which all self-employed women may pay Class 3 NICs in order to access MA paid at the standard rate.** This will revise the current MA process introduced when the collection of Class 2 NICs was moved into self-assessment in April 2015. This means that the mechanism for conferring entitlement to MA at the standard rate will be similar to that which currently applies for the majority of self-employed women.

3.14 The consultation recognised that requiring thirteen Class 3 NICs to be paid would be a considerable increase in the cost of accessing standard rate MA for self-employed women. As noted above, a number of the consultation responses also raised these concerns. In view of this, the government has decided that **only three Class 3 NICs payments will be required for self-employed women to qualify for MA at the standard rate**, meaning that the cost of access to the standard rate of MA for self-employed women will be maintained at broadly the same level (in 2016-17 for instance, the cost would be £42.30 instead of £36.40).

3.15 The government will also enable the amount of Class 3 NICs paid for MA purposes to be offset against an individual's Class 4 liability at the end of the tax year in which the Class 3 NICs were paid.

3.16 Self-employed women will still be able to claim MA at the lower rate of £27 for up to 39 weeks if they choose not to pay the required Class 3 NICs but do meet the current employment test. This is consistent with the current approach for those self-employed women who do not pay 13 Class 2 NICs during the test period.

3.17 The government acknowledges concerns that were raised by some respondents that using Class 3 NICs to confer entitlement to the standard rate of MA might replicate some of the existing complexities of Class 2 NICs. However, the government believes this option is very similar to the operation of the current system of entitlement so helping continuity and understanding of the process. The government has been keen not to add any further complexity to the current scheme, whilst ensuring fair access to MA for all self-employed women.

Women participating in the self-employed business of their spouse or civil partner

3.18 Currently women who are neither employed nor self-employed but who assist in the self-employed business of their spouse or civil partner for any part of the week in at least 26 weeks during their test period can be paid MA, at the lower rate of £27 for up to 14 weeks, provided their self-employed spouse or civil partner has paid Class 2 NICs for the 26 weeks in which the claimant assisted in the business. At the time the woman makes her claim, if the spouse / civil

partner has not paid sufficient Class 2 NICs for her to receive MA, a voluntary payment process for Class 2 NICs is available to them.

3.19 Having considered the comments received regarding this proposal, it is intended that for this group, entitlement will be based on the current employment test only (i.e. that the woman has participated in the self-employed business of her spouse or civil partner for any part of the week in at least 26 weeks in her test period). The current earnings test based on the Class 2 NICs payment of the spouse or civil partner will not be replaced. There will not be an equivalent requirement for the spouse or civil partner to pay Class 3 NICs.

3.20 For women who participate in their self-employed spouse's / civil partner's business the government will adopt an approach based on only having to meet the existing employment test in order to receive the lower rate of MA for up to 14 weeks.

Contributory Employment and Support Allowance (ESA)

3.21 Currently a claimant is entitled to contributory ESA if they satisfy two National Insurance conditions as well as conditions about the effects of their health condition or disability (and other entitlement conditions). As noted in Table 2.A, self-employed claimants must have paid a minimum amount of Class 2 NICs in one of the two tax years before the benefit year in which they claim (a benefit year roughly equates to a calendar year). Secondly, for both tax years they must have paid or been credited with a certain level of contributions. The replacement of the requirement for Class 2 NICs to have been paid with the requirement for a qualifying year derived through Class 4 NICs will have no impact on contributory ESA entitlement for the majority of self-employed individuals.

3.22 Self-employed individuals who have profits below the SPL (and who are therefore unable to generate a qualifying year via Class 4 NICs) in the relevant tax years preceding an ESA claim may not be able to access contributory ESA as a result of Class 2 abolition. However, income-related benefits such as Universal Credit will be available to many of those not entitled to contributory ESA (dependent on an individual's household income and level of savings). This will help to mitigate any impact of this on vulnerable individuals with health conditions. However, those who have been self-employed for a year or more would be subject to Universal Credit's Minimum Income Floor rules – an assumed level of earnings – which may affect the numbers eligible.

