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# **Payment of Class 2 Self-Employed National Insurance Contributions**

## **A Consultation Document**

Issued by:

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# **PAYMENT OF CLASS 2 SELF-EMPLOYED NATIONAL INSURANCE CONTRIBUTIONS**

## **A Consultation Document**

### **1. Background**

Before April 2010, Classes 1, 2 and 3 National Insurance Contributions (“Contributions”) were collected by the then Department of Health & Social Security, and Class 4 Contributions were collected by the Income Tax Division (“the Division”). Following the restructuring of Government in 2010, the Division became responsible for the collection of all classes of Contributions.

The current method of collecting Class 2 Contributions is, for such small amounts (£2.50 per week, or £130 per year), overly bureaucratic; and it is therefore proposed that the collection of Class 2 and Class 4 Contributions should be aligned.

The purpose of this consultation is to outline a proposed new method for paying Class 2 Contributions and to seek views and comments on it.

### **2. Introduction**

Class 2 Contributions are paid by self-employed earners. A person is defined as being self-employed if they are gainfully employed in the Isle of Man other than as an employed earner. In practice, this generally means someone who has their own business.

Class 2 Contributions may satisfy the contributory conditions for the following benefits: Incapacity Benefit, Maternity Allowance, Bereavement Payment, Widowed Parent’s Allowance, Bereavement Allowance, the Basic Retirement Pension and the Manx Pension Supplement Scheme.

In addition to Class 2 Contributions, Class 4 Contributions are payable at a set percentage rate on profits from self-employment which exceed a lower limit of £5,980 per year. Class 4 Contributions do not count towards entitlement to social security benefits.

Share fishermen can also pay Class 2 Contributions: although the rate in their case is £3.15 per week: which gives an entitlement to claim Jobseeker’s Allowance in addition to the benefits mentioned above.

The method for paying Class 2 Contributions has changed little since the introduction of the welfare state in the 1940s. Originally, self-employed people bought a National Insurance stamp from the Post Office and fixed it to a card; but they now pay the Division by direct debit, credit card, cheque or cash.

### **3. Small earnings exception**

A self-employed person can apply to the Division to be excepted from paying Class 2 Contributions if they expect their net profits in that tax year to fall below a set amount (£5,315 in 2011/12). This excuses them from a legal obligation to pay the Contributions. Applications for the small earnings exception can be backdated for up to 13 weeks from the

date of claim. However, as the person will not be awarded National Insurance credits for the period, an exception claim could affect their future entitlement to contributory benefits.

#### **4. Deferment of Class 2 and Class 4 liability**

When someone is employed and self-employed at the same time and from their employment has earnings which will equal or exceed the Upper Earnings Limit (above which the main rate of National Insurance is not payable), they can apply to the Division to have their liability to pay both Class 2 and Class 4 Contributions deferred until after the end of the tax year. If they did not eventually have earnings from employment which reached or exceeded the Upper Earnings Limit, they will then be liable to pay Class 2 and Class 4 Contributions of up to the maximum level of National Insurance payable in a tax year.

#### **5. Current payment method**

A self-employed person is liable to pay a Class 2 Contribution for each week that they are self-employed. These Contributions are paid monthly by direct debit, credit card, cheque or cash.

Class 4 Contributions are collected annually with income tax. The standard system is that, following assessment of the income shown on a self-employed person's tax return for the previous year to 5 April, any balance of income tax and Class 4 Contributions must be paid no later than the following 6 January. There may be no balance or it may be small, because payments on account of tax and Class 4 Contributions are also due on 6 January for the current tax year which carry forward to the assessment for that year once the person's tax return has been submitted.

#### **6. Proposed change to an annual payment of Class 2 Contributions**

It is proposed that self-employed people should pay their Class 2 Contributions for the whole of the tax year at the same time as their Class 4 Contributions payment on account: i.e. on or before 6 January in the tax year.

Where it is known that someone will not be self-employed for the whole of the year, e.g. they reach state pension age or they become an Incapacity Benefit recipient, the amount of Class 2 Contributions which they are asked to pay will reflect this.

#### **7. Effect on entitlement to certain benefits**

The proposed changes in the method of payment will not affect entitlement to benefits.

When self-employed people claim Incapacity Benefit they have to satisfy certain Contributions conditions in respect of certain tax years. For example, if they make a claim for Incapacity Benefit during the 2011 year, the tax years used to determine whether they satisfy the Contributions conditions will be 2008/09 and 2009/10. If the person was liable to pay Class 2 Contributions in either of those years and does so after the start of the benefit year, then, as a penalty for the late payment, 42 days elapse before the benefit can be paid. It is proposed that this penalty will continue should the method of paying Class 2 Contributions be changed.

#### **8. Rate of contribution due under the proposed scheme**

The Class 2 Contributions rate is set each year as part of the Budget immediately preceding the beginning of the tax year, which usually takes place in February. Under the proposal in this consultation document, the rate of Contributions for the year will be known at the time of payment.

Where Class 2 Contributions are paid after the end of the tax year following that in which they were due; a late payment penalty is charged. The effect of the penalty is to charge the Class 2 Contributions at a rate equal to the rate in the current tax year, which will be higher than in the year during which they should have been paid. It is proposed that this penalty will continue under the new payment scheme.

## **9. Treatment of the small earnings exception under the proposed scheme**

It is proposed that the small earnings exception will continue to apply and that the requirement to apply for it will be removed. The exception will be granted prospectively where a self-employed person's tax return for the previous year shows that their profits fall below the exception limit.

It is also proposed that the exception limit should be aligned with the lower profits limit for Class 4 Contributions; which means on today's limits that it would be raised from £5,315 to £5,980 per year.

## **10. Deferment of Class 2 and Class 4 liability under the proposed scheme**

It is proposed that deferment as described in section 4 above will continue to operate. However the requirement to apply for deferment of Class 2 and 4 NICs would again be driven by the information in the self-employed person's tax return for the previous year.

## **11. Submissions**

Anyone wishing to submit their views on the proposals in this document, or on any other issue related to self-employment, is invited to do so by 2<sup>nd</sup> March 2012. Responses should be sent to:

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In any consultation exercise the responses received do not guarantee that changes will be made to what has been proposed.

Following the consultation period, the responses will be reviewed and the conclusions, together with a summary of the comments received, will be published.