

NATIONAL INSURANCE CONTRIBUTIONS ACT 2008

EXPLANATORY NOTES

BACKGROUND

Specifying the amount of the Upper Earnings Limit

9. The National Insurance contribution rates and thresholds which include the upper earnings limit are reviewed each year and, where appropriate, changed each year in secondary legislation by reference to the retail price index. The power to set the upper earnings limit is conferred on the Treasury. The Treasury may increase or decrease the upper earnings limit; so far as increases are concerned, the power is limited in that the upper earnings limit can be set at no more than seven and a half times the primary threshold. The primary threshold is the point at which primary Class 1 contributions become payable on a person's earnings.

Changes

10. In his 2007 Budget speech the Chancellor of the Exchequer announced that from April 2009 the upper earnings limit would be aligned with the level at which higher rate income tax is payable. It is intended that this alignment will be achieved in two stages. The first stage was to increase the upper earnings limit by £75 per week above inflation for the 2008-09 tax year, by using existing powers. This increase was included as part of the normal 2008-09 up-rating exercise.
11. The second stage, subject to the usual Parliamentary process (which in this case would include Parliamentary approval) is to increase the upper earnings limit as part of the normal up-rating exercise, so that it is aligned with the level at which higher rate income tax becomes payable. To enable this second stage to take place, the existing restriction on the power to set the level of the upper earnings limit needed to be removed. The Act removes that restriction in relation to tax year 2009-10 and beyond.

Bringing forward introduction of the upper accrual point

12. In broad terms, for any given tax year state second pension accrues on the portion of an employee's annual earnings between the annual value of the lower earnings limit and the upper earnings limit for Class 1 National Insurance contributions (called the "surplus earnings factor"). This amount is revalued in line with the growth in average earnings up to the last full tax year of a contributor's working life. The accumulated surplus earnings factors are then divided by the number of years in the person's working life since 1978 to produce a "lifetime average" which is multiplied by the relevant accrual rate and divided by 52 to produce a weekly rate of additional pension.
13. For state second pension purposes earnings are split into three different bands with entitlement accruing at a different rate in each earnings band. People earning, or treated as earning, at or above the annual lower earnings limit accrue state second pension on

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a cumulative basis depending on the level of their earnings. Earnings above the annual upper earnings limit do not accrue state second pension.

14. Under the provisions of the Pensions Act 2007, state second pension is to be restructured to provide a simpler, flat-rate system. That Act provides for an upper accrual point to replace the upper earnings limit for the purpose of capping entitlement to the state second pension. On introduction the upper accrual point will be frozen in cash terms, leading to a gradual erosion of earnings-related accruals.
15. The upper accrual point was to be brought in along with a flat rate accrual amount of around £1.50 a week that would replace accruals on earnings between the lower earnings limit and the low earnings threshold. Taken together, it was expected (when the Pensions Bill that led to the Pensions Act 2007 was introduced) that these two measures would deliver entitlement to the state second pension on a completely flat rate basis by around 2030.

Changes

16. Following changes to align the upper earnings limit with the higher rate tax threshold as announced in Budget 2007, the Act introduces the upper accrual point from April 2009, before the introduction of the flat rate accrual amount.
17. The effect of the Budget 2007 announcements would have meant that without intervention, the level of the upper accrual point upon introduction in 2012 (as previously planned) would be significantly higher than that forecast in the Regulatory Impact Assessment provided for the Pensions Act 2007. As a consequence state second pension would have accrued on a greater amount of earnings than intended.
18. Bringing forward the introduction of the upper accrual point to April 2009, and fixing it at an amount broadly equivalent to the level that the upper earnings limit was projected to be at in 2012 prior to the Budget announcement, re-aligns with the proposals to achieve flat rate accruals by around 2030, set out in the Government White Paper: *Security in retirement: towards a new pension system*.
19. The upper accrual point will replace the upper earnings limit as the weekly upper cap on earnings when determining entitlement to the state second pension. It is set at £770 per week, the level of the upper earnings limit for 2008-09. It will be frozen in cash terms and together with the flat rate accrual amount provided in the Pensions Act 2007 will remove earnings-related accruals within the original time-span.
20. These changes affect calculations relating to the contracted-out rebate. If a pension scheme member is opted out of state second pension they receive a "rebate", which is based on the amount of state second pension foregone. The rebate is calculated on the same band of earnings on which state second pension accrues, and the Act therefore amends the rebate arrangements so as to reflect the introduction of the upper accrual point.

