



**National Insurance contributions on disguised remuneration
Frequently Asked Questions**

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Introduction

This document provides answers to frequently asked questions on the National Insurance contribution (NIC) rules about ‘disguised remuneration’ legislation.

Schedule 2 to the Finance Act 2011 made rules about employment income provided through third parties, to tackle arrangements used for the purposes of disguising remuneration in order to avoid or defer income tax or to circumvent the annual and lifetime allowances in registered pension schemes. These rules are chiefly found in Part 7A of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA).

Similar provision has now been made for NIC. The Social Security (Contributions) (Amendment No.5) Regulations 2011 (SI 2011/2700) amended the Social Security (Contributions) Regulations 2001 (SI 2001/1004), inserting new regulation 22B and new paragraph 2A of Part 10 of Schedule 3.

These FAQs will be subsumed into the National Insurance Manual in due course.

Chapter 1 - FAQs

General

FAQ1 How do the NIC rules work?

The NIC rules build on the income tax rules.

So, one has to look at the income tax position first. HMRC has published comprehensive guidance on the income tax rules (including illustrative examples) in the Employment Income Manual at [EIM45000](#) onwards.

In particular:

- [EIM45000](#) sketches the general approach to be taken, and
- [EIM45010](#) is a glossary of technical terms used in the income tax guidance (some of which are also used in these FAQs).

FAQ2 onwards explain the main NIC rules applying to disguised remuneration. FAQ9 onwards highlight differences between the income tax and NIC rules.

FAQ2 Under what circumstances will an arrangement give rise to earnings for Class 1 NIC purposes?

For income tax purposes, there will be an amount counting as employment income of a (current, former or prospective) employee under Chapter 2 of Part 7A of ITEPA if four conditions are met. These four conditions are bulleted below.

- An arrangement has come through the “section 554A gateway” (that is, the conditions in section 554A(1) of ITEPA – see [EIM45025](#)).
- A “relevant third person” has taken a “relevant step”. A relevant step is an action which gives rise to Part 7A income by reason of the (current, former or prospective) employee’s employment with the employer – see [EIM45055](#) onwards. But a relevant step only gives rise to Part 7A income if it is taken by a relevant third person – see [EIM45035](#).

- None of the exclusions in Chapter 1 of Part 7A of ITEPA has prevented the relevant step from giving rise to Part 7A income. On these exclusions, see [EIM45200](#) onwards.
- The reliefs in Chapter 2 of Part 7A of ITEPA have not reduced this income to nil. On the calculation of Part 7A income, see [EIM45700](#) onwards.

For Class 1 NIC purposes, this amount of income will be deemed to be earnings derived from an employed earner's employment.

It will only be necessary to consider whether Part 7A applies if a payment is not already earnings for NICs purposes.

FAQ3 How are the earnings measured?

The amount counting as employment income for income tax purposes is deemed to be an amount of remuneration for NIC purposes. Therefore, the income tax measure is used to measure the earnings for NIC purposes.

If the income tax rules reduce the amount counting as employment income for income tax purposes, then there is a corresponding reduction in the amount of remuneration for NIC purposes. And, if the income tax rules reduce the amount counting as employment income for income tax purposes to nil, then the amount of remuneration for NIC purposes is nil too. See, for example, FAQ8.

FAQ10 discusses a case in which the amount for NIC is different from the amount for PAYE.

FAQ4 When are the earnings paid?

For Class 1 NIC purposes, the earnings are paid in the earnings period in which the relevant third person takes the relevant step giving rise to the Part 7A income under review.

On 'relevant step', see [EIM45055](#) onwards.

FAQ5 To whom are the earnings paid?

In a disguised remuneration case, an amount counts as employment income of an employed earner by virtue of Chapter 2 of Part 7A of ITEPA.

For Class 1 NIC purposes, this amount is deemed to be earnings, and the earnings are paid to or for the benefit of this employed earner.

FAQ6 Do the exclusions in Part 7A of ITEPA also apply for NIC purposes?

Yes. To the extent that an exclusion in Part 7A of ITEPA prevents an amount counting as employment income for income tax purposes, it will also prevent earnings arising for NIC purposes. On the exclusions in Part 7A, see [EIM45200](#) onwards.

