Quick guide to national insurance

Strictly, not a tax at all

National insurance is a charge on earnings, which provides funds for state pensions and social security.

National insurance is an anomaly in the tax system in that, strictly speaking, it is not a tax at all. It is a compulsory state-run insurance policy, hence the name.

When first introduced in 1911, the government was keen to stress that this was not a new tax and that payments were not charitable hand-outs. Instead you were simply paying an insurance premium, and made a claim when you were unemployed, pregnant, sick or retired.

The original national insurance poster stressed that it was not a tax, it was a payment for a benefit, just like a train ticket.

Over the last century, national insurance has progressively lost the nature of insurance and assumed the nature of taxation. In particular:

- three of the six classes and much of a fourth do not count towards any entitlement,
- many social security benefits are paid regardless of whether the "premium" of national insurance has been paid,
- the amount of cover received is unrelated to the premium paid (with a limited exception for State Second Pension).

Some of the more unusual rules of national insurance derive from this part-evolution from insurance to taxation.

Some vestiges of insurance remain. National insurance is collected in a separate National Insurance Fund. Payments to it are called “contributions”. Many benefits still do depend on having paid sufficient national insurance, known as the “contributory principle”. National insurance is covered by separate laws from other taxes.

Age limits

National insurance uniquely has age limits. You do not pay national insurance of any class under the age of 16, nor above state retirement age.

Until 5 April 2010, state retirement age was 65 for a man and 60 for a woman. The age for women is now increasing to the same as for men, and both ages will then increase further. Details, with tables, are given in the separate article *When can a woman retire?*

For an employee, the age is at the date of the payslip. No apportionment is made for any period when the employee was under or over the relevant age.

Note that an employer pays employers' national insurance for an employee over state retirement age.

Earnings

National insurance is only paid on earnings, from employment or self-employment. This means that many sources of income are not subject to national insurance, even though they may be subject to income tax.

The following are not subject to national insurance:

- pension income
- investment income
- benefits in kind (but see below).

A benefit in kind paid to an employee is treated as earnings if it is a **readily convertible asset.** This includes such things as gold bars and National Savings certificates that are very similar to cash.

For other benefits in kind, the employee pays no national insurance, but the employer may have to pay class 1A.

In addition, national insurance contributions may be credited during periods of unemployment, home responsibility and full-time education. Indeed, the only ways in which most people do *not* build up any entitlement is when they are overseas for a long time or if failed to register properly.

Classes

There are six classes of national insurance, of which class 1 is by far the most important. It collects more than 90% of all national insurance.

Class 1 is paid on earnings from employment. Some is paid by the employer and some by the employee. It is collected through the payroll. More details are given later.

Class 1A is paid by the employer only, on the value of benefits provided to an employee.

Class 1B is paid by the employer only, on the value of income tax covered by a PAYE settlement agreement.

Class 2 is paid by the self-employed. It is a small fixed weekly amount, for 2011/12 just £2.50 a week. (Higher rates are paid by share fishermen and voluntary development workers.) This is usually collected monthly by direct debit. The self-employed are also liable for class 4.

Someone whose earnings are below a threshold (£5,315 for 2011/12) may elect not to pay class 2. Note that this is not compulsory; you may choose to pay class 2. Also note that paying class 2 to maintain your entitlement to the state retirement pension can be cheaper than paying class 3. You also become entitled to more social security benefits.

Class 3 is a novelty of the tax system in that it is entirely voluntary — no-one has to pay it. Indeed the law states who may *not* pay class 3. It is paid by those who otherwise do not have sufficient contributions to receive a full state retirement pension. For 2011/12, the weekly figure is £12.60.

Class 4 is paid by the self-employed as an addition to class 2. For 2011/12, it is paid at:

- 9% on profits between £7,225 and £42,475, plus
- 2% on profits above £42,475.

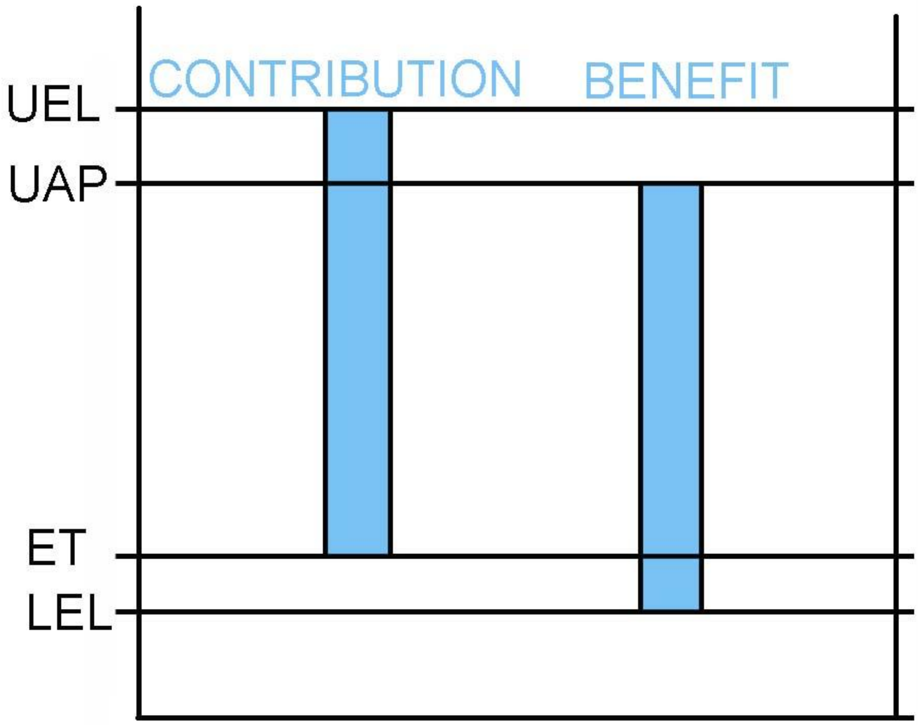
It is collected with income tax under self-assessment.