3.23 The consultation noted that the combination of a contributory test in Class 4 NICs and the protection possible under Universal Credit does not provide the same level of provision as the existing arrangements based on Class 2 NICs. In response to concerns raised about this particular issue, **the government will enable self-employed individuals with profits below the SPL to maintain access to contributory ESA. This will be through the payment of Class 3 voluntary NICs for any week of self-employment in a tax year where: Class 4 NICs has not been paid; Class 4 NICs has not been treated as paid; and no eligibility arises from another source such as a NICs credit or a payment of primary Class 1 NICs.**

Special groups of Class 2 4 NICs payers

4.1 Currently, Class 2 National Insurance contributions (NICs) can be paid by certain groups who are not necessarily self-employed, in order to gain access to contributory benefits. Additionally, for some specific groups, Class 2 can be paid at prescribed higher rates, to provide access to contributory benefits not available to those who pay Class 2 NICs at the standard rate.

4.2 This document confirms that the government will remove the special rules currently in place for these small groups of individuals. This will be a long overdue and considerable simplification of the NICs system. The consultation document confirmed that this would mean that all individuals affected will be able to gain access to contributory benefits through the NICs system in the same way as other self-employed individuals. The way in which this will affect each of the groups in question is described below.

Group 1: Those who currently pay special rates of Class 2

- share fishermen
- volunteer development workers

4.3 Share fishermen are those who work in the UK fishing industry and are paid a share of the earnings or profits of the vessel they work on. They pay the share fisherman rate of Class 2 NICs (currently £3.45 per week). This rate is slightly higher than the main Class 2 rate, and allows these individuals to be eligible for contribution-based Jobseeker's Allowance (JSA) on top of the normal range of contributory benefits to which Class 2 NICs give access.

4.4 This provision was originally introduced on the basis that certain challenges of their occupation meant that share fishermen ought to receive unemployment benefits via the National Insurance system for periods during which, for circumstances beyond their control, they were unable to work. However modern-day JSA is designed to support those looking for a job rather than self-employed individuals temporarily experiencing a shortage of work. Instead, tax credits / Universal Credit offers a level of support for share fishermen in times of need.

4.5 Furthermore, the government does not wish to re-introduce complexity into self-employed NICs after Class 2 NICs have been abolished, for instance by setting a different rate of Class 4 NICs (or Class 3 NICs) for this group (or any other groups), to maintain this existing provision. The abolition of Class 2 NICs will therefore remove the ability of share fishermen to gain access to contributory JSA through a dedicated route.

4.6 In the future, as with other self-employed individuals, share fishermen with profits at or above the Small Profits Limit (SPL) will be able to gain access to other contributory benefits via Class 4 NICs. In line with other self-employed workers, share fishermen with profits below the SPL would need to receive NI credits or pay Class 3 voluntary NICs to build up qualifying years for the State Pension. They will also be able to gain access to standard rate Maternity Allowance (MA) via Class 3 NICs. In common with other individuals who do not satisfy the conditions for contribution-based JSA, share fishermen may be entitled to appropriate income-related support (dependent on their household income and level of savings).

4.7 The government did not receive any consultation responses from this group or from anyone representing this group, however the government will continue to monitor the impact of this change.

4.8 Volunteer development workers (VDWs) are those who take part in projects in developing countries on a voluntary basis. Although they are not actually self-employed, they are able to voluntarily pay a special rate of Class 2 NICs (currently £5.60 a week)¹ which provides them with a specific route both to protect their State Pension and to access contribution-based JSA (on top of the normal range of contributory working age benefits to which Class 2 NICs give access).

4.9 Following the abolition of Class 2 NICs, VDWs will have to pay Class 3 NICs if they wish to continue to gain access to the new State Pension. This puts VDWs in the same position as volunteer workers in the UK. As described in Chapter 2, a small number of gaps in an individual's National Insurance record would be unlikely to affect their future State Pension. Under the new State Pension, 35 qualifying years will generally provide entitlement to the full amount.

