These notes refer to the National Insurance Contributions Act 2015 (c.5) which received Royal Assent on 12 February 2015

NATIONAL INSURANCE CONTRIBUTIONS ACT 2015

EXPLANATORY NOTES

SUMMARY AND BACKGROUND

Overview of NICs

4. The National Insurance Scheme was first established in 1911 and expanded in the late 1940s to provide funds for a more comprehensive and inclusive range of contributory benefits and to provide assistance with the funding for a new National Health Service.

5. Receipts from contributions are paid into the National Insurance Fund (NIF). Money kept in the NIF is separate from all other revenue raised by national taxes. The NIF is used exclusively to pay for contributory benefits and operates on a pay as you go basis: broadly speaking, this year's contributions pay for this year's benefits.

6. Briefly, the scheme consists of a number of benefits financed by NICs payable by earners, employers and others. Employees pay NICs on their earnings, employers pay NICs on the earnings they pay to their employees and the self-employed pay flat rate NICs and NICs on their profits and gains.

7. An earner can be either an employed earner or a self-employed earner. An employed earner is a person who is gainfully employed in Great Britain or Northern Ireland either under a contract of service, or in an office (including elective office) with earnings. A self-employed earner is a person who is gainfully employed in Great Britain or Northern Ireland otherwise than as an employed earner. Provision is made within the scheme to allow those who are not compulsorily covered to protect their entitlement to state retirement pension and bereavement benefits by means of voluntary NICs payments.

8. NICs are currently divided into six classes:

   - Class 1 contributions, which are paid by both employees and employers on the employee's earnings, are payable at 12% and 2% by employees and 13.8% by employers.

   - Class 1A contributions are payable annually, by employers only, on most taxable benefits in kind. Class 1A contributions are payable at a rate of 13.8%.

   - Class 1B contributions are payable annually, by employers on items which are dealt with under a PAYE Settlement Agreement (PSA) for income tax. Class 1B contributions are payable at a rate of 13.8% on the value of items included in the PSA and on the total tax payable by the employer under the PSA.

   - Class 2 contributions are paid by the self-employed at a flat rate of £2.75 per week for the 2014-15 tax year. Class 2 contributions are paid either monthly or six monthly. An individual whose earnings from self-employment are below a set level, which is £5,885 for 2014-15 (referred to as the small earnings exception (SEE)) and which is approximately equivalent to the exception limit that applies to employed earners[1], may apply for exception from Class 2 contributions on the grounds of low earnings.

- Class 3 contributions are payable at a flat weekly rate of £13.90 per week for the 2014-15 tax year by people who are not otherwise liable to pay Class 1 or Class 2 contributions, to protect entitlement to State Pension.

- Class 4 contributions are paid annually by the self-employed on profits chargeable to tax as trading income. Class 4 NICs are payable at a rate of 9% on profits between a lower and upper profits limit and 2% on profits above the upper profits limit.

9. An additional class of NICs (Class 3A) was introduced in the Pensions Act 2014 (section 25) and will be payable on a voluntary basis for a limited period by those who reach state pension age before 6 April 2016.

1 Employed earners do not pay NICs until their earnings reach the Primary Threshold but they are treated as having paid NICs from a lower threshold referred to as the Lower Earnings Limit (LEL). Employed earners pay no NICs below the LEL.