

# **Self-employed people and National Insurance Contributions**

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## **Research Report No. 84**

By Anne Corden

This research was commissioned to explore knowledge and understanding among self-employed people of the Class 2 NICS scheme, including liabilities for payments, associated entitlements to contributory pensions and benefits, and views regarding participation in this scheme. The research also considered contributors' knowledge and understanding and their preferences for payment method. It was carried out by the Social Policy Research Unit (SPRU) at the University of York in summer 1997. The main findings are:

- Individual people do not fit neatly into those who do and do not register with the CA, do and do not pay regularly, and do and do not get into debt. People may fall into all these categories at different stages in their working lives.
- Reasons for not registering immediately for NICs included non-recognition of formal employment status and corresponding NI liabilities and not getting round to the task in a busy start-up period.
- A number of factors influenced the maintenance of a pattern of regular payments: feelings of obligations to comply; incentives, in terms of benefits expected in return; avoidance of penalties; interventions, such as advice; prioritisation of income, such that NICS were relatively high on a list of priorities; appropriate methods of collection of payments; and knowledge and understanding.
- Many factors lead to people missing Class 2 NICs payments including: financial constraints; financial choices; transitional situations; receipt of wrong information; experience of procedural and administrative aspects; lack of commitment to the NI scheme; dissatisfaction with entitlements and views on indebtedness.
- Those who got into serious debt to the CA generally had no specific complaints about they way they were treated. Most were trying to repay what they owed.
- Factors that help people deal with debts to the CA included: considerate, helpful and understanding staff; time to pay, sensible negotiations; advice and support from professionals; stability of income.

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## **Introduction**

On behalf of the Contributions Agency (CA), the Department of Social Security (DSS) commissioned the Social Policy Research Unit at the University of York to undertake qualitative research to explore knowledge and understanding of the Class 2 NICS scheme, including liabilities for payment, associated entitlements to contributory pensions and benefits, and views regarding participation in this scheme. The research also considered contributors' knowledge, understanding and preferences for payment method.

The study group of 38 people was built to include some contributors with experience of each of the two main payment methods, some people who had missed payments and been involved in negotiations with the Debt Collection unit, and some people whose arrears had reached serious levels, involving them in negotiations with the Civil Recovery Section. The research included people from a range of occupations, industries, types of business organisations, lengths of self employment, income levels and patterns of earnings.

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## Perceptions of National Insurance among self-employed people

### Conceptualisations of NI

People found it hard to talk about the NI scheme without specific questions. Spontaneous conceptualisations that were offered were brief, but three themes were apparent:

- 'paying in' for returns
- a form of tax
- an imposed liability.

### Perceptions of obligations

In answer to specific questions, most people thought that payments of NICs were compulsory for those in work. It was not generally understood that low earners might be excepted from payment, and people who might have taken advantage of this facility wished they had known about it before.

The names of 'Class 2' and 'Class 4' contributions were often not recognised, and the distinction between the different classes of self-employed contributions was not well understood.

### Returns for contributions

People currently paying by bill generally knew how much was due, but there was less certainty among those paying by direct debit. Lower earners knew more accurately the amounts of Class 2 NICs due. There was some confusion among higher earners about the amounts due to the Inland Revenue (IR) in Class 4 contributions.

Understanding of the links between NICs and entitlements was patchy. Among people under 50 years old there was little expectation of benefiting personally from a basic retirement pension. Strong links were perceived between NICs and NHS provision.

### Private pension and insurance arrangements

There was a wide spectrum of views on, and levels of financial investment in, private pension and insurance schemes. People in their 30s and 40s, especially those with higher levels of formal education, believed that it was important to make private arrangements.

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## Methods of paying

No particular personal or business characteristic distinguished the contributors in this study who paid by bill and those who had direct debit arrangements. Use of one or the other method depended on a number of factors including understanding, advice, perceptions of level of income and cash flow, schemes for managing business and personal monies, perception of debt and previous experiences of dealing with the CA as a self-employed contributor but also as an employer or a previous employee.

## **Understanding payment methods**

Not everybody had a clear picture of the payment method in which they were participating. Some billed contributors with a long-term pattern of missing payments and arrears had lost touch with the periodicity of the scheme. Some people listed among direct debit contributors had also lost touch with the way their payments were made - they relied on other people to deal with them, or NICs represented such a small fraction of their income that they did not think about them.

## **Choices in payment methods**

Choices made about payment methods were linked to aspects of control and financial management. For each method, both high and low earners, with regular and irregular income flows could see advantages, while constraints such as low household income or high overdrafts operated on each side.

People who knew they received quarterly bills used this method:

- as a way of retaining the control needed in financial management of low incomes
- as a way of managing cash flow in more profitable businesses with irregular income and outgoings
- because of a lack of confidence in or suspicion about the banking system
- because they chose not to use a bank, for reasons of expense or inconvenience
- because an attempt to arrange direct debit had not gone smoothly
- because of lack of understanding of the direct debit option.

People who had themselves chosen to pay by direct debit used this arrangement:

- for ease and convenience
- to make sure payments were being made.

Accountants sometimes advised the direct debit scheme, especially to people who had already got into NI arrears and were trying to sort out financial problems. On the other hand, some accountants pointed out to financially astute clients the financial advantages of paying bills in arrears, with no interest charged.

## **Alternative payment methods**

Among higher earners, especially customers who received bills and had a pattern of late payments, there was support for an annual bill. There was little interest in paying by debit card. One of the few people who was enthusiastic noted that he would certainly have used a debit card, but he doubted that this would have changed much his irregular payment pattern.

