



TAXREP 54/13

(ICAEW REP 143/13)

ICAEW TAX REPRESENTATION

NIC FOR THE SELF EMPLOYED

Comments submitted on 8 October 2013 by ICAEW Tax Faculty in response to HMRC consultation document *Simplifying the national insurance processes for the self employed* published on 18 July 2013

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation document *[Simplifying the national insurance processes for the self employed](#)* published by HM Revenue & Customs (HMRC) on 18 July 2013.
2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.
3. On 17 September 2013 we attended a constructive meeting with HMRC in which we were able to put forward some key comments and concerns and discuss aspects of the consultation paper. We responded in June 2008 in [TAXREP 37/08](#) to the previous consultation on self employed NIC published in March 2008.
4. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

5. ICAEW is a professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.
6. Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.
7. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

KEY POINT SUMMARY

8. We support the initiative to simplify collection of self employed NIC but more radical change than that proposed by HMRC is needed to achieve real simplification. However, the NIC payments regime must be considered not in isolation but in conjunction with the impact on entitlement to state pension and contributory social security benefits.
9. We consider that:
 - to meet the minister's objective of real simplification of the NIC payments regime a more radical approach is needed – real simplification to payments would be achieved by abolishing Class 2 NIC, including the small earnings exception (SEE), and making Class 4 contributory, perhaps with a zero% NIC liability for those self employed who do not make profits greater than a set threshold or losses;
 - the impact on entitlement to state pension and contributory social security benefits of moving the timing of payment/crediting of NIC needs to be considered and appropriate changes made to the entitlement rules. At the same time, it may be appropriate to consider more widely and consult on whether and if so to what extent NIC and associated benefit entitlements should differ between the employed and self employed, eg to recognise factors such as risk and encourage entrepreneurship;
 - if Class 4 is made contributory then accretions to contributors' NIC records of NIC paid on account or credited and consequent entitlement to contributory social security benefits

- should be confirmed by submitting an SA return with a partnership or self employment page completed;
- the NIC and benefits position of the self employed with profits below the aforementioned profits threshold and losses, share fishermen and volunteer development workers, mariners and aircrew, and cross border workers including individuals coming into and leaving the UK needs to be resolved; and
- even if nothing else is changed, self employed and employer/employee NIC thresholds should be aligned.

MAJOR POINTS

- 10.** We welcome the government's initiative but we would take more radical steps than those suggested in the consultation document to achieve the minister's objective of simplifying the payment of NIC for the self employed. However, collection of NIC cannot be considered in isolation, ie without thinking about contributors' entitlements to state pension and contributory social security benefits.

Payments

- 11.** On the payments side, the way to achieve real simplification would be to abolish Class 2 NIC, including the small earnings exception (SEE), and make Class 4 contributory, with updating of contributors' NIC records following payments on account being confirmed on submission of an SA return with either a partnership or self employment supplementary page duly completed.
- 12.** Calculating liability to Class 4 NIC would be based on the same rules as currently, and the self employed would pay contributory Class 4 NIC where profits are above the Class 4 lower limit, as now.
- 13.** The rate at which Class 4 is payable between the lower limit and upper limit could be increased to achieve revenue neutrality. Whilst we do not have access to data to enable us to assess exchequer impacts, if simplifying self employed NIC is intended to be revenue neutral, we anticipate that people might question whether an increase of the Class 4 rate to more than around 9½% is truly revenue neutral, even if a greater figure is recommended by the Government Actuary.
- 14.** We suggest that there be a zero% payment liability for the self employed below the Class 4 lower limit, so that where the self employed individual does not make profits of more than that threshold, he would receive an NIC credit, like employees who earn between the lower earnings limit and the primary threshold.
- 15.** Such a credit could apply between the present SEE threshold and the Class 4 lower limit. Indeed, to take account of the risks that the self employed take, compared to employees who are paid (at least in the short term) regardless of competence, and to encourage entrepreneurship, the zero% rate referred to above could apply where profits are at any figure below the Class 4 lower limit or a loss is made.
- 16.** If it is felt that the self employed must pay something towards the contributory benefits, then there could be a low flat rate amount to pay, eg £140 per year, either between the thresholds or whether or not a profit or loss is made. However, paying NIC at greater than zero% between the present SEE threshold and the Class 4 lower limit would be out of line with the regime for the employed. We also consider that a zero% rate where the contributor does not make profits of more than a threshold would be simpler than a small fixed starting rate, because charging a positive rate of NIC where there are small profits or a loss is likely to necessitate a small earnings/loss opt out in the tax return, which would simply replace the complexity of SEE with a new complication.

