

Written evidence submitted by Citizens Advice to the Office of Tax Simplification review of Income Tax (IT) and National Insurance Contribution (NIC) alignment



1. Background

1.1 What industry/trade are you from and, if representing a group, how many members do you represent?

The Citizens Advice service is a charity that:

- delivers advice to solve individual problems;
- provides education to empower clients to help themselves in the future;
- campaigns to solve collective problems; and
- benefits society more generally through the way we work.

In 2014-15 Citizens Advice helped 2.5 million people with 6.2 million advice issues and had 20.7 million visitors to our website. We are in every community, with 316 local Citizens Advice organisations and 21,600 volunteers.

As the central organisation, Citizens Advice collates and uses the national data from all our services to identify issues and trends, to better understand our clients' needs and to demonstrate to government, policymakers and regulators the impact of policy or legislation.

From October 2015-16 to December 2015-16 there were 336,213 unique views of our webpages providing advice on tax issues (up 51% compared with the previous year) and in the same three-month period 13,523 clients visited local Citizens Advice for face-to-face advice about tax issues: an increase of 14% on the previous year, with specific enquiries about income tax up 22% (Figure 1). We are also seeing trends indicating an increase in clients enquiring about other issues related to this review, such as employment status, self-assessment & tax returns and disputes about Tax Credit claims (Figures 2,3 & 4).

This suggests that recently implemented or announced changes to income tax and national insurance, their related effect on benefit claims, particularly Tax Credits, and for self-employed people, on top of changes to Her Majesty's Revenue & Customs (HMRC) are increasingly causing problems for our clients. This response, therefore, highlights the current problems demonstrated by our national research, collated advice statistics and client case studies to inform the Office of Tax Simplification's review of closer income tax (IT) and national insurance contribution (NIC) alignment.

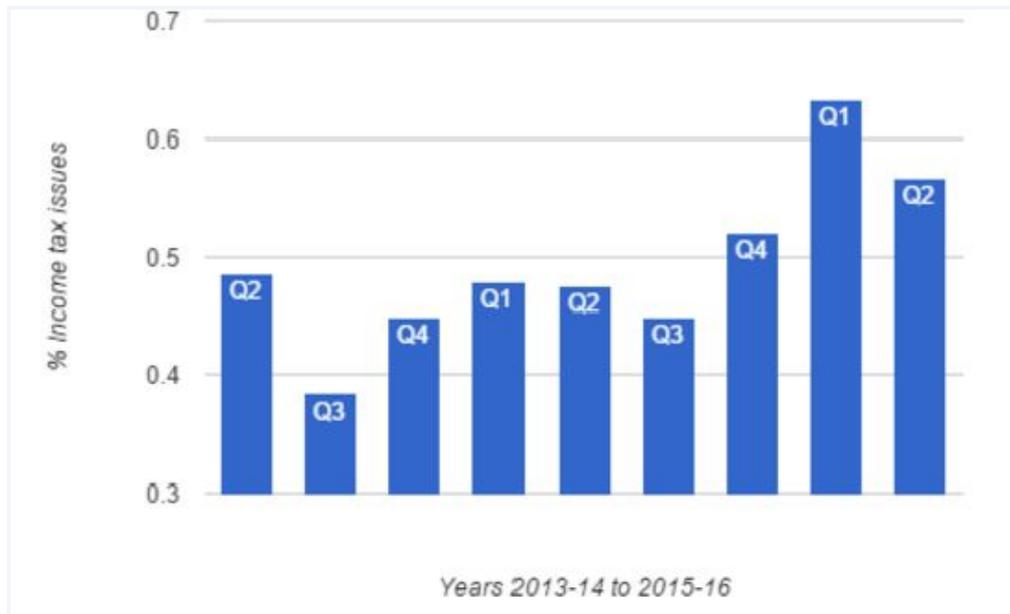


Figure 1 Percentage of all issues presented to Citizens Advice that concern income tax between Quarters 2 of 2013-14 and 2015-16

Numbers of issues varied between 4,852 in Quarter 3 2013-14 to 8,707 in Quarter 1 2014-15

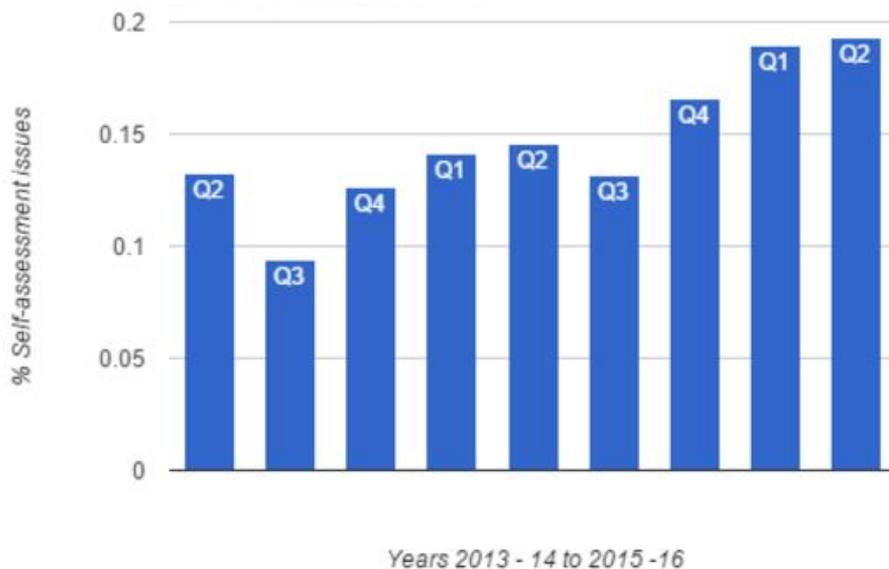


Figure 2 Percentage of all issues presented to Citizens Advice that concern self-assessment and tax returns between Quarters 2 of 2013-14 and 2015-16

Numbers of issues varied between 1,191 in Quarter 3 2013-14 to 2,769 in Quarter 2 2014-15

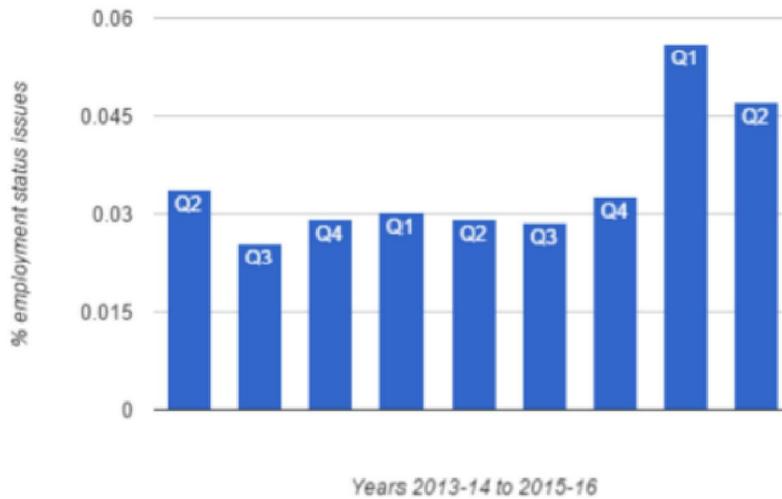


Figure 3 Percentage of all issues presented to Citizens Advice that concern employment status between Quarters 2 of 2013-14 and 2015-16

Numbers of issues varied between 323 in Quarter 3 2013-14 to 769 in Quarter 1 2014-15

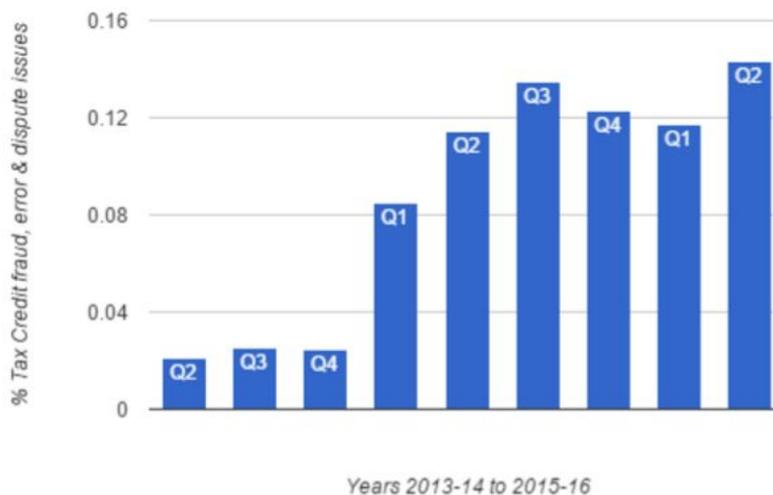


Figure 4 Percentage of all issues presented to Citizens Advice that concern Tax Credit fraud, error and disputes between Quarters 2 of 2013-14 and 2015-16

Numbers of issues varied between 36,333 in Quarter 1 2013-14 to 47,366 in Quarter 2 2014-15

1.3 What are your general thoughts and observations on the pros and cons of aligning IT with NIC?

The labour market is becoming more diverse, with a growth in self-employment and unstable work. But our benefit and tax systems are still based on a rigid model of full employment, in which spells of unemployment are frictional and short-lived, while employment, hours worked and wages paid are assumed to be relatively stable over many years.

A crucial question for 2016 is whether we need to do more to ease some of the inherently negative features and reduce the incidence of these new types of insecure work - or whether we should push for the systems around work – rights, consumer options, benefits and the IT and NIC systems – to catch up with this change in the labour market, so that people can take advantage of the flexibility and self-determination these types of work can offer, but not suffer the negative effects that lack of security and basic employment rights can trigger. Aligning NIC and IT would provide a simplification of the tax system that could be part of this modernisation, as there is significant evidence that simpler tax systems improve understanding and personal financial decision-making¹, which our evidence suggests are in short supply when considering our client’s current experience of the UK’s IT and NIC system.

