

National Insurance and Tax differences (Lecture B1418 – 17.39 minutes)

In the month where primary NICs are being reduced by 2% from 12% to 10% but income tax remains the same, it would seem appropriate to revisit the practical differences between National Insurance and Tax.

Many years ago, I collaborated with specialists who had trained with the contributions agency before it was merged into the Inland Revenue (as it then was). They would always stress how different the NIC system was from income tax. Even today, a quarter of a century after the disappearance of the Contributions Agency, tax and national insurance remain substantially different. This article reminds practitioners of some of the important differences.

The first difference is that contributions into the NI system give you potential benefits. Most notable of these is the State Pension where one needs 35 years of contributions or credits to obtain a full State Pension and a minimum of 10 years to achieve any pension at all.

There are also some other contribution related benefits which are listed below:

- Maternity Allowance
- Contribution-based/New Style Jobseeker's Allowance (JSA)
- Contribution-based/New Style Employment and Support Allowance (ESA)
- Bereavement Benefits
- Basic State Pension
- New State Pension

Where people have made voluntary contributions to uphold their entitlements may be disgruntled if the contributions make no difference to their entitlements.

The second important difference which is exemplified by the mid-year change in NI contributions, is that earnings are normally assessed on the payment frequency i.e. weekly, monthly or for Directors annually.

Both the primary threshold below which contributions are not required and the Upper Earnings Limit beyond which contributions fall to 2% are (with the exception of directors and the annually paid) assessed on a weekly or monthly basis.

This is the second year in which the rates have changed. In November 2022 they changed for both primary and secondary NI with a reduction of 1.25%. On the 6th of January 2024, the primary contribution rate changed from 12 to 10%.

National Insurance is levied on a UK wide basis. Unlike income tax, the devolved governments of Wales and Scotland have no powers to change NIC. This is a particularly acute issue in Scotland where the 42% band starts at £43,663; well below the upper earnings limit at £50,270 and therefore creates an effective marginal rate of 53%, which falls to 51% from January 2024.

National Insurance is levied on earnings although this definition has been widened over the years. However, there remain many elements of income such as interest, dividends, rents on which no national insurance is borne. In terms of employment related securities, although income tax is normally levied on any gains national insurance is only levied on gains on shares which are readily convertible assets. Broadly speaking, readily convertible assets are shares which can be traded on a recognised exchange or under arrangements which the employer sets up such as a trust which is set up to hold, buy and sell the shares.

Primary NICs is not due on benefits on kind. The employer pays Class 1A NIC on the P11D value, but the employee suffers no NIC charge. If the benefit is accounted for under a PAYE settlement agreement, the employer pays Class 1B NI contributions on the whole amount. Again, there is no liability on the employee.

Care needs to be taken because the way in which the benefit is procured affects whether there is a Class 1 primary and secondary NIC liability (employer and employee) rather than just an employer charge. If an employee is reimbursed for taxable expenses, or the employer settles the pecuniary liability incurred by the employee, then the reimbursement would be subject to PAYE and there would be both primary and secondary NI due.

There are some limited areas where NI is payable but there is an exemption from income tax. An area which is becoming more common is the bonus payments made by Employee Ownership Trusts (EOT's) which can be tax free up to the first £3,600 but are always subject to primary and secondary NIC.

The national insurance system has a number of incentives built into it as a result of government policies. The letters which appear as suffixes on codes offer a wide variety on NIC differential rates. These can be based on age, work carried out and previous employment.

For example, those above the State Pension Age are no longer required to make primary NIC contributions. The employer should substantiate this with a document that shows the employee's age. At the other end of the spectrum the employer may be relieved from secondary NIC if they employ young persons or apprentices. There is a one-year holiday from employer NIC if the employer takes on a recently discharged veteran from the armed forces. There is a whole list of these variations which affect either the primary or secondary liabilities. There are also reliefs from employer NI for recruitment in Freeport zones,

The self-employed pay different and lower rates of national insurance. These are however worked out on an annual basis, which is why the change to Class 4 NIC from 9% to 8% as well as the abolition of Class 2 contributions is not happening until the end of the tax year. The differential in the NI burden for the employed and self-employed was initially justified by the different levels of benefits that they could obtain. This differential has reduced but the NI advantages for the self-employed, but they remain very wide.

Last but not least to be considered, is the treatment of Internationally Mobile Employees. International tax issues are dealt with under double tax treaties. NIC is dealt with under social security agreements. They allow for international mobile employees to be subject to NIC/social security in only one jurisdiction. Under the Trade and Cooperation Agreement that the UK signed with the European Union, the UK remains effectively part of the European Social Security Agreement. This means that under certain conditions, individuals can become tax resident in the UK whilst remaining subject to social security contributions in their home country and vice versa.

The UK also has social security agreements with a number of other countries outside the European Economic Area. The most notable is the social security agreement with the United States which allows for an individual to remain in their home social security system for up to 5 years whilst paying tax in the country where they perform duties. This final point would be enough of itself to deter any merger of the income tax and NI systems. The countries which have signed social security agreements with the UK would not be satisfied if the advantage of the exemption from UK NIC was negated by its absorption into the income tax system.

In conclusion, tax and NIC's remain different in important aspects and a merger would make the current difficulties with Making Tax Digital seem small beer by comparison.

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