CHAPTER 24

CLASS 1A AND 1B NATIONAL INSURANCE

24.1 Introduction

Class 1A NIC is paid by **employers only**. Employees do not pay Class 1A National Insurance. SSCBA 1992, s. 10

Class 1A NIC is paid by employers on the **cash equivalent of benefits** as they appear on the form P11D. As Class 1A NIC is the liability of the employer, it is charged at the employer's rate of 12.8%.

Payment is made in one sum on **19 July following** the end of the tax year. This is deliberately timed so as to be two weeks after the submission of the form P11D. So having arrived at the cash equivalent of the benefit, it is easy for the employer to then go ahead and calculate his Class 1A NIC liability.

Class 1B is also paid by **employers only**. Class 1B NIC is charged on earnings which are included within a Pay As You Earn Settlement Agreement (PSA). We will look at PSAs later in this session. The rate of Class 1B NIC is 12.8%. Class 1B NIC is collected annually on 19 October following the end of the tax year. SSCBA 1992, s. 10A

24.2 Class 1A

If **benefits** are provided **to lower paid employees** – i.e. employees earning less than £8,500 per annum – no P11D will be prepared by the employer so accordingly there is **no liability to Class 1A** National Insurance Contributions.

There is no Class 1A charge if there is no associated income tax liability. This means that exempt benefits such as a mobile phone, a work car parking space, or exclusive nursery etc, will not be charged to Class 1A NIC. The £55 exemption for other types of childcare applicable to income tax also applies to Class 1A NICs. If qualifying relocation expenses and benefits are paid in excess of the £8,000 limit the **excess is chargeable to Class 1A NICs.**

If a payment in kind is categorised as earnings, and as such is charged to NIC under the normal Class 1 rules, that benefit will not be charged on the employer under Class 1A.

Therefore, if an employer provides an employee with benefits such as premium bonds, readily convertible assets or High Street store vouchers, the employer will have to pay Class 1 secondary contributions on those benefits because they are classified as earnings. The employer will not have to pay Class 1A as well.

Where an employer settles a personal liability of the employee, the payment is subject to Class 1 NIC and therefore not subject to Class 1A.

If, on the other hand, **the employer enters into the contract** with the third party, for example to provide an employee with medical insurance, then that is a **benefit subject to Class 1A NIC.**

If the employer provides an employee with an asset which is provided **purely for business purposes** such that the employee can claim a deduction for the full amount of the benefit when calculating their taxable earnings, then the **amount of the benefit is not subject to Class 1A.**

On the other hand, if the benefit is provided **partly for business and party for personal reasons,** Class 1A will be due on the **full amount** of the benefit even if the employee does claim some relief for tax purposes.

If **private fuel** is provided for use in an employee's own car, then generally Class 1 NIC is payable on the amount of the benefit. If, however, the fuel is provided from the employer's own fuel pump or using a company credit card or garage account and the garage is told that the fuel is being bought on behalf of the employer, then Class 1A contributions are payable.

As we shall see later, if a benefit is charged to National Insurance under Class 1B, this also takes priority over Class 1A.

If an employer reimburses genuine business expenses to an employee, as this is not a taxable benefit, it will not give rise to a Class 1A NIC charge.

The amount of Class 1A NIC payable is notified to HMRC on **Form P11D(b)**. It simply asks the employer to add up the amount of all the benefits shown on the P11D as liable to Class 1A. This total figure is then multiplied by 12.8% to arrive at the Class 1A payable. The form must be returned to HMRC by the 6 July following the end of the tax year.

Illustration 1

An employee receives the following remuneration package for 2010/11:

	£
Salary (paid monthly)	24,000
Company car benefit	4,200
Medical insurance benefit	600
High street store voucher (awarded December 2010)	200
Cash bonus (March 2011)	10,000

To calculate total National Insurance Contributions payable for the tax year, we first calculate the Class 1 primary contributions payable by the employee on his earnings. We then move on to calculate the Class 1 secondary contributions paid by the employer on earnings given to the employee. The final National Insurance will be the Class 1A NIC's payable by the employer on the benefits awarded to the employee.

We start with the Class 1 primary contributions. The employee is paid monthly so he has a monthly earnings period. For 10 months of the year he earns a salary of £2,000.