4.10 If VDWs are, in future, unable to satisfy the conditions to receive contributory working age benefits, they may be entitled to income-related Employment and Support Allowance (ESA), income-based JSA, or Universal Credit, as appropriate. This is in line with other workers who do not meet the conditions for contributory benefits. These benefits offer sufficient protection to VDWs who may wish to claim benefits on their return to the UK.

4.11 For Maternity Allowance, VDWs will be able to pay Class 3 NICs in the same way as self-employed women, in order to access standard rate MA. This means that access to MA is preserved for this group.

4.12 While no responses to the consultation were received from this group or their representatives, the government will continue to monitor the impact of this change.

Group 2: Those who are not self-employed in the UK but can pay Class 2 voluntarily

4.13 Those in this group are:

- self-employed working abroad
- individuals employed abroad
- mariners on foreign vessels

4.14 At present, someone working abroad does not usually have a liability for NICs in the UK, nor do mariners on foreign vessels. However they are able to gain access to the new State Pension by paying Class 2 NICs voluntarily,² whereas someone employed wholly in the UK but earning under £112 a week (and not eligible for NI credits) would have to pay Class 3 NICs if they wished to continue to gain qualifying years for the new State Pension. This means that they are currently paying much less than UK workers to gain access to the same State Pension on a voluntary basis.

4.15 The government believes it is right that everyone makes a fair contribution towards the State Pension, so the facility for those working abroad (and who are not UK insured) to pay Class 2 NICs voluntarily will no longer be available after the abolition of Class 2 NICs. In the UK, all those who do not gain access to the new State Pension based on employment earnings or self-employed profits, or who do not receive NI credits, will need to pay Class 3 NICs should they

¹ This corresponds to 5% of the weekly Lower Earnings Limit (LEL) in Class 1: Primary NICs.

² If they worked in the UK immediately before leaving, and had previously lived in the UK for 3 years in a row or paid 3 years' National Insurance.

wish to build qualifying years. Following the abolition of Class 2 NICs, the same rule will also apply to those working overseas.

4.16 As described in Chapter 2, under the new State Pension, there is scope for individuals to miss a number of years of NICs payments, and still receive a full State Pension. Furthermore, because Class 3 can usually be paid for up to six years after the year to which it applies, there is scope for the individual to decide whether to pay voluntary contributions.

4.17 These changes mean that there are potentially some implications for various bilateral treaties that the government has on social security contributions. The government will provide further guidance in due course on how the tax and NICs liabilities for individuals in this group will be affected.

Group 3: Those who are treated as self-employed specifically for NICs purposes and other groups affected by this change

4.18 Those in this group are:

- examiners
- foster carers
- Ministers of Religion
- some landlords³

4.19 For these groups, the abolition of Class 2 NICs will mean that:

- individuals liable for Class 4 NICs (such as examiners and foster carers) will be able to gain access to contributory benefits through the new Class 4 NICs benefit test
- individuals who are unable to meet the conditions of the new Class 4 NICs benefit test will be able to use NI credits or pay Class 3 voluntary NICs to gain access to the State Pension

4.20 While responses to the consultation on this particular proposal were generally positive, the government received representations from a number of organisations concerned about the impact that these changes could have on **Foster Carers**. Because this group receives tax deductible allowances, they are likely to show lower profits than otherwise expected, reducing the likelihood that an individual would qualify for contributory benefits on the basis of a Class 4 NICs test. While Foster Carers can already claim an NI credit to protect their entitlement to the new State Pension, this does not cover entitlement to working age contributory benefits.

Therefore, the government will upgrade the existing Foster Carers NI credit to a Class 1 credit,⁴ to provide access to contributory ESA and contribution-based JSA.

4.21 The government received two responses in relation to the position of **Ministers of Religion**. In the context of Class 2 abolition, generally only Catholic priests were affected, as they are classed as self-employed for National Insurance purposes (other Ministers of Religion are paid by stipend, which would be subject to Class 1 NICs). The relevant response – from the Churches' Legislation Advisory Service – was broadly supportive of the proposal to replace voluntary Class 2 NICs with voluntary Class 3 NICs. The government will therefore proceed on this basis.