17. The payments (and benefit entitlement) position for the following categories of individual needs to be resolved:
- *UK workers abroad* currently may pay voluntary Class 2. If Class 2 were merged into Class 4 then they will not have this option.
 - *Share fishermen and volunteer development workers* pay an enhanced rate of Class 2. If Class 2 were abolished, then consideration will have to be given to what NIC they should pay, for example an enhanced rate of Class 4.
 - *Mariners and aircrew* who fall outside the NIC system will often pay Class 2. They could well be taxable in the UK but will not pay Class 4. Paying Class 3 will not make them eligible for short term benefits.
 - *Individuals coming into and leaving the UK* may continue to be outside the scope of Class 4 NIC because they will be covered by the A1 and other certificates. For others there has to be 26 weeks residence in the UK before there is a Class 2 liability. We assume that they would have to submit an SA return in which case Class 4 NIC would be payable.

Benefit entitlement

18. The proposed payment reforms would impact on assessing entitlement of the self employed to state pension and contributory social security benefits. This is because the latest due date of payment of Class 4 NIC and the deadline for submitting the SA tax return (which would affect when contributors' NIC records are updated) are later than the periods over which state pension and contributory social security benefits are presently assessed. In addition, Class 4 NIC unlike Class 2 is an annual levy not matched to individual weeks.
19. If the payment rules are changed then where a self employed individual has submitted an SA return or made NIC payments on account or has paid Class 1 NIC, the fact that the final payment of Class 4 for a tax year would be approximately one month into the benefit year would not be a major obstacle to assessing entitlement to pension and other benefits. Where no payments on account have been made and no SA return or other declaration confirming self employed status for the year has been submitted then if the rules governing entitlement are not changed then interim awards will have to be made and adjusted subsequently. This would involve additional work to reassess entitlement and, where benefits have to be repaid, potential hardship for claimants.
20. Chapter 4 of the consultation document outlines the entitlement conditions for the state pension and other contributory social security benefits for the self employed. If NIC payment dates are changed then government will need to decide how the rules governing entitlement should be changed.
21. We suggest that it would be appropriate to consider more widely whether and if so to what extent the NIC rates and associated benefit entitlements should differ between the employed and self employed, eg to recognise factors such as risk-taking and to encourage entrepreneurship, and between all the different Classes of NIC.
22. For example, at present the self employed with small profits or losses who do not apply for SEE and who continue to pay Class 2 NIC buy rights not only to state pension and bereavement allowance but also employment & support allowance (ESA) and maternity allowance (MA), whereas if entitlement to pay contributory NIC were denied for example, owing to profits being below a threshold or losses, then even paying voluntary Class 3 would not entitle them to ESA or MA.

Even if nothing else is done...

23. Even if nothing else is done, we suggest that the opportunity is taken to align certain employee/er and self employed thresholds which differ by small amounts. We recommend

that the Class 4 lower limit (presently £7,755 per year) be equal to fifty two weeks' worth of primary (employee) threshold (PT) (ie £149 x 52 = £7,748). The PT and secondary (employer) threshold (ST) (presently £148 per week) could be aligned so they are both equal to the weekly figure to be used to calculate the Class 4 lower limit, say £149 per week. If SEE is retained, then we suggest aligning the SEE threshold (presently £5,725) with the lower earnings limit (thus £109 x 52 = £5,668).

24. We are aware that there are historical reasons for all the NIC thresholds being different but to the man in the street such misalignments appear to have neither rhyme nor reason.

RESPONSES TO CONSULTATION QUESTIONS

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

25. Yes. We believe that it would be simpler for the contributor to pay all taxes and NIC at the same time, and even more so if Classes 2 and 4 NIC were merged.

