AF1 2023/2024
National Insurance Contributions

After the frequent changes in NIC in 22/23 it seemed that questions on NIC in 23/24 would be simpler. However in the 2023 Autumn Statement changes were announced in the rate that employees pay NIC that will come into effect from January 6 2024. Under normal CII practice this should not be tested in the February exam. These notes are based on the pre-Autumn Statement rules but the changes will be covered at the end.

This milestones for this part are to:

- Understand the different NI contribution classes and who is liable to pay each one.
- Be able to calculate NI contributions for an employed and a self-employed individual.
- Be able to calculate NI contributions where an individual has more than one job.
- Be able to calculate NI contributions where an individual has income from both employment and self-employment.
- Know the changes announced in the 2023 autumn statement.

National Insurance dates from the immediate post war era and was designed as a quasi-insurance system. You paid in whilst you were working and that entitled you to benefits if you were unable to work. The insurance principle has diminished over the years except for the State pension where making sufficient NI contributions is a requirement to receive this.

Until 1975 NI contributions were a set weekly/monthly payment regardless of your earnings but since then it has been calculated as a percentage of earnings.

NIC and Income Tax are separate deductions on individuals' payslips. It has been argued that it would be simpler for employers (and AF1 candidates) if National Insurance and Income Tax were merged but there are some fundamental differences between the two.

- NICs are only payable on earnings from employment and self-employed profits. Income tax is payable on a wider range of income. E.g. pensions and dividends.
- The rates of NI are different for the employed and the self-employed.
- Employees do not pay NIC on benefits in kind.
- NIC are not paid once 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 £3,000 and pays pension contributions of 5% will only be taxed on £2,850 but will pay NIC on £3,000.
- 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

Olga has a working pattern where she works two days one week and four days the next. In the short week she is paid £100 and in the longer week £280 She is paid on a weekly basis.

In the weeks she earns £100 she pays no NIC
In the weeks she earns £280 she pays NIC

For income tax HMRC will look at her total earnings over the year and tax her on that. NIC considers each pay period, in this case weekly, as a separate event.

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 £3.45 a week
Class 3	Voluntary contributions paid at a flat rate of £15.85 a week
Class 4	Paid by the self-employed as a percentage of their profits.

NI for employees Class 1

Employees aged between 16 and state pension age are liable to pay class 1 contributions. These will be deducted from their gross pay and sent by the employer to National Insurance Contributions Office (NICO).

Two thresholds are used in calculating an employee's liability:

- Primary Contribution Threshold (PCT) of £242 a week or £1,048 per month (£12,570 annual).
- Upper Earnings Limit (UEL) of £967/£4,189 (£50,270 annual)

Note that the thresholds for NIC are now aligned with the income tax Personal Allowance and the threshold for higher rate

NIC is payable at the **main rate of 12%.** on earnings between PCT and the Upper Earnings Limit (UEL).
Earnings above the UEL are charged at the **additional rate of 2%**

Note that although the UEL is now the same as the higher rate threshold, pension contributions do not increase the UEL.

Harry makes a £5,000 contribution to his SIPP. His higher rate threshold would increase to £42,700 but for NI purposes is unchanged.

There is a further threshold called the **Lower Earnings Level (LEL)** of **£123- a week or £533 per month.** This is significant because if earnings for the pay period are lower than this the employee will not build up a credit for the **Single Tier State Pension**. On the other hand, if

someone has earnings over the LEL but below the PCT they will get a credit for the State pension even though they won't pay NIC.

The basic calculation is:

When pay period earnings are lower than the UEL

- Deduct PCT from gross salary.
- This figure is charged at 12%

David earns £600 a week. His NI is	
£358 (£600 -£242) @ 12%	£42.96

When earnings are higher than the UEL

- Deduct the UEL from the gross salary and charge at 2%
- Deduct the PCT from UEL and charge at 12%

Jill earns £5,000 a month	
She will pay Class 1 as follows:	
£3,141 (£4,189 - £1,048) @ 12%	£376.92
£811 (£5,000 - £4,189) @ 2%	16.22
	£393.14

Prior to April 1977 when a woman married, she could elect to pay the "married woman's stamp". Women who chose this option could retain it. The current rate is 7.1 % on earnings between PCT and UEL. It does not build up any credit for a State Pension and she will have to rely on her husband's contributions.

Employer contributions

The employer must also pay Class 1 NIC. The main rate is:

- 13.8% on all earnings above the **Secondary Threshold (£175 pw/£758 pm)**
- Unlike employee contributions there is no reduction in rates on earnings above the UEL. Similarly, whist an employee over State Pension age does not pay NIC, the employer must still pay.

