



# NATIONAL INSURANCE

You might not think of National Insurance as a tax – yet that is exactly what it is. The amount you pay is generally linked to what you earn, and your contributions fund much of the social security system

## NI CREDITS

You may receive NI 'credits', which can help you qualify for certain contributory benefits, such as the basic state pension, if you're unemployed or unable to work through sickness, for example. Credits are usually given automatically, but you may have to apply. Home responsibilities protection also helps protect basic pension entitlement for people receiving child benefit for a child under 16, or regularly caring for a sick or disabled person. Caring for a child aged up to five or a sick or disabled person can qualify you for S2P, too. Ask your local social security office for details.

The majority of people who work pay National Insurance contributions (NICs). The type, or 'class', of NIC you pay depends on your employment status. Some social security benefits, including the basic state pension, are available only to people who have paid or been credited with enough NI contributions. Such benefits are known as contributory benefits.

## IF YOU'RE AN EMPLOYEE

Employees pay Class 1 NICs on wages, salaries, commission, profit-related pay and overtime, as well as on sick pay and maternity, paternity and adoption pay from an employer. You don't pay NI on fringe benefits or most expense payments. NI is worked out on your gross earnings, before deducting income tax, pension payments or donations to charity under a payroll-giving scheme. You do not pay NI if you're under 16 or once you're over state pension age.

### How much employees pay

Employees pay a percentage of earnings between a minimum and maximum figure known as the earnings threshold and the upper earnings limit (UEL). The earnings threshold is the same as the income tax personal allowance. In 2004-2005 it was £91 a week (£4,745 a year), and in 2005-2006 it rose to £94 a week (£4,895 a year). The UEL was £610 a week (£31,720 a year) in 2004-2005, and is now £630 a week (£32,760 a year) for 2005-2006.

The rate you pay on earnings between the earnings threshold and the UEL is currently 11 per cent. You also pay 1 per cent on any earnings above the UEL.

If your earnings are below the earnings threshold, you pay no NI. But you still build up rights to benefits provided you earn over a certain level, known as the lower earnings limit. This was £79 a week (£4,108 a year) in 2004-2005, and in 2005-2006 it's £82 a week (£4,264 a year).

If you are in an employer's pension scheme that is contracted out of the state second pension (S2P), you pay lower NICs of 9.4 per cent between the earnings threshold and UEL, and 1 per cent on earnings above it. But if you contracted out independently of your employer your NICs remain at 11 per cent (and 1 per cent above the UEL), though part of what you pay will be rebated directly into your own personal or stakeholder pension arrangement. In most cases, you build up no entitlement to S2P for any years in which you're contracted out.

## IF YOU'RE AN EMPLOYER

In the 2005-2006 tax year, employers pay NICs at 12.8 per cent on all their employees' earnings over the earnings threshold and on the value of most fringe benefits, too. There is no UEL on employers' contributions.

## IF YOU'RE SELF-EMPLOYED

People who are self-employed pay Class 2 contributions unless their profits are less than a certain limit. In 2005-2006 this is £4,345 a year (up from £4,215 in 2004-2005). Below this, the self-employed can elect not to pay, but for any year they don't pay, they build up no entitlement to benefits. Class 2 contributions are £2.10 a week (up from £2.05 a week in 2004-2005).

## CLASS 1 NICS 2005-2006

Levels and rates	Amounts
Lower earnings limit (level of earnings at which you start to build up entitlement to benefits)	£82 a week (£4,264 a year)
Earnings threshold (level of earnings at which NICs become due)	£94 a week (£4,895 a year)
Upper earnings limit	£630 a week (£32,760 a year)
Rate paid if employer's pension scheme is contracted in to S2P	Employee pays 11% of earnings between £94 and £630 per week and 1% of earnings above £630 per week
Rate if employer's pension scheme is contracted out	Employee pays 9.4% of earnings between £94 and £630 per week and 1% of earnings above £630 per week
Rate if paying married woman's option	Employee pays 4.85% of earnings between £94 and £630 per week and 1% of earnings above £630 per week

Once their profits reach a certain limit, the self-employed must also pay Class 4 NI. In 2005-2006 this is 8 per cent of taxable profits between £4,895 and £32,760, and 1 per cent of any profits above that (8 per cent of taxable profits between £4,745 and £31,720, and 1 per cent of any additional profits in 2004-2005).

### VOLUNTARY CLASS 3 NICS

These help you qualify for basic retirement pension and bereavement benefits if: you're not working; you're not liable for, or you're exempt from, Class 1 or Class 2 NI; your contributions for a particular year aren't enough to count towards state pension entitlement; or you live abroad. The 2005-2006 rate is £7.35 a week (£7.15 a week in 2004-2005). If you're self-employed and exempt from Class 2 contributions, it is cheaper to pay Class 2 NI contributions than Class 3.

### WHAT NICS BUY

Employees pay Class 1 NICs, which entitle them to the following contributory benefits: basic state retirement pension, S2P (unless contracted out), contribution-based jobseeker's allowance, incapacity benefit and some bereavement benefits. To receive the full basic pension, you've got to pay, or be credited with, NICs for 90 per cent of your 'working life' (49 years for men, currently 44 years for women). Full-rate Class 1 NICs also pay for S2P – see 'Tax and your pension', p44.

To be eligible for contribution-based jobseeker's allowance (JSA), you must have paid, or been credited with, at least two years' NICs. Contributory JSA is payable for up to six months and is taxable.

Incapacity benefit pays out in the event of physical or mental illness. The contribution conditions are broadly similar to those for JSA. If you started claiming incapacity benefit after April 2001 and you're receiving an employer's or personal pension, your benefit will be reduced by 50p for every £1 of pension over £85 a week.

Your entitlement to bereavement benefits depends on the NI record of your spouse. Bereavement allowance is paid for a year after death provided that you are aged between 45 and state pension age and not caring for dependent children. A one-off bereavement payment of £2,000 is also available but only if your late spouse wasn't entitled to the basic state pension or you were under the state pension age when they died. Widowed parent's allowance is paid from the time of death while the surviving spouse is pregnant or caring for dependent children.

Class 2 NICs, paid by the self-employed, entitle you to incapacity and bereavement benefits and basic state pension but not S2P or contribution-based jobseeker's allowance. Class 4 NICs don't entitle you to any additional state benefits. ■

### MARRIED WOMEN

Before 11 May 1977, married or widowed women could either opt to be exempt from Class 2 contributions or pay a lower Class 1 rate. Even after the right to take the married woman's option was withdrawn, those women who had chosen this option were allowed to continue.

This lower rate for 2005-2006 is 4.85 per cent of earnings between the primary threshold and

UEL, and 1 per cent above the UEL.

Paying the married woman's option means that the wife or widow doesn't build up a basic state pension in her own right and is not eligible for other contributory state benefits. Instead, she is entitled to a state pension of 60 per cent of her husband's entitlement based on his contribution record.

Around 66,000 women currently pay reduced contributions.

### MORE HELP

#### Inland Revenue booklets

- CA01 NI for employees
  - CA02 NI for self-employed people with small earnings
  - CA08 Voluntary NI contributions
  - CA13 National Insurance contributions for women with reduced elections (Married Woman's Option)
  - CWL2 National Insurance for self-employed people
- #### Inland Revenue helpsheet
- IR220 More than one business