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

26. It would mean that the self employed would not have to pay the two Classes of NIC at different times. If the small earnings exception can be claimed on the SA return, those who wish to claim the small earnings exception would be able to do so without needing to apply on a separate form, or make a claim for refund of contributions after the tax year end. If Class 4 were made contributory and Class 2 merged into Class 4, then contributors would not have to pay and HMRC would not have to account for two classes of NIC at the same time.

Q1c) Do you see any drawbacks?

27. Under HMRC's proposal, Class 2 and 4 will still be two separate Classes of NIC. Changing Class 2 to a something calculated in the tax return and paid at the same time as income tax and Class 4 NIC may lead to a loss of clarity for contributors, who currently may identify paying Class 2 at a different time as a separate charge to 'buy' their pension and contributory benefits.
28. In order to record contributions, HMRC's self assessment payment recording system will have to be able to distinguish, both on taxpayer statements/demands as well as internally, contributory NIC from other payments (we assume that presently Class 2 is kept separate from SA tax and Class 4 NIC).
29. In order to safeguard contribution records, we suggest that the default should be that the first part of any payment which has not been allocated by a taxpayer/contributor is allocated to contributory NIC.
30. Currently, for those who cannot pay large amounts of SA income tax and Class 4 NIC when they fall due, either because they have difficulty with budgeting or are making losses by the time the SA liability is due, the ability to pay relatively modest amounts of Class 2 on an ongoing basis currently enables them to preserve their rights to the basic state pension and other contributory benefits.
31. On the contributory social security benefits side, the latest due date for payment for SA liabilities (31 January) is after the date that the benefit year starts (the first Sunday of the calendar year). This may render it necessary to make provisional awards of certain contributory social security benefits unless claimants submit SA returns and pay balancing payments before the benefit year begins. Indeed, we think that changing the payment date for contributory NIC for the self employed will render it necessary for government to revise the

eligibility criteria for state pension and contributory social security benefits for the self employed.

- 32.** As noted in para 17 above, the position for the following categories of individual needs to be resolved:
- UK workers abroad;
 - Share fishermen and volunteer development workers ;
 - Mariners and aircrew ; and
 - Individuals coming into and leaving the UK.
- 33.** We believe that the main drawback to HMRC's proposal is that it is not radical enough. We suggest that Class 2 should be abolished, and that Class 4 be made contributory. There should be no ability for the self employed to opt out of NIC – the right to contributory benefits should be linked to whether the individual completes and submits an SA tax return with the partnership or self employment pages duly completed, and where the profits are more than a certain figure, payment of the appropriate amount of (Class 4) NIC.

Q2) What do you consider will be the transitional challenges of moving from the current system to collecting Class 2 NICs through the SA system?

- 34.** The main challenge is that any change means new rules to learn, new processes to devise, new software to write and habits to form.
- 35.** There may be a gap between the final payment of Class 2 and the first payment of contributory Class 4. This may impact entitlement to social security benefits and exchequer cash flow.
- 36.** On the contributory benefits side, currently the latest date of payment of Class 2 NIC is the 31 July before the end of the previous benefit year. So it is easy to ascertain whether a claimant is entitled to a contributory social security benefit. If contributory NIC were collected via SA, then the latest due date of payment of contributory NIC would be the 31 January within the benefits year, perhaps rendering it necessary to make provisional awards of contributory benefits which would subsequently need to be adjusted, necessitating over- or underpayments to be clawed back or made up. See also our comments under *Major Points* above.

Q3) Would complete abolition of the SEE process and removing liability to pay Class 2 NICs from people who have profits below the SEE limit be simpler than the current system? What benefits could this bring and do you see any drawbacks?

- 37.** Yes. The SEE process is complicated and its interaction with deferment, which may be appropriate where a contributor is both employed and self employed, makes a complicated process significantly worse.

Q4) Would aligning the liability to pay Class 2 with the liability to pay Class 4 NICs be a simpler system for the majority of self-employed individuals? What benefits could this bring and do you see any drawbacks?

