EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY (CREDITS, AND CREDITING AND TREATMENT OF CONTRIBUTIONS) (CONSEQUENTIAL AND MISCELLANEOUS AMENDMENTS) REGULATIONS 2016

2016 No. 1145

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument amends various sets of existing legislation in consequence of changes made by Her Majesty's Revenue and Customs, from April 2015, to the payment and collection of Class 2 (self-employed) National Insurance contributions (NICs), under the National Insurance Contributions Act 2015 ("the 2015 Act") http://www.legislation.gov.uk/ukpga/2015/5/contents, and the introduction of accelerated payment of NICs by that Act. The Regulations make other miscellaneous amendments to the same Regulations, to tidy up existing provisions.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 As this instrument is subject to the negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

4.1 Under the 2015 Act, the deadline ("due date") for the payment of Class 2 NICs, from the 2015/16 tax year onwards, became 31 January of the following calendar year e.g. 31 January 2017 is the due date for the 2015/16 tax year. This creates a misalignment with the contribution conditions to be satisfied for the purposes of contributory Employment and Support Allowance (ESA) and contribution-based Jobseeker's Allowance (JSA), because claims for these benefits may be made before 31 January in the circumstances where entitlement relies on as-yet-unpaid contributions.

4.2 To address this misalignment, this instrument provides for payments of Class 2 NICs which are made by 31 January to be treated as having been made at an earlier date, in appropriate cases, to ensure that the claimants concerned are not disadvantaged by virtue of the changes introduced by the 2015 Act.

4.3 This instrument also makes provision for benefit decisions to be revised in the circumstances where, under the 2015 Act, the NICs upon which an award of benefit was previously based (whether wholly or partially) are subsequently repaid or refunded to the claimant.

5. Extent and Territorial Application

5.1 The extent of this instrument is Great Britain.

5.2 The territorial application of this instrument is Great Britain.

5.3 Separate but corresponding provisions will be made for Northern Ireland by statutory rule, by the Northern Ireland Department for Communities.

6. European Convention on Human Rights

6.1 As this instrument is subject to the negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

What is being done and why

Background: National Insurance contributions payable by the self-employed

7.1 Self-employed people currently pay two classes of National Insurance contributions (NICs): Class 2 and Class 4. Class 2 NICs count towards the following benefits: basic State Pension, new State Pension, contributory Employment and Support Allowance, Maternity Allowance, Bereavement Benefits and (but only in the case of the Class 2 NICs paid at special rates by share fishermen and volunteer development workers) contribution-based Jobseeker's Allowance.

7.2 Class 4 NICs are payable at a rate of 9% on profits above the Lower Profits Limit (£8,060 in 2016/17) and up to an including the Upper Profits Limit (UPL) (£43,000 in 2016/17), and at 2% on profits above the UPL. They do not currently provide entitlement to any benefits.

Simplifying the method of collection of Class 2 National Insurance contributions

7.3 Under the National Insurance Contributions Act 2015 (link as per paragraph 2.1), the reporting and collection of Class 2 NICs was brought within the framework of the annual process under which Her Majesty's Revenue and Customs already collects income tax and Class 4 NICs for any tax year (runs 6 April - 5 April), this being on the basis of a Self Assessment return made by the contributor after the tax year has closed. The aim of this change was to make it more simple and straightforward for the self-employed to pay Class 2 NICs, reducing the administrative burdens both on them and on the government. The change took effect from the 2015/16 tax year onwards.

7.4 Class 2 has now become an annual liability determined by a measure of profit for the tax year of assessment as declared on the contributor's Self Assessment return for that year. Where a person has relevant profits for a tax year which are at or above the small profits threshold (SPT) for that year (£5,965 for 2016/17), Class 2 NICs are payable at a flat rate (£2.80 per week in 2016/17) for every week or partial week of self-employment in that year. (Contributors with profits below the SPT are not required to pay any Class 2 NICs but may do so voluntarily.)

