Self-employed people and contribution-based Jobseeker's Allowance

Standard Note: SN00547

Last updated: 16 July 2014

Author: Steven Kennedy and Antony Seely

Section Social Policy and Business and Transport Sections

Contributory social security benefits are paid to individuals with a sufficient record of National Insurance contributions. With the phasing out of the additional State Pension and the introduction of a single-tier State Pension from 6 April 2016, self-employed people will be eligible for the same contributory benefits and pension as employed earners, with one exception. Self-employed people cannot claim contribution-based Jobseeker's Allowance (JSA).

The rule which excludes self-employed people from contributory unemployment benefits is long-standing. The main justification has been the difficulty in deciding whether a person who was self-employed is genuinely unemployed, given the fact that self-employed people can, to some extent at least, control their own working patterns.

From time to time it is suggested that self-employed people should be allowed to pay Class 1 (employee) National Insurance contributions on a voluntary basis, to enable them to claim contribution-based JSA should they become unemployed. Successive governments, including the current one, have however rejected such calls.

One issue that would have to be addressed when considering whether to extend contributory JSA to the self-employed is the fact that, even taking into account their reduced benefit eligibility, the self-employed contribute significantly less to the National Insurance system than employees.

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Contributory benefits are benefits which are only payable if a person has a sufficient National Insurance contribution record. They include:

- contribution-based Jobseeker's Allowance (JSA);
- contributory Employment and Support Allowance (ESA);
- Bereavement benefits;
- Maternity Allowance; and
- Category A and B Retirement Pensions

The following table shows which NI contributions count for which contributory benefit.[1]

National Insurance contribution classes and what they pay for

Benefit	Class 1 - paid by employees	Class 2 - paid by self-employed people	Class 3 - paid by people who want to top up their contributions
Basic State Pension	Yes	Yes	Yes
Additional State Pension	Yes	No	No
Contribution-based Jobseeker's Allowance	Yes	No (except for share fishermen and volunteer development workers employed abroad)	No
Contribution-based Employment and Support Allowance	Yes	Yes	No
Maternity Allowance	Yes	Yes	No
Bereavement benefits	Yes	Yes	Yes

Class 4 National Insurance contributions - paid by some self-employed people - don't count towards any state benefits.

Class 1A and Class 1B contributions - paid by employers only - don't count towards any state benefits.

1 From HMRC website, *National Insurance and state benefits*

As this indicates, Class 2 contributions paid by self-employed people count towards all contributory benefits with the exception of the additional State Pension and contribution-based Jobseeker's Allowance.

The **additional State Pension** was introduced in 1978. It was originally referred to as the State Earnings Related Pension Scheme (SERPS) and became known as the State Second Pension (S2P) following changes introduced in April 2002. National Insurance Contributions (NICs) as a self-employed person do not count towards the additional State Pension.

The Government legislated in the *Pensions Act 2014* to introduce a single-tier State Pension for future pensioners from 6 April 2016. People who reach State Pension age before that date will continue to receive their state pension entitlement under current rules. National Insurance contributions made by the self-employed will count towards the single-tier pension in the same way as those paid by employees.[2] Because of this, the self-employed are one of the key groups expected to benefit from the single-tier State Pension. The Government has said reasons for improving state pension entitlement for this group include the fact that they constitute a significant element of the labour market and have relatively low rates of private pension saving.[3]

With limited exceptions, only Class 1 (employed) contributions count towards **Jobseeker's Allowance**. This means that self-employed people who make Class 2 (self-employed) contributions do not normally qualify for JSA. The exceptions are share fishermen, and volunteer development workers employed abroad. These categories pay a special Class 2 NI contribution at a higher rate, which enables them to qualify for contribution-based jobseeker's allowance.[4] According to the Government, there is a "clear policy rationale for doing so which recognises the unique characteristics of their professions":

> In the case of share fisherman, this is the ongoing danger to the worker's life of undertaking this profession, and in the case of volunteer development workers it is the value and benefit of their unpaid work to the under-developed nations in which they are located.[5]

The remainder of this note looks at the position of self-employed people other than share fishermen and volunteer development workers in relation to contribution-based JSA.

2 Contribution conditions for Jobseeker's Allowance

There are two types of Jobseeker's Allowance: **contribution-based JSA**, which is payable for up to six months to people who have paid sufficient National Insurance contributions; and **income-based JSA**, which is means-tested.

