

## **NATIONAL INSURANCE CONTRIBUTIONS ACT 2006**

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### **DRAFT REGULATIONS**

To assist in further consideration of the National Insurance Contributions Act, which received Royal Assent on 30 March 2006, Her Majesty's Revenue and Customs is publishing a summary of the main points received during the consultation period on the draft regulations and HMRC's response.

The draft regulations are in respect of: -

1. The first use of the powers in the Bill to backdate National Insurance liability to reflect the tax provisions in Schedule 2 of the Finance (No. 2) Act 2005 and section 92 of the Finance Act 2006.
2. The voiding of National Insurance elections or agreement to prevent these being used to pass on any backdated employers National Insurance liability to their employees.
3. Extending the tax avoidance disclosure rules to National Insurance.

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## **THE DRAFT NATIONAL INSURANCE CONTRIBUTIONS (APPLICATION OF PART 7 OF FA 2004) REGULATIONS 2006**

**There should be separate regulations for direct taxes and NICs to reduce the complexity of the regulations.**

We believe that having NICs regulations that duplicate, in their entirety, the tax regulations is unnecessary and would run counter to the objective of having, in practice, a single tax/NICs disclosure regime. However, we are looking at modifications, intended to simplify and clarify, in relation to the Information Regulations SI 2004/1863, and regulation 8 thereof in particular (obligations of users to provide information about reference numbers etc). This is the area where the tax regulations need most modification to fit with the NICs system. The objective remains to have, in practice, a single system.

**An arrangement falling to be notified under both the Income Tax and National Insurance Contributions disclosure regimes should require a single disclosure on a single form.**

HMRC agree that should be the case.

**Regulation 20 is unclear.**

We intend to review regulation 20 and the application of the Information Regulations. Please see our comments above.

**What are the time limits where there is a Class 1A advantage?**

We believe the appropriate time limit for providing prescribed information should be the filing date of form P11D.

**Are established arrangements which deliver an advantage notifiable?**

Whether or not a scheme is notifiable depends upon the particular circumstances. However, it is hard to envisage that any established arrangement would be notifiable. Schemes that are not new and innovative should not trigger any of Descriptions 1-4 of the Arrangements Regulations. An arrangement might fall within Description 5 – standardised products. But schemes made available before a certain date (to be decided, but not earlier than 1 August 2006) will be excepted from notification under Description 5.

**Where a person claims legal professional privilege, the subsequent disclosure timing should be made clearer.**

We will be making clear what the appropriate action required will be.

## **THE DRAFT SOCIAL SECURITY, OCCUPATIONAL PENSIONS SCHEMES AND STATUTORY PAYMENTS (CONSEQUENTIAL PROVISIONS) REGULATIONS 2007**

### **What is the purpose of regulation 5 and 5A?**

New regulation 5A will deal with an issue that arises as a direct consequence of retrospective earnings and is something that has never before been required. Since the due date for the payment of Class 1 NICs on retrospective earnings cannot be any earlier than the date on which retrospective regulations are laid, the due date will necessarily fall after the date on which the retrospective earnings were originally paid and after the due date that would have applied had the payments been earnings when originally paid. In some cases the due date for the payment of NICs on retrospective earnings will fall after a relevant contributory benefit has been claimed. Where this occurs the employee's benefit position could be compromised, since one of the conditions for payment of contributory benefit is that the necessary contributions are paid before the claim to benefit is made. As Class 1 contributions which are paid by their due date cannot be considered late paid existing regulation 5 could not be invoked in these circumstances.

New regulation 5A will perform the unique act of treating contributions that are paid on time as having been paid at an earlier time - but only for the purposes of contributory benefit entitlement. In other words, new regulation 5A will ensure that where primary Class 1 contributions due on retrospective earnings are paid on time, the employee will derive the same benefit entitlement from them as he would have derived had those contributions been paid at the time the retrospective earnings were actually paid. Regulation 5A will ensure that just as retrospective earnings are to be subject to a retrospective NICs liability, the consequent contributory benefit entitlement secured by their payment will also be retrospective.

### **What would happen in the event of the retrospective contribution not being paid by the due date?**

Existing regulations 5 + 6 deal with contributions that are paid late. In brief, regulation 5 provides that where there is no consent, connivance or negligence on the part of the employee, contributions that are late in being paid will be treated as having been paid:

- (a) for the purposes of the first contribution condition for entitlement to contributory based job seeker's allowance or short term incapacity benefit, on the day on which the earnings in respect of which those contributions are payable were paid, and
- (b) for any other benefit purpose as paid on the due date.

