

CHAPTER 23

CLASSES 2 AND 4 NATIONAL INSURANCE

23.1 Introduction

Certain individuals are liable for Class 2 and Class 4 NICs. Persons **gainfully employed** in Great Britain **pay Class 1** National Insurance contributions. **Self employed** earners between 16 and the "pensionable age" **pay Classes 2 and 4 contributions**. Pensionable age is currently 65 for men, and 60 for women. Contributions arise where the individual has income chargeable to tax as Trading Income.

23.2 Class 2 Contributions

[SSCBA 1992, s. 11](#)

Class 2 National Insurance contributions are flat rate contributions, currently payable at **£2.40 per week**. Payment can be made either by a **monthly direct debit**, or by a **quarterly bill**.

No liability arises where earnings are **below the small earnings exception**. For 2010/11 the small earnings exception is **£5,075**. In order to apply the small earnings exception, the taxpayer must apply for a Certificate of Exception and must demonstrate that accounting profits are below the limit. Profits are apportioned to the appropriate tax year. It is not the Trading Income figure that we take in this case, but rather unusually it is the profit computed using **normal accounting principles** (i.e. after deducting depreciation etc). However, HMRC often accepts the taxpayer's Trading Income figure as shown on their self assessment tax return.

[SSCBA 1992, s. 11\(4\)](#)

If it turns out that Class 2 contributions have been paid unnecessarily (e.g. due to the earnings being smaller than the exception) **a refund is possible**. The taxpayer must **claim the refund by 31 December following the end of the contribution year**.

23.3 Class 4 Contributions

[SSCBA 1992, s. 15](#)

For 2010/11 Class 4 National Insurance contributions are payable at **8%** on profits **between £5,715 and £43,875**, with an **uncapped 1%** payable on profits **above £43,875**.

[SSCBA 1992, s. 15\(3\)](#)

For example:

	£
Class 4 NIC payable at 8%	
$£(43,875 - 5,715) \times 8\%$	3,052.80
Plus: additional amount at 1% if profits exceed the upper limit	
$£(\text{Profits} - 43,875) \times 1\%$	<u>X</u>
Total Class 4 NIC payable	<u>X</u>

"Profits" in this context is the Trading profits for the tax year.

Class 4 NICs are **payable with income tax under self assessment**, i.e. **payments on account** are due on the 31 January in the tax year and the 31 July following the tax year, based on the previous year's liability. A **balancing payment** is due on the 31 January following the end of the tax year.

[SSCBA 1992, s. 15\(2\)](#)

23.4 Class 4 Contributions and Losses

Losses are "negative earnings" for Class 4 NIC purposes. This is the case even if they have been **fully utilised for income tax purposes**, for instance where they have been claimed against other income under s.64 ITA 2007.

Losses used against non-trading income are **still available to be used for Class 4 NIC purposes**.

Illustration 1

In the year ended 31 March 2010, a trader made a trading loss of £16,000 and had other income of £10,000.

In the year ended 31 March 2011, the trader made trading profits of £30,000 and had other income of £5,000.

The trader submits a current year loss claim under S.64 ITA 2007. £10,000 of the loss will be set against the other income in 2009/10, reducing it to zero.

The trader will have losses to carry forward under S.83 ITA 2007 of £6,000.

Income tax computations:

	<i>2009/10</i>	<i>2010/11</i>
	£	£
Trading Income	Nil	30,000
Less: S.83 loss b/fwd		<u>(6,000)</u>
		24,000
Other income	<u>10,000</u>	<u>5,000</u>
Net Income	10,000	29,000
Less: S.64 current year loss	<u>(10,000)</u>	—
Revised Net Income	<u>Nil</u>	<u>29,000</u>

However, for 2010/11, the profits for Class 4 purposes will be £14,000 as the **full amount of the trading losses will be available against profits for Class 4 purposes**, even though only £6,000 will be available in 2010/11 for tax purposes.

We can **carry forward the full amount** where losses have been offset for income tax purposes against non-trading income.