COMMENTARY ON SECTIONS

Section 1: Amount to be specified as upper earnings limit: Great Britain

21. [Section 1](#) amends sections 5 and 176(1) of the Social Security Contributions and Benefits Act 1992 ("the SSCBA 1992").
22. The effect of *subsection (1)* of this section is to remove the current restriction that prevents the upper earnings limit from being set by secondary legislation at an amount greater than seven and half times the primary threshold. This will allow the upper earnings limit to be aligned, by secondary legislation, with the higher rate income tax threshold in the future.

23. *Subsection (2)* inserts new paragraph (zb) in section 176(1). This provides that draft regulations which set the upper earnings limit must be laid before Parliament and approved by resolution of both the House of Commons and the House of Lords before the regulations can be made. The purpose of this is to compensate for the removal of the restriction on the exercise of the power currently provided by section 5(3) of the SSCBA 1992. This approach is similar to that for the change made by section 7(5) of the Pensions Act 2007 in respect of the power to set the lower earnings limit once the level of the basic state pension is linked to earnings (the lower earnings limit is the point at which earnings start to count for benefit purposes).
24. *Subsection (3)* provides that the changes made by subsection (1)(b) and (2) have effect in relation to regulations that specify the level of the upper earnings limit for all tax years from 2009-10 onwards.

Section 2: Amount to be specified as upper earnings limit: Northern Ireland

25. **Section 2** replicates the provisions of section 1 in respect of the equivalent Northern Ireland legislation.

Section 3: Additional pension: upper accrual point to replace upper earnings limit from 2009-10

26. Currently an employee builds up entitlement to the state second pension on earnings up to the upper earnings limit and on which Class 1 National Insurance contributions have been paid or, in the case of a person earning between the lower earnings limit and the primary threshold, have been treated as paid. Such earnings give rise to earnings factors that are used in the calculation of state second pension entitlement.
27. **Section 3** brings forward introduction of the upper accrual point (as to which see paragraphs 16 to 20 above).
28. *Subsection (2)* amends the definition of the “applicable limit” in section 22(2B) of the SSCBA 1992 replacing “the flat rate introduction year” (as introduced in the Pensions Act 2007 and which was to have been set by order) with the tax year in which the upper accrual point is to be introduced — the 2009-10 tax year. The effect of the amendment is to provide for the upper accrual point, as the cap on earnings factors in the state second pension, to be switched on from 2009-10. Prior to 2009-10 the applicable limit will remain as the upper earnings limit.
29. *Subsection (3)* amends section 44(7)(c) of the SSCBA 1992, as above, replacing “the flat rate introduction year” with “2009-10”.
30. *Subsection (4)(a)* replaces the definition of the “upper accrual point” and sets it at £770, which is the level of the upper earnings limit for 2008-09.
31. This subsection provides for a weekly upper accrual point in contrast to the annual limit as originally defined in section 12 of the Pension Act 2007. This caters for situations where, for example, there are more or less than 52 earnings periods in a tax year. The provision of a weekly upper accrual point also maintains the current alignment between the earnings that count for state second pension and those that count for rebate purposes, and lends itself more easily to the calculation of the relevant upper accrual point figure where an employee is paid other than on a weekly basis.
32. *Subsection (4)(b)* inserts subsection (6A) and (6B) into section 122 of the SSCBA 1992. Subsection (6A) is a regulation making power, to be exercised by the Treasury, which allows for regulations to be made that prescribe equivalents to the upper accrual point in relation to earners paid otherwise than weekly, for example monthly paid employees. Subsection (6B) ensures that the prescribed equivalents once calculated can be rounded to a whole pound figure. As the upper accrual point, once introduced, will be fixed, so too will the prescribed equivalents.