In December 2010, he is given a High Street store voucher. This is regarded as earnings for Class 1 NIC purposes so his earnings for December 2010 go up to £2,200. Due to the cash bonus of £10,000 paid in March 2011, for this month his earnings in the period go up to £12,000.

Earnings:		
10 months	@	£2,000
1 month	@	£2,200
1 month	@	£12,000

Employees pay Class 1 National Insurance Contributions at 11% on monthly earnings between the earnings limits and at 1% above the upper earnings limit. The monthly earnings threshold for 2010/11 is £476 and the monthly upper earnings limit is £3,656.

	£
Class 1 primary	
£(2,000 – 476) @ 11% x 10 months	1,676
£(2,200 – 476) @ 11% x 1 month	190
£(3,656 – 476) @ 11% x 1 month	350
£(12,000 – 3,656) @ 1% x 1 month	83
	£2,299

Next we move on to Class 1 secondary contributions. Total earnings for the year are the salary of £24,000, the store vouchers of £200 and the bonus of £10,000. Total earnings, subject to secondary contributions in the year, are therefore £34,200. As there is no upper earnings limit for secondary contributions, all earnings in excess of the earnings threshold will be charged to NIC at the rate of 12.8%.

Class 1 secondary	
£(34,200 – 5,715) @ 12.8%	**£3,646**

Finally, we calculate the Class 1A liability. The car benefit is £4,200. The only other benefit which will appear on the P11D for the year is the medical insurance of £600. We add this on to give us total taxable benefits for the year of £4,800.

Class 1A	
£4,800 @ 12.8%	**£614**

In summary the following NICs are due:

Class 1 primary	**£2,299**	Collected monthly via PAYE system
Class 1 secondary	**£3,646**	Collected monthly via PAYE system
Class 1A	**£614**	Paid directly to NICO on 19 July 2011

This example demonstrates the interaction between Class 1 primary, secondary and Class 1A NIC. What it also shows is that the NIC burden is much heavier on employers than on employees. This is partly because there is no upper earnings limit for employers and also because employees do not have the burden of Class 1A contributions.

24.3 Class 1B contributions

To understand Class 1B contributions we first need to discuss exactly what we mean by the term **Pay As You Earn Settlement Agreement (PSA).** For those of you who have access to the tax statutes, it is certainly worth taking a look at Statement of Practice Number 5 of 1996 (SP 5/96) in which HMRC set out what can and what cannot be included within a PAYE Settlement Agreement.

ITEPA 2003, s.703
SP 5/96

The whole idea of a PSA is to **allow an employer to settle an employee's tax liability on minor or irregular benefits**. A common example of an irregular benefit which could be encompassed within a PSA, would be a staff Christmas party costing in excess of the tax-free threshold of £150 per person.

If an employer provides a Christmas party to an employee, and the cost of the party is £150 or less per employee, this is an exempt benefit. However, if the cost exceeds £150, the employee has a taxable benefit on the whole cost. It is therefore customary, as a gesture of goodwill, for the employer to meet any tax liabilities arising to employees. The employer will do this by negotiating a tax settlement with HMRC.

HMRC has also confirmed that PSAs are acceptable in instances where it is impractical for the employer to be able to apply Pay As You Earn to a particular emolument.

SP 5/96 clearly states that Pay As You Earn Settlement Agreements should not be used as a vehicle for settling tax liabilities on cash payments or on major benefits such as company cars or low interest loans etc.

If tax on a particular benefit is included within a PSA, that benefit does not then have to be entered on to form P11D. Similarly, the employee will not have to enter the cash equivalent of such benefits on to his own Self Assessment Tax Return. This is because someone else – i.e. the employer - will pay the tax.

Having agreed that items can be included within the PSA, HMRC will then negotiate the tax liability with the employer and the employer will pay the tax on a grossed up basis.

Illustration 2

A company has 100 employees. It holds a Summer Ball and the total cost of that function is £20,000, ie exactly £200 per head. Technically each employee will therefore have a benefit of £200 as the cost of the party exceeds the £150 per head threshold. However, as a gesture of goodwill, the company agrees to meet the tax liabilities via a Pay As You Earn Settlement Agreement. Of the employees, 50 of them pay tax at the basic rate of 20%, whilst 50 of them pay tax at the higher rate of 40%.

In order to work out the amount of tax to be paid by the employer under the PSA, consider the basic rate employees first. Each employee will have a benefit of £200. This is a "net" benefit because the employee is deemed to have received a benefit of £200 **after** the tax has been settled by the employer.

