

National insurance planning

Strictly speaking, national insurance is not a tax at all, but a compulsory insurance premium.

In the 100 years since national insurance was first introduced in 1911, it has evolved from the nature of insurance to that of tax. As a result of this part-evolved state, it has many curious provisions that offer scope for some legitimate tax planning.

AGE AND INCOME SOURCE

No-one pays national insurance once they have reached state retirement age.

This is currently 65 for men, and is slowly increasing from 60 to 66 for women. If you can defer assessable income to after this age, you avoid national insurance completely. By 2020, the age will be 66 for both men and women. We can advise you on when you reach your state retirement age.

National insurance is not payable on dividends, pensions or investment income. This means that it may be better to take an income from a company in the form of dividends rather than salary. Note that, following a case in 2009, this will usually not be effective for paying employees.

There are some other implications in paying dividends rather than salary, which we can explain.

MORE THAN ONE SOURCE

Unlike income tax, the exempt band applies to each employment. The earnings threshold is £139 from 6 April 2011. This is a significant increase from the £102 a week threshold in 2010/11. This means that significant savings can be made if extra income comes from a second and unrelated employer. If someone has three part-time jobs, each paying £120 a week, he will pay no national insurance. If he had one job paying £360, he would pay £26.52 a week.

For higher employed earners, care needs to be taken when earnings exceed the upper earnings limit. This is only £817 a week (£42,484 a year) from 6 April 2011. This is a reduction from £844 a week (£43,888 a year) compared to 2010/11.

Unlike income tax, the national insurance rate actually reduces on earnings above this limit. For 2011/12, the rates reduce from 12% to 2%. Last year the rates were 11% and 1% respectively.

This means that national insurance rates for the current and previous years are:

Tax year	No NI on earnings	Then NI at full	Full rate	Then rate reduces to
2010/11	£110	£844	11%	1%
2011/12	£139	£817	12%	2%

Workers on low incomes can benefit by having second employments below the threshold as these will avoid national insurance completely.

OVER THE TOP

Income tax is charged at progressively higher rates on each slice of additional income tax. National insurance does the opposite.

At an income of about £43,000, a person's income tax rate doubles from 20% to 40%. Their national insurance rate falls from 12% to 2%. But no one has to pay 12% on more than £678 a week. (That is £817 less £139.) If someone has income from two or more jobs, it is a simple matter to apply for 'deferment' of class 1 national insurance. This usually means that they pay no national insurance in the second employment.

Many people do not realise this, and thus pay too much national insurance.

