Class 1, Class 2 and 4 NICs limits and the Self-Assessment return

OMB Personal tax

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When completing a Self-Assessment (SA) tax return for an individual with both employed and self-employed earnings it is necessary to consider the Class 1, 2 and 4 annual maximum. Although HMRC say that they will automatically carry out this calculation on receipt of the SA return this requires the individual's NIC record to be complete. Any errors or omissions from the record are likely to result in HMRC asking for the wrong amount.

The peak SA return season is upon us and a regular matter raised by members this year has been HMRC's mixed advice regarding the correct way to resolve the issue of HMRC revising SA tax returns for the self-employed where Class 1 NICs have also been paid and as a result the taxpayer would pay too much Class 2/4 NICs if the full amount of Class 2/4 NICs were included. HMRC's suggestions seems to have been to either wait for them to revise the SA calculation or do the calculation yourself when filing the SA return. Neither is a perfect answer!

In the past one could apply for deferment of payment of Class 2 and/or Class 4 NICs if an individual was employed and self-employed, and expected to pay sufficient primary Class 1 NICs as an employee in the tax year. If a deferment was accepted then only Class 4 NICs at the additional Class 4 percentage rate of 2% of profits above the lower profit limit was usually paid through SA. HMRC would review the individual's NIC account after the end of the tax year to check whether the right amount of NICs was paid and write to them. If no deferment application was made before the end of the tax year, or an application was rejected, and excess Class 1, 2 and/or 4 NICs was paid, a claim could be made to HMRC for a refund once the SA return had been filed.

From 2015/16, HMRC ‘simplified’ the process so that no application for a deferment or refund of Class 2/4 NICs is required. Instead, HMRC said it would take account of Class 1 paid when the SA return was filed, automatically carry out the annual maximum calculation and show the adjusted amount of Class 2/4 NICs payable in the SA calculation. One consequence of this is the question of whether an agent includes on the SA return the full amount of Class 2 and/or 4 NICs without taking into account Class 1 NICs paid when filing a SA return (and wait for HMRC to make the adjustment) or make the calculation and include, where appropriate, the reduced Class 2/4 NICs payable (with an appropriate white space explanation). The answer seems to be that either can be done but both can still result in HMRC asking for the wrong amount!

Taxpayers filing earlier in the year found that the time delay between the information from employer’s PAYE filings under RTI being received and processed to an employee’s NIC record meant that the SA return calculation was not taking account of Class 1 NICs paid. As a result HMRC was showing the ‘wrong’ Class 2/4 to pay. Although a revised SA302 ought to have been issued by now, as the expectation was that Class 1 NICs information would reach an individual’s NIC record by this autumn, this is not ideal.

Consequently, many prefer the approach of working out the correct Class 2/4 NICs themselves and including these figures on the SA return. In most cases where third party software is used you have to manually input the Class 1 NICs to enable the software to complete the calculation. Unfortunately, however, if the information you hold regarding Class 1 and Class 2 paid does not match HMRC’s NIC record for the individual it is likely that HMRC will not accept your calculation and will amend the annual maximum calculation for Class 1, 2 and 4, to reflect the figures they have.

Issues can arise with some third-party software in accessing HMRC’s online portal to view and download details of Class 2 NICs paid. In some cases the information does not automatically pass from HMRC’s portal to third party software, although the information should be viewable online (and can then be manually entered). As this is the figure HMRC will use in its calculations, if you disagree with it you will need to contact HMRC. Also, if no Class 2 NICs information is viewable online this suggests that HMRC has not matched the individual’s SA record with their NIC record, or has not recorded the individual as being self-employed, and again you will need to contact HMRC to correct this/register the individual. In some cases this has resulted in Class 2 NICs paid through SA being wrongly refunded.

Hence, to avoid the wrong amount of NICs being demanded through SA, if a taxpayer has a combination of employed and self-employed earnings and the NICs annual maximum is likely to be relevant it is advised to check that HMRC's NICs record for the individual is correct and to contact HMRC if it appears to be wrong.

Further information can be found in HMRC's Q&A, which can be viewed on the CIOT website.