The better alignment of the current IT and NIC system has several arguments in support. These can be summarised as:

- The current lack of alignment and different treatment of employees and the self-employed provides a perverse incentive for “bogus” self-employment
- The current lack of alignment and different treatment of employees and self-employed people results in a disproportionately higher total tax contribution for some low-paid self-employed compared with low-paid employees, which is perversely usually accompanied by the low-paid self-employed person’s entitlement to fewer benefits than employees.
- The current lack of alignment complicates the system resulting in higher administrative, accountancy and legal costs for employers and single self-employed people.
- Single self-employed people are discouraged from growing their businesses by taking on employees, as employers have to pay additional NICs, while a sole trader earning over a certain income pays less IT and NICs than an employee earning the same.
- The current system is even more complicated for those whose working hours and income vary significantly throughout the year, although this type of work is increasingly common.
- Although not a direct result of the lack of alignment, the current IT and NIC system does not work well with the benefits system, particularly for those whose working hours and income vary significantly throughout the year: a change to the system offers a chance to simplify not just IT and NICs but their relationship with the benefit system too.
- In general people do not understand how the national insurance contributory system works² and what benefits it entitles people to claim, as well as eligibility to national insurance credits and how to claim these if necessary. This can result in significant hardship for those who find they are not entitled to benefits they’d assumed they would receive.

¹ Department for Work & Pensions (2013) Enabling and encouraging saving: the evidence around pension reform and saving

² *ibid* and our own case study evidence

- It is difficult for those on low incomes to find out whether they have made sufficient NICs each year, and to be able to afford additional contributions to address this if they have not.
- Our evidence suggests that often the IT and NIC system is poorly communicated, administered, and enforced by HMRC, and the support they provide is inadequate or inaccessible to many of our clients. This is particularly the case for self-employed people and those on Working Tax Credits, and many of our clients with low literacy levels, small businesses that do not use accounting software and those who do not have access to, or do not know how to use, information and communications technology. The complications and lack of alignment between IT, NICs and the benefit systems can result in people making mistakes in assessing their earnings or income and building up large debts unnecessarily. It is likely that the increasing use of digital systems to administer IT and NICs, the use of Real Time Income systems, the roll-out of Universal Credit and the loss of regional HMRC offices, will see an increase in the number of clients needing support around IT, NICs and in-work benefit issues.

Our evidence does not provide many arguments against aligning the IT and NIC systems. If such alignment is considered as a form of simplification of the system, which would raise awareness of benefit entitlements associated with NICs, increase understanding of IT and NICs and reduce problems associated with current misconceptions, most Citizens Advice data and case studies provide only support for taking this forward. However, considerations against include:

- Any change that aligns systems across government departments is likely to be expensive to manage and administer when it is introduced.
- Alignment is likely to highlight the combined tax burden of IT and NICs to the UK electorate: it will either produce both winners and losers, or will cost a significant amount of money to ensure that no one is worse off: either of these factors make it unpopular politically. This lack of political will is enhanced by the fact that our evidence suggests that the system is so complicated that few members of the electorate understand it enough to follow the arguments for alignment.
- Most well-established employers will have developed automated payroll systems based on the current lack of alignment - these would have to be adapted or upgraded, which could require an upfront cost.

These are all short-term upfront financial and political considerations. Overall administrative, accountancy and legal savings caused by simplification and the long-term savings of improving job security and the rights of vulnerable workers suggest that, with time, the pros would outweigh the cons.

2. The present structure of IT and NIC

2.1 Do you think the present structure of IT and NIC is well understood by taxpayers?

No. The increasing number of clients coming to Citizens Advice with enquiries about income tax, self-assessment & tax returns, employment status or disputes and errors around Tax Credits (Figures 1,2,3 and 4) suggests that more and more people need advice

to navigate the structure of IT and NICs, and their associated benefit entitlements, and that these numbers have increased over the last 2-3 years.

This is further evidenced by HMRC research³, which found that most self-employed people did not have much understanding of the current NICs process. More alarmingly, once informed about it they became concerned about the impact on their pensions, particularly if they believed they might have gaps in their NICs.

"It would be better if they said everyone needs to make national insurance contributions in order to get their state pension."

"They [HMRC] should still make you aware that this will affect you in the future....and your contributions."

Self-employed participants in the HMRC research study

Our own qualitative research based on semi-structured interviews with self-employed people⁴ also indicates that although those who had been self-employed for many years felt they understood the structure of IT and NIC, several of our interviewees had had either formal or informal help from an accountant in completing their annual IT self-assessment return. Some felt it was good value for money to employ an accountant.

"I leave it to my neighbour - he is my accountant... When I was working more I used to employ him, but now I am poorer he does it for me for nothing"

Liz, 54, editor, self-employed for ten years

The smaller numbers of our self-employed interviewees who struggled with self-assessment were generally those who considered their financial literacy was poorer, were new to self-employment, or who had not planned to become self-employed.

"I hate it, I hate it [the self-assessment process]... Last year I had a really bad experience with HMRC where I said I wanted to do it online and they said they'd sent a password. It turned out they sent the password to the wrong address. That happened 3 times. I finally spoke to somebody who went and investigated....It took 8 months to sort it out. I had to get my MP involved. It was very scary."

Wendy, 55, various businesses, self-employed for 18 years

2.2 Does the present structure cause [Citizens Advice clients] difficulties, and in what ways, or do [they] find it works well?

2.5 Does the present structure impact taxpayer behaviour? If so, in what ways?

The present structure causes Citizens Advice clients difficulties in:

³ Personal Tax Customer Design Team, HMRC (2013) Simplifying Class 2 National Insurance Processes for the self-employed

⁴ Citizens Advice (2015) Going Solo

[<https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/work-policy-research-surveys-and-consultation-responses/work-policy-research/going-solo/>]

- completing their self-assessment IT returns, for which many, even those on low incomes, hire an accountant as they find the process too difficult or confusing;

“Every year it gets to December and I think arghhhh!! It’s that time of year again ,not just Christmas shopping time but Self-Assessment Tax return time...because of how complex the self-assessment is I have to pay an accountant to complete it for me. This costs £280, at this time of year an expense not needed! In previous years I have attempted to do it myself but it is too difficult and complex and I fear too much I may make an error which could have serious consequences.”

Kevin, self-employed painter & decorator who contributed to Citizens Advice self-employed diaries⁵

- knowing whether they have paid sufficient yearly NICs to qualify for the state pension and other contributory benefits; not understanding that exemptions on Class 2 NICs when earnings are below the Small Profits Threshold may affect their entitlement to these benefits; and often only finding out that their yearly NICs are insufficient when it is too late to make additional payments to be entitled to the full state pension or full maternity allowance;

Case study 1

Georgie, a 28 year old married mother visited her local Citizens Advice as she was expecting her second child but had found that she was only entitled to a Maternity Allowance of £27 per week, as opposed to the £139 per week she had thought. HMRC said that this was because she had not made enough Class 2 NICs in the past two years. Georgie had been made redundant from her previous job in 2013 and had subsequently registered as a self-employed retailer of handmade gifts and crafts. When registering, Georgie was advised to apply for a Small Earnings Exemption Certificate by HMRC, as she was earning very little at this early stage of the business. However, she was not told the consequences of not paying her Class 2 NICs, and duly applied and received the exemption. Trusting that HMRC had given her the correct advice, Georgie felt no need to look at the small print of the Certificate so did not realise that this exemption reduced her entitlement to certain benefits, including Maternity Allowance.

Citizens Advice supported Georgie to appeal the application of the certificate, and negotiated to see if she could pay her Class 2 NICs in arrears, but this was not accepted by HMRC. As a result Georgie was forced to stop her self-employed work which had developed into a business generating an £8,000 per annum income and to look for alternative employment to support her family while she was pregnant.

Case study 2

Angela came into Citizens Advice as she had been claiming Employment Support Allowance while being treated for cancer, but had received a letter saying that once this treatment ended she should be fit enough to return to work. However, she could not

⁵Citizens Advice self-employment diaries [<http://cabsselfemployment.tumblr.com/>]

return to her previous job as her previous employer had gone into liquidation and so she had found another job which would involve working part-time for a small private sector employer as a cleaner. This was for 16 hours per week paying the National Minimum Wage, which put her income below the Lower Earnings Limit. Angela had originally visited Citizens Advice because of her concern that her health was not good enough to be able to perform the work required in her new role: she had not realised that by earning so little per week and being classified as self-employed, neither herself nor her employer would be obliged to pay her NICs and that this could affect her entitlement to the full state pension and any future contribution-based Employment Support Allowance entitlement. She felt that it would be impossible to increase her hours in this role because of her poor health. Because of her worry about how she would be able to manage in the future when she either had to give up work entirely because of ill health or when she reached retirement age, she felt unable to accept the job offer.

- even those clients with some understanding of the IT and NICs system have difficulty finding out the details of their yearly NICs from HMRC;

Case study 3

Ed is a married man with no dependent children who had paid off his mortgage on a previous home, sold up and bought his and his wife's new home outright. He had been self-employed for many years, during some of which he had been exempt from paying Class 2 NICs, but had spent the last year doing up his new home, while he and his wife lived off the savings from the sale of their previous home. Ed had realised that this meant he could risk a shortfall in his yearly NICs that could mean he was not entitled to the full state pension. He had tried to find out what his situation was by ringing the HMRC NICs telephone helpline on several occasions and, when he could not get through, had written to HMRC twice requesting details of the NICs he had paid and any shortfalls. However, he had received no reply. Finally he came to Citizens Advice, where the advisor supported him to make a formal complaint to HMRC. Only after this, did Ed get the information he had requested.

