

National Insurance

National Insurance contributions take a big slice of your income. Read on to see what you pay and what you get in return

Forget romantic notions of stamps on cards...National Insurance is just another income tax. The amount you (and any employer) pay is generally linked to what you earn. Your earnings are used to pay the costs of the social security system; in return you build up an entitlement to benefits. However, the benefits you get depend on whether you're employed, self-employed or making voluntary contributions. See our 'Benefit entitlement at a glance' table, overleaf.

WHO PAYS THEM

Most people who work pay National Insurance contributions (NICs). The type, or class, you pay depends on your employment status. Employed people have to pay one type of contribution, known as class 1. If you're self-employed, you'll probably have to pay class 2 and possibly class 4 as well. Class 3 contributions are those that you can pay voluntarily.

You don't have to pay National Insurance if you're aged under 16 or over the state pension age. You also don't have to pay it if you earn below a certain amount – see 'How much you pay', overleaf. This applies whether you're employed or self-employed.

EMPLOYERS

Employers also have to pay National Insurance on behalf of their employees. In the 2006-2007 tax year, they pay contributions at 12.8 per cent on all their employees' earnings over the earnings threshold (less if the employee is contracted out). They also pay contributions on the value of most fringe benefits. There is no upper earnings limit on employers' contributions.

PROTECTING YOUR BENEFITS

There will be gaps in your contributions record if you don't pay National Insurance. But in many circumstances you'll be 'credited' with contributions. NI credits can help you qualify for certain contributory benefits, such as basic state pension, if you're unemployed or unable to work through sickness, say. You usually get them automatically, provided that you're drawing some kind of benefit.

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 or a foster child.

WHAT YOUR CONTRIBUTIONS BUY

Entitlement to some benefits depends on the National Insurance contributions you've made

Some social security benefits, including the basic state pension, are available only to people who have paid, or been credited with, enough contributions (see 'Protecting your benefits', above).

Remember that different classes of National Insurance buy different benefits – see 'Benefit entitlement at a glance', overleaf.

BENEFITS ELIGIBILITY

Full basic pension To receive the full basic pension, you have to have paid, or been credited with, contributions for 90 per cent of your 'working life' (49 years for men, currently 44 years for women).

Contributory jobseeker's allowance

This is payable for up to six months and is taxable. Contribution conditions apply – check with your local JobCentre Plus (see phone book) or contact www.jobcentreplus.gov.uk.

Incapacity benefit This pays out in the event of physical or mental illness. Contribution conditions are broadly similar to those for jobseeker's allowance. If you started claiming after April 2001 and you receive an employer's or personal pension or payments from an income protection policy, the amount of benefit is reduced by 50p for each £1 of pension over £85 a week.

Bereavement benefits Entitlement is based on the NI record of your spouse (most will qualify). A one-off payment of £2,000 is available but only if your late spouse wasn't entitled to the basic state pension or you were under 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. It stops early if you remarry or cohabit. Where you have no dependants, bereavement allowance is paid for a year after death to those aged between 45 and state pension age. It stops early if you remarry, cohabit or reach state pension age.

HOW MUCH YOU PAY

The type of National Insurance you pay depends on your employment status

CLASS 1 (EMPLOYED)

You pay class 1 contributions on your salary or wage, commission, profit-related pay and overtime, as well as on sick pay and maternity, paternity and adoption pay from an employer. NI is calculated on gross earnings before deducting income tax, payments to pensions or charity donations under a payroll-giving scheme.

You pay a percentage of your earnings between a minimum and maximum figure, known as the earnings threshold and the upper earnings limit (UEL). You also pay a percentage of any earnings above the UEL. (The earnings threshold is the same as the personal allowance.) If your earnings are below the earnings threshold, you pay no contributions but still build up rights to benefits provided you earn over a certain level, the lower earnings limit. See table, right, for details.

CLASS 2 (SELF-EMPLOYED)

If you're self-employed you pay class 2 contributions unless your profits are less than a certain limit – £4,465 for 2006-2007 (£4,345 in 2005-2006). Below this, you can elect not to pay, but for any year you don't, you build up no benefit entitlement. Contributions are £2.10 a week for 2006-2007 (£2.10 in 2005-2006).

CLASS 3 (VOLUNTARY)

You can pay these only if: you're not working; you're not liable for, or you're exempt from, class 1 or class 2 NICs; your contributions for a specific year aren't enough to count towards state pension entitlement; or you live abroad. The 2006-2007 rate is £7.55 a week (£7.35 in 2005-2006). If you're self-employed and exempt from class 2 contributions, it is cheaper to pay class 2 NI contributions than class 3.

CLASS 4 (SELF-EMPLOYED)

If you're self-employed, you must also pay class 4 NI once your profits reach a certain limit. In 2006-2007 class 4 contributions are 8 per cent of taxable profits between £5,035 and £33,540 (£4,895 and £32,760 in 2005-2006), and 1 per cent of profits above that.

CLASS 1 NICs 2006-2007 AT A GLANCE

Levels and rates	Amounts
Lower earnings limit (level of earnings at which you start to build up entitlement to benefits)	£84 a week (£4,368 a year)
Earnings threshold (level of earnings at which NICs become due)	£97 a week (£5,035 a year)
Upper earnings limit	£645 a week (£33,540 a year)
Rate paid if employer's pension scheme is contracted out of S2P	Employee pays 9.4% of earnings between £97 and £645 a week and 1% of earnings above £645 a week
Rate if employer's pension scheme is contracted into S2P or employee has contracted out independently	Employee pays 11% of earnings between £97 and £645 a week and 1% of earnings above £645 per week
Rate if paying married woman's option – see below	Employee pays 4.85% of earnings between £97 and £645 a week and 1% of earnings above

MARRIED WOMAN'S OPTION

Until 11 May 1977, married or widowed women could either opt out of paying class 2 NICs or pay a lower class 1 rate – 4.85 per cent of earnings between the earnings threshold and upper earnings limit and 1 per cent above, for 2006-2007. Women who took up the option have been allowed to continue with it.

The married woman's option means women do not build up a basic state pension in their own right and are not eligible for other contributory state benefits. Their state pension is 60 per cent of the husband's entitlement.

BENEFIT ENTITLEMENT AT A GLANCE

If you pay...	You are building up entitlement to...
Class 1 contributions (employees)	Basic state pension; state second pension (S2P); private pension if contracted out Contribution-based jobseeker's allowance Incapacity benefit; bereavement benefits for spouse/civil partner
Class 2 contributions (self-employed)	Basic state pension Incapacity benefit; bereavement benefits for spouse/civil partner
Class 3 contributions (voluntary)	Basic state pension Bereavement benefits for spouse/civil partner
Class 4 contributions (self-employed)	No benefits but self-employed people must pay them once their taxable profits exceed a set level – see 'Class 4', above

MORE HELP

HMRC booklets

- CA13 National Insurance contributions for women with reduced elections (Married Woman's Option)
- CA5603 To pay voluntary NI contributions
- CF10 Self-employed people with small earnings

HMRC helpsheet

- IR220 More than one business