7.5 At the same time, the deadline (the "due date") for payment of Class 2 NICs in respect of any relevant tax year has aligned with the corresponding deadline for payment of income tax and Class 4 National Insurance contributions (NICs) in respect of the same tax year - this being 31 January of the calendar year immediately following the end of the tax year. This means that, for the 2015/16 tax year, for example – this being

the first tax year to which the new arrangements apply - a self-employed person has until 31 January 2017 to file their return and pay any tax and (if their profits are at or above the small profits threshold) any NICs due - although they can, of course, file and pay before that date if they choose; and so on for each succeeding tax year.

Impact of the changes of the Department for Work and Pensions

7.6 The impact, on the Department for Work and Pensions (DWP), of payments of Class 2 NICs which, under the new arrangements introduced by Her Majesty's Revenue and Customs (HMRC), are made later than would previously have been the case, is two-fold. Firstly, it increases the likelihood of Class 2 NICs being brought to account on a person's National Insurance record *after* a pension or bereavement benefit claim has been made and decided; and, secondly, the new, final payment date of Class 2 NICs creates a misalignment with the contribution conditions to be satisfied for the purposes of contributory Employment and Support Allowance (ESA) and contribution-based Jobseeker's Allowance (JSA).

7.7 These conditions require a self-employed claimant to have paid at least 26 Class 2 NICs in at least one of the two tax years prior to the benefit year in which the claim is made; and they must have paid those NICs before the start of the first week in respect of which entitlement is being considered.

7.8 Since a "benefit year" begins with the first Sunday in January in any calendar year, but, under HMRC's new payment arrangements, the final date for payment of Class 2 NICs for any tax year has become 31 January of the following calendar year, it follows that, starting in January 2017, and in each successive January thereafter, DWP may receive ESA and JSA claims which might rely on the payment of Class 2 NICs for the most recent tax year to satisfy the contribution condition, but where, quite lawfully, those Class 2 NICs have not yet been paid. So the claim will fail, even though the claimant has acted entirely properly.

Treating Class 2 National Insurance contributions as being paid at an earlier date

7.9 In recognition of this misalignment, this instrument amends the Social Security (Crediting and Treatment of Contributions, and National Insurance Numbers) Regulations 2001 (S.I. 2001/769) http://www.legislation.gov.uk/uksi/2001/769 to the effect that, provided the claimants in question pay their Class 2 NICs (including voluntary Class 2 NICs, where applicable) for the previous tax year by 31 January, the payment will be treated as having been made before the start of the first week in respect of which entitlement to benefit is being considered. This will help the claimant to satisfy the relevant contribution conditions.

7.10 Where an adverse decision has already been made on the claim before the payment of Class 2 NICs is made, this instrument amends the Social Security and Child Support (Decisions and Appeals) Regulations 1999 (S.I. 1999/991) http://www.legislation.gov.uk/uksi/1999/991 and the Universal Credit, Personal Independence Payment, Jobseeker's Allowance and Employment and Support Allowance (Decisions and Appeals) Regulations 2013 (S.I. 2013/381) http://www.legislation.gov.uk/uksi/2013/381/contents to the effect that, provided the claimant pays their Class 2 National Insurance contributions (NICs) (including voluntary Class 2 NICs, where applicable) for the previous tax year by 31 January, the decision may be revised in the claimant's favour.

7.11 These changes will, collectively, allow benefit entitlement to arise, where appropriate, from the same point from which it would otherwise have arisen, so the claimant won't lose out overall. In the interim, by way of mitigation, people will still have access to the range of means-tested benefits that act as a safety net for those with the lowest income - income-related Employment and Support Allowance, income-based Jobseeker's Allowance or Universal Credit, as appropriate.

7.12 In similar vein, where a decision on a claim for State Pension, new State Pension or Bereavement Benefit has already been made, and Class 2 NICs are paid after the date of the decision but by the due date, and, as a consequence of the adjusted National Insurance record, a person either establishes entitlement for the first time (where they had previously failed to meet the qualifying conditions) or becomes entitled to an increased award (where entitlement had previously been established), this instrument provides that the relevant decision may be revised, as appropriate. Again, arrears will be paid back to the date of first entitlement.

7.13 This instrument also provides for a benefit decision to be changed in the circumstances where NICs are paid after the date on which they were due, but nevertheless still count (from the date of payment onwards) for the purposes of entitlement to the benefit concerned.