	2010/11
	£
Trading Income	30,000
Full loss b/fwd	<u>(16,000)</u>
Profits chargeable to Class 4 NIC	<u>14,000</u>

Example 1

Calculate the Class 4 National Insurance due in the illustration above.

23.5 Annual Maxima

There is an "annual maxima" of contributions applying to any individual for a "contribution year". The contribution year is the same as the tax year. These "annual maxima" rules apply where the earner either has **two jobs** (and is therefore paying Class 1 NICs twice) or he is **both employed and self employed**.

Employees pay Class 1 NIC and the self-employed pay Classes 2 and 4. If an individual has substantial earnings and profits as both an employee and as a self employed individual, this could add up to a sizeable amount of NIC each year. Therefore there is a **maximum cap** which applies each year.

There are **2 tests**. "Test 1" compares Classes 1 and 2 and allows us to reclaim any excess of Class 2 (and then if appropriate any of the Class 1). "Test 2" may allow a refund of the Class 4 contributions.

The annual maxima rules are complex and difficult to remember. It is therefore important that you are familiar with where to locate these rules in the tax statutes. The annual maxima rules are contained in **Statutory Instrument 2001/1004 within the NIC section of the Tolley Yellow Handbooks**.

23.6 Test 1

[SI 2001/1004](#)
[Reg 21](#)

Test 1 applies when either the taxpayer has more than one employment, or has a self-employed trade as well as a job and is therefore paying both Class 1 and Class 2 contributions.

SI 2001/1004 contains a series of steps which we must follow to calculate the maximum NICs payable in the year. Although we will reproduce the various steps below, **we do not recommend that you try to learn them**. You should always answer a question on these annual maxima rules by referring to SI 2001/1004.

Step 1:	Calculate $53 \times (\text{UEL} - \text{PT})$	£ <u>£38,902</u>
	Where:	
	UEL is the weekly upper earnings limit for the year (£844 for 2010/11)	
	PT is the weekly primary threshold (£110 for 2010/11).	

Step 2:	Multiply the result of Step 1 by 11%	<u>£4,279.22</u>
Step 3:	For each of the employments, calculate the amount by which earnings exceed the primary threshold but do not exceed the upper earnings limit.	
Step 4:	Figure found by Step 3 Less: Figure found by Step 1	X <u>(X)</u> <u>X</u>
Step 5:	Step 4 figure x 1%. (If Step 4 is a negative number, this will be zero)	
Step 6:	For each of the employments, calculate the amount by which earnings exceed the upper earnings limit.	
Step 7:	Step 6 figure x 1%.	
Step 8:	Figure found by Step 2 Figure found by Step 5 Figure found by Step 7 ANNUAL MAXIMUM Less: Class 1 (primary) actually paid Less: Class 2 paid Refund due (Class 2 first)	X X <u>X</u> X (X) <u>(X)</u> <u>(X)</u>

Illustration 2

Alex is employed by a firm of solicitors for 2 days each week earning a salary of £663 per week (£34,476 p.a.). For the rest of the time he has his own sole practice and in 2010/11 his trading income was £21,000.

The NICs actually paid in 2010/11 are as below:

	£
Class 1 primary:	
$52 \times (663 - 110) \times 11\%$	3,163.16
Class 2:	
$52 \times £2.40$	124.80
Class 4:	
$£(21,000 - 5,715) \times 8\%$	1,222.80

The maximum Classes 1 and 2 National Insurance he is required to pay will be calculated as follows:

Step 1:	$53 \times £(844 - 110)$	£38,902
Step 2:	$£38,902 \times 11\%$	£4,279.22
Step 3:	$£(34,476 - 5,715)$	£28,761.00

Step 4:	Step 3	£
	Less: Step 1	28,761.00
		<u>(38,902.00)</u>
		<u>(10,141)</u>

As this is a negative figure, it can be assumed to be NIL

Step 5:	Not necessary as Step 4 is a negative number
Step 6:	Not necessary as no earnings exceed the upper earnings limit
Step 7:	Not necessary

Step 8:	Figure found by Step 2	£
	Figure found by Step 5	4,279.22
	Figure found by Step 7	Nil
	ANNUAL MAXIMUM	<u>Nil</u>
	Less: Class 1 (primary) actually paid	4,279.22
	Less: Class 2 paid	<u>(3,163.16)</u>
		<u>(124.80)</u>
		<u>£991.26</u>

As the actual NICs paid are less than the annual maximum, there is no NIC refund under Test 1. This is commonly the case where the taxpayer only has one employment.

