

# National Insurance Contributions 2020/2021

For R03 you must:

- know the different NI contribution classes and who is liable to pay each.
- Be able to calculate NI contributions for an employed and a self-employed individual.
- Be able to calculate NI contributions where individuals have income from employment and self-employment

Students of a certain age may recall the National Insurance stamp. Each employee had a card and at the end of the week someone would go down to the post office to buy the correct value stamp for each card. These were then put stuck on to the employees' cards (hence the euphemism for being fired "I was given my cards")

For many years it was a flat rate so it was relatively more expensive for lower paid employees. During the 70's the need to physically buy stamps was replaced by payroll deduction direct to the relevant government department and we moved to NIC being a percentage of earnings.

NIC and Income Tax have over the years moved closer together and now both fall under the control of HMRC. Payments for all but Class 4 are made to the National Insurance Contributions Office (NICO)

There are though some fundamental differences between income tax and National Insurance.

- NICs are only payable on earnings from employment and self-employed profits. Income tax is payable on a wider range of income.
- Unlike Income Tax the calculation of NI is different for the employed and the self-employed.
- NIC are not paid by anyone over State Pension age. Income tax has no upper age limit.
- Individual pension contributions cannot be used to reduce NIC. For example someone whose gross monthly pay is £2,000 and pays pension contributions of 5% will only be taxed on £1,900 but will pay NIC on £2,000.
- Liability to NIC for employees (apart from directors) is on a "pay period" (usually weekly or monthly). Income tax is calculated on an annual basis

## The four classes of NIC

Class 1	Payable by employees and their employers
Class 2	Paid by the self-employed at a flat rate of £3.05 a week
Class 3	Voluntary contributions paid at a flat rate of £15.30 a week
Class 4	Paid by the self-employed as a percentage of their profits.

## Class 1 NIC

An employer must deduct NIC from every employee aged between 16 and state pension age.

There are three thresholds that determine an employee's NIC liability.

**Lower Earnings Level (LEL)** which is £120 a week or £520 per month.

**Primary Contribution Threshold (PCT)** which is £183 a week or £792 per month.

**Upper Earnings Limit (UEL)** of £962/£4,167

**Employees don't pay NIC until their weekly or monthly income is above the PCT.** If they earn between the **LEL and the PCT they don't pay NI** but get a credit for the State Pension. However, if the employee earns **below the LEL** they would not build up any credit for the State Pension (Single Tier Pension).

Once the PCT is exceeded employees NIC is payable at the **main rate** of 12%.

Once the UEL is exceeded NIC is payable at the **additional rate** of 2%.

In all cases employees have contributions deducted from their pay and these are then paid along with the employer contributions to NICO.

Jill earns £4,500 a month

She will pay Class 1 as follows:

£3,375 (£4,167 - £792) @ 12%	£405.00
£333 (£4,500 - £4,167) @ 2%	<u>6.66</u>
	£411.66

An employee does not pay NIC on taxable benefits in kind. The employer pays Class 1A on the taxable benefit of company cars.

Women who married before April 1978 could elect to pay the "married woman's stamp". This is now 5.85% on earnings between PCT and UEL. It does not build up any credit for a State Pension and rely on their husband's contributions. As it is 42 years since this right was abolished only women above 60 are likely to still be paying it.

The employer also pays NIC. The rates are:

- 13.8% on all earnings above £169 pw/£732 pm. For employees under 21 and recognised apprentices under 25 the employer rate is only paid on income above the Upper Earnings Level

The employer has to pay NIC for employees above the State Pension Age.

Businesses and charities can deduct £4,000 from their NIC bill if the NIC liability in the previous tax year was less than £100,000. This is known as the **employment allowance**.

## More than one job

A key difference between Income Tax and National Insurance is that if an individual has more than one **unconnected job** the NI for each job is calculated separately. This means:

- The PCT can be deducted from each job.
- If earnings in one job are more than £50,000, they only pay 2% in the second job.

## Self Employed

The self-employed have to pay **Class 2** and **Class 4** contributions.

Class 2 is a flat rate of £3.05 a week that is payable once their profits are greater than £6,475

If someone registers as self-employed they are liable to pay Class 2 even if they have weeks of inactivity or holiday. There is no liability for complete weeks when the person is entitled to sickness, invalidity benefit or maternity allowance

Whilst the payment is shown as weekly the National Insurance Contributions Office will collect these by direct debit at regular intervals through the tax year. They are collected four months in arrears

If profits are likely to be lower than £6,205 an individual can apply for exemption. (Small earnings exception limit) HMRC will check at the end of the tax year to see if profits turned out to be higher and if this is the case then the individual will be liable for class 2 contributions.

They also have to pay **Class 4** when profits exceed £9,500. The rate is 9% until profits reach £50,000 when the additional rate of 2% is chargeable. This is paid direct to HMRC as part of the self-assessment process.

Class 4 is an exception to the rule that payments cease at state pension age (SPA). They are payable in the year you reach SPA but you are only exempt in the following year. This means a man who reached State Pension Age in May 2020 would be liable for class 4 for the whole of tax year 20/21.

Tom is self employed and has profits of £35,000 for 20/21. His NIC liability will be

Class 2 £3.05 x 52 =	£158.60
Class 4 £35,000 less £9,500 = £25,500	
£25,500 @ 12%	<u>£3,060.00</u>
	£3,281.60

## Both employed and self employed

An individual in this situation could be liable to pay Class 1, 2 & 4. As the main rate for Class 1 is not charged above earnings of £50,000 a year, under certain circumstances too much may be charged.

### Class 2

If employed earnings are above the Upper Earnings Limit (£50,000) the individual can claim exemption to Class 2 contributions. If it is below this figure, then Class 2 is payable.

### Class 4

The basic principle is that the amount of Class 1 and Class 2 reduces the amount of Class 4 that is due

The maximum Class 4 contribution at the main rate is:

£50,000 less £9,500 @ 9% = £3,645

If the total of Class 1 payments made is greater than this, there is no further main Class 4 liability. If it is less Class 4 contributions will be capped at the difference between the above figure and the actual Class 1 + 2 payments. The exact liability will be calculated through self-assessment.

Even if no main class 4 NICs are payable, there is still a 2% liability on all profits in excess of £9,500

Callum is employed and earns £60,000 a year. He also runs a consultancy business on a self-employed basis with profits of £30,000.

He has deferment from Class 2 and Class 4 at the main rate but must pay Class 4 at:

$£30,000 - £9,500 = £20,500 @ 2\% = £410$

## Interaction of Income Tax and NI

- An individual who is paid monthly will start to pay NIC once their pay is more than £792
- However they will not pay income tax if they have the full basic personal allowance until their monthly pay is more than £965
- At the other end of the scale they will start to pay higher rate tax once monthly pay is greater than £3,862 at which point they would start to pay the additional rate of NIC

The combined rate of income tax and NIC based on monthly pay is as follows:

Below £792	0
£792 to £1,042	12%
£1,042 to £4,167	32%
£4,167 to £12,500	42%
Above £12,500	47%