Effect of refunds of Class 2 National Insurance contributions

7.14 This instrument also provides for the position where a declared profit for any tax year is subsequently revised downwards *after* the due date for filing the Self Assessment return has passed.

7.15 Where the adjusted profits figure now falls below the small profits threshold for the year, Her Majesty's Revenue and Customs (HMRC) can refund any Class 2 NICs previously paid in respect of that year, because it will have turned out that there was no liability after all.

7.16 A refund of Class 2 NICs may, however, jeopardise people's current and future entitlement to contributory benefits. If the claimant chooses not to pursue the refund, the NICs will be re-classified as voluntary Class 2 NICs and will remain on the contributor's NI record. If, on the other hand, the contributor pursues and accepts the refund, the Class 2 NICs in question will be retrospectively removed from their NI record and, for the purposes of determining their entitlement to benefit, the NICs refunded will be treated as not having been paid.

7.17 Where this has a material effect on any benefit decision (i.e. where any benefit has been awarded, in whole or in part, on the basis of the now-refunded NICs), this instrument provides that the decision as to the person's entitlement to the benefit may be revised. Recovery of any resultant overpayment will be pursued, as appropriate.

Effect of refunds of Accelerated Payments of National Insurance contributions

7.18 This instrument also provides for the position where Her Majesty's Revenue and Customs (HMRC) repays National Insurance contributions (NICs) which have been paid under the Accelerated Payments process.

7.19 Accelerated Payments (APs) relate to the tax and NICs due on payments which HMRC considers to be being made under an avoidance scheme or arrangement. HMRC wants the users of such avoidance schemes to pay the tax and NICs in dispute on demand, rather than when the litigation and any investigations are complete. NICs

which are paid under the AP process are regarded as lawfully-paid contributions; and people can become entitled to contributory benefits or statutory payments as a consequence, in the normal way.

7.20 If HMRC's view of the law is subsequently overturned by the Courts, some or all of the NICs paid by the contributor under the AP process will be due to be refunded. In this event, the relevant NICs will be removed from the contributor's National Insurance record, and, for the purposes of determining their entitlement to benefit, the NICs repaid will be treated as not having been paid.

7.21 Again, where this has a material effect on any benefit decision (i.e. where any benefit has been awarded, in whole or in part, on the basis of the now-repaid NICs), this instrument provides that the decision may be revised. Recovery of any resultant overpayment will be pursued, as appropriate. In these circumstances, however, Part IV of the Finance Act 2014 (follower notices and accelerated payments) http://www.legislation.gov.uk/ukpga/2014/26/contents/enacted/data.htm, as modified by paragraph 17(7) of Schedule 2 to the National Insurance Contributions Act 2015 ("the 2015 Act") http://www.legislation.gov.uk/ukpga/2015/5/schedule/2/enacted, specifically provides that the refund will not affect any payments of benefit made to a person before the date of repayment. Accordingly, recovery of any overpayment can be pursued only for periods arising after the date of repayment.

Other provisions

7.22 Finally, this instrument makes miscellaneous amendments to the Social Security (Credits) Regulations 1975 (S.I. 1975/556) http://www.legislation.gov.uk/uksi/1975/556 and the Social Security (Crediting and Treatment of Contributions, and National Insurance Numbers) Regulations 2001 (S.I. 2001/769) (link as per paragraph 7.9), to tidy up existing provisions.

Consolidation

7.23 Informal consolidated text of instruments is available to the public free of charge via 'the National Archive' website http://www.legislation.gov.uk/.

8. Consultation outcome

8.1 Public consultation has not been carried out on these Regulations. Consultation was not considered necessary as the amendments are considered to be technical and comprise, principally, changes designed to ensure that no-one claiming contributory Employment and Support Allowance, contribution-based Jobseeker's Allowance, State Pension, new State Pension or Bereavement Benefit (in the circumstances where entitlement, or additional entitlement, relies on the payment of Class 2 National Insurance contributions {NICs} for the previous tax year) will be unfairly disadvantaged by the reforms introduced by Her Majesty's Revenue and Customs (HMRC) under the National Insurance Act 2015 ("the 2015 Act") (link as per paragraph 2.1).