Illustration 3

Steve has two jobs. He works for a publishing company for 3 days a week earning £900 per week (£46,800 pa). At weekends he works for a bookmaker and earns £250 per week (£13,000 pa).

The Class 1 primary NICs actually paid in 2010/11 are as below:

	£
Publishing job;	
52 x (844 - 110) x 11%	4,198.48
52 x (900 - 844) x 1%	29.12
Bookmakers job;	
52 x (250 - 110) x 11%	<u>800.80</u>
	<u>5,028.40</u>

The maximum Class 1 National Insurance he is required to pay will be calculated as follows:

Step 1:	53 x £(844 - 110)	<u>£38,902</u>
Step 2:	£38,902 x 11%	<u>£4,279.22</u>

£

Step 3:	£(43,875 - 5,715)	38,160
	£(13,000 - 5,715)	<u>7,285</u>
		<u>£45,445</u>
		£
Step 4:	Step 3	45,445
	Less: Step 1	<u>(38,902)</u>
		<u>6,543</u>
Step 5:	£6,543 x 1%	<u>£65.43</u>
Step 6:	£(46,800 - 43,875)	<u>£2,925</u>
Step 7:	£2,925 x 1%	<u>£29.25</u>
Step 8:		£
	Figure found by Step 2	4,279.22
	Figure found by Step 5	65.43
	Figure found by Step 7	<u>29.25</u>
	ANNUAL MAXIMUM	4,373.90
	Less: Class 1 primary actually paid (above)	<u>(5,028.40)</u>
	Refund due (Class 1)	<u>£(654.50)</u>

Employed earners who are contracted out of SERPS via an occupational pension scheme, only pay NICs at 9.4% on earnings between the limits (a 1.6% contracted out rebate is given on earnings between the limits).

However, for the purposes of the annual maxima test above, the rules assume that the employee had paid Class 1 NICs at the "contracted in" rate (i.e. at 11% between the limits). Therefore for a contracted out employee who is subject to the annual maxima test, a computation will be necessary to calculate the "notional" Class 1 primary NICs that would have been paid had the contracted out election not been made.

[SI 2001/1004](#)
[Reg 21\(3\)](#)

23.7 Test 2

[SI 2001/1004](#)
[Reg 100](#)

This second test applies when a taxpayer is **both employed and self-employed** and is therefore paying NICs under Classes 1, 2 & 4. The second annual maxima test may result in a refund of Class 4 contributions only.

The annual maxima computation here is extremely complex. Once again, a step-by-step approach is laid down in SI 2001/1004 at paragraph 100.

		£
Step 1:	£(Upper profit limit - lower profit limit)	<u>38,160</u>
Step 2:	Multiply the result of Step 1 by 8%	<u>3,052.80</u>
Step 3:	Figure found by Step 2	3,052.80
	Add: 53 x Class 2 NICs	<u>127.20</u>
		<u>3,180.00</u>
		£
Step 4:	Result from Step 3	3,180.00
	Less: Class 1 primary NICs paid at 11%	(X)
	Less: Class 2 NICs paid	<u>(X)</u>
		<u>X</u>

Once we have arrived at the Step 4 figure above, there are three possible outcomes.

Case 1: If Step 4 is a positive figure, we must compare it with the result of the following test:

	£
Class 1 NICs paid at 11%	X
Class 2 NICs paid	X
Class 4 NICs paid at 8%	<u>X</u>
"Comparative total"	<u>X</u>

If Step 4 exceeds the comparative total, then Step 4 is the maximum Class 4 NICs payable for the year. Any excess Class 4 contributions will be refunded.