- or are not able to make up shortfalls in their yearly NICs when required;

Case study 4

Emma came along to Citizens Advice as she had been on income support for many years because of depression, but now felt well enough to return to work. She had been offered a job working 10 hours a week paying her £7.80 per hour. However, she had realised that this would mean she was below the Lower Earnings Limit, and that neither she or her employer would be required to pay her NICs. As she was approaching retirement age and was concerned about her pension, she had also found out that she could maintain her contributions by making voluntary NIC payments but these would be charged at the Class 3 NIC rate of £13.90 per week, and she would need to pay at least 50 weeks to maintain her annual contributions. Emma told Citizens Advice that she was finding it extraordinarily difficult to decide what to do. She would either have to pay a large

proportion (almost one-fifth) of her already low income as voluntary NICs or risk losing her full entitlement to a state pension and other contribution-based benefits.

- the lack of knowledge and understanding of the complex IT and NICs systems also means that clients do not question “rogue employers” who tell them they are employees but register them as self-employed and do not pay their IT and NI contributions, or force them into self-employment, so they pay their own IT and NICs and lose employee rights, while treating offering them none of the advantages of self-supervision, -direction and -control enjoyed by genuinely self-employed contractors;

Case study 5

In 2008 Davey had been working as labourer and was contracted by company X to do construction work on a new building. He was informed by company X that in order to receive his pay he would need to set up a business account with his bank. Davey said that he had done this and was aware that other labourers on the same job were being asked to do the same. An accountant from company X would also come to the site once a week to take a payment of £10 from each worker – Davey was told that this was his IT contribution, and had not questioned this as it was documented on his wage docket, although as this was 5 years ago he had since disposed of these.

In 2015 Davey received notification from HMRC that he owed £1,392.63 in IT and fines for not registering for self-assessment, as company X had classified him as self-employed and had not passed any of his IT contributions on to HMRC. He contacted HMRC and explained the situation and was told that he needed to speak to Companies House and find out whether company X was still trading. He checked and found that company X had gone into liquidation.

Davey then came to Citizens Advice because he was unsure what to do next and had received another letter from HMRC, who were now adding further fines and interest to the amount owed, as it had not been paid.

At this time Davey was living with his partner and his two children (aged 8 and 9), but was too unwell to work. His partner worked 25 hours per week earning around £1,000 per month in take home pay but the couple had no savings and had already run up large arrears on their council tax payments. When he visited Citizens Advice he was highly stressed as he was being pursued by bailiffs contracted by HMRC for priority arrears, and he could not afford to pay them the full amount being demanded.

With support from Citizens Advice, HMRC finally accepted that Davey had been bogusly self-employed and wrote off the debt, but the stress had had a negative effect on his health.

- managing benefit claims when their income is unstable and fluctuating; this is being magnified with the introduction and roll-out of Universal Credit and HMRC Real Time Information systems. Incorrect and delayed assessments of benefit claims are currently commonplace and increasing.

"We did claim housing benefit for a few weeks around the time I started [my business] but we had to pay most of it back as when I told them my earnings were increasing. They then said we were overpaid. Which also happened with Tax Credits."

Kim, self-employed childminder from Citizens Advice self-employed diaries

Case study 6

Michelle moved onto Universal Credit after her self-employment work dried up. There were delays in getting payments initially as those assessing her claim kept requesting extra information to validate her self-employed earnings. After several weeks when there had been no further requests but there had still been no payment, Michelle contacted the Universal Credit assessors again. She was told that as she had received a rebate from HMRC of £700 her income was too high to qualify for a Universal Credit payment for that month. However, when Michelle checked with HMRC she was told no rebate payment had been made and they could not give any further details.

Michelle then sought support from Citizens Advice. Her advisor deduced that the new Real Time Information processing system had registered a tax refund being made which Michelle had not received and HMRC confirmed had not been made. With support from Citizens Advice Michelle chased this up with the Universal Credit assessors but the confusion resulted in further delays to her claim.

As Michelle's claim had included an amount towards her rent she got behind with this and was at one stage at risk of her landlord taking possession action. She also had no money to live on as her Child Tax Credit payments had been stopped when they were included on the Universal Credit claim. This led to additional stress and financial hardship for the whole family.

Citizens Advice's research⁶ also looked at the issue of how benefit claims worked for self-employed people, and could be linked with changes to the IT and NICs systems. It found that benefit payments can be a significant component in bringing stability to new businesses and enabling self-employed people to move towards profitability and even expansion. Self-employed people in the first few years of starting their business, those who had dependent children, or those who had health issues or caring responsibilities were the most likely to claim an ongoing top-up to their low income in the form of Working and/or Child Tax Credits. Some mentioned the challenges posed by their fluctuating income when it came to determining eligibility, but most felt that the ability to average out earnings annually helped them to smooth this.

"I get tax credits because my income is low... Sometimes I have been worried but it has always been ok because the hours average out across the year"

Liz, 54, editor, self-employed for ten years

There was some awareness and concern about changes being made to Tax Credit arrangements. The ability to smooth fluctuating incomes by taking yearly averages will change under the replacement Universal Credit system which requires monthly income

⁶ Citizens Advice (2015) Going Solo

[<https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/work-policy-research-surveys-and-consultation-responses/work-policy-research/going-solo/>]

reporting by self-employed people, creating potentially significant budgeting challenges and extra burdens for self-employed people, particularly if their income fluctuates widely over the new reporting periods⁷. Another disparity for self-employed people claiming Universal Credit compared with employees is the application of a 'Minimum Income Floor' (MIF), meaning the amount of Universal Credit they receive is calculated as if they earn at least the equivalent of a full-time worker (35 hours per week) on the National Minimum Wage (shortly to be increased to the National Living Wage so exacerbating the inequality compared with low income employees). Self-employed people earning less than the MIF will receive a reduced UC award. This situation could result in a self-employed person's Universal Credit award being capped by the MIF when their income is low, without then being recovered in months when they earn more, leaving some self-employed workers much worse off than employees with identical annual incomes. The Department of Work & Pension's own research⁸ found a significant group of low-earning self-employed people were balancing work with caring for sick relatives, children or working around their own poor health and that this group was disproportionately female. Universal Credit is set to make those precarious livelihoods impossible, and force such workers to give up their business.

In contrast to such long-term support through in-work benefits, around half of our self-employed research participants who had claimed benefits had only done so for occasional, discrete periods⁹. This was often linked to illness or injury. Some were positive about the support they were able to access, which prevented them from falling into debt during periods where they are unable to work.

"[When I've been ill] I've gone to the council and got housing benefit and they've always been very understanding."

Louise, 43, designer, self-employed for 6 years

However, others had found the benefit system difficult to navigate and slow to respond, making it hard to rely on when circumstances changed briefly.

Unexpected ill-health is clearly a problem for self-employed people who are not entitled to statutory sick pay through the current class 2 NICs system. Our research suggested the biggest challenges were for those self-employed people on very low incomes with no savings. The evidence from these in-depth interviews suggests, some had sought help from the benefit system, generally through a claim for Employment and Support Allowance (ESA). However, this is a complicated benefit primarily designed for longer-term illness. It takes a long time to apply for, meaning it cannot be effective as a stop-gap measure for shorter spells of illness. Without more suitable options for short-term help from the current tax-benefit system, self-employed people remain at risk of falling into debt after illness, or

⁷ See Finch, D. (2015) Making the most of UC: Final report of the Resolution Foundation review of Universal Credit, p.19 (<http://www.resolutionfoundation.org/wp-content/uploads/2015/06/UC-FINAL-REPORT1.pdf>)

⁸ Sainsbury, R. & Cordon, A (2013) Self-employment, Tax Credits and the move to Universal Credit (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/197691/rrep829.pdf)

⁹ Citizens Advice (2015) Going Solo

(<https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/work-policy-research-surveys-and-consultation-responses/work-policy-research/going-solo/>)

even exacerbating health conditions by attempting to continue working. Some of our interviewees had lost assets and even seen businesses fail following periods of illness.

Most significantly in relation to the review of IT and NIC alignment, the self-employed research participants who did not feel that anything would help them to save more for the future were, unsurprisingly, the ones who were on an income that did not meet the Small Profits Threshold for NICs. Any tax-benefit scheme designed to better support such low income self-employed people would need to take this into account and ensure that lower earners were not left without any form of support when their income was low, whether this was a result of the early stages of business development, personal illness or a changing external environment. Consideration should be given to the way the current system could be adapted to better support the needs of an increasing self-employed and more insecure workforce, who currently earn insufficient to pay NICs, cannot afford voluntary NICs and are not eligible for National Insurance Credits, as well as similarly low income employees, when they are sick, have children or in encouraging saving for retirement.

2.4 Can you quantify the administrative costs of the present divergent structure of IT and NICs?

Our estimate of the nationwide prevalence of bogus self-employment is 10% based on extrapolation of our own survey results¹⁰. Using Office of Tax Simplification projections this suggests that the Government loses £314 million per year in IT and NICs¹¹ purely from the perverse incentives of the current IT and NIC system to categorise employees as being self-employed. KPMG estimated that in 2006 businesses spent an additional £51 million per year to comply with legislation around the IT and NIC systems¹². The introduction of more legislation over the last 10 years to reduce bogus self-employment, and other tax avoidance measures by employers, mean this cost is likely to have increased.

3. Distinctions between IT and NICs - definitions

3.2 What about permitted deductions, including expenses and pension contributions?

Although the OTS states that expenses and pension contributions are not part of their Review's remit, they have included this question. It seems relevant to point out that the evidence Citizens Advice has collated around these two issues again points to problems with the lack of alignment between IT and NICs and the negative impact on those on low incomes in particular.

There is some evidence that the different treatment of expenses in the IT and NICs systems and between employees and self-employed people affects taxpayer behaviour in ways that can have negative consequences for other areas of self-employed people's lives. The current systems incentivise the maximisation of the business expenses of self-employed people in their accounting systems to reduce the amount of tax they pay. However, the

¹⁰ Citizens Advice (2015) Neither One Thing nor the Other
[<https://www.citizensadvice.org.uk/Global/CitizensAdvice/Work%20Publications/Neither%20one%20thing%20n%20or%20the%20other.pdf>]

¹¹ Office of Tax Simplification (2015) Employment Status Report
[https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/422248/OTS_Employment_Stat%20us_report.pdf]

¹² *ibid*

minimised earnings these accounts report can create difficulties when the self-employed try to rent, take out a mortgage or apply for credit.

