

These notes refer to the National Insurance Contributions Act 2015 (c.5) which received Royal Assent on 12 February 2015

NATIONAL INSURANCE CONTRIBUTIONS ACT 2015

EXPLANATORY NOTES

ANNEX A:

1. This annex sets out how NICs for the self-employed currently operates and summarises the changes that are being made.

BACKGROUND ON NATIONAL INSURANCE FOR THE SELF-EMPLOYED

2. The definition of self-employed for National Insurance purposes is a person who “is gainfully employed” in a trade, business, profession, office or vocation other than as an employed earner. The Act proposes no change to the current definition of a self-employed earner for National Insurance purposes.
3. All self-employed earners in Great Britain and Northern Ireland are required to notify HMRC of the start and end dates of their self-employment and are liable for weekly Class 2 contributions unless they are excepted (see below) or exempt¹ from payment. If they have UK profits that are chargeable to tax as trading income, they are also liable for Class 4 NICs on an annual basis².

Exception for low earnings from Class 2

4. Where a self-employed individual estimates that they will have earnings below the SEE level (set at £5,885 for 2014-2015) in the coming tax year they can apply to be excepted from Class 2 liability. If they do not apply for a SEE then they remain liable for Class 2 contributions.

Earnings for Class 2 purposes

5. The term ‘earnings’ for social security purposes includes “any remuneration or profit derived from an employment”. The effect of this is that the definition of earnings for NICs purposes applies equally to the income of an employed and a self-employed earner although how such earnings are calculated or estimated differs between the two.
6. Since Class 2 contributions are a flat rate contribution, not earnings related, the question of a self-employed earner’s earnings only becomes relevant in the context of eligibility for the SEE, which is based on net earnings.
7. Net earnings for the purposes of the SEE is interpreted as meaning the figure which would normally appear in a profit and loss account prepared in accordance with normal accounting principles. Deductions are allowed for business expenses and depreciation but not for income tax or Class 2 or 4 NICs paid.

Collection of Class 2

8. Class 2 contributions are currently collected either by payment of a six monthly bill or by monthly Direct Debit. Where these collection methods do not secure payment, recovery proceedings may be taken. The methods of recovery are diverse but include collection through a person’s tax code, by distraint and county court and high court proceedings. Unlike Class 4 contributions, unpaid Class 2 contributions are subject to the Limitation Act 1980 which means that enforcement of a Class 2 debt is limited, in most cases to 6 years.
9. At present Class 2 has its own late payment regime which is wholly separate from income tax and Class 4. For example, if Class 2 contributions are paid after the end of the tax year following the one for which they were due to be paid, they are payable at a higher rate.

¹ The most common reason for Class 2 liability to be suspended is where the individual is incapable of working, claiming maternity allowance or undergoing imprisonment.

² Where a self-employed earner is also employed and expects to pay the maximum amount of contributions as an employee they can apply to HMRC to defer payment of their Class 2 & 4 contributions.

Class 2 and securing entitlement to contributory benefit and maternity allowance

10. Class 2 contributions provide the means by which self-employed earners can access social security benefits.
11. Entitlement to the standard weekly rate of MA (currently £138.18) is based on payment of Class 2 contributions in respect of a prescribed period (currently any 13 weeks in the 66 week test period). A self-employed woman is treated as meeting the minimum earnings level if she holds an SEE certificate for the period in question, thus entitling her to the lower weekly MA rate (currently £27).
12. Class 2 contributions are also the means by which a self-employed earner accesses entitlement to contributory benefits such as the State Pension and the contributory strand of employment and support allowance. In addition, payment of Class 2 contributions allows access to contribution-based Jobseeker's Allowance for a limited group of people; namely self-employed share fishermen who pay a special rate for Class 2 contributions. A person needs to have a specific number of qualifying years (currently 30) in their working life to receive the full basic State Pension. Class 2 contributions will also count towards entitlement to the new State Pension which will be introduced on 6 April 2016.

Class 4 NICs

13. Those who are self-employed will normally also be liable to pay Class 4 NICs. A Class 4 NICs liability will arise if a self-employed individual's profits or gains are chargeable to income tax as trading profits.
14. Class 4 NICs do not secure benefit entitlements but are instead intended to equalise, broadly, the levels of NICs paid by both employed and self-employed individuals. They are charged annually as a percentage of the taxable profits (as opposed to earnings) above a lower profits limit (LPL) (for tax year 2014-15 the LPL is £7,956). They are assessed, collected and enforced through the income tax SA system, with some minor differences, for example, Class 4 NICs liability does not arise for tax years after a person reaches state pension age. There are also certain matters which are dealt with outside of the SA system, for example, an application for deferment of Class 4 liability.