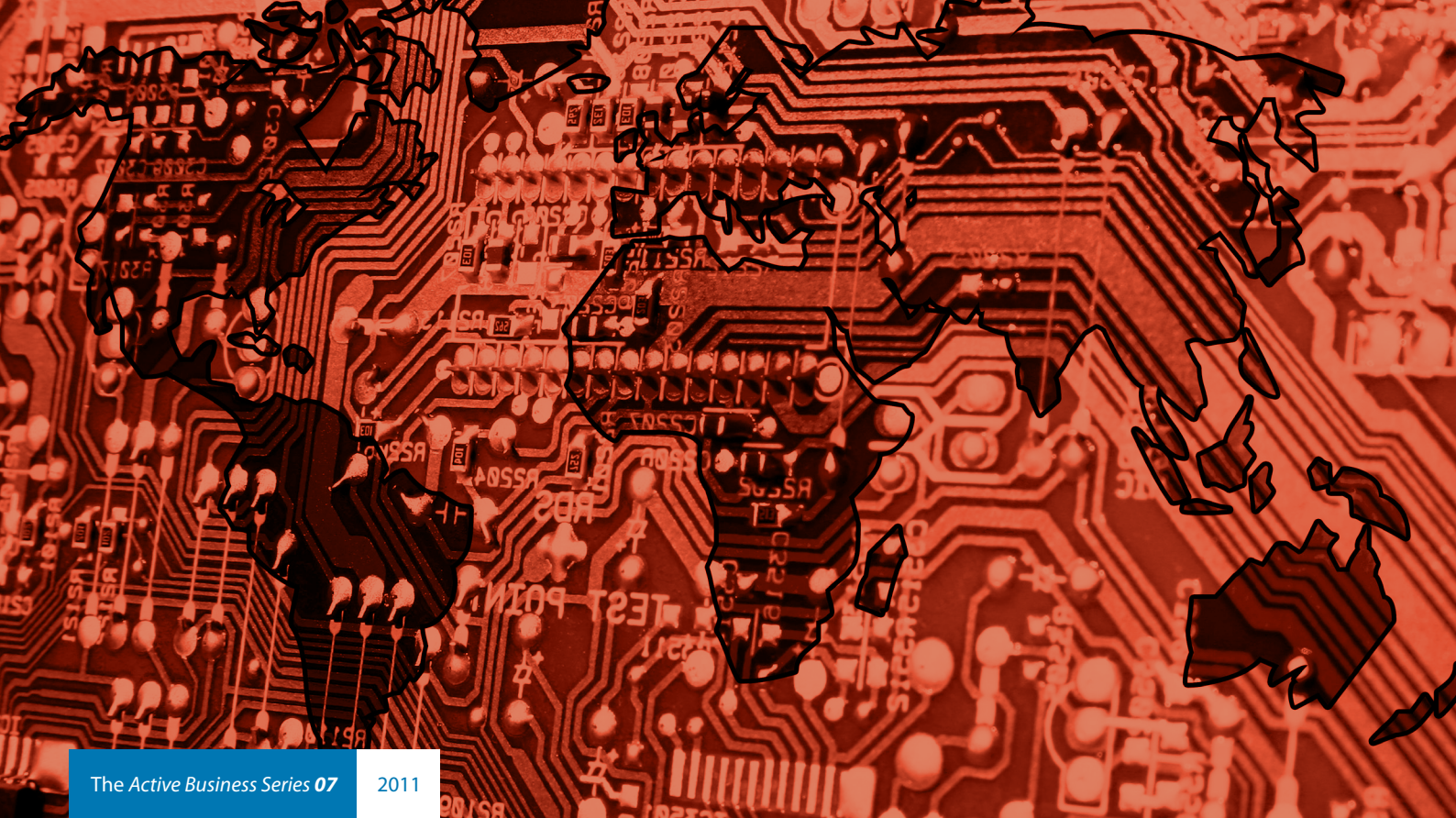
BENEFITS IN KIND

Employees can receive benefits in kind in addition to their pay in cash. Such benefits often include a company car, medical insurance, cheap loans, use of assets and similar.

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Most of these benefits are subject to income tax. However most non-cash benefits are not subject to class 1 national insurance. So if you provide £1,000 in cash, an employee may pay £200 in income tax and £120 in national insurance, leaving £680. If you provide £1,000 in benefit, the employee may pay £200 in tax and nothing in national insurance, leaving £800.

The employer will usually have to pay class 1A national insurance on such benefits. The rate is the same as employers' national insurance for class 1. So the cash benefit is to the employee only. The employer only gets a small cashflow advantage as class 1A (13.8%) is paid later than class 1.

Some benefits are free of national insurance and tax. These include weekly childcare vouchers, personal incidental expenses while away on business, and partnership shares in a share incentive plan. These benefits are of particular benefit to employees and employers.

Sometimes tax and national insurance can be saved by transferring cash salary to a tax-advantaged benefit in a salary sacrifice scheme. Note that such a scheme requires the contract of employment to be varied. We can ensure that any such scheme is properly implemented.

PENSION ENTITLEMENT

National insurance is not just a tax, it is also a contribution towards the state retirement pension.

In broad terms, you must have paid class 1, class 2 or class 3 contributions for 30 years to qualify for a full pension. It is advisable to fill in a pension entitlement form, available from the DWP website or from Jobcentres. This is a free service from the government, and tells you how much pension entitlement you have. It highlights any missing years in your national insurance record.

As a working life is now up to 49 years (16 to 65), some years can be missing without affecting the pension. However, there have recently been a succession of sad cases of people retiring and finding they do not get the state pension they expected. By then it is too late to do anything about it.

You can make up a shortfall by paying class 3 national insurance for up to six years ago. The rate for 2011/12 is £12.60 a week, or £655.20 a year. If you have less than 30 years' contributions, this is almost always worth doing.

If you know you will have insufficient contributions for the future, it is better to pay class 2 national insurance contributions by starting a little business, which need not make much profit. You then pay just £2.50 a week or £130 a year. This saves more than £500 a year. Class 2 also entitles you to some social security benefits that class 3 does not.

We can arrange a pension summary from the DWP for you, and can advise you on whether you need to make up your national insurance record, and, if so, how best to do it.

EARNINGS PERIODS

Unlike income tax, national insurance is calculated for an 'earnings period'. This can be for a whole year, like income tax, but is usually for a month or however frequently a person is paid.

Sometimes someone may have different earnings periods. A sales person may receive a monthly salary, quarterly commission and an annual bonus. In this case, the earnings period is usually the shortest period. This means that a large bonus in one month could put some of the income into the 2% band, whereas it would be taxed at 12% if spread evenly throughout the year. We can advise if this could work for you.

A similar effect can be achieved for statutory maternity pay. For the first six weeks, SMP is paid at 90% of weekly earnings, calculated as an average over an eight-week period. If an annual or quarterly bonus is paid in that eight-week period, the woman will receive additional SMP.