“My accountant obviously writes everything possible off against tax which is good for my tax bill each year, however, when applying for credit or a loan or in this case a mortgage, my low earnings were a worry. Without a joint application I probably wouldn’t have been able to get this mortgage, even though I budget really well.”

Kevin, self-employed painter from Citizens Advice self-employed diaries

It also makes it hard to accurately record and compare the incomes of employees and the self-employed. Self-employed people are a rising proportion of the workforce (around 15% currently) in a change to the UK workforce that looks likely to continue¹³. Alignment of the treatment of expenses and of the IT and NICs system between employees and the self-employed would make it easier to see the impact of policies on the self-employed, compare this with employees and better assess the health of the overall economy.

The Citizens Advice response to a recent Government consultation on pensions tax relief¹⁴ provided evidence to argue that the Government should use the IT and NICs system to offer people more incentives to save for an adequate income in retirement. Currently pensions tax relief mainly offers incentives for higher rate taxpayers and gives a large public subsidy for a minority of people who make pension savings well beyond a simply ‘adequate’ level. At the same time self-employed people, part-time workers on low incomes and carers all lack access to the new pension auto-enrolment system and have little incentive to save. Just 2.2% of tax relief on pensions contributions goes to self-employed people, even though they represent 15% of the workforce. Citizens Advice proposed that pension tax relief funds should instead be used to offer a £1 match for every £1 put in (i.e. 50% tax relief) on contributions up to 1% above auto-enrolment levels. This would offer an incentive for employees eligible for auto-enrolment to increase their contributions beyond the minimum, such as from a total of 8% to 10%. It would also give self-employed people and part-time workers with an income below the auto-enrolment threshold a ‘kick start’ to a savings habit, as well as rewarding carers for continuing pension saving when they return to work.

5. Employed vs self employed

At Citizens Advice, we help over 30,000 self-employed people per year in our local offices and many more online. Citizens advice data indicates that this debt problem has a much higher incidence amongst self-employed clients, and that unlike the trend for employees, which is relatively constant, it appears to be increasing over the last five quarters (Figure 5). This suggests that Citizens Advice clients who are self-employed are having greater difficulties navigating, understanding and/or making financially sound decisions about the IT and NICs system than those who are employees.

¹³ Tatomir, S. (2015) Self-employment: what can we learn from recent developments?

[<http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q105.pdf>]

¹⁴ Citizens Advice (2015) Strengthening the incentive to save: a consultation on pensions tax relief

[<https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/pensions-policy-research-surveys-and-consultation-responses/pensions-surveys-and-consultation-responses/strengthening-the-incentive-to-save-a-consultation-on-pensions-tax-relief/>]

Quantitative analysis of data New Policy Institute commissioned by Citizens Advice¹⁵, showed that self-employed people are not an homogenous group, and as this population has grown there is now even greater diversity in terms of age, gender, type of industry and financial well-being than a decade ago. Being self-employed today means that you are more likely to have a low income, to be female, to be a lone parent, to be a private renter and to have part-time hours of work than 10 years ago. In short, self-employment is more likely than a decade ago to come with insecurity. This change argues for greater alignment of the IT and NICs system to provide better support for the larger number of self-employed people on low incomes and lacking security.

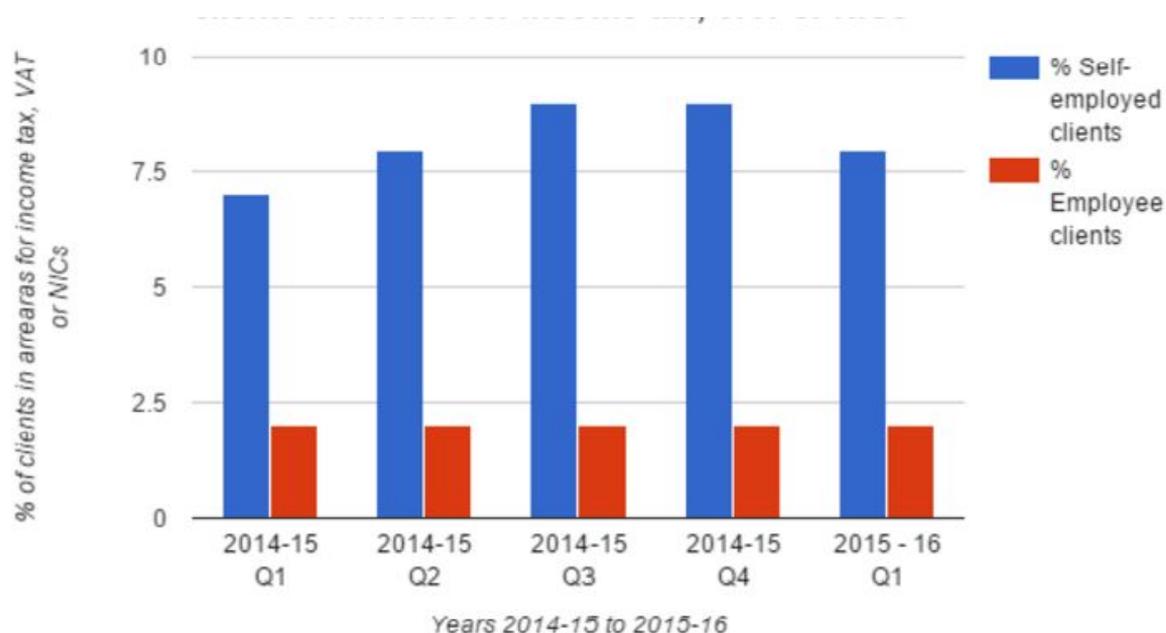


Figure 5 A comparison of the percentage of self-employed and employee clients attending local Citizens Advice that have issues with IT, VAT or NICs arrears between Quarters 1 2014-15 to 2015-16

The number of clients categorised as self-employed with issues with IT, VAT or NICs was 210 in Quarter 1 2014-15 and 251 in Quarter 1 2015-16 compared with 397 and 350 respectively for those categorised as employees

Informing this review of IT and NICs alignment, the Bank of England has provided evidence that the prevalence of self-employment in the workforce can be shaped by tax codes and regulation. For example, the number of self-employed workers increased sharply with the introduction of the Enterprise Guarantee Scheme, the New Enterprise Allowance and the Onshore/Offshore Intermediaries legislation, all of which affected incentives to become self-employed¹⁶. We have already discussed the evidence that the current IT and NICs system provides a perverse incentive for employers to contract self-employed people

¹⁵ Citizens Advice & New Policy Institute (2015) Who are the self-employed? [<https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/work-policy-research-surveys-and-consultation-responses/work-policy-research/who-are-the-self-employed/>]

¹⁶ Tatomir, S. (2015) Self-employment: what can we learn from recent developments? [<http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q105.pdf>]

rather than hire employees (section 2.1, as well as section 5.1). Citizens Advice evidence also suggests that many people are now deterred from challenging their employment status at tribunals by the introduction of tribunal fees in July 2013¹⁷.

As self-employment becomes more mainstream, it is important that the tax and legal frameworks are modernised to enable people to take advantage of this way of working. The flat rate system of national insurance was abolished for employees in 1975, but today the self-employed still pay flat rate Class 2 contributions which are not linked to their earnings. The Government is now addressing this with its consultation on the abolition of Class 2 NICs and reform of Class 4 NICs for the self-employed, but it needs to go further and ensure that the self-employment status definition is clear and relevant to today's economy. The government has also recently announced that the Office of Tax Simplification will lead a cross-departmental review of employment status with the hope of simplifying and aligning definitions across tax and employment legislation. This is to be welcomed and will be essential if we are to see true alignment of the IT and NICs systems and a simpler and more equitable and supportive tax-benefit system that meets the changing needs of the workforce.

Case study 7

Meg, who sought help from Citizens Advice, worked as a childminder's assistant but was concerned about her employment status. She worked regular hours every day, did not need to provide her own equipment and did not have the option to send someone else to do her work if she was unable to come. However, the childminder had presented her with a "contract of self-employment" on the day she began the job and, not knowing the implications, Meg signed it. By law, determining whether Meg was self-employed or not is very difficult. Her Majesty's Revenue and Customs' (HMRC) Employment Status Indicator suggests that she was an employee, but without taking the matter to a tribunal, she would be unable to conclusively find out. After seven months of working in this way, Meg had been off sick once and had taken one holiday (and wasn't paid during either period). She couldn't take any more time off as she could not afford it and she had become confused after being told that she would need to register for tax self-assessment, something she had never done before. Meg was advised that she may not be eligible for contribution-based Jobseeker's Allowance, as she had not paid employee NICs in this job. Meg felt that she could not risk losing her job and being ineligible for Jobseeker's Allowance.

This meant that she was reluctant to take her employer to a tribunal to rule on her employment status, despite the poor conditions and the possibility that she was wrongly not granted her employee rights, full NICs and benefit entitlements, as she feared.

Case study 8

¹⁷ Citizens Advice (2015) Fairer Fees

[<https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/work-policy-research-surveys-and-consultation-responses/work-policy-research/fairer-fees/>]

Mary is 74 years old, but due to a mis-sold mortgage is still having to work in order to make ends meet. She has worked as a part-time free paper distributor since 1999. In that time her employers have changed a number of times. Her current employer Company X had employed her since 2005. She came to Citizens Advice as Company X had contacted her to say that Company Y would be taking over the running of the distributors and had offered her new employment with Company Y, but with significant changes to her conditions of employment. The two main ones that most concerned Mary were that she would be responsible for her own IT and NICs and would no longer receive 5 weeks holiday entitlement, only being paid on the days that she actually worked. The previous company X, had the same postal address as the new company Y.