Case 2: If Step 4 is a positive figure and is less than the comparative total, then Step 4 is the maximum Class 4 NICs payable for the year at the 8% rate. An additional 1% will be payable using the rules we shall look at below.

Case 3: If Step 4 is a negative figure, the Class 4 NICs payable at 8% for the year will be NIL. It is however possible for the 1% rate to apply (see below).

Steps 5 to 9 need only be taken if Cases 2 or 3 apply.

Step 5:	Step 4 x 100/8	<u>X</u>
Step 6:		£
	Lower of: Actual profits or upper profit limit	X
	Less: lower profit limit	<u>(5,715)</u>
		<u>X</u>

Step 7:	Figure at Step 6	X
	Less: figure at Step 5	<u>(X)</u>
		<u>X</u>
	If this is a negative figure, it can be assumed to be NIL	
Step 8:	Step 7 x 1%	<u>X</u>
Step 9:	£(Actual profits - upper profit limit) x 1%	<u>X</u>

The maximum Class 4 NIC payable is:

Figure found by Step 4	X
Figure found by Step 8	X
Figure found by Step 9	<u>X</u>
ANNUAL MAXIMUM	X
Less: Class 4 NIC actually paid	<u>(X)</u>
Class 4 refund due	<u>(X)</u>

Illustration 4

Continuing illustration 2, Alex had employed earnings of £663 per week and self-employed income of £21,000 for 2010/11.

The Class 1 NIC paid (all at 11%) was £3,163.16. Class 2 NIC paid was £124.80. Class 4 NIC paid was £1,222.80.

The Class 4 refund is calculated under Test 2 as follows:

Step 1:	£(43,875 - 5,715)	£38,160
Step 2:	£38,160 x 8%	£3,052.80
Step 3:	Figure at Step 2	£ 3,052.80
	Add: 53 x Class 2 NICs	<u>127.20</u>
		<u>3,180.00</u>
Step 4:	Result from Step 3	£ 3,180.00
	Less: Class 1 primary NICs paid at 11%	(3,163.16)
	Less: Class 2 NICs paid	<u>(124.80)</u>
		<u>(107.96)</u>

As Step 4 is negative, no Class 4 NIC is payable at the main rate of 8%. However, we must prepare another computation to see if any Class 4 is due at the additional 1% rate. We assume Step 4 is nil for these purposes.

Step 5:	Step 4 x 100/8 (NIL x 100/8)	<u>NIL</u>
Step 6:		£
	Lower of: Actual profits or upper profit limit	21,000
	Less: lower profit limit	<u>(5,715)</u>
		<u>15,285</u>
Step 7:	Figure at Step 6	15,285
	Less: figure at Step 5	<u>(NIL)</u>
		<u>15,285</u>
Step 8:	£15,285 x 1%	<u>£152.85</u>
Step 9:	Not necessary as actual profits do not exceed the upper profits limit	

The maximum Class 4 NIC payable is:

	£
Figure found by Step 4	NIL
Figure found by Step 8	152.85
Figure found by Step 9	<u>NIL</u>
ANNUAL MAXIMUM	152.85
Less: Class 4 NIC actually paid	<u>(1,222.80)</u>
Class 4 refund due	<u>£(1,069.95)</u>

Illustration 5

Bert has earnings of £12,000 and self-employed profits of £48,000 for 2010/11.

Bert's NIC paid is as follows:

	£
Class 1:	
£(12,000 - 5,715) x 11%	691.35
Class 2:	
52 x £2.40	124.80
Class 4:	
£(43,875 - 5,715) x 8%	3,052.80
£(48,000 - 43,875) x 1%	<u>41.25</u>
	3,094.05

Test 1 is performed first as follows:

Step 1:	53 x £(844 - 110)	£38,902
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Step 2:	£38,902 × 11%	£4,279.22
Step 3:	£(12,000 - 5,715)	£6,285
Step 4:	Step 3 Less: Step 1	£ 6,285 <u>(38,902)</u> <u>(32,617)</u>
As this is a negative figure, it can be assumed to be NIL		
Step 5:	Not necessary as Step 4 is a negative number	
Step 6:	Not necessary as no earnings exceed the upper earnings limit	
Step 7:	Not necessary	
Step 8:	Figure found by Step 2 Figure found by Step 5 Figure found by Step 7 ANNUAL MAXIMUM Less: Class 1 (primary) actually paid Less: Class 2 paid	£ 4,279.22 Nil Nil <hr/> 4,279.22 (691.35) (124.80) <hr/> <u>£3,463.07</u>

No refund of either Class 1 or Class 2 contributions is due under Test 1.

