Introduction

National Insurance (NI) is a system of compulsory contributions paid by employers and employed people (including company directors) and self-employed people.

Employed and self-employed individuals are liable for different types (or classes) of National Insurance Contributions (NICs), which qualify them for different types of state benefits such as the State Pension, Jobseeker's Allowance and Incapacity Benefit.

Subject to certain exceptions, most employees are liable for deduction of Class 1 Primary contributions from their earnings, and employers with employees who are liable for Class 1 NICs are required to pay Class 1 Secondary contributions. Employers' contributions are calculated and charged on the amount of their employees' pay and on any benefits in kind employees receive, such as company cars.

Some individuals (whether employed or self employed) also choose to pay voluntary Class 3 NICs, for example to protect their State Pension if they have not otherwise made sufficient contributions.

This factsheet provides a guide to employers' and employees' National Insurance (NI) and explains the NI process, how employees' NICs are calculated, which employees are exempt from paying NICs and how to assess the NICs due. It also covers how directors' NI is calculated, and explains employers' NICs, voluntary NI payments, the process for reclaiming over-payments of NI, and the NI Employment Allowance that employers can claim.

The National Insurance process for employers and employees

NICs must be paid by individuals to qualify them to receive various state benefits, which are paid to them when they are out of work or suffering long-term illness. The payment of NICs also qualifies an individual to receive the State Pension when they reach retirement age. However, it is necessary to build up a specific amount of 'qualifying years' contributions in order to qualify for the State Pension, so individuals can make voluntary Class 3 NIC payments if necessary to fill any gaps in their NI record.

HMRC tracks contribution records via NI numbers and provides an online NI checking facility to enable NI records to be checked to see if there are any gaps in contributions. More information about how to check an NI record is available at www.gov.uk/check-national-insurance-record.

Class 1 Primary NI is deducted by employers at source from employees' pay, and employers are responsible for paying it over to HM Revenue & Customs (HMRC), usually on a monthly basis, along with employers' Class 1 Secondary NI.
Class 1 contributions must be paid by the 19th day of the month after the employee was paid, except where payments are made electronically. In the latter case, contributions must be paid by the 22nd of the month. Any balance due on the preceding year’s contributions must be paid by 19 April (or 22 April where payments are made electronically). Failure to pay by the deadlines will result in interest being charged on the outstanding amount.

**How employees' National Insurance is calculated**

NICs paid by both employees and employers are calculated on the basis of an employee's gross earnings (before deduction of tax), and their 'Category Letter'.

Category Letters, which define the percentage rate of NIC deductions, are similar to tax codes as they relate to an individual's personal circumstances, and whether or not they are a member of a contracted-out pension scheme. There are various different Category Letters including those for individuals who are over the State Pension age and for married women or widows who are entitled to pay 'reduced rate' contributions.


There are also various NI thresholds in place, which impact on the calculation of NICs, and which are similar in principle to income tax bands because they set earnings limits on liability for payment of NI, and usually change in April each year.

For the tax year 2016/17 the Weekly Primary Threshold (PT) for employees is £155, meaning that anyone earning less than £155 per week does not have to pay any NI.

Most employees' NICs are deducted at 12% of their gross earnings between £155 (the PT) and £827 (the Upper Earnings Limit or UEL), and at 2% on any earnings above £827 per week.

**NIC exemptions**

Employers do not have to pay Class 1 Secondary NI contributions for employees aged 20 or under who earn less than the upper earnings limit which is £827 per week. However, employees under 21 have to pay normal Class 1 contributions.

Some employees are not liable for any NICs. These include:

- Employees who earn less than £155 per week in the 2016/17 tax year.

- Those aged 15 or under. It is the date on which the employee is paid that counts, rather than the date the wages were earned. So if work is done when a person is 15 but they are paid when they are 16, NICs are due.

- Those who have reached the State Pension age do not have to pay any NI even if they continue working, in which case they must show their employer proof of their age, for example a passport or birth certificate, and their employer must update their PAYE (Pay As You Earn) records and stop deducting NI from their employee's wages.
• If an employee has more than one job and pays the maximum amount of NI from one of these jobs, they may not need to pay contributions on the second job or in certain circumstances may be able to delay payment of Class 1 NI on their second job. The most they can pay in a year is the full rate of NI multiplied by the weekly upper earnings limit, over 53 weeks. Both employers must still pay employers' contributions for such employees. Go to [www.gov.uk/defer-national-insurance](http://www.gov.uk/defer-national-insurance) and [http://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-with-more-than-one-job](http://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-with-more-than-one-job) for more information.

For more information about what to do when an employee reaches State Pension age, go to [www.gov.uk/employee-reaches-state-pension-age](http://www.gov.uk/employee-reaches-state-pension-age).

**Assessing how much National Insurance is due to be paid by employees**

NICs are assessed based on gross pay, and while there are many potential payments that make up an employee's pay, some are liable for NI while others are exempt.

The following list is not exhaustive, but includes most types of payment that comprise gross pay and that must be included in calculations for NI liability purposes:

- Wages or salary before deduction of income tax.
- Arrears of pay, such as a backdated pay rise.
- Commission.
- Christmas, productivity and completion bonuses.
- Holiday pay (subject to certain exemptions), Statutory Sick Pay (SSP) and Statutory Maternity Pay (SMP).
- Payments made to company directors in anticipation of future earnings.
- Payment in alcohol where no UK duty has been paid.

Not included in gross pay are the following:

- Board and lodging provided free.
- Uniforms purchased for staff by an employer.
- Personal, unexpected gifts made to an employee.
- Redundancy, termination or in lieu of notice payments (though this may be chargeable if it is in the contract or if it is standard practice to pay it).
- Compensation awarded by an employment tribunal.