As a result of the intended amendments to regulations 1 and 4 of SI 2001/769 (see draft regulation 2(2) and 2(3) of the Social Security, Occupational Pension Schemes and Statutory Payments (Consequential Provisions) Regulations 2006) the existing late paid provisions will apply equally to Class 1 NICs due on retrospective earnings which are paid late. If retrospective Class 1 liabilities are paid after the due date, the employee will not be penalised providing he is not at fault. The due date for payment of Class 1 NICs in respect of retrospective earnings will be that set out at new paragraph 11A of Schedule 4 to SI 2004/1004. The same duality of purpose will apply to both regulation 4 itself which deals with late paid contributions that are not subject to the consent etc conditions of regulation 5 and to retrospective contributions that are not paid but which can be treated as paid by regulation 60 of SI2001/1004 – see draft regulation 5 of the Social Security Contributions (Consequential Provisions) Regulations 2006 which will amend regulation 60.

Taken together, amended regulations 1 and 4 of SI2001/769, new regulation 5A of SI2004/769 and amended regulation 60 of SI2001/1004 will afford the same contributory benefit treatment to retrospective Class 1 NICs as is currently afforded 'non retrospective' Class 1 NICs. This ensures that one of the main principles of the NI Act 2006 (that the employee should be put in the position that he would have been in had a liability existed at the time retrospective earnings were paid) is carried through to the contributory benefit entitlements that are derived from the payment of NICs.

**Will entitlement to contributions-based benefits have to be retrospectively reassessed, in the event of earnings retrospectively becoming liable to NICs?**

Yes. Any retrospective entitlement to contributions-based benefits will be an automatic consequence of retrospectively increasing an earner's earnings. Retrospective earnings will, for all contributory benefit, be treated in the same manner as any other earnings. If the retrospective earnings are earnings not exceeding the Upper Earnings Limit (in the earnings period in which the earnings were actually paid) they will be included in a person's earnings factor.

**Will retrospective earnings count for the purposes of Statutory Payments?**

A new provision, (sub-paragraph za) is inserted into the following regulations: –

- Regulation 20(4) Statutory Maternity Pay (General) Regulations 1986
- Regulation 17(3) Statutory Sick Pay (General) Regulations 1982
- Regulation 39(3) Statutory Paternity Pay and Statutory Adoption Pay (General) Regulations 2002.
- Regulation 2 Social Security (Maternity Allowance) (Earnings) Regulations 2000.

In each of these regulations the new provision at sub-paragraph za will ensure that any amount retrospectively treated as earnings by regulations made by virtue of section 4B (2) will be included when calculating earnings for the purposes of Statutory Payments. A re-determination of any previously calculated statutory payment will be required if the retrospective earnings affect the original determination.

**Will retrospective earnings count as emoluments for student loan repayment purposes?**

Regulation 39 of the Education (Student Loans) (Repayments) Regulations means the employer does not have to recalculate Student Loan deductions even if the earnings on which NICs, and therefore Student Loans are calculated, increase. This is because Regulation 39 provides that the employer has to pay either the amount which he has deducted, or the amount which he is required to deduct, whichever is the smaller. So if, as a result of the retrospective NIC legislation, the employer should have deducted a higher figure, Regulation 39 means he does not have to.

Furthermore, the definition of "emoluments" in regulations 27 is intended to encompass prospective changes to the meaning of earnings in the Social Security Contributions and Benefits Act 1992. There is no express provision to indicate that it should include changes which are retrospective.

## **THE DRAFT SOCIAL SECURITY CONTRIBUTIONS (CONSEQUENTIAL PROVISIONS) REGULATIONS 2007**

**The regulations do not set out the rate of NI where there is a liability to pay retrospective contributions.**

The regulations do not set out the rate of NI to apply to retrospective earnings because section 4B(9) of the Social Security Contributions and Benefits Act (inserted by section 1 of the National Insurance Act 2006) provides for a re-determination of the amount of Class 1 contributions payable once retrospective regulations have been made. Sub section 9 provides that the re-determination is to be undertaken as it would have been undertaken at the time of the original determination but by reference to the revised amount of earnings. Section 4B (9) therefore requires the re-determination to apply the National Insurance rates and thresholds relevant at the time the earnings were paid. All of the existing assessment rules are to be applied, including the need to add the retrospective earnings to any other earnings paid in the relevant earnings period.