Only classes 1, 2 and 3 count towards a person's national insurance record.

Class 1 bands

Class 1 national insurance represents both a duty to pay and a right to receive.

This is best explained by an illustration:



An employee and their employer are liable to **pay** class 1 national insurance for earnings between the earnings threshold (ET) and upper earnings limit (UEL).

Using weekly figures for 2011/12, the ET is £139 for the employee and £136 for the employer. The UEL is £817. The employee pays 12.0% on this income between these thresholds, and at 2% on earnings above the UEL. The employer pays 13.8% on all earnings above the ET. (The 13.8% and 12.0% rates may be reduced a little if the employee is in a contracted out occupational pension scheme.)

In terms of earning a **benefit,** the threshold is the lower earnings limit. This is the threshold at which an employee starts to built up a national insurance record. It is also the threshold for many other benefits including statutory sick pay and statutory maternity pay.

For the purposes of State Second Pension only, the amount paid up to the upper accruals point determines how much entitlement has been earned. All class 1 paid above the UAP is pure taxation as no additional benefit is earned.

Using weekly figures for 2011/12, the LEL is £102, and the UAP is £770.

This means that an employee earning between £102 and £139 a week pays no national insurance but is regarded as having made a national insurance contribution.

Note that national insurance is **non-aggregative.** That means you do not add up different sources. If you earn £240 a week in a part-time job, you will pay national insurance. If you earn £120 a week in each of two part-time jobs, you pay no national insurance as they are each below the earnings threshold.

Also, national insurance is **non-cumulative.** Under the PAYE system for income tax, if you have little or no earnings one week, you may get a tax rebate or reduction in a later week. That does not happen for national insurance. Every week or pay period is considered separately.

Earnings period

The example above uses figures for a weekly paid employee, as is traditional for national insurance.

Where an employee is paid monthly or at a different interval, the figures are proportionately increased:

NI threshold	Weekly	Monthly	Annual
Upper earnings limit	£817	£3,540	£42,475
Upper accruals point	£770	£3,337	£40,040
Earnings threshold (employee)	£139	£602	£7,225
Earnings threshold (employer)	£136	£589	£7,072
Lower earnings limit	£102	£442	£5,304

Where someone is paid at another interval, such as every four weeks or every three months, the appropriate threshold above is multiplied up.

If someone is paid for irregular periods, such as per voyage or per project, the thresholds are calculated as one seventh of the weekly rate for each day of the pay period.

Someone may be paid in different series of pay periods, such as a sales representative receiving a monthly salary, quarterly commission and an annual bonus. The rule is that all contributions are assessed on the shortest period, except that HMRC may direct a longer period.

A **director** always has an annual earnings period.

The earnings period depends entirely on when the person is paid, by reference to the same PAYE calendar as used for income tax.

Some miscellaneous points

National insurance is recorded for each contributor by reference to a **national insurance number.** This takes the form of two letters, six digits and a final letter in the form:

AB 12 34 56 C

This is issued automatically for most contributors when they are 15. Other contributors must apply. This number is used for many other purposes; it is really a national identification number.

The employer determines the correct rate of national insurance by reference to a **contribution letter.** This is a single letter of which A is by far the most common.

Some married women and widows could elect to pay a **reduced rate** of national insurance up to 1977, and receive less social security entitlement. That right has long since been removed, but women who had made the election are allowed to keep it. There are believed now to be fewer than 3,000.

Someone who has two or more employments whose combined earnings would exceed the **upper earnings limit,** may either claim a rebate or apply for deferment.

Under EU law, someone only pays national insurance or its equivalent in one member state at a time. Broadly, someone already employed who works **overseas** remains in the UK system for two years, possibly longer. If someone leaves the UK to start a new job, they become liable for the foreign equivalent immediately. This is a sweeping summary of complex provisions to which there are many exceptions and special provisions in treaties. Someone in this position is advised to get professional advice.

An **appeal** on a national insurance matter may be made as for other taxes.

There are duties to keep **records** and the usual range of penalties for non-compliance.