FAQ7 Some of the exclusions in Part 7A of ITEPA are conditional exclusions; “fall-back charges” will be imposed if the conditions are breached. See, for example, [EIM45270](#) on section 554H(7) to (11) of ITEPA. Do these fall-back charges also give rise to NIC liability?

Yes. A fall-back charge deems a relevant step to be taken giving rise to an amount counting as employment income. This deemed relevant step gives rise to Class 1 NIC liability in the same way as an actual relevant step.

FAQ8 HMRC is offering employers who have used employee benefit trusts (EBTs) and similar arrangements the opportunity to resolve outstanding enquiries. If an employer reaches a settlement with HMRC, how will that affect the NIC position if a relevant third person takes a relevant step on or after 6 December 2011?

Details of the EBT settlement opportunity are set out on [the HMRC internet site](#).

There is the possibility of double taxation if what is effectively the same amount is:

- first taxed as earnings from the employment in relation to a step taken before 6 April 2011, and
- then taxed again under Part 7A of ITEPA 2003.

This could happen if there is a third party arrangement which results in employment income being taxed both as earnings from the employment and under Part 7A.

There are special rules to stop this double taxation by reducing the value of the relevant step to take account (to summarise) of the amount taxed. This reduction is sometimes called the “settlement credit”. These income tax rules are explained in [EIM45935](#) onwards.

If the settlement credit reduces the amount counting as employment income for income tax purposes under Part 7A, then it will likewise reduce the earnings for Class 1 NIC purposes.

Note that the settlement credit reduces the amount which is subject to income tax and Class 1 NIC as a result of the disguised remuneration rules. It does not give credit for tax against tax or NIC against NIC.

Differences between income tax and NIC

FAQ9 When do the new rules begin to apply?

The NIC rules come into force on 6 December 2011. They are not retrospective.

The income tax rules have effect in relation to relevant steps taken on or after 6 April 2011. And, for income tax purposes, anti-forestalling rules cover relevant steps taken in the period from 9 December 2010 to 5 April 2011. To the extent that a relevant step taken in that period has not been taken back before 6 April 2012, it will give rise to Part 7A income for 2012-13.

Relevant steps taken before 6 December 2011 (including relevant steps taken before 6 April 2011) will not give rise to NIC liability. But it must not be forgotten that normal NIC liability rules must still be considered in respect of these payments.

FAQ10 [EIM11813](#) explains that, if the relevant step is not the payment of a sum of money, the employer does not apply PAYE to employment income to which the remittance basis applies. In such a case, should the employer apply NIC and PAYE to the same amount?

No. There is no remittance basis in NIC. In such a case, the employer must apply NIC to the full amount counting as employment income, without any reduction for the remittance basis.

FAQ11 [EIM45865](#) explains that special income tax rules apply if the (current, former or prospective) employee under review has died. Do these rules also apply for NIC purposes?

No. If the relevant third person takes the relevant step after the employed earner's death, there is no Class 1 NIC liability in relation to the late employee.

FAQ12 Section 554Z13 of ITEPA prevents a further income tax charge arising after Part 7A income has arisen, if certain conditions are met. See [EIM45870](#). Does this rule also apply for NIC purposes?

No. New paragraph 2A in Part 10 of Schedule 3 to the Social Security (Contributions) Regulations 2001 provides that payments which represent or arise or derive from amounts which have already been treated as earnings under new regulation 22B are to be disregarded in the calculation of an employed earner's earnings for Class 1 NIC purposes.

New paragraph 2A is partly intended to ensure that amounts treated as earnings under regulation 22B are not subsequently liable to NIC a second time. To that extent, it performs a similar function to section 554Z13 of ITEPA. But it is not intended to be a direct NIC equivalent.

FAQ13 Section 554Z14 of ITEPA permits an application for income tax relief to be made where earmarking is not followed by a further relevant step. And sections 554Z14 and 554Z21 of ITEPA permit an application for income tax relief to be made where earmarking or provision of security is not followed by payment of a contribution or provision of a benefit. See [EIM45875](#) and [EIM45880](#). If income tax relief is given under these rules, will NIC relief be given too?

No. It is a long-standing principle of the NIC system that Class 1 NIC is not refunded unless the NIC has been paid in error. Where earmarking gives rise to a relevant step under section 554B of ITEPA with resulting income tax and NIC charges, the NIC payable will have been properly due at the time.