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33. *Subsection (4)(c)* repeals subsections (7) and (8), which were inserted by the Pension Act 2007 and which defined the upper accrual point and allowed the Secretary of State to vary by order the rate of the upper accrual point before its introduction.

Schedule 1: Consequential amendments

34. *Schedule 1* contains consequential amendments arising as a result of the introduction of the upper accrual point.
35. *Paragraphs 1 to 6* amend the SSCBA 1992.
36. *Paragraph 2* inserts new section 22(9). This is a minor technical change that provides that when calculating earnings factors derived from an employee's earnings for an employee paid other than weekly, any reference to earnings not exceeding the upper earnings limit or from 2009-10 the upper accrual point is to be read as a reference to earnings that do not exceed the prescribed equivalent.
37. *Paragraph 3(3)* inserts new section 23(3A), which provides that for the purpose of calculating additional pension from the tax year 2009-10 onwards the upper accrual point replaces the upper earnings limit as the cap on earnings factors.
38. *Paragraphs 4* amends section 44A by replacing the reference to the upper earnings limit, as the ceiling on deemed earnings factors for state second pension purposes, with a reference to the "applicable limit" provided in section 44.
39. *Paragraph 5* amends section 44B(2)(a) by replacing the now superfluous reference to the applicable limit with a reference to the upper accrual point. As the upper accrual point will be introduced from 2009-10 it will be the only ceiling relevant for earnings factors derived under the new deeming provisions for state second pension that take effect from 2010-11 onwards.
40. *Paragraph 6* makes amendments to paragraph 1 of Schedule 1, which deals with the calculation of National Insurance contributions where an earner is employed in more than one employment, to reflect the introduction of the upper accrual point from 2009-10. Where earnings from two or more employments are aggregated, the separate earnings are afforded a priority order. At present any contracted-out rate contributions are assessed on contracted-out earnings up to the upper earnings limit. The amendment, which takes into account earlier amendments made to paragraph 1 by the Pensions Act 2007, ensures that where earnings from two or more employments are aggregated after 6 April 2009, any contracted-out rate contributions are assessed on contracted-out earnings up to the upper accrual point.
41. *Paragraphs 7 to 13* amend the Pension Schemes Act 1993 as a result of bringing forward the introduction of the upper accrual point and setting it at the level of the 2008-09 upper earnings limit.
42. *Paragraphs 8, 11 and 12* cover changes required to the contracting-out arrangements for defined contribution (money purchase) schemes as a consequence of the changes to the state second pension. The amendments have the effect of mirroring the change to the band of earnings on which state second pension accrues (ie the upper accrual point replacing the upper earnings limit as the maximum amount of earnings on which state second pension accrues) in certain calculations connected with the contracted-out rebate. The amendments ensure that this change is reflected in:
- the definition of "minimum payments" (paragraph 8);
 - the band of earnings on which reduced rate of Class 1 contributions and rebates are paid in respect of members of money purchase contracted-out schemes (paragraph 11);
 - the band of earnings on which "minimum contributions" are paid to members of appropriate personal pension schemes (paragraph 12).

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43. Paragraphs 9, 10 and 13 cover the changes required to the arrangements for defined benefit (salary related) schemes as a consequence of the decision to introduce the upper accrual point from 2009-10. These amendments revise those made in the Pensions Act 2007 when the upper accrual point introduction date was planned for 2012. The amendments ensure that the change is reflected in:
- the calculation of reference scheme test benefits (paragraph 9);
 - the band of earnings on which reduced rates of Class 1 contributions are paid in respect of members of salary related contracted-out schemes (paragraph 10);
 - the band of earnings on which the rebate is paid in cases of bankruptcy where the employer must make, as a priority, a payment to the scheme of outstanding contributions in relation to the rebate (paragraph 13).