Mary was distributing 800 newspapers over 2 days and was paid £32.30 a week. Company X had previously stated that the agreed time to deliver 511 copies was 5.20 hours which amounts to about 98 copies an hour. This suggested that it would have taken Mary 8.16 hours to deliver 800 newspapers, which if she were paid the National Minimum Wage would produce earnings of £53.04 a week. This implied that company X had been paying Mary below the legal minimum wage.

Mary was also losing her sight and concerned that she would be unable to continue the work for much longer.

On top of all this she now risked getting no holiday pay and was very concerned about having to manage her own IT payments.

However, Mary told Citizens Advice that concern about losing her job meant that she did not want to test the legitimacy of her new contract through an employment tribunal, despite evidence that the new company was attempting to change her employment status, and thus avoid National Minimum Wage legislation, while she continued to do exactly the same work as when she was an employee.

5.1 Would the same treatment for the employed and self-employed be a simplification?

Most of the evidence we present in this response argues that equal treatment for the employed and self-employed by the IT and NICs system would be a simplification that would make it easier for people to understand, less likely to build up IT or NIC arrears, and would reduce issues such as bogus self-employment. There is also some evidence that the current different treatments discourage single self-employed people from growing their business by taking on employees because of the additional employer NICs they would have to pay¹⁸.

Citizens Advice evidence presented in this section, and previously, suggests that the lack of alignment of the IT and NICs system, and the way it currently works with the benefits system, is not responsive to the needs of self-employed people. In particular, it perpetuates self-employed people's increasing loss of financial stability. The growing number of low-paid and financially insecure self-employed people in the workforce are disadvantaged by the distortions, burdens and costs of the current IT and NICs system, which reduces their eligibility for in-work support, sickness and parental benefits and a full state pension. As

¹⁸ Urwin, P. (2011) Self-employment, Small Firms and Enterprise
[<http://www.iea.org.uk/sites/default/files/publications/files/IEA%20Self-employment%20web%20complete%202.9.11.pdf>]

more of the workforce chooses self-employment, this is becoming increasingly economically unsustainable. Specifically:

- recent rises in personal IT allowances have done little to benefit many low income self-employed people who fall above the NICs threshold but below the IT threshold;
- the current IT and NICs system provides perverse incentives for self-employed people themselves, unscrupulous employers, or intermediary companies to use bogus self-employment to reduce their NICs;
- the IT and NICs systems need to be better aligned to simplify the assessment process and reduce the risk of falling into arrears for self-employed people, particularly those with fluctuating working hours, income and/or cash flow; and
- the IT and NICs systems need to be better aligned to work better with the welfare system. This could ensure that low-earning self-employed people, who are not eligible for exemption from NICs, no longer pay more than employees. Alignment of IT and NICs provides an opportunity to simplify the system and better integrate it with the welfare system so it provides self-employed people with more security around benefit eligibility.

Some low income self-employed people pay more in NICs than employees with a gross salary equal to their profits but are entitled to less in benefits. Class 2 NICs are a fixed tax of £2.80 per week for all self-employed workers earning above the Small Profits Threshold of £5,965 per year. Self-employed people with profits of less than around £12,200 but more than £5,965 per year (around 3.7 million self-employed people) pay more total IT and NICs than employees with the same income, who are charged Class 1 NICs, which are a percentage of earnings. A self-employed person with total profits of £10,000 per year pays £319 per year in NICs, £87 more than an employee earning the same (Table 1).

Employee Gross Salary /Self-Employed Earnings (£)	Employee Tax & National Insurance (NI) (£)			Self-Employed Tax & National Insurance (NI) (£)			
	Employee Tax	Employee NI	Employee Total Tax & NI	Self-Employed Tax	Self-Employed NI Class 2	Self-Employed NI Class 4	Self-Employed Total Tax & NI
2500	0	0	0	0	0	0	0
5000	0	0	0	0	0	0	0
10000	0	232	232	0	145	174	319
15000	880	832	1712	880	145	624	1649

Table 1 Comparison of total IT and NICs paid by employees and self-employed people at different gross salary or earning levels below £15,000 per year. Figures are for 2015-16

At higher levels of income it is employees who pay more IT and NICs than the self-employed with the same total profits. For instance, in 2015-16 an employee earning £20,000 per year

pays £213 per year more than a self-employed person whose profits after outgoings are also £20,000, whilst an employee earning £100,000 per year pays £885 per year more than a self-employed person with the same profits (Table 2).

The difference in employee and self-employed IT and NICs is relatively small at each level of gross salary - although it is always higher for employees when their gross salary is above £12,200 per year (Table 2 and Figure 6a). However, the cost to employers of hiring an employee on the same take-home salary as received by a self-employed worker being paid over £8,112 (the Secondary Threshold) per year, is much higher because of the introduction at this earnings level of employer NICs (13.8%) for employees only (Figure 6b). Comparing like-for-like labour value, there is a very substantial gap, with many employees facing a 10% higher effective tax rate (including the employer NICs) than an equivalent self-employed worker. An employee doing £40,000 worth of work is effectively taxed at around 35% in total while the same self-employment profit would be taxed at 22%. (Figure 7).

Employee Gross Salary /Self-Employed Earnings (£)	Employee Tax & National Insurance (NI) (£)			Self-Employed Tax & National Insurance (NI) (£)			
	Employee Tax	Employee NI	Employee Total Tax & NI	Self-Employed Tax	Self-Employed NI Class 2	Self-Employed NI Class 4	Self-Employed Total Tax & NI
20000	1880	1432	3312	1880	145	1074	3099
30000	3880	2632	6512	3880	145	1974	5999
40000	5880	3832	9712	5880	145	2876	8899
50000	9403	4271	13674	9403	145	3241	12789
60000	13403	4471	17874	13403	145	3441	16989
100000	29403	5271	34674	29403	145	4241	33789

Table 2 Comparison of total IT and NICs paid by employees and self-employed people at different gross salary or earning levels above £20,000 per year. Figures are for 2015-16

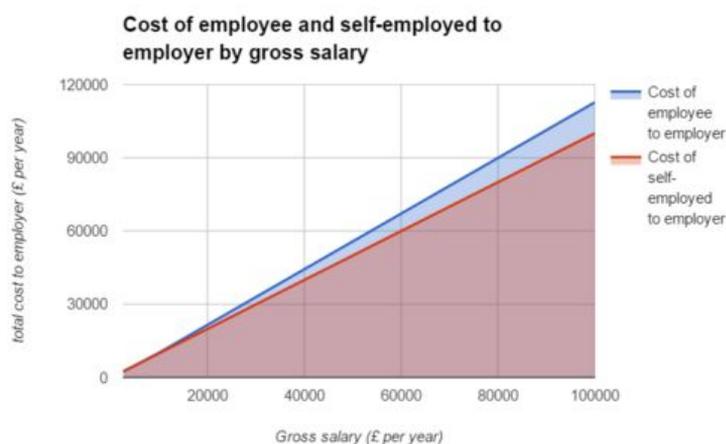
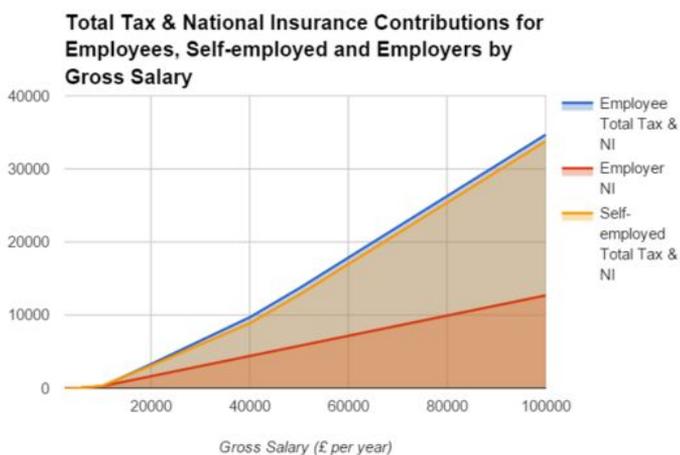


Figure 6a Comparison of total tax and national insurance contributions paid by employees, self-employed people and employers at different gross salary or earning levels. Figure 6b Comparison of total cost for an employer of an employee and a self-employed contractor paid at different gross salary or earning levels. Figures are for 2015-16

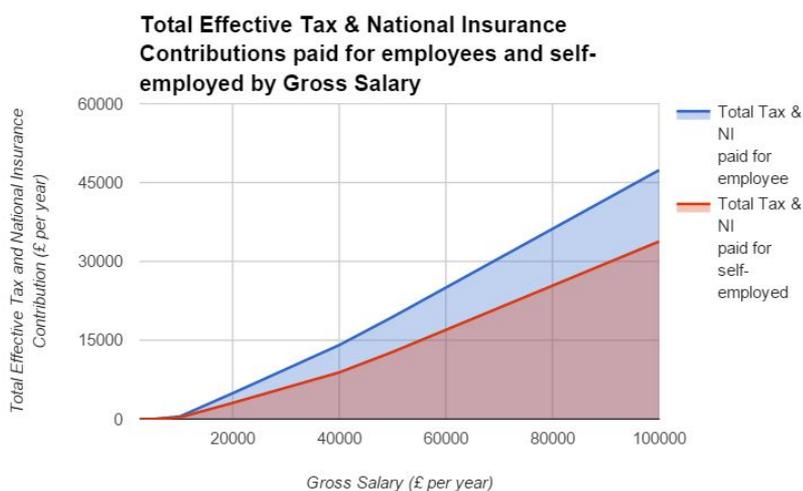


Figure 7 Comparison of total effective tax and national insurance contribution rates paid by employees and self-employed people at different gross salary or earning levels in 2015-16.