Moving on to Test 2:

Step 1:	£(43,875 - 5,715)	£38,160
Step 2:	£38,160 × 8%	£3,052.80
Step 3:	Figure at Step 2 Add: 53 × Class 2 NICs	£ 3,052.80 <u>127.20</u> <u>3,180.00</u>
Step 4:	Result from Step 3 Less: Class 1 primary NICs paid at 11% Less: Class 2 NICs paid	£ 3,180.00 (691.35) <u>(124.80)</u> <u>2,363.85</u>

As Step 4 is positive, we must compare it with the total below:

	£
Class 1 NICs paid at 11%	691.35
Class 2 NICs paid	124.80
Class 4 NICs paid at 8%	<u>3,052.80</u>
"Comparative total"	<u>3,868.95</u>

As Step 4 is less than the comparative total, we follow the rules in case 2.

Step 5:	Step 4 x 100/8 (£2,363.85 x 100/8)	<u>£29,548.13</u>
Step 6:		£
	Lower of: Actual profits or upper profit limit	43,875
	Less: lower profit limit	<u>(5,715)</u>
		<u>38,160</u>
Step 7:	Figure at Step 6	38,160.00
	Less: figure at Step 5	<u>(29,548.13)</u>
		<u>8,611.87</u>
Step 8:	£8,611.87 x 1%	<u>£86.12</u>
Step 9:	£(48,000 - 43,875) x 1%	<u>£41.25</u>

The maximum Class 4 NIC payable is:

	£
Figure found by Step 4	2,363.85
Figure found by Step 8	86.12
Figure found by Step 9	<u>41.25</u>
ANNUAL MAXIMUM	2,491.22
Less: Class 4 NIC actually paid	<u>(3,094.05)</u>
Class 4 refund due	<u>£(602.83)</u>

23.8 Deferment of NIC

[SI 2001/1004](#)
[Regs 44, 96](#)

Deferment is possible where an individual can **demonstrate they will be due refunds** of Classes 2 and 4 contributions, usually due to paying maximum Class 1 primary contributions. The deferment application means that the Classes 2 and 4 liabilities are not in fact paid in full as they are likely to be refunded anyway. Application for deferment of Classes 2 and 4 NICs is **made to NICO on form CA72B**.

Class 2 deferment applications may be made at any time during the year, although they may **not be made retrospectively** - for example, if a trader has started in business and has not registered to pay Class 2 contributions, he may not apply to NICO and ask them to defer contributions from the date they should originally have been made.

The National Insurance Contributions Office will permit a full deferment of Class 2 contributions, and will repay any Class 2 contributions if the deferment authorisation comes part way through the year. Alternatively the NICs may remain on his record to be used for future offset.

However, where **Class 4 NIC** is deferred, the taxpayer will **still be required to pay Class 4 contributions at 1% on all profits in excess of the lower limit** of £5,715. The maximum permitted deferment is therefore 7% of profits between the limits. Because Class 4 NIC is usually paid on the self-assessment payment dates along with income tax, Class 4 deferment may apply retrospectively.

A National Insurance contributions **assessment will be raised if a deferment was given which was not in fact due**. This could happen, for instance, if the individual left the employment part way through the year and did not pay the maximum Class 1 contributions. The National Insurance Contributions Office will raise the appropriate assessment and collect the underpayment directly from the taxpayer.