³ A minority of landlords may be carrying on a business for the purposes of Class 2 NICs, so although they are not liable for Class 4 NICs they can pay Class 2 NICs voluntarily.

⁴ Class 1 credits provide access to the same contributory benefits as someone who has paid or been treated as having paid Class 1 contributions i.e. contribution-based JSA, contributory ESA, bereavement benefits and the new State Pension.

Other groups affected by the abolition of Class 2 NICs

4.22 Representative bodies raised concerns on behalf of **farmers, actors, and musicians**, in relation to the impact of low profits on their access to contributory benefits. For farmers, this was in relation to losses incurred in a number of years, arising from events which were beyond any control. For actors and musicians, this was of particular concern for those starting out in the profession, who might struggle to secure sufficient work and therefore the profits to qualify on the basis of Class 4.

4.23 As was noted in the previous chapter however, those with low incomes could continue to build qualifying years for the new State Pension through NI credits and Class 3 voluntary NICs. As previously noted, the new State Pension rules mean that an individual can have up to 15 years without any NICs paid or NI credits recorded, and still gain access to the full State Pension. Furthermore, the provision being introduced to enable self-employed individuals with profits below the SPL to pay Class 3 NICs to gain access to contributory ESA will protect workers who have low profits and fail to qualify for equivalent means-tested support, including those in these groups.

4.24 The government intends the NICs system to be transparent and straightforward for all workers, and wishes to remove complexity and anomalies wherever possible. It does not see a case for maintaining or re-introducing into the NICs system different treatment for particular small groups of workers, and has no plans to do so.

5 Next steps

5.1 The government will **publish further information in due course**. In particular, this will confirm how the government will enable the self-employed to access contributory Employment and Support Allowance and Maternity Allowance by paying Class 3 National Insurance contributions (NICs) as described in Chapter 3.

5.2 The government will also make sure that the abolition of Class 2 NICs and the introduction of new contributory benefit tests for the self-employed is implemented with close reference to **Making Tax Digital (MTD)**. MTD is HMRC's flagship transformation programme, which will support the government's commitment to reduce burdens for taxpayers, building a transparent and accessible tax system fit for the digital age. From April 2018, most businesses, the self-employed and landlords will start keeping records digitally and providing regular digital updates to HMRC for the purposes of meeting their National Insurance obligations. The changes to the NICs rules resulting from the abolition of Class 2 NICs will be in place by the time self-employed individuals start to make more regular updates.

5.3 The government will also consider how to work with stakeholders and representative groups to **improve understanding of the NICs system** amongst the self-employed, which was cited as a major concern for many responding to the consultation. In particular, the government will consider how to ensure that the self-employed could be made more aware of existing provisions in the NICs system, such as NI credits for those in particular circumstances and facilities such as 'Check your State Pension'.¹ The government will consider how it can best communicate with self-employed individuals to ensure they are made fully aware of these forthcoming changes to the NICs system in April 2018.

¹ This new service accessible via GOV.UK is currently being tested and improved. It gives users information about their forecasted State Pension amount and the earliest they can get it. Users can also see information from their NICs record, including any years where payment of voluntary NICs may improve their State Pension.

A Summary of responses

A.1 The government received 46 responses to the consultation on abolishing Class 2 National Insurance contributions (NICs) and reforming Class 4 NICs. A full list of organisations who submitted responses is provided in Annex B.

A.2 Responses to the consultation broadly supported the aim of simplification, and that this could be achieved through the abolition of Class 2 NICs. However there were a number of concerns raised. The main issues raised by respondents are set out below.

A Class 4 profits test and new benefit tests

A.3 The primary concerns of respondents were around self-employed individuals who have low profits following the abolition of Class 2 NICs. In particular, consultation responses described how some self-employed individuals were more likely to have lower or fluctuating earnings, and so would be more affected by a profits test set at the existing Small Profits Threshold. Responses noted that the protections already in the system would not help those who no longer could qualify for contributory Employment and Support Allowance (ESA).