## **Suggestions for improvement in service**

Across the whole group, the main suggestion for improvement of service was for more information on a regular basis. It would be useful to be told regularly about the links between NICs and entitlements, and the exemption for low earners. People said they had learned about these things too late, and there were examples where this was linked to non-payment.

## **What encourages compliance with Class 2 NICs payments?**

Individual people do not fit neatly into those who do and do not register with the CA, do and do not pay regularly, and do and do not get into debt. People may fall into all these categories at different stages in their working lives.

### **Registration**

Two main patterns of influence encouraged immediate registration:

- personal understanding of need for a contribution record in order to maintain entitlements
- advice from a significant person or help in making arrangements.

### **Delays in registration**

Only one person deliberately delayed registration. Others who discovered that they should have registered earlier were shocked to find themselves with NI arrears.

Reasons for not registering immediately included:

- non-recognition of formal employment status and corresponding NI liabilities
- not getting round to the task in a busy start-up period.

It could be specially hard for some people to recognise their liabilities when they arrived at the formal status of self-employment without experiencing a change in circumstances. People moving to subcontracted status did not always recognise that they should register themselves and start to make payments.

Triggers that alerted people to their status and their NICs obligations included enquiries by the CA, and discussions with accountants and advisers.

### **Maintaining regular Class 2 NICs**

A number of factors influenced the maintenance of a pattern of regular payments:

- feelings of obligation to comply with requirements, sometimes strengthened by personal philosophies
- incentives, in terms of benefits expected in return
- avoidance of penalties, including lack of access to benefits, and the shame of debt
- interventions, such as advice or practical help
- prioritisation of income, such that NICs were relatively high on a list of priorities
- appropriate methods of collection of payments
- knowledge and understanding.

For each person who maintained a regular payment pattern, the 'balance' of the different factors was different. Appropriate payment methods were helpful, although personal and business characteristics were also important.

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## **What leads to missing payments?**

### **Factors leading to missing payments**

Many factors lead to people missing Class 2 NICs payments including:

- financial constraints
- financial choices
- personal characteristics
- transitional situations
- receipt of wrong information
- experience of procedural and administrative aspects
- lack of commitment to the NI scheme
- dissatisfaction with entitlements
- views on indebtedness.

Some of these factors are associated with personal and business characteristics, where the CA can exert little influence. However, there are some opportunities for intervention by the CA, where information and communication might help people avoid missing NICs payments.

## **Regaining a regular payment pattern**

Most people tried to restore a regular pattern after one or two missing payments. Those who failed to do this after initial approaches from the CA fell into four groups:

- those who were choosing not to
- those with severe financial constraints
- people who were no longer required to pay Class 2 NICs
- people for whom there had been some problems of communication with the CA.

## **Dealing with Class 2 NICs debts**

Those who had got into serious debt to the CA, and dealt with the CRS, generally had no specific complaints about the way they had been treated. Most were trying to repay what was owed, but some were currently in personal circumstances from which it would be hard to repay debts. Only one person was deliberately avoiding settling debts, a person in dispute with the CA about his employment status.

In general, factors that help people deal with debts to the CA included:

- considerate, understanding and helpful CA staff
- time to pay, sensible negotiations, instalments
- advice and support from accountants and business partners
- skilled assistance in dealing with multiple debts
- family support
- stability of income, sometimes from a change in employment.

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## **Discussion**

Findings from this study fill some of the gaps in knowledge about self-employed people with liabilities for Class 2 NICs. Findings may help to interpret and understand what influences compliance and non-compliance among the wider contributor base.

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## **Beginning and ending self-employment**

Problems arising at the beginning and ends of periods of self-employment, in respect of Class 2 NICs, included non-recognition of formal status, lack of understanding of NI liabilities and confusion in communicating with the CA. Such problems led to non-registration and missing payments.

There may be opportunities for initiatives by the CA to overcome some of these problems including new ways of notification of the 'end' of self-employment, and encouragement of firms with subcontracted workforces to pass information and explanations about Class 2 NICs.

## **General understanding about National Insurance**

Gaps in understanding about the general NI scheme and Class 2 contributions and liabilities were not encouraging compliance in a number of ways, for example by reducing incentives to maintain contribution records.

The CA might seek ways of providing more information, in particular about entitlements and the Small Earnings Exception rules. Mail-outs to quarterly billed and direct debit customers might be one vehicle. Other routes that might be considered include accountants and bookkeepers, and financial officers in large firms and companies which offer work to self-employed people.

## **Payment methods**

Disadvantages attached to the quarterly billing system include opportunities for some people to maximise incomes by allowing arrears to accumulate. However, some people who use the quarterly billing system would find it hard to maintain regular direct debit arrangements.

Options for encouraging compliance among billed customers might be considered, including rewards for quick payments, administrative charges for late payments, fixed financial penalties for late payments, or interest charges. All these options would, however, penalise some people who try hard to comply but face financial constraints.

There was no evidence that introduction of debit cards might encourage compliance among the people studied.

## **Dealing with the Contributions Agency**

There was general satisfaction about 'service issues'. This generally positive image of the CA and its staff did act to encourage compliance and communication. The disadvantage was that a tolerant and benign image did nothing to discourage people who went to the limits of non-compliance, short of court appearance. The CA has a hard line to tread here, but there would be much to lose in moving away from the current positive image.

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## **Relevant publications**

Boden, R., Corden, A., Hutton, S. and Sainsbury, R. (1997) "Self-Employed people: a literature review for the Contributions Agency." DSS In-house report No. 28.

Craig, R. (1995) "Contributions Agency Customer Satisfaction Survey, 1994, London:" DSS Research Report No 37. TSO.