8.2 The 2015 Act itself followed a government consultation document published on 18 July 2013 entitled *Simplifying the National Insurance Processes for the Self-Employed* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/224605/hmrc_consultation_Simplification_of_Self-employed_July_2013-4.pdf, which sought

views on proposals to simplify Class 2 NICs by collecting it through Self Assessment, alongside Class 4 NICs and income tax.

8.3 The summary of responses to the consultation https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/266218/Simplifying_NICs_consultation_response.pdf published on 17 December 2013, concluded that "there was strong support for reforming self-employed National Insurance contributions with many responses indicating that reform would bring simplicity and reduced administration".

8.4 The changes being delivered by this instrument were scrutinised by the Social Security Advisory Committee on 12 October 2016, under the provisions of section 173 of the Social Security Administration Act 1992 http://www.legislation.gov.uk/ukpga/1992/5. The Committee decided that it did not require the changes to be formally referred to it and, accordingly, it did not conduct a public consultation exercise on them.

9. Guidance

9.1 The Department for Work and Pensions (DWP) has developed appropriate instructions for staff in the Jobcentre Plus offices who advise customers, and for staff in benefit centres, relating to the handling of claims, decisions and awards which are affected by the provisions of the 2015 Act. These will be available from December 2016.

9.2 The DWP has amended its telephony scripts for Employment and Support Allowance (ESA) and Jobseeker's Allowance, and messages on GOV.UK https://www.gov.uk/, to forewarn self-employed people of the impacts of the 2015 Act, and to stress the prudence of the paying their Class 2 NICs as soon as they can to avoid any delays. The telephony scripts will be available from 3rd January 2017 and Gov.UK messages from 16th December 2016.

9.3 HMRC has issued a series of mailshots to self-employed contributors over the past 18 months, summarising the high level impacts of the reform of Class 2 NICs. For self-employed claimants who advise HMRC that they can't pay the full amount of tax and NICs due under the Self Assessment return, but that they need to pay Class 2 NICs for the purposes of an ESA claim, HMRC tailor its guidance to enable the payment the contributor makes made to be allocated, in the first instance, as a payment in respect of Class 2 NICs.

9.4 The Department for Work and Pensions (DWP) has devised a new letter to inform Employment and Support Allowance (ESA) and Jobseeker's Allowance (JSA) claimants, in appropriate cases, that their disallowance decision will be revised if they pay their Class 2 National Insurance contributions (NICs) to Her Majesty's Revenue and Customs (HMRC) by the end of January. This letter will be published and available for use from 1st January 2017.

9.5 Similarly, when a Bereavement Benefit claim is disallowed because the deceased person did not meet either or both of the contribution conditions, DWP has amended the decision notice to advise claimants that, if their late spouse or civil partner was self-employed, but had not paid Class 2 NICs for the last complete tax year before they died, and payment for that year would make a difference to the decision, they should contact HMRC and ask for information about paying Class 2 NICs on behalf

of their late spouse or civil partner. This amended notice has been available and in use since April 2016.

10. Impact

10.1 There is no impact on business. The DWP has engaged with Citizens Advice to ensure its advisers are familiar with the changed regime for NICs, and are able to advise individuals requesting information about claiming contributory ESA and contribution-based JSA, as appropriate.

10.2 The impact on the public sector is minimal. The DWP estimates that only around 4,000 people who claim contributory ESA or contribution-based JSA in January each year might be relying on as-yet-unpaid Class 2 NICs to gain entitlement. Nevertheless, whilst the principal changes introduced by this instrument are designed to preserve the status quo as far as possible, and are not, in themselves, complex, given the potential for re-work, they have an unavoidable impact on operations. The DWP has devised appropriate arrangements, in conjunction with HMRC, to ensure the changes are delivered with minimal disruption. Some processes have been slightly amended but in the main, the existing processes will continue to be utilised; and there is no change to the eligibility conditions or the amount payable.

10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The legislation does not apply to activities that are undertaken by small businesses.

12. Monitoring & review

12.1 The operation of the Regulations will be reviewed through the normal avenues of guidance, enquiries received from the DWP's offices and correspondence from members of the public.

13. Contact

13.1 David Crowther at the Department for Work and Pensions (Tel: 0114 293 4835; e-mail: david.crowther@dwp.gsi.gov.uk) can answer any queries regarding this instrument.