**What is to happen if a secondary contributor is unable to recover primary contributions?**

An employer's ability to recover primary contributions payable on retrospective earnings mirrors the existing recovery rules where an underpayment of primary Class 1 NICs arises as a result of an error occurring in good faith. Currently an employer who discovers an error in good faith can recover any primary underpayment from future earnings paid to the employee for the remainder of the tax year in which the error is discovered and the following tax year. Where the employee is no longer in the employment the employer can make no recovery and becomes himself liable for the underpaid primary NICs. The same will apply to NICs due on retrospective earnings.

**Will Extra-statutory Concession B46 "Automatic Penalties for Late Company and Employers' and Contractors' End-of-year Returns" apply?**

It would be inappropriate, given the circumstances giving rise to the requirement to file a supplementary return, for Extra –statutory concession B46 to apply. Consequently the concession will not apply.

**What will be the due date for payment of Class 1 contributions in respect of retrospective earnings?**

Draft regulation 8(6) will insert new paragraph 11A into Schedule 4 to the Social Security (Contributions) Regulations 2001. In all cases the due date for the payment of Class 1 NICs on retrospective earnings will be determined by the date on which the relevant retrospective regulations come into force. The due date is set as 14 days [or 17 days in the case of approved electronic

communications] after the end of the tax month immediately following the tax month in which the relevant retrospective regulations come into force. So for example: -

- If retrospective regulations come into force on the 4th February 2007, the date on which payment of Class 1 contributions will be due on any retrospective earnings which are paid prior to 6th January 2007 will be due on 19th (or 22nd) March 2007;
- if retrospective regulations come into force on the 6th April 2007, the date on which payment of Class 1 contributions will be due on any retrospective earnings which have been paid prior to the 6th April will be the 19th (or 22nd) of June 2007;

Regulation 11A ensures that, irrespective of the date on which retrospective regulations come into force, there will always be a minimum of 6 weeks before payment of any Class 1 NICs on retrospective earnings falls due;

Draft regulation 8(10) will insert a new subparagraph into paragraph 22. In all cases where a liability arises to pay contributions on respective earnings and those earnings were paid in a closed tax year, the employer will need to submit a replacement return (or new one if one has not already been submitted) before the 20th May following the end of the year in which the relevant retrospective regulations came into force. So, using the two examples above: -

- retrospective regulations coming into force on 4th February 2007 will require a revised return (or returns) to be rendered in respect of any tax year up to and including the 2005/2006 tax year in which retrospective earnings were paid, no later than 20th May 2007. [Any retrospective earnings paid during the period 6 April 2006 and 3rd February 2007 should be included in the 2006/2007 return which will also be due on 20th May 2007.]
- retrospective regulations coming into force on 6th April 2007 will require a revised return (or returns) to be rendered in respect of any tax year up to and including the 2006/2007 tax year in which retrospective earnings were paid, no later than 20th May 2008.

The amendment to paragraph 22 ensures that, irrespective of the date on which retrospective regulations come into force, there will always be a minimum of 6 weeks before a revised return reporting retrospective earnings is required. In most cases, as in the second example, we anticipate that the amount of time given for a return to be rendered will be much longer.

## **THE DRAFT SOCIAL SECURITY (CONTRIBUTIONS) (AMENDMENT NO.2) REGULATIONS 2007**

**“UK businesses face uncertainty with the restriction on the use of an election to transfer liability to secondary contributions to the earner where a retrospective charge is imposed.”**

The ability to transfer the secondary NIC by way of a joint NIC Agreement or Election was introduced in 2000 to enable companies to deal with future unpredictable and unquantifiable NICs liability arising on share options. This facility was extended in 2004 to awards of restricted securities and convertible securities again only to cover future NIC liability arising, for example, on the lifting of a restriction.

Sections 5 and 6 of the NI Act 2006 make it clear to employers and employees that they cannot use this facility to support schemes or arrangements that seek to avoid National Insurance. Employers who choose to put in place and offer remuneration to employees in securities that avoid National Insurance cannot be allowed to benefit from the ability to transfer the secondary contributions to the employee when a National Insurance liability is applied with backdated effect. Those employers who choose to avoid their fair share of National Insurance are, when caught by legislation introduced under the powers contained in the NI Act 2006, only being made to pay what they had avoided.