

Simplifying the National Insurance Processes for the Self-Employed Response by the Chartered Institute of Taxation

1. Introduction and Executive Summary

- 1.1 The Chartered Institute of Taxation (CIOT) is pleased to comment on HM Revenue & Customs' (HMRC) consultation on collecting Class 2 National Insurance Contributions (NICs). HMRC's proposals appear to follow from previous recommendations of the Office of Tax Simplification (OTS) in 2011 and 2012.
- 1.2 We note, in particular, that the OTS, as part of its '*Small business tax review*', suggested in its March 2011 interim report that more efficient collection of Class 2 NIC should be a priority area for reform in the shorter term. For example, paragraphs 4.11-17 of the report raised a number of problem areas with the way Class 2 contributions are assessed and collected, eg the Small Earnings Exemption (SEE) and post-tax year refunds, and recommended that DWP, HMRC and HMT find a workaround for these issues.
- 1.3 The OTS also noted at paragraph 4.36 of its March 2012 final report on '*HMRC administration*' for the small business, in the context of Class 2 NICs, that 'there could be simplification and cost reductions for HMRC and small businesses in looking at combining the collection process as part of the SA return'.
- 1.4 We agree with the OTS that including Class 2 NIC in the SA process could reduce administration burdens. In particular, we think that National Insurance deferment applications and over/under payments should be part of the SA return process. We also think that including the SEE process within SA has the potential to be simpler if liability to Class 2 NICs is based on established annual profits.
- 1.5 We do however think that HMRC will need to do more to help those on low incomes to pay their taxes if the proposed changes are to benefit all taxpayers. In particular, there should be education around the need to budget for paying taxes and also a 'pay monthly on account' option to include not only Class 2 NICs but also Class 4 and income tax.

- 1.6 Finally, we think this should be seen as a first step towards combining Classes 2 and 4 into a single Class of NICs for the self-employed, and possibly ultimately aligning liability for self-employed NICs with the primary threshold for Class 1 NICs.

2. The Current System

- 2.1 We acknowledge that for the vast majority the payment of Class 2 NICs is very easy; ie set up a direct debit, pay monthly or half-yearly, and let it continue. However, liability for Class 2 NICs can present problems for those at both ends of the earnings spectrum.
- 2.2 The Small Earnings Exemption (SEE) is based on anticipated profits and cannot be backdated (beyond a maximum of 13 weeks). This leads to some self-employed individuals paying Class 2 NICs when they may not need to or, having failed to apply for a SEE at the correct time, being pursued for payment of Class 2 NICs when they have little or no profit from their self-employed activity.
- 2.3 Deferment applications have to be made annually, which means an individual has to anticipate whether income from employment and self-employment in the next tax year will cause the annual NIC maxima to be exceeded. This can lead to under or overpayments at the end of the tax year, which is dealt with through a separate process.
- 2.4 Bringing the assessment of Class 2 NIC liabilities within the SA process therefore has the potential for:
- a) Individuals to apply for the SEE through the SA return based on actual profits for the tax year of assessment (and to recover Class 2 NICs paid in error); and
 - b) Including i) the deferment application, ii) the calculation of the NICs annual maxima, and iii) the payment of underpaid NICs/recovery of overpaid NICs within the SA process.
- 2.5 Consequently, we welcome HMRC's consultation on collecting Class 2 NICs through the SA process.

3. Collecting Class 2 NICs through Self-Assessment

- 3.1 ***Question 1 a) Overall would collecting Class 2 NICs through the Self Assessment system be simpler?***
- 3.2 For the vast majority of individuals the timing of the payment of Class 2 NICs, whether by direct debit/half-yearly billing or through the SA system, in one instalment on or before the 31 January after the end of the tax year, will make little difference, although combining this into one set of payments, one direct debit mandate etc, will be welcome for many. In addition, including Class 2 NICs in the SA process is likely to be administratively simpler for HMRC and has the potential to benefit some individuals.

3.3 Question 1 b) What benefits do you think this could bring to customers?

3.4 We think that (as noted above) including deferment applications, over/under payments, and the SEE process within the SA process has the potential to bring significant benefits to the individuals affected. We agree with the point made by HMRC at 3.10 of exploring the idea for an annual calculation of whether the maximum NICs have been exceeded by the individual to be generated through the SA return.