These examples using 2015-16 figures clearly show the tax bias towards self-employment. Compared to hiring an employee, the employer pays less and yet the worker also takes home more money. This tax difference under the present system is a perverse incentive for unscrupulous employers to take people on as bogusly self-employed, rather than as employees. This avoids payment of their employer NICs and the need to provide employee rights. When self-employment is bogus, the worker generally has none of the freedoms and control over work of a truly self-employed contractor.

IT is payable on all income, NICs are paid on earnings only, so exclude income from pensions, savings or company dividends. This lack of alignment between the IT and NICs system provides an incentive to provide a service through a personal service company, since company dividends are exempt from NICs and can be split between shareholding family members. The Federation of Small Businesses, who we are working with to input into the BIS Review of support to self-employed people, has stated that:

“Currently, the legal status of many small businesses is driven by tax rather than economic considerations, such as the conversion of tax treatment of income on labour (wages) to income on capital (dividends) which can produce significant tax savings. This leads to complexity and increases compliance activity by HMRC to ensure taxes are paid and rules are not abused. Small businesses consider compliance with tax rules their heaviest

compliance burden – larger than other areas of regulation. Tax rules have been modified so many times that small businesses often have no other option than to pay for professional advice.”¹⁹

Thus the different treatment of income by IT and NICs encourages tax avoidance measures by small companies, costs businesses in terms of the professional advice needed to ensure they are complying with these complex regulations and produces further enforcement costs for HMRC.

6. Employers’ NICs

6.3 What are the issues in seeking to align the tax base for individuals’ employment income with the tax base for employers’ NIC?

6.4 Do employees in general understand employers’ NICs?

When Citizens Advice advisors who had specialist expertise in IT and NIC issues were consulted on how the issue of employer’s NICs should be treated in a more aligned system, they argued that employers should pay some contribution to cover the costs to the state of ensuring their employees receive support if the employer has to make them redundant, reduce their hours of work or cannot employ them any longer because of sickness, illness or injury. If these employer NICs are completely abolished and all the NI contribution placed on employees, they argued that employees would also be covering their employer’s liabilities by paying part of the cost to maintain a workforce both when it is actually working and when it is standing by; and because it is in the employer’s interest that their employees should have security against the risk of unemployment or sickness.

However, employer NICs are one of the incentives within the present IT and NICs systems for bogus self-employment. However, they may not be the primary incentive: the introduction of the £2000 Employment Allowance to reduce employer NICs in April 2014 and the abolition of employer NICs for some employees under 21 years of age introduced in April 2015 has coincided with an increase rather than a decrease in the percentage of Citizens Advice enquiries about employment status (Figure 3). This provides some hint that other factors, such as the different rights of employees and self-employed people and the new duties for employers to contribute to the pensions of those employees who do not opt out of auto-enrolment into a pension scheme, may be stronger incentives for “rogue” employers to attempt to bogusly self-employ staff. In support of this it is argued by some that the costs of employer NICs are currently met through reduced employee wages²⁰.

The rising percentage of enquiries about employment status at local Citizens Advice, and the number of case studies submitted by local Citizens Advice about clients who had not realised that their employer was not paying their NICs suggests that employees have very little understanding of employers’ NICs and many are unaware of, and unconcerned about,

¹⁹ Federation of Small Businesses (2015) Be the Voice of Small Businesses: FSB business Manifesto for the 2015-20 Government
[http://www.fsb.org.uk/docs/default-source/Publications/manifestos/fsb_a4_manifesto_final_webc38c32ba4fa86562a286ff0000dc48fe.pdf?sfvrsn=0]

²⁰ Urwin, P. (2011) Self-employment, Small Firms and Enterprise
[<http://www.iea.org.uk/sites/default/files/publications/files/IEA%20Self-employment%20web%20complete%202.9.11.pdf>]

whether they have been paid - often for many years until a point comes when they try to claim contributory benefits.

Case study 9

Alex has worked for a builder for 15 years and during all of his employment he has been treated as an employee, according to the legal definitions. His employer has paid his IT for him, but Alex attended Citizens Advice as he had just discovered that he had not paid his NICs. Alex had already contacted HMRC who had stated that he was an employee according to his evidence and were taking up the case on his behalf.

This issue came to light when Alex took three days off because of back pain three months before and then was not offered any more work. Alex had assumed he would be getting work eventually so only made a claim for Job Seekers Allowance 3 months later, to find out that his NICs had not been paid, meaning he was not entitled to contribution-based benefits.

As a result Alex had had no income for 3 months and was very distressed about his position on benefit entitlements and with regard to his retirement pension. He was also very upset at the way he had been treated after working for the same person for so long. Alex was advised by Citizens Advice that he would have to make a claim to an employment tribunal to get any compensation from the National Insurance Fund.

7. General administration

7.4 How will new technology and HMRC's move to digitalisation impact?

Citizens Advice has considerable evidence from our data and case studies that HMRC administration of the tax and NI system, and support to help people navigate this, is poor and becoming more of a problem for more people as the service undergoes structural reorganisation following significant staff cuts. Other organisations have reported similar concerns^{21,22}.

Citizens Advice has reported that the number of issues involving our clients falling into debt as a result of repaying overpaid tax credits increased by 14% in the 2013-14 tax year²³. Tax Credit debts arise when HMRC overestimates a person's entitlement to financial support and ends up having to recoup overpayments. In the 2013-14 tax year, Citizens Advice dealt with 29,366 problems relating to debts from overpaid Child and Working Tax Credits, 14,157 of which were about helping those affected to budget effectively so they could repay money owed to HMRC, a 19% increase on the previous tax year.

²¹ Which? (2015) HMRC helplines leave people hanging

[<http://www.which.co.uk/news/2015/12/hmrc-helplines-leave-people-hanging-427544/>]

²² ICAEW (2015) Getting through to HMRC on the telephone in 2015: Report your problem

[<http://www.ion.icaew.com/Taxforum/post/Getting-through-to-HMRC-on-the-telephone-in-2015--Report-your-problem>]

²³ Citizens Advice (2014) Citizens advice records 14 per cent increase in debt problems caused by HMRC over-payments

[<https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/citizens-advice-records-14-per-cent-increase-in-debt-problems-caused-by-hmrc-overpayments/>]

In September 2015 we reported the results of an analysis of social media communication about HMRC²⁴. It found that frustrated callers had tweeted HMRC over 11,500 times in the previous 12 months to complain about long phone line queues. Analysis showed people complained via Twitter about spending an average of 47 minutes in total to speak to someone at HMRC. While official figures suggested an average wait of 10 minutes, the study shows many people were waiting longer, with one person tweeting that they had tried to get through to HMRC on four occasions - waiting an hour each time. Despite the fact that HMRC phone lines are 0300 numbers, meaning calls are charged at the same rate as a standard landline call, if a person is waiting 47 minutes it could cost them £4.66. The reasons given for calling HMRC included explaining a change in circumstances that would impact on their tax credit payment or to clarify income tax payments both of which could result in financial detriment to the enquirer if the call is not answered. A person's tax credits would not be adjusted to reflect their new circumstances if they couldn't get through to update HMRC. This could mean they don't receive all the support available at the time when they most need it, or are overpaid, which can cause debts further down the line when HMRC finally gets the correct information and demands repayment. Similarly, if someone is not able to file their self assessment tax return on time because they could not get through on the phone, they could face a fine for missing the deadline.

We also published an analysis²⁵ showing that between August 2014 and September 2015 Citizens Advice helped with 295,000 enquiries which could require people to contact HMRC. Three out of four of these cases specifically related to tax credits, the others included IT, NICs and Child Benefit issues. This shows the scale of the impact of these delays in contacting HMRC and this is supported by data published by HMRC itself²⁶.

Case study 10

Fiona's employer changed her from one payroll system to another part way through the 2014-15 tax year. Her employer reported Fiona's taxable income using Real Time Information up to February 2015 as £8,000 and also for the complete tax year as £9,000.

Fiona visited Citizens Advice as her Tax Credits renewal notice listed her as having earnings of £17,000 for the 2014-15 tax year, although she had actually earned £9,000. She had already contacted the Tax Credits Office (TCO) who saw how the mistake could have arisen (by summing the February 2015 and end of year figures), but told her that they had to use the Real Time Information to calculate her Tax Credits and so could not change the assessment until this was changed on the system. The TCO told her to contact HMRC. However, when Fiona spoke to HMRC she was told that she would have to contact her employer and explain to them the steps HMRC outlined to her to correct the Real Time Information system. Fiona had subsequently got in touch with her employer, but they had not corrected the mistake and were now not returning her calls.

Although it was Fiona's employer who has made the mistake, HMRC seem to have delegated

²⁴ Citizens Advice (2015) Thousands turn to Twitter to complain about HMRC phone lines [<https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/thousands-turn-to-twitter-to-complain-about-hmrc-phone-lines/>]

²⁵ *ibid*

²⁶ HMRC (2015) HMRC acts to improve customer service [<http://www.mynewsdesk.com/uk/hm-revenue-customs-hmrc/pressreleases/hmrc-acts-to-improve-customer-service-1184557>]

responsibility for putting it right to Fiona. If this remains uncorrected, Fiona's 2014 Tax Credits award will be finalised using the incorrect earnings, and she will be wrongly deemed to have received an overpayment, which HMRC will ask her to repay. The incorrect earnings will also be used to calculate her 2015/16 Tax Credit award, so also wrongly significantly reducing this.

The introduction of new Real Time Income reporting systems, as well as HMRC's new digital systems for IT self-assessment could mean waiting times will further soar as more and more people try to speak to someone at HMRC about glitches in the new systems or have queries about changes to their entitlements when they are switched over to Universal Credit. Citizens Advice is already receiving case study reports from our local advisors identifying problems with the new Real Time Income reporting system, the problems caused to some of our clients through the use of online self-assessment, the lack of communication between different departments within HMRC and unnecessary delays in HMRC informing people of, and taking action on, IT arrears resulting in the build up of huge debts, which could have been avoided.

