Simmers & Co
Chartered Accountants

Albany Chambers
Albany Street
Oban
Argyll PA34 4AL

Phone: 01631 562169
Fax: 01631 565959
Email: mail@simmers.co.uk
Web: www.simmers.co.uk

PARTNERS
David A McGregor
Jacqueline M Hoey

CONSULTANTS
David WT Hodge
Jack Tollan

National Insurance

National insurance contributions (NICs) are essentially a tax on earned income. The NICs regime divides income into different classes: Class 1 contributions are payable on earnings from employment, while the profits of the self-employed are liable to Class 2 and 4 contributions.

National insurance is often overlooked yet it is the largest source of government revenue after income tax.

We highlight below the areas you need to consider and identify some of the potential problems. Please contact us for further specific advice.

Scope of NICs

Employees

Employees are liable to pay Class 1 NIC on their earnings. In addition a further secondary contribution is due from the employer.

For 2014/15 employee contributions are only due when earnings exceed a 'primary threshold' of £153 per week. The amount payable is 12% of the earnings above £153 up to earnings of £805 a week. In addition there is a further 2% charge on weekly earnings above £805.

Secondary contributions are due from the employer of 13.8% of earnings above the 'secondary threshold' of £153 per week for 2014/15. There is no upper limit on the employer's payments.

Benefits in kind

Employers providing benefits such as company cars for employees have a further NIC liability under Class 1A. Contributions are payable on the amount charged to income tax as a taxable benefit.

Most benefits are subject to employer's NI. The current rate of Class 1A is the same as the employer's secondary contribution rate of 13.8% for benefits provided for 2014/15.

The self-employed

NICs are due from the self-employed as follows:

- flat rate contribution (Class 2)
- variable amount based on the taxable profits of the business (Class 4).

Class 2 contributions are currently paid by direct debit at a rate of £2.75 per week from April 2014. Class 4 contributions are collected with the income tax liability payable on the profits of the business.

For 2014/15 Class 4 is payable at 9% on profits between £7,956 and £41,865. In addition there is a further 2% on profits above £41,865.

Voluntary contributions

Flat rate voluntary contributions are payable under Class 3 of £13.90 per week 2014/15. They give an entitlement to basic retirement pension and may be paid by someone not liable for other contributions in order to maintain a full NICs record.

National Insurance - £2,000 employment allowance

The Government has introduced an allowance of up to £2,000 per year for many employers to be offset against their employer Class 1 National Insurance Contributions (NIC) liability from 6 April 2014.

There will be some exceptions for employer Class 1 liabilities including liabilities arising from:

- a person who is employed (wholly or partly) for purposes connected with the employer's personal, family or household affairs
- the carrying out of functions either wholly or mainly of a public nature (unless charitable status applies), for example NHS services and General Practitioner services
- employer contributions deemed to arise under IR35 for personal service companies.

There are also rules to limit the employment allowance to a total of £2,000 where there are 'connected' employers. For example, two companies are connected with each other if one company controls the other company.

The allowance is limited to the employer Class 1 NIC liability if that is less than £2,000.

The allowance will be claimed as part of the normal payroll process. The employer's payment of PAYE and NIC will be reduced each month to the extent it includes an employer Class 1 NIC liability until the £2,000 limit has been reached.

Employer NIC for the under 21s

From April 2015 the Government will abolish employer NIC for those under the age of 21. This exemption will not apply to those earning more than the Upper Earnings Limit, which is expected to be £42,285 per annum for 2015/16. Employer NIC will be liable as normal beyond this limit.

Class 3A Voluntary National Insurance

From October 2015 a new class of voluntary NIC (Class 3A) will be introduced that gives those who reach State Pension age before 6 April 2016 an opportunity to boost their Additional State Pension.

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The Government expects that Class 3A will give pensioners an option to top up their pension in a way that will protect them from inflation and offer protection to surviving spouses. In particular, it could help women, and those who have been self-employed, who tend to have low Additional Pension entitlement.

Potential problems

Time of payment of contributions

Class 1 contributions are payable at the same time as PAYE ie monthly. Class 1A contributions are not due until 19 July after the tax year in which the benefits were provided.

It is therefore important to distinguish between earnings and benefits.

Earnings

Class 1 earnings will not always be the same as those for income tax. Earnings for NI purposes include:

- salaries and wages
- bonuses, commissions and fees
- holiday pay
- certain termination payments.

Problems may be encountered in relation to the treatment of:

- expense payments
- benefits.

Expense payments will generally be outside the scope of NI where they are specific payments in relation to identifiable business expenses. Round sum allowances give rise to a NI liability.

In general benefits are not liable to Class 1 NICs. There are however some important exceptions including:

- most vouchers
- stocks and shares
- other assets which can be readily converted into cash
- the payment of an employee's liability by an employer.

Directors

Directors are employees and must pay Class 1 NICs. However directorships can give rise to specific NIC problems. For example:

- directors may have more than one directorship
- fees and bonuses are subject to NICs when they are voted or paid whichever is the earlier
- directors' loan accounts where overdrawn can give rise to a NIC liability.

We can advise on the position in any specific circumstances.

Employed or self-employed

The NICs liability for an employee is higher than for a self-employed individual with profits of an equivalent amount. Hence there is an incentive to claim to be self-employed rather than employed.

Are you employed or self-employed? How can you tell? In practice it can be a complex area and there may be some situations where the answer is not clear.

In general terms the existence of the following factors would tend to suggest employment rather than self-employment:

- the 'employer' is obliged to offer work and the 'employee' is obliged to accept it
- a 'master/servant' relationship exists
- the job performed is an integral part of the business
- there is no financial risk for the 'employee'.

It is important to seek professional advice at an early stage and in any case prior to obtaining a written ruling from HMRC.

If HMRC discover that someone has been wrongly treated as self-employed, they will re-categorise them as employed and are likely to seek to recover arrears of contributions from the employer.

Enforcement

HMRC carry out compliance visits an attempt to identify and collect arrears of NICs. They may ask to see the records supporting any payments made.

HMRC have the power to collect any additional NICs that may be due for both current and prior years. Any arrears may be subject to interest and penalties.

Please contact us for advice on NICs compliance and ways to minimise the effect of a HMRC visit.

How we can help

Whether you are an employer or employee, employed or self-employed, awareness of NICs matters is vital.

HMRC have wide enforcement powers and anti-avoidance legislation available to them. Consequently it is important to ensure that professional advice is sought so that all compliance matters are properly dealt with.

We would be delighted to advise on any compliance matters relevant to your own circumstances so please contact us.