Applications on form CA72A are also permitted for deferment of **Class 1** primary contributions, for example where the taxpayer has more than one employment. **NICO will determine for which of the employments** deferment will be granted. In those employments where Class 1 deferment is granted, the employee will **continue to pay Class 1 contributions at 1% in excess of the upper earnings threshold**.

Example 2

Margo is employed part time and earns a salary of £235 per week. She is also a sole trader with trading profits of £50,000 in respect of the tax year 2010/11.

You are required to calculate the Class 4 National Insurance liability refund she would be entitled to.

23.9 Future changes

It has been announced in the Budget of 22 June 2010 that the upper limit will be reduced for 2011/12. In addition an overall increase in NIC rates of 1% is planned, increasing the 2011/12 class 4 rate to 9%.

There is a summary of all classes of NIC at the end of this chapter for your reference.

Answer 1

Class 4 NIC for 2010/11:

$$£(14,000 - 5,715) \times 8\% = \underline{£663}$$

Answer 2

Margo's NIC paid would be as follows:

	£
Class 1 paid	
$£(235 - 110) \times 11\% \times 52$	715.00
Class 2 paid	
$£2.40 \times 52$	124.80
Class 4 paid	
$£(43,875 - 5,715) \times 8\%$	3,052.80
$£(50,000 - 43,875) \times 1\%$	<u>61.25</u>
	3,114.05

First of all apply Test 1 for the maximum classes 1 and 2 payable:

Step 1:	$53 \times £(844 - 110)$	£38,902
Step 2:	$£38,902 \times 11\%$	£4,279.22
Step 3:	$£(12,220 - 5,715)$	£6,505
Step 4:	Step 3	£6,505
	Less: Step 1	<u>(38,902)</u>
		<u>(32,397)</u>

As this is a negative figure, it can be assumed to be NIL

Step 5: Not necessary as Step 4 is a negative number

Step 6: Not necessary as no earnings exceed the upper earnings limit

Step 7: Not necessary

Step 8:		£
	Figure found by Step 2	4,279.22
	Figure found by Step 5	Nil
	Figure found by Step 7	Nil
	ANNUAL MAXIMUM	<u>4,279.22</u>
	Less: Class 1 (primary) actually paid	(715.00)
	Less: Class 2 paid	<u>(124.80)</u>
		<u>£3,439.42</u>

No refund of either Class 1 or Class 2 contributions is due.

Moving on to Test 2:

Step 1:	£(43,875 - 5,715)	£38,160
Step 2:	£38,160 × 8%	£3,052.80
Step 3:	Figure at Step 2 Add: 53 × Class 2 NICs	£ 3,052.80 <u>127.20</u> <u>3,180.00</u>
Step 4:	Result from Step 3 Less: Class 1 primary NICs paid at 11% Less: Class 2 NICs paid	£ 3,180.00 (715.00) <u>(124.80)</u> <u>2,340.20</u>

As Step 4 is positive, we must compare this with the total below:

	£
Class 1 NICs paid at 11%	715.00
Class 2 NICs paid	124.80
Class 4 NICs paid at 8%	<u>3,052.80</u>
"Comparative total"	<u>3,892.60</u>

As Step 4 is less than the comparative total, we follow the rules in case 2.

Step 5:	Step 4 × 100/8 (£2,340.20 × 100/8)	<u>£29,252.50</u>
Step 6:	Lower of: Actual profits or upper profit limit Less: lower profit limit	£ 43,875 <u>(5,715)</u> <u>38,160</u>
Step 7:	Figure at Step 6 Less: figure at Step 5	38,160.00 <u>(29,252.50)</u> <u>8,907.50</u>
Step 8:	£8,907.50 × 1%	<u>£89.08</u>
Step 9:	£(50,000 - 43,875) × 1%	<u>£61.25</u>

The maximum Class 4 NIC payable is:

	£
Figure found by Step 4	2,340.20
Figure found by Step 8	89.08
Figure found by Step 9	<u>61.25</u>
ANNUAL MAXIMUM	2,490.53
Less: Class 4 NIC actually paid	<u>(3,114.05)</u>
Class 4 refund due	<u>£(623.52)</u>