Contribution-based JSA is an individual benefit, i.e. it is payable regardless of the income or work status of the claimant's partner, if they have one. The amount a person receives may be affected by earnings, payments at the end of a job, or by an occupational or private

[2] DWP, The single-tier pension: a simple foundation for saving, January 2013, Cm 8528, page 29; *Pensions Act 2014*, Section 2

[3] DWP, *Government Response to the Fifth Report of the House of Commons Work and Pensions Select Committee, Session 2012-13, into Part 1 of the draft Pensions Bill*, Cm 8620, May 2013, p17) For more detail, see Library Research Paper RP 13/37 Pensions Bill, page 39-40.

[4] For further details see the HMRC *National Insurance Manual*, paras NIM34001-35007

[5] HMRC, *National Insurance and Self-employed Entertainers: Consultation document*, 15 May 2013, para 8.10

pension. However, only the claimant's earnings (and not those of any partner) are taken into account. Payment is not affected by any other income or savings the person, or their partner, has.

For the purposes of contribution-based JSA, the Department for Work and Pensions will usually look at a claimant's contribution record for the **two complete tax years immediately before the benefit year in which the claim is made**.[6] "Benefit years" run from the first Sunday in January to the end of the first Saturday in the following January. Since 2 November 2010, people have had to satisfy both the following contribution conditions to qualify for contribution-based JSA:

- To satisfy the **first contribution condition**, the claimant must in one of the years have paid Class 1 (employee) contributions on earnings of at least the Lower Earnings Limit in 26 weeks, which need not be consecutive

- To satisfy the **second contribution condition**, in **each** of the two relevant contribution years the claimant must have paid or been credited with Class 1 contributions on earnings of at least 50 times the weekly Lower Earnings Limit

For 2014-15 the National Insurance Lower Earnings Limit (LEL) is £111 a week.

After a person has been entitled to JSA for six months, or from the outset of the claim if they do not satisfy the National Insurance contribution conditions, they may receive **income-based JSA**. Income-based JSA is means-tested, and income and capital held by **both that claimant and his or her partner** will be taken into account. Also, the claimant's partner[7] must not be in "remunerative work", defined as 24 hours or more on average a week.

Self-employed people are liable for Class 2 (flat rate) and Class 4 (earnings-related) contributions – see section 3 below for further details. Class 2 contributions count for all contributory benefits **except** contribution-based JSA. Class 4 contributions do not give entitlement to any benefit.

A formerly self-employed person who is now unemployed may be able to claim income-based JSA, but this may not be the case if their household has other income and/or capital, or if they have a partner who is in work.

3 Why can't self-employed people claim contributory JSA?

The rule which excludes self-employed people from contribution-based JSA is a long-standing one.

The UK's contributory system for financing social security benefits was established in 1948, following the recommendations of Sir William Beveridge's 1942 report *Social Insurance and Allied Services*. In his report, Beveridge argued that the self-employed should be excluded from contributory unemployment benefits:

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6 There are exceptions to this general rule. For example, someone who was getting Carer's Allowance may able to rely on their contribution record for the tax years before they started claiming Carer's Allowance.

7 In this context "partner" means a spouse or civil partner, or someone who lives together with the person as if they were a spouse/civil partner, and not a business partner.

> The income of a farmer, a shop keeper or business manager may come at any time; how busy or how active he is on a particular day is largely within his own control. It is not practicable to have a general system of maintaining earnings of persons gainfully employed otherwise than by way of employment, by benefits conditional upon not working or appearing to work on a particular day.[8]

In the past, Conservative and Labour Ministers have used the same formula when replying to PQs on this subject: it was not possible to extend contributory unemployment benefit to the self-employed "because of the difficulty in deciding whether people who, to some extent at least, can control their own working patterns, are really unemployed".[9]

In 1980, the Conservative Government published a discussion document, *The Self Employed and National Insurance*"[10] which looked at the possibility of extending unemployment benefit to the self-employed:

