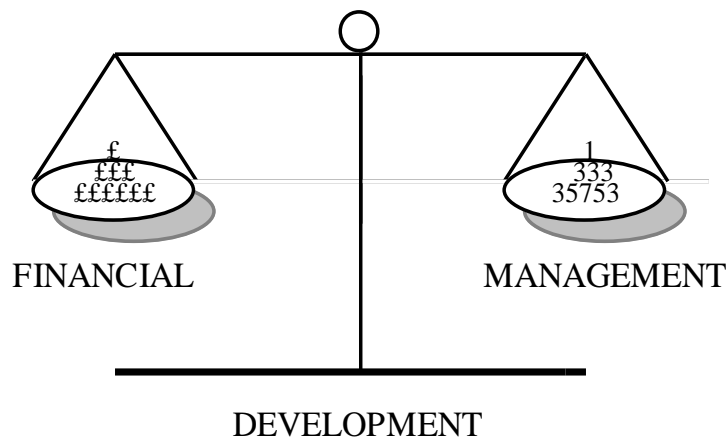


FINANCIAL MANAGEMENT DEVELOPMENT

Taxation

NO 414

NATIONAL INSURANCE



ONE OF A SERIES OF GUIDES FOR
FINANCIAL MANAGEMENT DEVELOPMENT

FROM

www.FinancialManagementDevelopment.com

This is one of a series of documents produced by David A Palmer as a guide for managers on specific financial topics to assist informed discussion. Readers should take appropriate advice before acting upon any of the issues raised.

NATIONAL INSURANCE

The National Insurance Scheme is basically an additional tax on earnings to cover state benefits. NI Contributions are collected by HMRC. Payment of National Insurance has an impact on the entitlement to benefits - particularly pensions.

There are four class of contribution:

CLASS 1	PRIMARY	-	This is earnings related and applies to employees.
	SECONDARY	-	This is earnings related and applies to employers.
CLASS 2	This is a flat rate paid by self-employed.		
CLASS 3	Payable voluntarily to increase benefits entitlement.		
CLASS 4	Payable by self-employed in respect of trading profits.		

National Insurance is payable by earners, employers and others and the legislation defines earners by stating that earnings includes any remuneration or profit derived from employment. Contrary to the HMRC Schedule E meaning, employment includes any trade, business or profession.

EMPLOYED VS. SELF-EMPLOYED

S.21 (1) (A) SS 1975 defines an employed earner as: "a person who is gainfully employed in Great Britain either under a contract of service, or in an office with emoluments chargeable to income tax under Schedule E".

S.2 (1) (b) SSA 1975 defines a self-employed earners as: "a person who is gainfully employed in Great Britain otherwise than in an employed earner's employment".

It is not necessary for someone to be assessed under Schedule E in order to be 'employed' if he is under a contract of service. It is crucial therefore to decide if an earner is under a contract of service whether or not such income is assessed under Schedule E.

A contract of service indicates an employment as contrasted with a contract for services which indicates self-employment.

This distinction between a contract of service (i.e. of employment) and a contract of services is of vital importance to the application of the social security legislation and is a distinction relevant to income tax.

Two main tests appear to have emerged in deciding the dividing line.

The degree of **control** will indicate the nature of the relationship. Obviously a contractor providing services will be controlled, to some extent, in that he must work to agreed specifications. However, if, as a question of fact, control extends over every aspect of the work including how, where, and when the job is performed this would indicate the existence of an employment.

A less obvious test is that of **integration**. If a person's work is integrated into the activities of the business and becomes an integral part of the business he is likely to be under a contract of service (i.e. employed). Integration is less likely to be established if the person uses his own equipment, employs others to assist in his work, and benefits from the exercise of good management of his activities or, conversely, bears the risk of loss.

In both of these broad categories of tests, the presence or absence of any single 'badge' of self-employment is not conclusive but has to be looked at in conjunction with the other factors.

EARNINGS LIABLE

Although both employed and self-employed "earnings" are liable the income derived is quite different and therefore the regulations differ.

CLASS 1 (Employed earners) earnings

This is the gross earnings from employment. No relief is given for employees' contributions to pension schemes or any necessary business expenses or personal allowances. Any cash payment is treated as gross pay. However, benefits in kind are not included so there is an advantage for both employer and employee in paying remuneration in kind rather than by salary even where the benefit is taxable under Schedule E.