A.4 The main issues raised were:

- There is **complexity** involved in moving the self-employed benefit test to an annual basis while retaining the weekly basis of the actual contributory benefit system. On the other hand, some welcome the idea of awarding entitlement based on profits, and a larger number welcome the new 0% band in Class 4 NICs, on the grounds that it avoids imposing a new NICs charge on individuals while protecting their benefit position.
- **Complexities of dealing with part-year self-employment, or concurrent employment and self-employment:** Groups such as Equity pointed out that those with low profits who supplement their income through some employment earnings could fail both the new self-employed NICs profits test and the employee NICs earnings test – this stems from NICs being charged on a per-employment basis.
- This creates an unfair **'cliff edge'**: A profits test would see those with profits above the Small Profits Limit gain a qualifying year for free, while those below would in theory have to pay over £700 in Class 3 voluntary NICs.
- There is a **lack of awareness** about NICs so people may lose out: All responses noted a lack of understanding and awareness of how NICs works. Respondents were concerned that, as a result, individuals may not claim relevant NI credits or pay Class 3 voluntary NICs in time.

A.5 Despite these concerns raised, this document makes clear that there would be minimal impact on access to new State Pension or Bereavement Support Payment as a result of this reform for the reasons set out in Chapter 2, and that the government will introduce special provisions to safeguard access to contributory ESA.

Maternity Allowance

A.6 The comments from the responses regarding Maternity Allowance (MA) were that access to MA must be maintained for self-employed women, with no significant increase in cost to them. Respondents also noted that the replacement test should be as straightforward, accessible and fair as possible. In addition, respondents were concerned about the risk in replicating or

exacerbating the existing complexity of the current system of access to MA, if the first or second approach were adopted as set out in the consultation. Many of the respondents also raised the issue that the cost of the Class 3 NICs must not be substantially greater than the Class 2 NICs that are currently paid.

A.7 A large number of respondents favoured option 1 (earnings test with voluntary Class 3 NICs) yet had concerns about the fivefold cost increase from the Class 2 NICs to Class 3 NICs. Respondents suggested that the cost of Class 3 NICs would need to be reduced to avoid a negative impact on MA access. Another option suggested was that any payment of Class 3 NICs could be offset against a Class 4 liability. The government has taken these concerns into account in designing the new rules for access to the standard rate of MA.

A.8 The majority of responses regarding option 2 (13 week estimated earnings test) were that it would be too complex in practice, difficult to work out and therefore would be inaccurate. They also suggested that it would disadvantage certain groups of self-employed workers.

Special groups

A.9 The main issues raised in consultation responses in relation to special groups of Class 2 NICs payers are summarised in Chapter 4.

Other issues raised

A.10 As noted in Chapter 5, many respondents stated that, amongst the self-employed population, understanding and awareness of how the NICs system operates was low. The government will take this into account as it develops a communications strategy to inform self-employed NICs payers of how they would be affected by the abolition of Class 2 NICs in April 2018.

List of respondents and meetings

B

B.1 The full list of organisations that responded:

- Low Incomes Tax Reform Group
- National Farmers Union
- Residential Landlords Association
- Musicians' Union
- TaxAid
- Working Families
- Churches' Legislation Advisory Service
- RC Dioceses of England and Wales
- Association of Accounting Technicians
- Broadcasting Entertainment Cinematograph and Theatre Union
- Citizens Advice
- Citizens Advice Northern Ireland
- Childhood Bereavement Network
- Institute of Chartered Accountants in England and Wales
- London Society of Chartered Accountants
- Equity
- Social Security Advisory Committee
- Institute of Chartered Accountants of Scotland
- Federation of Small Businesses
- Incorporated Society of Musicians
- Association of Taxation Technicians

B.2 The government met with the following organisations during the consultation period:

- Equity
- Low Incomes Tax Reform Group
- Churches' Legislation Advisory Service
- Social Security Advisory Committee
- Federation of Small Businesses

HM Treasury contacts

This document can be found in full on our website: <http://www.hm-treasury.gov.uk>

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