



**Response from ICAS to the
HMRC consultation document**

**The abolition of Class 2 National Insurance:
Introducing a benefit test into Class 4 National
Insurance for the self-employed**

26 February 2016

The abolition of Class 2 National Insurance: Introducing a benefit test into Class 4 National Insurance for the self-employed

About ICAS

1. The following submission has been prepared by the ICAS Tax Committee. This Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 20,000 members working across the UK and internationally. Our members work in all fields – predominantly across the private and not for profit sectors.

General comments

2. ICAS welcomes the opportunity to comment on the consultation 'The abolition of class 2 National Insurance: Introducing a benefit test into class 4 National Insurance for the self-employed' issued by HMRC on 11 December 2015.
3. The proposal to end class 2 is likely to have little impact on many groups, and significant impact on some very specific groups. In this context, the decision to delay any significant changes until April 2017 is noted and welcomed.
4. The desire to mirror, for the self-employed, the National Insurance banding currently available to employees – with a zero-rate band between the Small Profit Threshold and the Lower Profits Limit for class 4 National Insurance, is equitable.
5. However, self-employment and employment are very different, with the former subject to significant fluctuations in taxable earnings due not only to business results, but also to tax allowances, claims and elections. This difference in nature between employment and self-employment means that similar rules may produce results which appear inequitable in some circumstances.

Specific questions

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?

6. It is important to maintain existing access to contributory benefits. As outlined in the consultation, this could be achieved through class 3 contributions, so long as the benefit rights attaching to such contributions are changed to match those attributable to class 1 and class 2 under the current system.
7. In addition, consideration should be given to making the cost of such contributions no more than the equivalent weekly class 1 contributions, which would result in the same benefit rights: that is those payable on a weekly wage of just over the primary threshold.
8. At present there is a significant difference between the rates of class 2 and class 3 National insurance. The class 3 rate is equivalent (at 2015-16 rates) to class 1 contributions for employee earnings of around £272.50 per week (£14,170pa); whereas class 2 is equivalent to class 1 contributions for an employee on earnings of around £178.33 per week (£9,273pa).
9. There could perhaps be two rates of class 3 National Insurance, one for earned income, with a limit close to the cost of primary contributions for an employee who is just over the primary threshold; and a higher one for un-earned income.

10. The question of partnerships has not been directly addressed. If contributions are based on profit allocations, then small changes in profit sharing ratios could have significant impact on benefit entitlements.

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?

11. The issue of changes to the contribution requirements, from six months to 12 months, under the new proposals is noted. This reduces the problem of in-year payment and crediting of contributions for the self-employed. Yet there is still a significant practical issue with the timing of payment and crediting for contributions. This has been recognised and addressed as a consequence to the already implemented changes to class 2 payment date and small profit exceptions.
12. The need for a system of voluntary payment of class 2 in advance, has been recognised for 2016-17; as under normal self-assessment rules, returns and payments for class 2 might not be submitted until 31 January following the end of the tax year. The result being that an individual wishing to claim benefits might experience delays to their claim as their class 2 liability was unquantified or unpaid.
13. This issue is likely to be exacerbated where there are self-employed individuals, with no tax or National Insurance liability, who are entitled to National Insurance credits under the proposed system (on profits between the Small Profit Threshold and Lower Profit Limits); and for individuals who are liable to pay class 4, but not before the usual self-assessment payment deadline.
14. Such individuals may wish to file a return immediately after the end of the tax year, in order to validate possible benefit claims. This raises the spectre of two filing deadlines. Perhaps there could be an alternative of voluntary advance payment of contributions, or provisional notification of a right to credits.
15. This issue of part-years of self-employment also needs consideration here. Using annual limits pro-rata, with the option on buying in weeks via payment of class 3 contributions, would seem equitable. Self-employment can be unstable, and individuals moving between self-employment and employment, or self-employment and out of work benefits, may otherwise be left with partially completed years.
16. An additional issue is that of tax losses, claims and elections, such as farmers' averaging claims and cash basis elections; and potential differences between business profits for class 4 National Insurance and income tax. For example, an individual with a profitable business, which makes a tax loss due to an Annual Investment Allowance claim, would have continued to gain benefit rights through paying class 2 under the current system, but with the proposed system, would now need to look for alternative methods of maintaining contributions history. Given the time limits for claims and elections – now up to five years for farmers' averaging - this could create confusion and uncertainty.

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?

17. The proposals seem reasonable, subject to the issue of timing and recognition of payments and credits, as noted in question 2 above.

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?

18. Anecdotal evidence is that many people are unaware of the subtle distinctions between benefit rights accruing to class 3 and class 2 contributions; neither are they aware of the scope of NI credits.
19. The new system will require much greater awareness, and switching between systems, for some individuals. Significant education will be needed to ensure that individuals obtain appropriate information and are able to make decisions in an acceptable timeframe.
20. It might be a good time to rationalise the system. For example, special National Insurance credit arrangements are mentioned for Foster Carers, but would there be similar arrangements for Shared Life Carers in the new system? Both groups are subject to income tax on the same basis as Qualifying Care Relief.

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.

21. Alignment of voluntary contributions rules, so that class 3 is the only voluntary alternative seems acceptable, with the proviso that consideration is given to a lower rate for earned income as indicated above. This would protect the position of low paid self-employed workers who might otherwise be disadvantaged as against employees.

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?

22. It seems appropriate for all workers to be able to access both Bereavement Support Payments and Contributory Employment and Support Allowance. Business profits can fluctuate severely and, for the self-employed, profits could easily be adversely affected by the illness and death of a close relative.
23. It would seem harsh were an individual to be denied Bereavement Support Payment, or Contributory Employment and Support Allowance, due to profits being below the Small Profit Threshold, when this was a result of, say, a prolonged terminal illness of a business partner or close relative. Carer's Allowance might not be available, in the specific circumstances, as a means of obtaining NIC credits. Such arrangements would seem most appropriate for UK resident workers.