> 44. The main problem in extending <u>unemployment benefit</u> to the self-employed is that somebody who has been self-employed cannot provide evidence from an employer to confirm the fact that he is out of work and the reasons for it. If unemployment benefit were payable, some thought would have to be given to whether additional conditions might be needed to cater for this lack of evidence and to ensure that people who had some degree of control over their means of livelihood and were able to take up and lay down self-employment readily did not take unfair advantage of the system. The test of availability for work would have to be applied in some form or other. It is not however altogether clear how far it would be possible for the Employment Service Division of the Manpower Services Commission to measure suitability for employment of someone whose job qualifications lay entirely in the field of self-employment. This would have to be looked at further. One way of countering the risk of abuse to the system might be to impose an initial waiting period, like the 6-week disqualification which can at present be imposed when someone leaves work voluntarily.
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> 45. In some fields of self-employment there may be virtually no need for unemployment benefit cover. This is no more a factor which could be recognised by providing some method of contracting out than it is for employed people in occupations which carry little risk of unemployment. The social insurance principle of risk-sharing would have to be accepted for the whole class.
>
> […]
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> 47. The cost of extending unemployment benefit to self-employed people might be of the order of £50m a year, but there would be offsetting savings in supplementary benefits. The staff costs would depend on how many people would no longer need to claim supplementary benefit.
>
> […]
>
> Any increase in the benefit entitlement of the self-employed would of course lead to a corresponding increase in their contributions.

Nothing ever came of the discussion document, however, as responses indicated “no clear consensus”:

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8 *Social Insurance and Allied Services,* Cmd 6404, November 1942, p54, para 122

9 See for example Stan Orme, HC Deb 3 May 1978 c143w and Linda Chalker, HC Deb 10 December 1980 c671w

10 DHSS, 1980

> **Mr. Maude** asked the Secretary of State for Social Services what were the results of his Department's review of the position of the self-employed in the national insurance system that took place in 1981.
>
> **Dr. Boyson:** In 1980 we published a discussion document and consulted widely on the basis of it; but there was no clear consensus among the 16 organisations and 63 individuals who responded to it. Even the most popular change suggested-extending unemployment benefit to self-employed people-failed to command majority support and is open to serious objections. In particular, even the organisations that supported it did not think that self-employed people would be prepared to pay the extra amount needed in class 2 contributions-about £7 a week for the current year, instead of the present £4-40. We therefore concluded that the national insurance system is not an appropriate vehicle for channelling help to self-employed people. We are grateful to all those who replied and to the organisation that took part in subsequent discussions.[11]

More recent governments have also resisted calls to extend contribution-based JSA to the self-employed. In a written answer on 20 April 2009 the then Minister for Welfare Reform, Tony McNulty, said:

> Class 2 [self employed] national insurance contributions provide self-employed people with protection against ill-health, bereavement and old age by providing entitlement to employment and support allowance, bereavement benefits and basic state pension and the rate of contributions they pay reflects this. There are no plans to extend this entitlement to contributory jobseeker's allowance.[12]

The current Government has rejected calls to allow self-employed people to pay “voluntary” Class 1 NICs to enable them to claim contribution-based JSA, as the following PQs from last year indicate (note the final paragraph in the first written answer has exactly the same working as the response above from April 2009):

> **Richard Burden:** To ask the Secretary of State for Work and Pensions if he will make it his policy that self-employed people should be able to pay voluntary class 1 national insurance contributions to ensure that they are eligible for contribution based jobseeker's allowance if they become unemployed. [163230]
>
> **Mr Hoban:** HM Revenue and Customs is responsible for the policy around voluntary national insurance contributions. However, income-based jobseeker's allowance is available to self-employed people who meet the eligibility criteria. The Department administers a wide range of benefits and allowances that are available to people on low incomes. Self-employed people who meet the qualifying criteria may be entitled to housing benefit, help with council tax and NHS charges. Those working and on a low income may be entitled to working tax credit whilst those with children may be entitled to child tax credit.
>
> Class 2 national insurance contributions provide self-employed people with protection against ill-health, bereavement and old age by providing entitlement to employment and support allowance, bereavement benefits and basic state pension and the rate of contributions they pay reflects this. There are no plans to extend this entitlement to contributory jobseeker's allowance.[13]

[…]

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11 HC Deb 3 November 1983 c456w

12 HC Deb 20 April 2009 c133w

13 HC Deb 4 July 2013 c738w

> **Richard Burden:** To ask the Chancellor of the Exchequer if he will make it his policy to enable self-employed people to pay voluntary class 1 national insurance contributions to ensure that they are eligible for contribution-based jobseeker's allowance if they become unemployed. [167387]
>
> **Mr Gauke:** The contributions that self-employed earners pay have never counted towards contribution-based jobseeker's allowance entitlement. There are no plans to either change this rule or to allow the self-employed to pay Class 1 contributions voluntarily.[14]

4 Self-employed National Insurance contributions

Many self-employed people think it is unfair that they cannot claim contribution-based JSA, given that they pay National Insurance contributions. However, even taking into account their reduced eligibility for benefits, estimates still show that the self-employed significantly "under-contribute" to the National Insurance fund, in comparison with employees.