Case study 11

Darren has learning disabilities and is working as a self-employed cleaner. He came to Citizens Advice wanting help to complete his SA200 self assessment short IT return for 2014-15. He was not able to use the online process as he did not have an online computer or laptop. In previous years, Darren had attended Citizens Advice and the adviser had downloaded the form and helped him to complete it in writing ready for Darren to sign and post. Unfortunately in 2015 it was no longer possible to download the form, and copies had to be requested from HMRC. The adviser telephoned HMRC for Darren, but was advised that there was a 40 minute wait to make request for the SA200 form to be sent out

Case study 12

Lucy had been sent a letter from HMRC's Child Benefit office stating that they did not have any records of NICs she had paid, when they had checked her Child Benefit claim. Lucy's Child Benefit had been stopped until she sent in copies of P60's for 3 years and pay slips for the remaining time to show that she had been working in the UK. Once Lucy had submitted these her Child Benefit payments were reinstated.

Some months later, HMRC's Tax Credit Office wrote to say that Lucy's Tax Credits for the whole year 2014-15 had been overpaid and asked for a repayment of over £5,000.

Lucy had suffered months of worry about having to repay over £5,000 and more financial worries and stress when her benefits were stopped. She and the Citizens Advice adviser had had to speak to multiple departments in HMRC to get anyone to understand and advise on the issue. The first telephone call they made involved speaking with 4 different departments with no resolution. On the second telephone call, they spoke with 2 different departments, both of whom first said that this was not issue but then, when looking at the system, agreed that there was a reason to write in again. Lucy sent copies of her P60's and tax slips 4 times to different addresses and departments of HMRC but there was no formal acknowledgement these had been received or that she had been working in the UK, had paid her NICs and was entitled to both the original 2014-15 Tax Credit payments and Child Benefit payments.

The HMRC Tax Credit Office did not respond to letters within a reasonable timescale, acknowledge information received at their offices, nor check whether other HMRC departments

had received the relevant information, before making key decisions to stop benefits and raise interest payments against the incorrect decision that 2014-15 Tax Credits had been overpaid. Eventually the Tax Credit Office said it had received all the information it needed and the issue was resolved, with Lucy's Tax Credit payments being resumed at the previous rate and no further mention of any overpayment. However, at no time in the process did the HMRC Tax Credits Office explain why they believed her Tax Credits had been overpaid or speak to the other HMRC Departments where she had already sent her full pay and NIC details. This caused unnecessary delays, additional stress and considerable financial hardship to Lucy and her family.

Case study 13

Jim is a 67 year old self-employed painter decorator, who lives with his wife in a home on which they have paid off the mortgage and own outright.

He came to Citizens Advice as he had been served with a notice of impending bankruptcy proceedings by HMRC, who claim that he owes them over £90,000 from unpaid IT, NICs and VAT dating back to 2006-7. Jim's wife had been administering his accounts and correspondence with HMRC but had not known how to respond to their first correspondence on arrears, felt her accounts were correct and HMRC had made an error, and so had ignored them.

However, had HMRC issued proceedings within a shorter time, or followed up on the fact that their original correspondence had remained unanswered with efforts to speak to Jim or his wife, Jim could possibly have managed to pay off the much smaller amount of arrears accumulated and avoided building up further arrears in the future. The many years before HMRC started court proceedings mean that Jim and his wife now face losing their home to pay off the debts HMRC claim they have accumulated over 9 years.

8. The contributory principle

8.1 What are your views on the contributory principle?

When Citizens Advice advisers with a specialism in IT and NICs issues were consulted about the contributory principle all who replied raised the fact that recent to changes to entitlements to the single state pension had already significantly reduced the contributory principle, although this had been to the benefit of self-employed people. Previous changes to the IT and NICs systems have also reduced the original contributory principle proposed when national insurance was introduced.

8.2 In your experience, what do [Citizens Advice clients] generally, believe paying NICs achieves?

Between October 2014 and September 2015 local Citizens Advice received enquiries from 4,768 clients about their NICs. As outlined in the many Citizens Advice case studies included in this response concerning the lack of awareness about how non-payment of NICs made clients ineligible for some benefits, our general experience suggests that there is little understanding of what paying NICs achieves amongst our clients. In the majority of our case studies submitted by local Citizens Advice advisers people only realised too late that they had made insufficient NICs to qualify for the full state pension and other contributory benefits, could not afford to make the voluntary NICs required to gain full payments or did not realise that the class of NICs they paid meant they were not eligible for other benefits. Others did not realise that they needed to actively claim National Insurance credits, as the

system for who automatically receives credits and those who are only eligible if they submit a claim is incredibly complex, with no transparency about why these different conditions apply.

Advisers highlighted clients who were not making contributions but might benefit from improved communications and information from HMRC about their NIC status and the impact it would have on their entitlements. These included:

- People who weren't working, but weren't claiming Job Seekers Allowance with no children or caring responsibilities
- People with multiple jobs, none of which paid more than the Lower Earnings Limit
- People who worked varying hours for varying pay, who changed jobs frequently, who were on Statutory Sickness, Maternity, Paternity or Adoption Pay and who did not satisfy the conditions for making contributions for 50 weeks in a tax year.
- Employees who earned less than the Lower Earnings Limit or self-employed people whose profits were less than the Small Profits Threshold
- People who are unaware of any contributions gaps such as those who have had their benefits sanctioned for more than two weeks.

Case study 14

Michael was disabled and had worked for many years as a self-employed adviser on improving digital access for disabled people. The flexibility of this type of employment had allowed him to fit his work around periods of ill health and better manage his condition.

He visited Citizens Advice on learning that because he had claimed the Small Earnings Exemption from paying Class 2 NICs over many of the years of his working life, he was now not entitled to a full state pension. He had been shocked to discover this, having never realised the connection between class 2 NICs and entitlement to the state pension. Citizens Advice supported Michael in making a case for late payment of additional voluntary NICs to increase his entitlement, but this was not accepted. Michael now faces having to continue working past his state pension age, at a time when his health is worsening. This will merely to maintain his current low income, as his state pension entitlement is not sufficient to replace this.

10. Finally, if wholesale alignment between IT and NIC is not feasible or practical, what would be your top 3 areas of alignment on which effort should be concentrated?

- Addressing the anomalies in IT and NIC payments and benefit entitlements between low income self-employed people with profits above the Small Profits Threshold and employees with similar earnings.
- Legislating for a clearer definition of employment status across government departments, that better aligns the cost to employers of employees and self-employed contractors and reduces the need for employment tribunal decisions on employment status.
- Ensuring that those who earn less than the Lower Earnings Limit or whose profits are below the Small Profits Threshold have more aligned protections and are encouraged to think about how they will save for their retirement, periods of ill health or times when they are unable to find profitable work.

Citizens Advice Secure Self-employment campaign

Citizens Advice launched its secure self-employment campaign in October 2015. The campaign recognises that self-employment is now a mainstream career option and works well for many people, but highlights that it can be complicated, particularly when you're first starting up.

We are campaigning for simpler and more responsive policies that give self-employed people the security to plan and balance their lives, while developing their business. But we also want to reduce bogus self-employment where people whose work has all the hallmarks of employment have been classified as self-employed to reduce their employers' costs and responsibilities.

The overarching campaign objectives are that:

- self-employed people should have the same simple systems as employees to encourage them to save for retirement;
- self-employed parents should be better supported to balance family life and work;
- self-employed people should not be disadvantaged by planned reforms to IT and NICs systems;
- newly self-employed people should have specialist and flexible support to allow their business time to develop to its full potential;
- no employee should be forced into self-employment or wrongly classed as self-employed.

Many thanks to all the people who have contributed to this response including:

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Case studies were also provided by:

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Appendix 1: Citizens Advice discussion on IT and NIC alignment

(Telephone conference discussion between 6 people with experience of these issues - 5 advisers and 1 self-employed person (new paragraph indicates different speaker), facilitated by Angela Brown, Senior Policy Adviser, Office of Tax Simplification on Friday, 8th January 2016)

What are the issues advisers are seeing?

I am seeing many clients who Job Centre Plus or Work Programme advisers have suggested should become self-employed, but they have not provided them with the advice on how to do this, such as the fact they will need to fill in tax self-assessment returns and that HMRC has tightened up regulations on self-employed people who claim Tax Credits and business viability tests. Many of those who try this then decide it is not feasible but do not know how to inform HMRC that they are no longer self-employed and are sent tax return forms and often fined as a result. Many advisers do not understand the difference between IT and NICs and even self-employed clients who understand the NICs system do not properly understand the IT system and so try to get their profits down to zero by claiming more business expenses, although this is not necessary. Others think that they will be taxed on turnover rather than profits.

People are very unclear about the difference between Class 2 and Class 4 NICs. Once they have paid Class 2 NICs it is not clear why they should then pay Class 4 NICs. Many do not understand the difference between Class 2 and Class 4 NICs and IT in terms of benefit entitlements and the contributory principle.

The current system of Class 2 and Class 4 NICs is confusing and it is good that the Government is reforming these. There should only be one Class of NICs for the self-employed and there would be further simplification if there was only one Class of NICs for employees and self-employed people.

I have consistently seen self-employed people who do not understand the difference between Class 2 and Class 4 NICs. Some thought that it was payment of Class 4 NICs that covered their entitlement to the state pension.

I have seen clients who thought that Class 2 NICs covered the basic state pension and Class 4 NICs gave an additional pension payment over the basic. When informed this was not the case, many said that they felt cheated and did not understand why they had paid Class 4 NICs. Most self-employed people assume that the NICs they pay entitle them to the same benefits as those offered by employees paying Class 1 NICs.

Do you think the IT and NIC systems should be better aligned for self-employed people and employees?

There are currently 6 different classes of NICs. I feel it would be much simpler and easier to understand if there was only one class of NICs for both employees and self-employed people.

I see a lot of self-employed people who need support with IT and NIC issues. The different IT and NIC systems are confusing and add to my workload. The different classes of NICs also cause great confusion.

