What is Income Tax and National Insurance?

Income Tax is a tax paid on income. This tax on paid on things like money earnt from employment, profits made from self-employment, benefits from a job, rental income and many others.

National Insurance is, very loosely, another form of income tax. Your national insurance contributions enable you to qualify for some state benefits and the *State Pension*.

Most people pay income tax and national insurance contributions through a system called Pay As You Earn (known as PAYE). This is where your employer makes deductions on your behalf before they pay your wages or pension.

Most people in the UK get a *Personal Allowance* of tax-free income. This is the amount of income you can have before you pay tax. There are currently (2022/23) three different rates of income tax that are applied to different bands of income.

Income Tax (PAYE) limits 2022/23

Personal Allowance	Basic Rate	Higher Rate	Additional Rate
Up to £12,570	£12,571 - £50,270	£50,271 - £150,000	above £150,000
0%	20%	40%	45%

1) How much income tax would the people doing the professions below pay and how much money do they *take home*?

a) Secretary, salary = £22,000

b) Engineer, salary = £48,000

c) Dentist, salary = £72,000

d) CEO, salary = £200,000

National Insurance limits 2022/23*

Lower Earnings Limit	Upper Earnings Limit	Higher Rate
Up to £12,570	£12,571 - £50,270	Above £50,270
0%	13.25%	3.25%

*Figures are for Nov 2023 onwards

1) How much national insurance would the people doing the professions below pay?
2) Considering income tax and national insurance payments, how much money do they *take home*?

a) Secretary, salary = £22,000

b) Engineer, salary = £48,000

c) Dentist, salary = £72,000

d) CEO, salary = £200,000

How Pension payments affect income tax

Most, or perhaps all, employees make tax free payments towards a pension scheme. These payments are deducted from salaries before tax and national insurance is paid and thereby reduce the amount of income upon which tax and national insurance is due.

Assuming each of the people above pay pension contributions of 10% of their salary…

1) How much do they contribute towards their pension each year?
2) How much tax do they pay now and how does this compare to before?
3) What is their *take home pay* now?

Can I reduce the amount of tax that I pay?

Yes and no. Mostly no.

It is possible to marginally reduce the amount of income tax that you pay by reducing the amount of your taxable income. None of these leave you significantly better off however.

- Pay more into your pension
- Make charitable donations
- Union subscriptions
- Student loan repayments
- Employee benefit schemes such as cycle to work or car lease schemes

Tax Avoidance. vs Tax Evasion

Tax avoidance through sensible finance planning is legal and sensible
Tax evasion through lying or non-declaration is illegal and naughty

Links

- https://www.gov.uk/guidance/rates-and-thresholds-for-employers-2022-to-2023
- https://www.moneyhelper.org.uk/en/work/employment/how-income-tax-and-personal-allowance-works
- https://uk.jobted.com/salary
- https://www.gov.uk/income-tax
- https://www.gov.uk/national-insurance

How Income Tax is calculated throughout the tax year

The UK tax year runs from 6th April to 5th April the following year.

The system by which employers deduct income tax from employee wages via PAYE is really logical and clever.

It adds up earnings and tax paid for the current year, assumes that current monthly earning will continue for the rest of the year then projects the likely total tax due and splits this equally between remaining months.

As the year progresses, these totals are refined until they are consolidated to meet the total tax due in the final month of the tax year.

Consider the following scenarios…

a) The long term, permanent established employee earning £29,600 per year, paid monthly on 5th of each month.
b) The similar, permanent employee also earning £29,600 per year but who gets a £1000 pa pay rise in July and another £1000 pay rise in October. Also paid monthly on 5th of each month.
c) The temporary employee doing holiday work who earns £1300 over Easter (paid on 5th May) then £2600 over the summer holidays (paid £1300 on 5th August and £1300 on 5th September) and £2400 over Christmas holidays (paid on 5th January).

How National Insurance is calculated throughout the tax year

The system by which employers deduct national insurance from employee wages via PAYE is not very clever.

NI is due and deducted on each period of payment (weekly, fortnightly, monthly etc.) There is no running total and there are no refunds in subsequent periods if the employee earns less than in previous periods. The temporary (holiday work) employee is likely to pay NI in the months where they work, even though their annual income might fall below the lower earnings limit upon which NI is due..

Template for Calculating Monthly Income Tax

		Monthly Income	Likely Year-Total	Annual Tax Due	Tax Already Paid	Tax Due this Month	Tax Payments to Date
1	5th May						
2	5th June						
3	5th July						
4	5th Aug						
5	5th Sept						
6	5th Oct						
7	5th Nov						
8	5th Dec						
9	5th Jan						
10	5th Feb						
11	5th Mar						
12	5th Apr						