CLASS 2 AND CLASS 4 (self-employed earners) earnings

A self-employed earner's earnings include all **profits** from their trade. However, the basis for determining the amount depends on whether the earnings fall into Class 2 or Class 4.

CLASS 2

Earnings are determined without regard to the normal tax adjustments to profits or the normal preceding year basis. Earnings is the accounting profit.

CLASS 4

These are defined as the profits chargeable under Schedule D Case 1 normally on the preceding year basis. Capital allowances are an allowable deduction, as are losses. In addition one half of the Class 4 contributions are allowed as a deduction for income tax.

For National Insurance purposes husband and wife are separate individuals.

CLASS 1

Class 1 contributions consists of primary contributions paid by the employed earners as a percentage of earnings and secondary contributions payable (usually) by the employer, again as a percentage of earnings. Contributions are not payable where earnings are below so much per week However, employees may be "contracted out" of the state scheme if their employers operate an approved pension scheme. The rates are then reduced. National Insurance Contributions are collected as part of the PAYE procedures.

For 2012 If earnings are more than £139 a week and up to £817 a week, the employee pays 12 per cent of the amount earned between £139 and £817, plus 2 per cent of earnings over £817. The employer pays 13.8% on weekly earnings above £136.01.

CLASS 2

Class 2 contributions are payable at a flat rate per week (2012 - £2.50) by self-employed earners. An exemption can be obtained if earnings are below an amount per year. (2012 - £5,315). Class 2 contributions are normally collected by direct debit, half on 31 January and half on 31 July with the income tax payments. Note self-employed earners may also have to pay Class 4 contributions.

CLASS 3

Class 3 contributions are voluntary and are normally paid to top up pension entitlement. For 2012 they are set at a flat rate of £12.60 a week.

CLASS 4

Class 4 contributions are payable on a % of profits assessable to income tax under Schedule D between a lower limit and an upper limit. This is paid to HMRC with the Schedule D income tax charge. For 2012 the rates are 9 per cent on profits between £7,225 and £42,475, and a further 2 per cent on profits over that amount

SPECIAL RATES

There are other rates that apply in certain cases. Examples of these are:
the married women's - and widows' - reduced rate
the special rate for share fishermen
the special rate for volunteer development workers

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David is an experienced financial professional who has devoted his skills to management training in practical understanding and utilisation of financial information. A Graduate, Chartered Accountant, and Associate of the Institute of Taxation, he is also a Member of the Chartered Institute of Personnel and Development and has been an Ordained as a Deacon in the Catholic Church.

He has worked as a Financial Controller and Company Secretary in the Finance industry and as a Director of Finance and Administration in the Computer Services industry. Since 1990 he has conducted management development programmes for over forty major organisations including Arla Foods, Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, Royal Mail, Unilever and Zeneca. He also runs programmes for the Leadership Foundation and the management teams at a number of Universities. International training experience includes work in Belgium and Holland for CSC, in Denmark, Kenya and the Czech Republic for Unilever, in Holland and the US for Zeneca, in Dubai for Al Atheer, in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. In addition he has run courses in acquisition evaluation (The Economist, Eversheds, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). All training is specifically tailored to the needs of the organisation with the emphasis on practical applications to enhance profitability and cashflow. He has developed material for delivery by in-house personnel (Royal Mail, Lloyds Bowmaker and Conoco), computer based training packages (The Post Office, Unilever and BP), and post course reinforcement self-study workbooks (CSC and Zeneca). He has also produced a training video on Cashflow Management.

He is a prolific writer of case studies, role plays and course material. He has also published articles on the financial justification of training, financial evaluation of IT investment proposals, the use of Activity Based Costing and Customer Profitability statements, commercial considerations for consultants, the need for taxation awareness training for general managers, evangelisation and Christian business ethics.

Many of his generic documents are freely available on his website:

FinancialManagementDevelopment.com including papers on Charity Management.

In addition to his Diaconal work in the Church, he has held a number of voluntary positions including University, College and School Governor, Hospice Treasurer and Trustee of various charitable institutions. He continues to provide ad hoc commercial advice to several other charitable organisations. He has been married for over 35 years and has one daughter and three granddaughters.

This series of papers is designed to help managers by providing a basic understanding of key financial concepts to assist them in their work. It is provided at no cost since this knowledge is a Gift from God and thus to be shared (Matthew 10:8).

(I wonder how God copes with disallowance of this cost in his Tax Computation?)