Question 7

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

24. Yes, where credits are not available, availability of the class 3 route seems appropriate.

Chapter 3: Access to Maternity Allowance

Question 8

Do you have any comments on the approaches proposed for Maternity Allowance in this chapter? 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)

25. Using a profits test with the option of class 3 top-up seems sensible. The argument about the additional costs of class 3 applies equally to any low income self-employed business. There could be a worker's rate of class 3 as discussed above, which would reflect the cost of employee contributions at just above the Primary Threshold.
26. It would seem an unnecessary complication to have a special class 3 rate specifically for Maternity Allowance; no less so if the entitlement is to be based on a spouse's, or civil partner's contributions.

b. Estimated earnings during the 13 week test period

27. Employment and self-employment have very different characteristics. Employment, by its very nature, is usually covered by a written contract setting out intended earnings, rates of pay and conditions. Estimation of such earnings can therefore be expected to be reasonably reliable.
28. There will be cases where estimating employment income is difficult, eg with zero hours contracts; but these situations will normally be identifiable.
29. By contrast, the process of estimating self-employed profits is far more complex. Given that the figure required is that for profits as calculated for class 4 NIC purposes, where there could be year-end adjustments needed for stock and accruals etc, this does not seem a satisfactory basis for achieving benefit entitlement.

c) (For participating spouses only). The conditions of the existing employment test only

30. Though the suggestion is to make comments on the employment test only, it seems more appropriate to comment on the situation generally. There is a conflict here between independent taxation, which expects the tax affairs of individuals to be separate, and that of the benefits system, which is looking at a household view: for married couples and civil partners in this case.
31. It seems unwelcome to require estimation of business income (as mentioned at 3.17), both for the reasons set out in part b) above, and also because of a presumption of the transfer of information. If a couple were to split up close to the birth of the child, it may not be possible for such estimated business information to be obtained.
32. A system based on voluntary class 3 and actual results seems preferable. HMRC currently responds to enquiries on High Income Child Benefit Charge with a yes/no response; a similar system could supply an indication of profits below Small Profit Threshold, between Small Profit Threshold and Lower Profits Limit, or above Lower Profits Limit. This could apply even where the couple has separated.

Question 9

Can you suggest any alternatives?

33. There is a problem with timing of benefit entitlement and payment or credit of the relevant contributions. If entitlement is based in circumstances in the 66 weeks, prior to the due date, much of this period could fall outside the period for which self-assessment returns have been submitted.

34. While not ideal, consideration could be given to provisional entitlement based on advance payment of class 3 contributions, which could then be re-assessed on the self-assessment return based on actual profits for the period – pro-rata if necessary.
35. The class 3 liability paid could then be credited against any class 4 liability due on the return, when submitted. Where the final return shows profits between the Small Profit Threshold and the Lower Profits Limit, then class 3 would be refunded, or credited against any income tax liability on the return.

Chapter 4: Those 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?

36. Many individuals who move into and out of self-employment within a tax year will be on low income. It seems sensible to apportion National Insurance thresholds for this group. The option to pro-rata the limits should be available wherever self-employment is not continuous: not just for transitions from employment to self-employment, but also for transitions between, for example, self-employment and state benefits.
37. It is likely that a number of people within this group will have left self-employment because they were unable to make a sustainable living. This may mean that for tax purposes the business has made a loss, or negligible profit.
38. It is therefore necessary also to consider the issue of making up the contributions, other than through the new class 4 route. This means that voluntary contribution must be available and affordable to such individuals, otherwise there is the inequity of failing to achieve a full year's contributions history due to a very limited time of self-employment.

Chapter 5: Impact on 'special groups' of Class 2 NICs payers

Question 11

For the following groups:

- **Share fishermen**
- **Volunteer Development Workers**

Do you have any comments on the proposed approach?

39. As discussed above, to maintain benefit rights, it would be necessary to modify the benefit rights attaching to class 3 contributions to ensure that, particularly in the case of Volunteer Development Workers, that UK entitlements are preserved. To deny Volunteer Development Workers the ability to maintain the same benefit rights which they currently achieve through their special rate of class 2 would seem retrogressive.
40. To achieve equity, it may be necessary to have a new type of class 3 entitlement.

Question 12

For the following groups -

- **Self-employed abroad**
- **Employed abroad**
- **Mariners on foreign flagged ships**

Do you have any comments on the proposed approach?

41. As some people living abroad pay class 2 mainly in order to maintain UK state pension rights, against the intention of retiring to the UK, it would not seem inequitable to have a class 3 rate which only provided entitlement to the UK state pension and would be available to this group.
42. Without statistics for the number of people living abroad or aboard ship, who currently pay class 2 on a voluntary basis, it is difficult to estimate the potential impact.

Question 13

For the following groups:

- **Examiners**
- **Ministers of religion**
- **Foster carers**
- **Some landlords**
- **Self-employed women with a reduced rate election**

Do you have any comments on the proposed approach?

43. This is a diverse group. It may be that separate consideration of each, in the context of income tax as well as national Insurance, is needed to achieve a satisfactory resolution of the issues involved. It may be time to remove some small inconsistencies which have accrued.
44. Foster carers, as mentioned above, are taxed on the same basis as Shared Life Carers, but have different access to National Insurance credits.
45. The class 2 boundary for landlords has been problematic in practice and could usefully be removed.
46. The married women's reduced rate election could last be made in April 1977. It would be helpful to have statistics on its current importance, but its abolition would not appear to have significant disadvantages: indeed, it might increase the state pension rights of women still affected.