At present self-employed people are liable for two types of national insurance contributions:

- **Class 2 flat rate contributions** - currently £2.75 a week (people who earn less than £5,885 from self-employment in the current tax year do not need to pay). Payment of Class 2 National Insurance contributions (NICs) counts towards entitlement to certain social security benefits including the basic (flat rate) Retirement Pension, ESA, and bereavement benefits – but not to contribution-based JSA.[15]

- **Class 4 earnings-related contributions** - currently 9% of profits or gains between £7,956 and £41,865 and 2% of profits or gains above £41,865. Class 4 contributions do not count towards benefit entitlement.

It is an important feature of the National Insurance system that the self-employed contribute less than employees, even given their lower entitlement to benefits – though the relative benefit they enjoy, as a group, was reduced significantly as a package of reforms to the structure of NI in 1999-2001. At present this benefit is put at around £2.85 billion a year – though, as noted in previous written answers on this issue, these estimates are "particularly uncertain due to their complex nature" (see below). Moreover, this is a figure for the self-employed **as a whole**; it is possible that the situation may vary across the income spectrum.

As noted above, Beveridge argued that the self-employed should be excluded from contributory unemployment benefits on the grounds that, for a self-employed person, the decision about whether or not to work was largely within their control.[16]

Initially, National insurance contributions were flat-rate contributions, varied by age and sex, including a flat rate contribution paid by the self-employed (Class 2).

In 1961 partially earnings-linked contributions were added to this structure, though class 2 contributions remained fixed-rate. In 1975 NICs became fully related to earnings; as part of this reform, a new earnings-related contribution for the self-employed was introduced (class 4); as a survey of the tax and benefits system which was published a few years ago by the

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[14] HC Deb 4 September 2013 c434w

[15] There is a useful checklist of the way in which payment of the different categories of NI trigger benefit entitlement on the department's site here, http://www.hmrc.gov.uk/ni/intro/benefits.htm

[16] *Social Insurance and Allied Services* Cmd 6404 November 1942 p54 (para 122)

Treasury explains, this change was to "spread the cost of benefits available to the self-employed in a more equitable way and so reduce the burden on the self-employed with low earnings."[17]

The relative benefit that the NI system gives the self-employed was a point made in the 1998 Taylor Report on the tax system and work incentives, the conclusions to which lead to some important changes in both Class 2 and Class 4 NICs.[18] The report examined the position affecting the self-employed as it stood in 1998-99, and argued that, as a class of contributor, they should be required to pay more into the NI Fund (**emphasis added**):

> The self-employed will pay a flat rate Class 2 charge of £6.35 a week in 1998-99. That will be paid by everyone with earnings over about £69 a week. They also pay a 6 per cent Class 4 charge, based on their taxable profits, between the lower profits limit (LPL) at around £140 a week and the upper profits limit (UPL) at £485 a week. Only the Class 2 charges gives entitlement to contributory benefits. The Class 2 charge is analogous to an entry fee. Indeed, it is markedly larger than the entry fee at the LEL for employees. At 6 per cent, the Class 4 rate is below either the employee or the employer headline rate, let alone both together.
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> Taking these factors together, it would be consistent with my proposals for employees:
>
> - to abolish the Class 2 charge (which means inventing a new benefit entitlement test, such as a minimum profits test or a minimum Class 4 payment, for contributory benefits);
> - to align the LPL with the revised LEL;
> - to increase the Class 4 rate nearer to the employee rate, so as at least to restore the Class 2 yield. (There are timing issues for the year of introduction, since Class 2 is paid in-year and Class 4 essentially end-year.)
>
> **Although the self-employed have less entitlement than employees to contributory benefits, they substantially under-contribute to the National Insurance Fund, even allowing for their reduced entitlements. So there would be an argument for making the self-employed component of such a package revenue-raising, rather than revenue-neutral.**[19]

Initially the Labour Government deferred a decision on these recommendations, as the then Chancellor Gordon Brown explained in his March 1998 Budget;[20] however, the following year Mr Brown announced changes to both Class 2 and Class 4 NICs to "align national insurance arrangements for the self-employed closer to those of employees."[21] Details were given in a press notice:

> From April 2000 the position of self-employed workers with lower profits will be improved significantly. The flat-rate Class 2 national insurance charge, currently payable once profits reach £69.00 a week, will be reduced from £6.35 per week to £2 per week. This will reduce the burden of national insurance on the lowest earning self-employed and encourage start up of self-employed businesses.

