

INCREASE IN NATIONAL INSURANCE THRESHOLDS

As we detailed in our article back in April (and following the Spring Statement), changes to National Insurance contributions (NICs) have just come in to effect. The new NIC thresholds took effect from 6 July. But what does that mean for you?

If you are a self-employed worker, you will already pay different levels of National Insurance compared to an employee. But now the thresholds are changing, so this article will explain all the changes and what this means for you and your business.

How does National Insurance work?

Before we go into detail about how the new NICs thresholds will affect you, let's start with an overview of the National Insurance system.

There are different classes of NICs as set out below, which vary depending on whether you are employed or self-employed and whether you choose to voluntarily pay contributions.

Class 1 NICs are paid by employers and employees. Employees pay Class 1 NIC if they are under the state pension age and earn more than the 'Primary Threshold', in the majority of cases. These are automatically deducted by employers.

Class 1A and 1B NICs are paid directly by employers on their employees' benefits.

Class 2 NICs are paid by self-employed individuals earning more than the 'Small Profits Threshold'. If you earn less than this, you can choose to pay voluntary contributions to fill in the gaps in your National Insurance record (known as Class 3 NICs).

Class 4 NICs only apply to self-employed individuals earning profits above the 'Lower Profits Limit'.

Most self-employed individuals pay Class 2 and Class 4 NICs through their self-assessment Tax Returns.

As well as different classes, there are a number of different thresholds based on earnings. For the purposes of this article, though, we'll focus on the main thresholds at which employed and self-employed individuals start paying NICs: the Primary Threshold for Class 1 NICs, the Small Profits Threshold for Class 2, and the Lower Profits Limit for Class 4.

What's changing?

As announced in the Spring Statement, both the Primary Threshold and the Lower Profits Limit are rising from £9,880 to £12,570 as of 6 July 2022, bringing them in line with the income tax personal allowance. Going forward, it is planned that the NICs and income tax thresholds will remain aligned.

The £2,690 threshold rise will save employees an average of £330 in National Insurance each year compared to the previous threshold.

Aligning the income tax and NICs thresholds had been an ambition of the Government for a number of years, but the announcement also came ahead of the new health and social care levy, which was introduced in April 2022. This saw all National Insurance rates, as well as dividend tax rates, increase by 1.25% with effect from 6 April 2022.

The new thresholds for the self-employed

While employees' National Insurance is deducted by their employer throughout the year, if you are self-employed, you pay NICs on an annual basis at the end of the tax year via your Tax Return.

This means things aren't as straightforward as implementing a new threshold from July. Instead, the Lower Profits Limit for Class 4 NIC will rise to an apportioned threshold of £11,908 in the current tax year ending 5 April 2023 - allowing for 13 weeks under the previous threshold and 39 weeks at the new threshold.

Taken together with the increase in the NIC rates from 6 April 2022, this means self-employed profits between £11,908 and £50,270 will be charged at 10.25% in 2022/23 and profits over £50,270 will be charged at 3.25%. From April 2023 onwards, the self-employed will be able to earn £12,570 before paying any NICs.

Meanwhile, Class 2 NIC liabilities have been reduced to nil on profits between the Small Profits Threshold (£6,725 for 2022/23) and the Lower Profits Limit (£11,908), which will allow individuals to continue to build up National Insurance credits without actually paying Class 2 NICs. To receive the credits, you will have to submit a Tax Return. The rate of Class 2 NICs for those with profits in excess of £11,908 is £3.15 per week.

How will you be affected by the increase in thresholds?

For employees, the main change you can expect to see is a difference in your take home pay. A higher threshold means you will be able to earn more before having to pay National Insurance. From this month onwards, the Government stated that around 70% of those paying NICs will be paying less, even with the introduction of the 1.25% health and social care levy.

The change to Class 2 NICs will provide a tax cut for 500,000 self-employed people and is worth up to £165 per year.

That said, actual gains for self-employed individuals will be different depending on their circumstances. For example, if you had annual profits of £20,000 over the 2021/22 tax year, you would have suffered £1,097.48 in Class 2 and 4 NICs. With the threshold increases that would go down to £993.23, representing a saving of £104.25.

The above is for general guidance only and no action should be taken without obtaining specific advice.

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