Special Groups

15. In addition to the self-employed in Great Britain and Northern Ireland, there are a small number of special groups who are either liable to pay Class 2 contributions or who have the option of paying them on a voluntary basis under EU law and bi-lateral Social Security agreements with non-EU countries.
16. These include people who are usually self-employed in the UK but go to work in another European Economic Area Member State temporarily and those who are self-employed in more than one Member State but who reside in the UK and carry out a substantial part of their activity here.
17. There are also some other groups who are liable for Class 2 contributions or have the option of paying voluntary Class 2 contributions, including:
 - Mariners who are not liable to pay Class 1 contributions;
 - Share fishermen who are liable for a special rate of Class 2 contributions (£3.40 per week in 2014-2015) which provides additional benefit entitlement, specifically access to contribution based jobseeker's allowance; and
 - Volunteer Development Workers who can choose to pay voluntary Class 2 contributions at a special rate (£5.55 per week in 2014-2015) which provides them with the same additional benefit entitlement as share fishermen.

CHANGE TO THE STRUCTURE OF CLASS 2 CONTRIBUTIONS AND THE SMALL EARNINGS EXCEPTION

18. The Act will change the structure of Class 2 contributions from the existing liability that arises in respect of each week, or partial week, of self-employment to an annual liability which is triggered by reference to a self-employed earner's Class 4 NICs profits (rather than earnings) and which is then calculated by reference to the number of weeks, or part weeks, of self-employment in the tax year.
19. The Class 2 contributions liability will arise at the end of the tax year and the amount due will be assessed on an annual basis, with reporting and collection through the SA process. The self-employed will, as now, be required to file their SA return by the 31 October following the end of the tax year if submitted on paper, or by the 31 January following the end of the tax year if submitted online.
20. The payment of Class 2 contributions will be due no later than 31 January following the relevant year.
21. Penalties and appeals will be more closely aligned with those for SA so that the self-employed are not subject to two different regimes.
22. The current SEE arrangements will no longer be necessary. Liability for Class 2 contributions will be determined by whether the self-employed earner's Class 4 NICs profits (rather than earnings), declared at year end, exceed a set threshold – the SPT. The SPT has been determined by uprating the Class 2 contributions SEE level for 2014-2015 by reference to the consumer prices index and will in future be uprated annually along with other NICs thresholds and limits. Those with either low profits (or even losses) or no profits, who will no longer be liable for Class 2 contributions under the new arrangements, will be able to opt to pay Class 2 contributions voluntarily so that they may protect their benefit rights.
23. The Class 2 contributions bi-annual bill and Direct Debit arrangements (monthly & six monthly) will end for the majority of self-employed earners. These customers will instead receive a payment request (either via paper or electronically) once they have filed their SA return at the end of the tax year.
24. Most self-employed earners will be able to choose to make in-year payments to budget for any annual Class 2 contributions liability (or to pay voluntary Class 2 contributions if their profits fall below the threshold). This is to avoid those with low profits facing a large end of year bill, something which was raised in a number of responses to the consultation on collecting Class 2 contributions through SA.
25. Those who are self-employed for Class 2 contributions purposes, but not for tax and Class 4 NICs purposes and who therefore do not have any Class 4 NICs profits for the purposes of establishing liability (for example, those running a property or investment business), will still be entitled to pay Class 2 contributions voluntarily. A separate process will be retained to allow these self-employed earners and the special groups mentioned above (other than Share Fishermen who can pay through SA) to continue to pay Class 2 contributions under the new arrangements.
26. Self-employed women wishing to claim MA may be impacted by the change given the contemporaneous nature of the qualifying condition that currently determines the weekly rate of MA payments to the payments of Class 2 contributions. Women who have not had the opportunity to file an SA return and pay Class 2 NICs will be able to pay Class 2 contributions early in order to secure MA entitlement at the standard weekly rate. This payment option will apply whether or not the woman ultimately becomes liable to pay Class 2 contributions. Self-employed women who choose not to make an early payment of Class 2 will receive the lower rate of MA, unless they have an SA record which demonstrates that they have made the requisite number of Class 2 contributions.

27. Women who are neither employed nor self-employed but who participate in the business of their spouse or civil partner can receive the lower rate of MA for 14 weeks if their spouse or civil partner has paid Class 2 contributions for 26 weeks, voluntarily or as evidenced by their SA return. Those spouses or civil partners who have not had the opportunity to file an SA return and pay Class 2 contributions will also be able to pay Class 2 contributions early.