Smaller businesses and charities can claim **Employment Allowance** that will write off £5,000 of their NIC liability. To qualify the employer NI contributions paid by the firm in the previous tax year must have been less than £100,000

Credits for Class 1

Someone reaching State Pension age on or after 6th April 2016, needs 35 years NIC contributions to get the full Single Tier Pension

It is possible to get credits if an individual is not paying Class I NIC. The main situations are as follows:

- Individuals aged between 16 & 18 in full time education
- On an approved training course
- Receiving Statutory Maternity, Paternity or adoption pay.
- Job Seekers Allowance
- On jury service
- Off work due to sickness
- Receiving Child Benefit if child is under 12
- Having been in prison and had the conviction quashed

Employed with more than one job

If someone has one job with one employer there should be no problems in paying the correct level of NIC since it is calculated on a pay period basis rather than an annual basis. However, if someone has two different jobs with different employers, things can get more complex.

There are two reasons for this:

- The Primary Contribution Threshold can be deducted from earnings from each employment provided the jobs are unconnected.
- There is a maximum liability to NIC at the main rate. On an annual basis this is **£37,700** (£50,270 less £12,570) @ 12% which is £4,524

To see how these impacts on different cases let's look at some examples.

Osmin has two jobs. In the first one he earns £500 a week and in the other gets £300 a week.

£500 less £242 = £258 @ 12% = £30.96
£300 less £242 = £58 @ 2% = £1.16

Total NIC per week =£32,12

In this case there are no issues because the total weekly income after deducting the PCT from both (£242) is below the UEL.

Kay is employed as a solicitor and earns £4,500 a month. She is also employed by another firm and earns £1,500 a month.

As her monthly earnings in the main job are above the Upper Earnings Limit of £4,189 she is not liable for the main rate of NIC on the second job. All employers are legally obliged to deduct NIC at the main rate so Kay applies to NIC for deferment. This is a certificate that instructs the second employer to charge NIC at the additional rate of 2% on her earnings in excess of the primary contribution threshold.

She would pay £1,500 less £1,048 = £452 @ 2% = £9.04

If her monthly earnings in the second job were £900 she would not pay NIC as it is below the PCT.

So far two situations have been considered:

- Earnings from both jobs are in excess of PCT but the total is less than the UEL
- Earnings in the main job are more than the UEL.

The third possibility is that earnings from both jobs are less than the UEL but when totalled they are more than the UEL. ***This is a complex calculation and is less likely to be tested as it would eat up too many marks, particularly as you would have to do three calculations for the basic NI calculation***

Directors

Directors are employees but are assessed for NIC on an annual rather than a weekly or monthly basis. They may be paid monthly basis and NIC will be deducted but at the end of the year the amount must be recalculated on an annual basis and any deficit made up.

Provided the directorships are for unconnected companies the PCT can be deducted from each directorship.

Maria holds three unconnected directorships as follows

Company A	£60,000	
Less UEL	£50,270	
	£9,730 @ 2% =	£194.60
	£50,270	
Less PCT	£12,570	
	£37,700 @ 12%	£4,524.00
		£4,718.60

Company B

Fee is £20,000 but as company A took her above UEL she is only liable to pay 2% on fees above the PCT

	£20,000	
Less PCT	£12,570	
	£7430.@ 2% =	£148.60

Company C

Her fee is £5,000 which is below the PCT so no NIC is payable

Her total liability is £4,781.60+ £148.60 = £4,930.20

NI & the Self Employed

The self-employed are liable to pay **Class 2** and **Class 4** contributions. Class 2 contributions are planned to be abolished in the 24/24 tax year.

Although Class 2 contributions are quoted on a weekly basis they are collected through self-assessment. Class 2 is a flat rate of **£3.45 a week** that is payable once **annual profits are greater than £12,570**

If profits are between **£6,725 (Small profits threshold) and £12,570** individuals will not be liable to pay Class 2 but will continue to build up a credit for the State Pension.

Once 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

Class 4 become payable when profits exceed **£12,570 The rate is 9% until profits reach £50,270 when the additional rate of 2% is chargeable.** This together with Class 2 is normally paid direct to HMRC as part of the self-assessment process.

Hamish is self-employed and with profits for 23/24 of £95,000. His liability will be:

Class 2

52 x £3.45 =	£179.40

Class 4

£50,270 less £12,570 = £37,700 @ 9% =	£3,393.00
£95,000 less £50,270 = £44,730 @ 2% =	£894.60
	£4,467.00

Class 4 is an exception to the rule that payments cease at state pension age (SPA). They are payable in the tax year you reach SPA and only become exempt in the following year. This means someone who reaches SPA on April 7 2023 would be liable for class 4 for the whole of tax year 23/24.