17 HM Treasury, *Tax Benefit Reference Manual*, 2009/10 ed. Deposited paper 2009-1987 para 5.35
18 HM Treasury, *Work incentives: a report by Martin Taylor*, March 1998
19 *Work incentives: a report by Martin Taylor*, March 1998 para 2.25-2.28
20 HC Deb 17 March 1998 c 1104
21 HC Deb 9 March 1999 c 187

The point at which Class 4 contributions on profits become payable will be aligned with the personal tax allowance (£85 per week for 2000/2001, assuming statutory indexation). The rate of class 4 will change from six to seven per cent. The upper profits limit - the point at which liability for class 4 ends - will rise to £535 from April 2000 and then to £575 in April 2001, in line with the changes to the upper earnings limit for employees set out above.

These changes:

- reduce the self-employed's 'entry fee' into the NICs system by over £4.35 per week;
- enhance work incentives by taking a large part of the burden of NICs off the shoulders of low earners - all self-employed people earning under around £9,460 per year will be better off as a result of these changes;
- recoup national insurance revenue lost through changes to class 2 and address the undercontribution to the National Insurance Fund of the sector as a whole;
- make national insurance for the self-employed fairer; and
- simplify the system by bringing closer alignment with the tax system and with NICs for employees.

Benefit entitlement for the self-employed is based on Class 2 NICs which is why they will be retained, but at £2 per week.[22]

Following these changes, the question whether the self-employed could still be said to "under contribute" to the NI Fund was raised in a PQ:

Mr. Webb: To ask the Chancellor of the Exchequer if he will set out the basis for the assessment made in para 2.28 of the Taylor report "The Modernisation of Britain's Tax and Benefit System: Number Two" regarding the under-contribution to the NI Fund by the self-employed; what his latest estimate is of that under-contribution; if he will undertake a similar comparison between the contributions paid by married woman at the reduced rate and the benefits to which such women are entitled; and if he will make a statement.

Ruth Kelly: The latest estimate of the value of the reduction in contributions by the self-employed which is not matched by reduced benefit entitlement is in Inland Revenue Statistics table 1.5 .. [which gave the figure of £2.3 billion for 2000-01]. The value is calculated by estimating the total employee and employer national insurance contributions which would be paid by the self-employed if they were to be subject to Class 1 contributions instead, and comparing this with the estimated total Class 2 and Class 4 contributions actually paid by the self-employed.

An adjustment is made to allow for the fact that the self-employed are not eligible for certain contributory benefits, such as contribution-based jobseeker's allowance and the state second pension (or SERPS prior to April 2002). If a similar calculation was performed for married women who have opted to pay national insurance contributions at the reduced rate it would not show any under-contribution.[23]

There have been two changes in the structure of NICs since this reform – which have affected both employees and the self-employed. In the 2002 Budget the Labour Government

22 HM Treasury Budget press notice HMT9, 9 March 1999
23 HC Deb 16 May 2002 c 806W

announced a substantial increase in health spending over the following five years and to meet this cost a series of tax measures, including increases in the rates of NICs for employees, employers and the self-employed took effect from April 2003. For the self-employed the rate of NICs was increased by 1 percentage point to a rate of 8% on all earnings between the lower profits limit and the upper profits limit – *and* a new 1% rate of NICs was introduced on profits above the upper profits limit. Second, these rates of NICs were all increased an **additional** one percentage point from April 2011 – an increase announced in the 2009 Pre-Budget Report by the then Chancellor, Alistair Darling.

The current version of the table cited in the above written answer from 2002 estimates the cost of reduced National Insurance contributions for the self-employed – not attributable to their reduced benefit eligibility – at £2.85 billion for 2013-14.[24] The footnote to the table states that this:

> Represents the difference between Class 2 and 4 NICs paid by the self employed on their profits and an estimate of the Class 1 NICs that would be paid at contracted out rates on an equivalent amount of employee earnings. The Class 1 estimate includes employer contributions due but assumes a corresponding reduction in earnings to hold staff costs broadly constant, and also takes account of the resulting reduction in income tax.

24 HM Revenue and Customs, *National Statistics: Table 1.5 - Estimated costs of the principal tax expenditures and structural reliefs*, April 2014