European Commission

National insurance contributions and the self-employed in the UK

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On 8 March, as part of his budget proposal, the UK Chancellor announced that the main rate of national insurance contributions (NICs) for the self-employed would be increased from 9% to 11% in two steps (compared to 12% for employees). The proposal was criticised, including by a number of the government's own Members of Parliament, for breaking an election pledge not to increase VAT, income tax or NICs. The Prime Minister announced that legislation would be delayed until the autumn, and the publication of a report on the future of work. Yet, within a week the proposal was dropped, and a promise made not to increase NICs in this parliament.

Description

Employees are required to pay Class 1 National insurance contributions (NICs) at the rate of 12% on earnings over an annual threshold (£8164 (€9552) from April 2017) up to the upper earnings limit of £45032 (€52688), and 2% on earnings above that. Their employers also make contributions. In return, employees are entitled to a range of cash benefits when they are sick, unemployed or over statutory pensionable age.

The self-employed currently pay flat-rate Class 2 NICs (£2.85 (€3.33) per week from April 2017) on profits of £6025 (€7049) per year or more; those with earnings above £8164 (€9552) are also required to pay Class 4 NICS at the rate of 9% up to £45000 (€52650) per year and 2% above that. There are no employer contributions. They do not qualify for contributory unemployment benefit but do qualify for all other benefits with contribution conditions, including state pension, employment and support allowance (long-term incapacity benefit) and state maternity allowance. They do not qualify for employer provided benefits.

It is technically Class 2 contributions that entitle them to benefits. But Class 2 NICs are due to be abolished in 2018. In the Budget on 8 March, the Chancellor (the UK Finance Minister) announced that he was going to increase Class 4 NICs to 11% (10% in April 2018 and 11% in April 2019) for all self-employed people earning between £8164 (€9552) and £45000 (€52650) per year. The motives for the change were various: to raise revenue (by £645 (€755) million per year, said to be needed to help solve the funding crisis in social care); to simplify and make fairer the NICs system (an employee earning £32000 (€37440) pays £6170 (€7218) in NICs, while a self-employed person on the same earnings pays £2300 (€2691)); and to remove a possible incentive for people becoming self-employed, or being artificially made self-employed rather than employees to evade taxes. The self-employed are also going to be entitled to the higher single-tier state pension being paid to those who claim after April 2016. The government said it would examine how to include self-employed people in parental pay provisions.

The proposed rise was opposed by the Labour Party as well as, more crucially, by a number of Conservative Members of Parliament who argue that it is a breach of the party's 2015 election pledge not to increase VAT, income tax or NICs, and that it stifles enterprise and harms traditional Conservative voters. The self-employed point out that they do not get paid holiday or parental leave. Tax experts at the Institute for Fiscal Studies and the Resolution Foundation think-tank have tended to defend the policy, arguing that it is a sensible simplification, it is progressive, it should allow better control of the gig economy and it is in line with the abolition of Class 2 NICs and the extension of a higher state pension to the self-employed already taking place. 45% of the growth in employment since 2008 has been in self-employment, which undermines the capacity to collect revenue. The measure was redistributive if seen alongside the abolition of Class 2 NICs and the raising of the tax threshold already announced.

The government only has a small majority in parliament and the Prime Minister quickly announced that the legislation required to implement this reform would not be introduced until the autumn and after the report from Matthew Taylor (who welcomed the increase in NICs), who is reviewing the future of the labour market in the context of recent changes, including the growth in self-employment. In his report, Matthew Taylor is expected to propose wide-ranging measures to control the gig economy, zero hours contracts and the exploitation of the self-employed. The Chancellor then announced that the proposed increase would be dropped, citing the need to encourage public trust in government responsiveness and to follow the spirit as well as the letter of the 2015 Conservative Party election manifesto (which had been followed up with legislation clarifying that the undertaking not to increase NICs referred to employees only). He has also undertaken not to raise NICs at all in this parliament.

Outlook & Commentary

The increase in NICs for the self-employed was a sensible and welcome change. It would have made the system more even between self-employed and employees. The political storm raised about these progressive proposals contrasts with the lack of attention being paid to the huge (£12 (€14) billion per year) and highly regressive cuts being implemented for working age benefits, particularly for families with children, from April 2017. Another important change is that the self-employed will be deemed to be working 35 hours per week on the "national living wage" (minimum wage) when assessed for universal credit (with relief from this rule for those starting out). Overall, the Treasury is forecast to lose around £6 (€7) billion each year from the more favourable tax treatment of self-employed incomes. The government has not contradicted the analysis of the proposed rise in NICs for the self-employed as the right direction to go in; it has bowed to political and public pressure and abandoned this step forward. The editorial in the Financial Times (16 March 2017) argued that this was "putting politics over good policy".

Further reading

Bell, T. (2017) Reforming tax for the self-employed should be welcomed by progressives and fiscal hawks alike

http://www.resolutionfoundation.org/media/blog/reforming-tax-for-the-self-employed-should-be-welcomed-by-progressives-and-fiscal-hawks-alike/

Bradshaw, J. and Bennett, F. (2017) ESPN Thematic Report on Access to social protection of people working as self-employed or on non-standard contracts: UK (forthcoming), http://ec.europa.eu/social/main.jsp?catId=1135&intPageId=3589

DWP, HMRC & HM Treasury (2016) The abolition of Class 2 NICs: Introducing a benefit test into Class 4 NI for the self-employed: https://www.gov.uk/government/consultations/consultation-on-abolishing-class-2-national-insurance-and-introducing-a-contributory-benefit-test-to-class-4-national-insurance-for-the-self-employed/

Institute for Fiscal Studies (2017) Budget 2017 https://www.ifs.org.uk/tools_and_resources/budget/515

Taylor, M. (2017) "Reforming work and the systems around it is vital", RSA Issue 4, 2016/17, Royal Society of Arts

The Sun (16 March 2017): https://www.thesun.co.uk/news/3095228/philip-hammond-drops-hated-national-insurance-hike-after-sun-campaign-as-chancellor-makes-stunning-u-turn-on-tax-raid-on-white-van-man/

Tomlinson, D. (2017) A small and sensible National Insurance rise for the self-employed is not the real strivers tax http://www.resolutionfoundation.org/media/blog/a-small-and-sensible-national-insurance-rise-for-the-self-employed-is-not-the-real-strivers-tax/

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