Self-employed who pay Class 1

There is sometimes a grey area between employment and self-employment. Some occupations have argued that they are self-employed whilst HMRC has argued that they are employed.

Actors fall into this group. They have argued that they are freelance and hire themselves out to a company or producer. HMRC claims that when they are cast in a play or film they are effectively employed by the producer. As a compromise, there are certain occupations where whilst they can be treated as being self-employed for tax purposes they will be treated as employed for NIC and pay Class 1 contributions.

These are:

- Actors
- Entertainers
- Ministers of religion
- Domestic workers/office cleaners
- Workers in film or TV
- Agency workers
- Labour only subcontractors

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 £50,270 a year, under certain circumstances too much may be charged.

Class 2

If employed earnings are above the Upper Earnings Limit (£50,270) the individual can claim exemption from 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:

£50,270 less £12,570 @ 9% = £3,393

If the total of Class 1 payments 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 total of Class 1 & 2 payments. The exact liability will be calculated through self-assessment.

Even if no main rate class 4 NICs are payable, there is still a 2% liability on all profits in excess of £12,570

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 - £12,570 = £17,430 @ 2% = £348.60

Class 3 NIC

These are voluntary contributions payable at a flat rate of £17.45 a week. However, if you are registered as being self-employed the rate is £3.45 a week.

The clue is the word, “voluntary”. Individuals who aren’t paying NI because their earnings are below the LEL will miss out on a year’s credit for the State pension so within limits choosing to make class 3 contributions will fill this gap.

Since individuals have potentially 45 to 47 years of working life and 35 years contributions or credits are needed to get the full Single Tier Pension it doesn't follow that class 3 contributions should be made if they take a type of "gap year" or work abroad for a few years.

The AF1 examiners seem to be including a few pension questions and whether paying Class 3 is advisable could be tested. The main rationale is that an individual does not have 35 years contributions or credits and will not therefore be entitled to a full state pension. Before deciding to make contributions individuals should contact the Pension Service to check their NI contribution record.

If someone is short of the 35 years, making Class 3 can be excellent value for money. For a total cost of £907.40 (52 x £17.45) you would build up a potential pension of £304.20 a year (based on 23/24 figures) which will be indexed linked. This means if you survive beyond 69 you will have received more in pension than the initial cost.

Note that the pension cannot be increased above the STP.

Another justification for paying Class 3 is for someone approaching state pension age who was contracted out of SERPS/S2P. The pre 2016 system was a flat rate pension (Basic State Pension) topped up with an earnings-related element.

Prior to the change final salary scheme members could have been **contracted out** by their employer so they would only get the Basic State Pension but not the earnings-related element. Former contracted out employees who continue to work will potentially increase their pension up to the level of the STP by continuing to pay class 1 contributions.

Retired employees who have not yet reached State Pension Age and whose pension is lower than the Single Tier Pension can increase their state pension by paying Class 3 contributions.

Helen was a teacher who retired in June 2023 aged 60. Her State pension which will be paid when she is 66 but she's unlikely to receive the full STP because she was contracted out until April 2016. It will be higher than the old Basic State Pension following NIC made between April 2016 and her retirement.

As she doesn't intend to work she can't increase her pension through class 1 contributions. She can however pay class 3 NIC until State Pension Age as each year's contribution will increase her state pension by 1/35 of £203.85 which is about £5.82. a week based on 2023/24 rates.

Normally you can only go back a maximum of six tax years. However, if an individual has missing years of contributions between 6 April 2006 and 5 April 2016 they can make class three contributions but this must be done by 5 April 2025

Changes from January 6 2024.

As announced in the 2023 Autumn Statement the main employee rate of Class 1 will be reduced from 12% to 10% from January 6 2024. There are no changes to other rates or bands.

The February exam may get round this by asking you to calculate the NIC liability for a self employed individual. If it is based on an employed person then they pay 39 weeks @12% and 13 weeks @10%

However make sure you read the question as it may ask you to ignore the changes announced in the autumn statement.

That concludes this part so you should now:

- Understand the different NI contribution classes and who is liable to pay each.
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- Be able to calculate NI contributions where an individual has more than one job.
- Be able to calculate NI contributions where an individual has income from both employment and self-employment
- Know the changes announced in the autumn statement.

Sources and further information

https://www.gov.uk/self-employed-national-insurance-rates

https://taxaid.org.uk/guides/information/an-introduction-to-income-tax-national-insurance-and-tax-credits/national-insurance/national-insurance-for-employees-and-employers/national-insurance-thresholds