3.5 We also think that by including Class 2 NICs within the SA process it will be administratively simpler to collect the correct Class 2 NICs liability, especially when an individual starts and ceases self-employment.

3.6 Question 1 c) Do you see any drawbacks?

3.7 The main drawbacks are that:

- i. Some very low paid may cease to pay Class 2 with the result that they subsequently miss out on some contributory benefits. We think that even under SA HMRC should explore the option to pay Class 2 contributions voluntarily. Clearly there would need to be appropriate differentiation from voluntary Class 3 contributions, but these are of course much more expensive, thus adversely affecting the lowest earners;
- ii. For some individuals, particularly those on a low income, the payment of Class 2 NICs in a lump sum, at the same time as income tax and Class 4 NIC is paid, will be financially difficult; and
- iii. To help prevent individuals with low earnings unwittingly losing valuable contributory benefits, we propose HMRC adopt their own suggestion at 3.5 to include a question on the SA return as to whether the individual wishes to apply for the small earnings exception.

3.8 To assist in alleviating the financial difficulties with paying income tax and NICs on 31 January (and 31 July, where payments of account are due), we think it is essential to include an option for individuals to pay monthly on account. HMRC must do more to help individuals who may have difficulty in paying taxes in one lump sum to meet their obligations without incurring interest and penalties for late payment. This includes greater education of when liabilities are due (having one or two payment dates is, potentially, far simpler to understand and budget for than 12, 13 or 14). We think however that individuals must be able to opt for paying monthly on account; this could for example be achieved by basing the payment on the amount returned for Universal Credit purposes, so that payments can fluctuate with cash flow. Another option might be greater promotion and use of Budget Payment Plans.

3.9 Question 1: What do you consider will be the transitional challenges of moving from the current system to collecting Class 2 NICs through the SA system?

3.10 We do not think that there are any insurmountable challenges to bringing Class 2 NICs within the SA system. The main challenge will be to explain the change to individuals. Existing direct debits and standing orders will need to be stopped, the SA return and guidance will need to be redesigned and a few individuals who pay Class 2 NICs but are not within SA (see paragraphs 3.14 and 3.15 of the consultation document) will need to be brought within SA.

3.11 If Class 2 NICs are to be included as part of the 'payments on account' process HMRC will need to recognise that those individuals who previously made a single payment by 31 January after the end of the tax year may find that they have a

transitional year where an extra 50% is due on top at the same time, as a payment on account for the following tax year. This is an existing problem but we are concerned that HMRC do not recognise sufficiently the problems that can arise when payments on account first become due. For those on low incomes this can give rise to serious financial difficulties.

4. Scope for further Simplification

- 4.1 Question 3: 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?**
- 4.2 From a tax point of view, it would be administratively simpler to have a 'strict liability' system, as with Class 4 NICs. However, we recognise that there may be some contributory benefit entitlement issues to address and would encourage HMRC to consult with DWP and relevant stakeholders first.
- 4.3 Question 4: 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? Do you see any drawbacks?**
- 4.4 We think that alignment of the thresholds for Classes 2 and 4 NICs with the primary threshold (PT) for Class 1 NICs would result in a much simpler system for individuals to understand. Longer term, there may be a case for realigning the threshold for paying NICs with the income tax personal allowance, although this becomes ever more difficult as the personal allowance continues to rise.
- 4.5 The main drawback to a higher contributory threshold would be loss of entitlement to contributory benefits. This could be offset by, for example, crediting individuals with contributions if earnings are between the lower earnings limit (LEL) and PT, although this preserves complexity.
- 4.6 Question 5: What groups might be excluded from paying Class 2 NICs if liability to pay Class 2 NICs [is] aligned with the current Class 4 rules?**
- 4.7 Paragraphs 5.10 & 5.11 of the consultation document identify two groups of individuals (property/investment business owners and overseas residents) who are liable to Class 2 NICs but not Class 4. The consultation document does not make any case for changing the existing rules as to the scope of Class 2 NICs and it is unclear what this would achieve.
- 4.8 Question 6: Do you have any other ideas that might deliver further simplification for the collection of NICs from the self-employed?**
- 4.9 We would suggest merging Classes 2 and 4 NICs into a single Class of NIC for the self-employed. We would also suggest changing the liability to NICs from weekly 'earnings' to annual (this could be achieved by adopting rules similar to those applying to directors).

5. The Chartered Institute of Taxation

- 5.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 17,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation

9 October 2013