Abolishing Class 2 National Insurance and introducing a contributory benefit test to Class 4 National Insurance for the self-employed

Personal tax

01 April 2016

ATT and LITRG comment on the HMRC consultation

The 2015 Budget confirmed the government's intention to abolish Class 2 NICs. A recent consultation document, Consultation on Abolishing Class 2 National Insurance and Introducing a Contributory Benefit Test to Class 4 National Insurance for the Self-employed, explored the issue further. LITRG and the ATT responded to this consultation.

LITRG welcomed the simplification but highlighted issues arising from the withdrawal of the ability to pay voluntary Class 2 NICs to build up future entitlement to state benefits. The groups affected include foster carers, those resident overseas and more generally those who are self-employed but on a low income. It is proposed that these groups might make Class 3 NICs instead at a significantly higher cost (£14.10 a week for Class 3 as opposed to £2.80 for Class 2). LITRG pointed out that such a significant cost increase might place voluntary contributions beyond the means of some taxpayers, thus making them more reliant on means-tested benefits in the future. Some self-employed earners are to be protected by an NI credit system but this will not cover all those who currently make voluntary Class 2 NICs.

This further change to NICs for the self-employed coming shortly after the change introduced from April 2015 relating to payment of Class 2 NICS causes concern. Without significant education and publicity LITRG suggests that taxpayers may not have the ability to make properly informed decisions on whether they should pay

voluntary Class 3 NICs. Accordingly, LITRG recommends that these changes are properly considered and are not rushed through.

The ATT's response focused on the impact of the proposals on self-employed workers who earn below the small profits threshold. These individuals will not be entitled to a credit for Class 4 NIC. To protect their entitlement to the state pension and benefits they will need to pay voluntary Class 3 NIC at the much higher rate noted above. This represents a major change to the current system under which they can pay Class 2 NIC voluntarily. Moreover, they can do this through their self-assessment tax return, whereas Class 3 NIC payments would need to be made through a separate process.

The ATT suggests that this will create barriers for lower earners and discourage them from protecting their benefit entitlement. The risk is that those affected will decide not to make Class 3 NIC payments either due to the increased cost or the increased burden of a separate process (or even a lack of knowledge of it) and will therefore fail to build up enough provision for retirement and will rely more on the state for assistance.

The ATT suggests that the proposed zero-rate band for Class 4 NIC (to protect the benefit entitlement without an NIC payment being due), which is proposed to start above the small profits threshold, should start at zero profits to protect all self-employed workers with low profits.

The ATT put forward in its response that a zero-profits entry point could also have the benefit of encouraging low-earning self-employed workers to register their self-employed activities with HMRC.

The ATT also suggests that the digital tax accounts should be designed in a way that allows individuals to check their NIC record and make voluntary payments.

The full LITRG response can be read here. The full ATT response can be read here.