Special rules apply to mileage allowances that are paid when an employee uses their own vehicle for business purposes. If a mileage allowance that is higher than HMRC-approved mileage rates is paid to employees, the difference is liable for Class 1 NICs.
How company directors' National Insurance is calculated

Company directors are liable to pay NICs on the same basis as ordinary employees and must pay Class 1 Primary NICs provided they are aged 16 or over, under state retirement age and earning more than the primary threshold (£155 per week for 2016/17). However, the method of calculating contributions for company directors differs from that for normal employees, as directors’ contributions are assessed on an annual cumulative basis, including any bonuses or fees. However, contributions can still be paid on a weekly or monthly basis if directors are paid regularly.

For more information about the different methods of deducting directors' NICs, go to www.gov.uk/employee-directors.


Employers' National Insurance contributions

Employers that have employees who are liable to pay Class 1 Primary contributions must also pay Class 1 Secondary contributions based on the amount of their employees’ gross pay and Category Letter. Employers' NICs are also subject to thresholds but these differ slightly from the thresholds for employees.

For the tax year 2016/17, the Primary Threshold (PT) for employers' Class 1 Secondary contributions is £156 per week, and contributions must be paid at the rate of 13.8% of the employee’s gross pay. There is no Upper Earnings Limit (UEL) for Class 1 Secondary contributions.

In addition to Class 1 Secondary contributions on wages, employers must also pay Class 1A NICs on any ‘benefits in kind’ such as a company car or medical insurance they provide to employees or directors who earn more than £8,500 per year. Class 1A NICs are calculated at 13.8% of the cash equivalent of the benefits provided.

Class 1B NICs are also payable by certain employers who have entered into a Pay As You Earn (PAYE) Settlement Agreement with HMRC to account for tax on minor and irregular benefits and expenses. These include items that it would be impractical to value for tax and NI purposes, such as incidental travel costs. Where a PSA is agreed with HMRC, Class 1B NICs are paid by employers based on the value of the expenses or benefits plus the tax paid under the PSA, calculated at a rate of 13.8%. For details, go to www.gov.uk/paye-settlement-agreements.

Employment allowance

In April 2014 the Government introduced a £2,000 Employment Allowance for eligible employers to offset against their Class 1 NICs. Eligible employers include sole traders, firms or charities that pay Class 1 NICs on their employees' or directors' earnings.

The Employment Allowance is delivered through payroll software and the Real Time Information (RTI) system. In order to benefit, employers need to confirm their eligibility through their payroll process. The £2,000 will then be deducted from their NIC payments via the Pay As You Earn (PAYE) system through the course of the year.

From April 2016 Employment Allowance will rise to £3,000. However, it will not be available for companies that have only one employee who is the sole director.
Go to www.gov.uk/claim-employment-allowance for further information.

**National Insurance Holiday Scheme**

Eligible employers may be able to make a retrospective claim for an NIC payment holiday under a scheme that ran in certain parts of the UK from 2010 until 2013.

Under the NICs Holiday Scheme, proprietors of new firms in specific UK sectors and locations that started to trade between 22 June 2010 and 5 September 2013 could claim up to £5,000 as a deduction from the employers’ NICs they paid for the first ten employees they recruited.

Eligible employers are able to make a retrospective claim under the scheme until 4 September 2017 at the latest, depending on when their business started to trade and their employees commenced work.

More information about claiming under the scheme is available at www.gov.uk/regional-employer-nics-holiday-making-a-retrospective-claim.

**Payment of voluntary Class 3 NICs**

Class 3 NICs are flat-rate voluntary contributions that can be made by anyone who wishes to protect their entitlement to a State Pension or certain other long-term benefits but have not made sufficient contributions over the years, for example because they were out of work but not claiming state benefits that would have provided them with NI ‘credits’.

For the tax year 2016/17, Class 3 NICs are £14.10 per week.

**Claiming back overpaid NICs**

Where NICs are overpaid, for example when an employee reaches state retirement age but an employer mistakenly continues to deduct NI, it is possible for the employee to claim back the amount overpaid. HMRC will normally get in touch with the employee to initiate a refund where the overpayment is £54.50 or more. Otherwise, it will be necessary for the employee to write to HMRC at the end of the tax year, explaining the circumstances and including evidence such as P60 statements.

HMRC provides a tool to assist employees in claiming a refund of NICs, which is available at www.gov.uk/claim-national-insurance-refund.

**Hints and tips**

- All correspondence should include the correct NI numbers, as this is one of the most common mistakes encountered by HMRC.

- Under the Employment Allowance and the National Insurance Holiday Scheme employers can claim significant deductions from their employers’ NICs resulting in considerable cost savings.

- The final deadline for retrospective claims under the National Insurance Holiday Scheme is 4 September 2017, although actual final deadlines applicable to firms depend on the date they started to trade and when their employees commenced work.
Further information

To access hundreds of practical factsheets, market reports and small business guides, go to:
Website: www.scavenger.net

BIF 15 An Introduction to Tax, National Insurance and VAT
BIF 53 A Guide to Setting up and Running a Payroll System
BIF 483 A Guide to Tax Deadlines in 2016

Useful publications

'Tax and Tax Credit rates and thresholds for 2016-17'
HM Revenue & Customs (HMRC)

'Employer further guide to PAYE and NICs' (2016)
HMRC

Useful contacts

HM Revenue & Customs (HMRC) is the government department responsible for the collection of tax. It also provides information and advice to individuals and businesses.
Tel: 0300 200 3200 (Employers' helpline)
Website: www.gov.uk/government/organisations/hm-revenue-customs

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