To calculate the tax on this net benefit, as we are dealing with a basic rate employee, we multiply the net figure of £200 by 20 over 80. This gives tax of £50 and gives rise to a gross benefit of £250. If you work this back, the gross benefit of £250 multiplied by the basic rate of tax of 20% gives a tax charge of £50.

Basic rate employee:	£
Net benefit	200
Tax @ $\frac{20}{80}$	50
Gross benefit	**£250**

For each higher rate employee, again we start with the net benefit of £200. This time we arrive at the tax by multiplying the net benefit by 40/60 to give tax of £133. The gross benefit in this instance is £333. Again, check this by taking the gross benefit of £333 and multiplying it by the higher rate of 40% to give tax of £133.

Higher rate employee:	£
Net benefit	200
Tax @ $\frac{40}{60}$	133
Gross benefit	**£333**

To finish the example, we calculate the total tax to be included in the PSA:

Tax in PSA	£
50 employees @ £50	2,500
50 employees @ £133	6,650
	£9,150

Whenever tax is settled under a PAYE settlement agreement, the employer also needs to consider the impact of Class 1B National Insurance. Class 1B NIC is **charged on benefits included within a PSA**. Included within the PSA is the total cost of the staff function - i.e. £20,000. We then need to add on any income tax that has been included within the PSA – i.e. any income tax paid by the employer on behalf of its employees. Class 1B National Insurance is charged at the employer's rate of 12.8%.

	£
Earnings within PSA	20,000
Income tax payable	9,150
	29,150
Class 1B NIC @ 12.8%	**£3,731**

Class 1B is the **employer's liability only** and the **due date for payment is 19 October (or 22 if payment made electronically) following the end of the tax year**. The income tax payable is due at the same time.

At first sight this may appear a little harsh, in that as well as paying income tax of £9,150, the employer also has to pay National Insurance at 12.8% on the income tax paid. This is because the income tax of £9,150 is strictly the liability of the employees, so what the employer is doing is settling the employees' personal liability. We know that if an employer settles an employee's liability under normal circumstances, there will be a charge to Class 1 secondary contributions. Here the charge is under Class 1B instead.

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

24.4 Interest and penalties

Interest is charged on the late payment of Class 1A and Class 1B from the due date.

Where the payment of Class 1A or 1B is outstanding more than 30 days after the payment due date, a penalty of 5% of the unpaid NIC will be charged. A further 5% penalty will be charged in respect of NIC outstanding more than 5 months after the first penalty is charged.

FA2009 Sch 56 Para 3

Finally, an additional penalty of 5% will apply to NIC still outstanding more than 11 months after the first penalty is charged.

The new penalty provisions for filing forms P14 and P35 late, being introduced by FA 2009 which we looked at in Chapter 22, will also apply to forms P11D(b) which are filed late.

If the form P11D(b) is incorrect, the penalty charged will be a percentage of the extra tax due as a result of the discovery of the error. The level of the penalty will be based on the behavior giving rise to the error. This is the same penalty regime that we looked at in Chapter 22. FA2007 Sch 24

Example 1

Norman receives the following non-cash benefits from his employer, Techno plc. Techno plc is a company listed on the UK stock exchange.

a) Company car and fuel
b) Interest free loan of £4,000
c) 500 shares in Techno plc
d) £100 high street store voucher
e) Contributions to company pension scheme
f) Membership of local gym arranged by employer.

Which of the above are subject to Class 1A NIC?

Example 2

Brian is awarded a holiday to Florida by his employer. The holiday cost £3,000 and the company agree to pay the tax on Brian's behalf via a PSA. Brian is a salesman earning £20,000 per annum.

Calculate the Class 1B NIC liability for the employer.

Answer 1

		Class 1A?	
a)	Company car and fuel	✓	P11D item
b)	Interest free loan of £4,000	X	Exempt as <£5,000
c)	500 shares in Techno plc	X	Class 1 applies
d)	High street store voucher	X	Class 1 applies
e)	Pension contributions	X	Exempt
f)	Local gym membership	✓	P11D item

Answer 2

	£
Earnings covered by PSA	3,000
Tax @ $\frac{20}{80}$ (basic rate taxpayer)	750
	£3,750
Class 1B NIC @ 12.8%	**£480**