- 38.** We consider that abolishing Class 2 and making Class 4 contributory would be the simplest outcome so far as concerns payments although those who have difficulty paying income tax and Class 4 NIC may put at risk their entitlement to state pension and contributory social security benefits if Class 2 is merged into Class 4. Such individuals normally manage to pay their Class 2, and many make a point of doing so, so as not to lose entitlement to state pension and contributory benefits.
- 39.** Changing the timing of contributory NIC payments to fit in with SA will necessitate making changes to the rules for assessing entitlement to state pension and contributory social security benefits.

40. Presently, the latest time by which Class 2 NIC should be paid is 31 July after the end of the tax year to which it relates (this applies when paying in response to an HMRC payment request; the final direct debit date is earlier, eg for 2013/14 on 11 July 2014). This means that all Class 2 NIC has been collected six months before the start of the benefits year (which starts on the first Sunday of the calendar year), whereas if contributory NIC were collected via SA then the latest payment date would be 31 January after the end of the tax year (eg for 2013/14, 31 January 2015) which is about three weeks after the start of the benefits year.
41. In the cases of state pension and employment & support allowance, interim awards could be made and adjusted later for those who become entitled in that three week period or before the contributors account has been update. However, reviewing and adjusting the amounts paid would create additional administration and potential confusion for both claimants and HMRC, which would be at odds with the reason for change, ie to simplify processes, and clawbacks of overpaid pension and benefits could cause hardship for claimants.
42. More difficult to reconcile with payments being made via SA are the rules for assessing eligibility to maternity allowance (MA) and we welcome the fact that government has undertaken to consider how best to ensure that any changes to payment dates would have no inverse impacts.

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

43. Employees who pay Class 2 NIC when working abroad would be excluded. Any individual who is not self employed and who pays Class 2 would be excluded. They would have to pay Class 3.
44. This begs the question of why paying the more expensive Class 3 NIC gives contributors less benefit rights than Class 2.

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

45. The way to achieve real simplification would be to abolish Class 2 NIC, including SEE, and make Class 4 contributory.
46. Liability to Class 4 would be based on the same rules as it is now, and the self employed would pay contributory Class 4 NIC where their profits are above the Class 4 lower limit, as now.
47. We suggest that there be a zero% payment liability for the self employed below the Class 4 lower limit, so that where profits are less than the lower limit or the trader makes a loss, the trader would receive an NIC credit, like employees who earn between the lower earnings limit and the primary threshold. This would obviate the need for SEE.
48. Whether or not the contributor actually pays Class 4 NIC or receives a credit because his profits are too small or he makes a loss, his contributions record would be credited if he makes a payment on account of NIC or once he submits an SA return with either a partnership or self employment supplementary page duly completed or some other form of declaration where necessary, for example where the individual claims a contributory benefit before submitting the SA return which cannot be completed because, say, partnership profit/loss allocations are not yet available.
49. The rate at which Class 4 is payable between the lower limit and upper limit could be increased to achieve revenue neutrality. Whilst we do not have access to data to enable us to

cost what the rate should be, we anticipate resistance to change and questions as to whether the change is truly revenue neutral if the new rate is more than 9½%.

50. We think that in many cases the fact that the final payment of Class 4 for a tax year would be approximately one month into the benefit year is not an obstacle where payments on account have been made or Class 1 NIC paid. Where no payments on account have been made and no SA return or other declaration confirming self employed status has been submitted then if the rules governing entitlement to contributory social security benefits are not changed, interim awards would have to be made and adjusted subsequently. Clawbacks of pension or benefit already paid could create hardship for contributors.

51. Even if nothing else is changed, we suggest that the opportunity be taken to align certain employee/er and self employed thresholds, so that the Class 4 lower limit (presently £7,755 per year) is equal to fifty two weeks' worth of primary (employee) threshold (PT) (ie £149 x 52 = £7,748), and at the same time align the PT and secondary (employer) threshold (ST) (presently £148 per week) so they are both equal to the weekly figure to be used to calculate the Class 4 lower limit, eg £149 per week. If SEE is retained, then we suggest aligning the SEE threshold (presently £5,725) with the lower earnings limit (thus £109 x 52 = £5,668). We are aware that there are historical reasons for all the NIC thresholds being different but to the man in the street such misalignments appear to have neither rhyme nor reason.

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

52. We have no comments to add to those made above and below.

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

53. We have no comments to add to those already in the assessment and made above.

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APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/-/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)