As a self-employed person I think the welfare state has become increasingly confusing and many benefits are now non-contributory. The difference between the benefits that self-employed people and employees are entitled to is not spelled out clearly and causes more confusion. It seems the present benefit entitlements are discriminatory against self-employed people.

I see a lot of self-employed clients who do not realise that payment of Class 2 NICs does not entitle them to the same benefits as payment of Class 1 NICs. Why can't we have a single class of NICs that entitles everyone to the same rights and benefits.

Class 1A and 1B NICs that employers pay on expenses and benefits they give to their employees are also incredibly confusing. I think that there should be a single class of NICs for employees and self-employed people paid on self-employed people's end-of-year profits and employees' wages. Employer NICs also need to be simplified, but not abolished, as employers' should pay for the safety net that their NICs provides for their employees and the potential workforce this enables them to access.

My work as an adviser for other advisers suggests that the IT and NIC systems are not well understood even amongst advisers. The purpose and entitlements of the different classes of NICs, in particular, are not understood by either advisers or clients. People are not aware of the contributory principle. In addition, who is entitled to National Insurance credits when not paying NICs is incredibly complex. Many are not sure if they are eligible, whether they need to apply or will be granted them automatically, or how they should apply for credits if they need to. The introduction of Universal Credit is also going to cause even more complexity in linking the NIC and IT system to eligibility to benefits for self-employed people. Universal Credit will require self-employed people to provide details of their profits on a monthly basis so Universal Credit can be paid correctly, which is much more often than at present and there will be penalties if they do not provide this. We have already seen problems and inaccuracies with the new Real Time Income reporting systems for PAYE employees. Self-employed people are likely to see even more problems as their income varies from month to month. There needs to be a better alignment of IT and NICs and the links to benefits for employees and self-employed people before Universal Credit is rolled out across the country.

What problems have you seen amongst people who have multiple jobs?

I've seen clients who have 3 or 4 low paid jobs. NICs are calculated on each individual job and they were below the level at which they had to pay on each individual job, although if they were earning the same from a single job they would have had to make NICs. They didn't realise the effect this would have on their benefit entitlements. This causes many considerable distress at the end of their working life when they find they are not entitled to state pension payments that they had assumed they were.

I have seen self-employed people who have worked for 3 or 4 microenterprises and haven't accrued entitlements to any contributory benefits, but are completely unaware of this.

There needs to be better communication, especially now auto-enrolment to an employers' pension scheme is introduced for some employees, but not those earning below a certain income nor self-employed people and because of changes to the entitlements to the single state pension. Changing jobs and multiple low paid jobs need to be addressed so that people know what they are entitled to and can make up the difference to ensure they can claim contributory benefits.

I work in a university town and see a fair number of clients with multiple jobs, some low paid and some on higher incomes. The problem arises when each employer treats the job as the sole employment for IT and NIC purposes, often even when the employee has provided information that this is not the case. This can result in clients having to repay IT at the end of the year and in some cases not realising they have overpaid NICs. This is particularly the case with education employers who employ university lecturers on several different contracts. There needs to be better employer education on IT and NICs for those with employees with multiple jobs and better recognition of IT underpayments and NIC overpayments through the new Real Time Information system, so that IT debts do not build up and NIC overpayments are avoided.

This problem is exacerbated by the poor cross-departmental communication within HMRC.

Many clients come in with problems around repaying IT due, but then find out that they have also overpaid their NICs, without previously having any awareness of this. Most clients are more aware of IT and notice problems there. NICs are lower and many therefore do not understand them and do not notice if they haven't been paid or have been overpaid. Even well-educated clients don't understand the difference between NICs and IT. They often think they are the same thing.

Should we treat income from multiple sources the same in the IT and NIC systems?

I think a lot of people with multiple jobs wouldn't like this initially, but I think it that if it ensures they were entitled to contributory benefits in the longer-term it would be a good thing. I have seen some catastrophically nasty cases where it is too late for people to make up their NICs to receive the state pension.

We mainly work with clients who have already fallen into debt so are not so concerned with pension savings in the short term. Those who are self-employed often do not understand the IT and NIC systems and many have low levels of literacy so need face-to-face support to help them navigate through. They often turn up with debts for IT and later NI, simply because they didn't understand the IT and NIC systems and what they were expected to pay.

What are the key things that you think need to change?

Job Centre Plus staff need to be much better trained to support self-employed people. If they are advising people to become self-employed to get them away from claiming benefits

or to hit their targets, they should provide them with the correct advice around IT, self-assessment, NICs and business viability tests for Tax Credits.

I have seen a lot of trainers employed by Work Programme providers and Job Centre Plus who run courses on self-employment but do not know the correct advice themselves. For instance when I went along to one course to teach people about NICs for the self-employed, the trainer had told everyone to set up companies and become directors, even if this was a totally unsuitable business model for the type of self-employed work they were planning to begin.

Do you see many people who have been forced to become self-employed?

I see quite a lot of cases of bogus self-employment. For many it is an even worse situation than for clients who are on zero hour contracts. Often they have previously been employees and the employer has then just suddenly told them that they must become self-employed and pay their own tax and national insurance, although they still stipulate the hours that they must work.

I also see a lot of bogus self-employment. The employment status rules need to be stricter and better enforced so that employers can not exploit employees and avoid paying NICs, sick pay and pension contributions. A lot of small and medium enterprises in my area turn to this type of bogus self-employment when they take on new staff. In many cases the clients didn't realise that their employer was treating them as self-employed contractors and not paying their NICs and they didn't realise they were responsible for registering for self-assessment to pay their IT. It's not clear if avoidance of employer NICs is the only driver of bogus self-employment. It seems that the lack of other employee rights, such as sickness and holiday pay and the new employer pension contributions for employees earning above a certain income may also be drivers of bogus self-employment for employers.

The roll-out of Universal Credit will cause even more problems for those who are self-employed or bogusly self-employed and earning a low income. The Minimum Income Floor will mean that many will lose out on in-work benefit support, that employees on the same income will receive. For those who are already self-employed on a low income and are transferred over to Universal Credit, the Minimum Income Floor will take effect immediately, and could cause a dramatic decrease in their income immediately.

What difficulties do you see as a result of non-alignment of the IT and NIC system?

A lot of the self-employed people we see who have fallen into debt, have done so because of total ignorance of the systems. They don't realise how much IT they will have to pay at the end of the year and have not saved for this. Many of them have low levels of literacy or suffer from mental health problems. It would be easier for them if they could pay monthly as employees do through PAYE - but many don't know that you can set up monthly direct debits to pay IT if you are self-employed. This is not well publicised.

Many self-employed people don't understand the difference between IT and NICs and feel resentful that they are having to pay tax twice, as they see it. The PAYE system for employees means that they do not see IT and NICs as different taxes, as the same amount

of each is usually paid each month and the deductions are administered by their employer. For self-employed people the different NIC and IT systems are much more visible, but they do not understand the difference between them.

There is complete incomprehension amongst clients about the NIC system. The whole IT and NIC systems need to be simplified in every way. The clients we see don't understand the words used or the guidance provided and people only come along to get our help and support once everything has gone horribly wrong for them as a result of this lack of understanding.

There needs to be much better communication to increase understanding of the IT and NIC systems across the board.

This is particularly true for people who have just become self-employed. The whole system for them needs to be simpler and more transparent.

I'd say around half of the clients I see understand the contributory principle around benefit entitlements, but few accurately understand which benefits they are actually entitled to and which are covered by which different class of NICs. Aligning IT and NICs and treating employees and the self-employed the same would greatly improve understanding and would ensure the low income self-employed people did not get such a bad deal on pensions and other benefits such as maternity allowance. It would also help to improve awareness about self-employed people's entitlement to contribution-based Job Seekers Allowance. At the moment many self-employed people do not realise they will not be entitled to Job Seekers Allowance if they have a partner who is working.

The roll-out of Universal Credit could make a big difference and needs to be modified to reflect any simplification and alignment of the IT and NIC systems and more equal treatment of employees and self-employed people.

It's currently difficult to estimate the impact of Universal Credit on self-employed people as the pilots have concentrated on single employees with no children.

In Croydon they have now implemented the full Universal Credit system and we are already seeing big problems amongst our clients since this began.

Have you seen problems with HMRC?

Generally the HMRC telephone helpline for enquiries about self-employed clients takes forever to be answered. Usually 45 - 60 minutes. Before, when there was a call centre in our area, calls would be answered within a minute, but this area call centre has now been closed. The closure coincided with the huge increase in waiting times for the telephone helplines. It is impossible to reach human beings and that is who we need to contact, so the HMRC website is no use.

I find the new gov.uk website much more difficult to navigate than the old HMRC website. My organisation luckily still has access to the old webpages and we also belong to an HMRC

group where we can ask more technical questions about the IT, NIC and Tax Credit systems and HMRC officials provide answers directly to us.

The changes HMRC is currently making to the IT and NIC systems are opaque and it is difficult to find out any information about them. They need to communicate better and more widely.

It is also increasingly difficult to get hold of old tax returns from HMRC or to access archived documents that have been sent to them. The HMRC digital service needs to be vastly improved.

The changeover to digital systems and Real Time Income is likely to cause many more problems with HMRC, particularly for self-employed people. A large number are not sufficiently used to using digital systems and, even those who have sufficient knowledge and expertise, could face problems in submitting their returns because of poor internet connectivity, particularly if they live in isolated areas such as the Highlands & Islands.

A lot of my clients had previously been self-employed and then decided to go back into full-time education. Many stop completing self-assessment returns as soon as they stop their self-employed activities, and are then shocked when they receive bills from HMRC over the next 3-4 years. It needs to be much easier to let HMRC know that you have ceased being self-employed, and more information is needed to explain when you need to still complete self-assessment returns.

The HMRC webinars on how to complete self-assessment tax returns are useful, but not well publicised.