

THE BASICS OF NATIONAL INSURANCE FOR EMPLOYEES & EMPLOYERS (INCLUDING COMPANY DIRECTORS)

Class 1

A two-part payment by both the employee and employer, the contributions are based on a percentage of earnings including most benefits. The employees' contributions are deducted from wages and salaries together with PAYE deductions, but are not allowable against income tax. The employer's contribution is eligible for tax relief.

The principal difference between 'earnings' for national insurance contribution purposes and 'pay' for income tax purposes is that for NI there is no deduction in respect of contributions to a pension scheme. Earnings include:

- commissions
- salaries
- bonuses
- certain benefits in kind

The following items are specifically excluded:

- reimbursed business expenses actually incurred by the employee, and for which a proper receipt is available
- redundancy payments
- use of employer-owned or leased assets, e.g. houses
- medical insurance (e.g. BUPA) arranged by the employer

Class 1 national insurance contributions are payable for 2011/12 are follows:

Payment Period	Weekly	Monthly	Yearly
Employees	£	£	£
Nil on first	102	442	5,304
*0% on next	37	160	1,921
12% on next	678	2,938	35,250
2% on anything over	817	3,540	42,475
Employers			
Nil on first	136	589	7,072
13.8% on balance		(no upper limit)	

Current rates can be found at: <http://www.hmrc.gov.uk/rates/nic.htm>

*Earnings between the lower earnings limit and the earnings threshold protect an entitlement to basic state pension and other contributory benefits without incurring any actual national insurance liability.

There are lower rates for employees who are part of a company pension scheme which is contracted out of the state scheme – details on request.

Class 1A

Special rules, and a special class of NICs, apply to benefits in kind. Class 1A contributions are payable by employers only. These contributions apply to those taxable benefits which do not attract Class 1 contributions in respect of 'P11D employees'. (employees earning £8,500 or more per annum (including benefits) and directors).

The charge is worked out on an annual basis using the cash equivalent of the benefit (as for income tax). The amount of Class 1A contributions is calculated by using information recorded on Forms P11D and applying the Class 1 employers' contribution rate for the relevant year (13.8% for 2011/12)

Once the amount of Class 1A contributions has been calculated it must be declared using form P11D(b). This form, and the related payment, must be received by the Inland Revenue by 19 July following the end of the tax year to which it relates. In most cases special Class 1A payslip will be sent to relevant employers in the first week of April.

Dividends instead of salary

For shareholders in a company you should consider paying dividends rather than salary. Where directors are in receipt of a salary from a company, the NIC cost may be such that part of the payment could be more cost effectively made as a dividend. There are special rules for some companies providing personal services (IR35).

To save NICs:

- Pay employers contributions towards pension schemes (providing employer contracts with the insurance company)
- Seek advice on the possibility of disincorporation and trading as a sole trader or partnership
- Pay less by way of regular salary, but pay a bonus to reduce employees' NICs (does not affect directors), but note there is no cap on employers' contributions
- Pay dividends as part of a company package
- Consider child care provision
- Pay earnings in the range which attracts national contributions only to protect entitlement to state benefits

Actions unlikely to save NICs:

- Giving employees benefits in kind, except for 'non P11D' employees
- Round sum allowances - any profit element will attract NIC
- Employees contributions to pension schemes

Please call us if you would like further help or information on this subject.

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