These notes refer to the National Insurance Contributions Act 2015 (c.5) which received Royal Assent on 12 February 2015

NATIONAL INSURANCE CONTRIBUTIONS ACT 2015

EXPLANATORY NOTES

SUMMARY AND BACKGROUND

Overview of NICs

4. The National Insurance Scheme was first established in 1911 and expanded in the late 1940s to provide funds for a more comprehensive and inclusive range of contributory benefits and to provide assistance with the funding for a new National Health Service.

5. Receipts from contributions are paid into the National Insurance Fund (NIF). Money kept in the NIF is separate from all other revenue raised by national taxes. The NIF is used exclusively to pay for contributory benefits and operates on a pay as you go basis: broadly speaking, this year's contributions pay for this year's benefits.

6. Briefly, the scheme consists of a number of benefits financed by NICs payable by earners, employers and others. Employees pay NICs on their earnings, employers pay NICs on the earnings they pay to their employees and the self-employed pay flat rate NICs and NICs on their profits and gains.

7. An earner can be either an employed earner or a self-employed earner. An employed earner is a person who is gainfully employed in Great Britain or Northern Ireland either under a contract of service, or in an office (including elective office) with earnings. A self-employed earner is a person who is gainfully employed in Great Britain or Northern Ireland otherwise than as an employed earner. Provision is made within the scheme to allow those who are not compulsorily covered to protect their entitlement to state retirement pension and bereavement benefits by means of voluntary NICs payments.

8. NICs are currently divided into six classes:

   - Class 1 contributions, which are paid by both employees and employers on the employee's earnings, are payable at 12% and 2% by employees and 13.8% by employers.

   - Class 1A contributions are payable annually, by employers only, on most taxable benefits in kind. Class 1A contributions are payable at a rate of 13.8%.

   - Class 1B contributions are payable annually, by employers on items which are dealt with under a PAYE Settlement Agreement (PSA) for income tax. Class 1B contributions are payable at a rate of 13.8% on the value of items included in the PSA and on the total tax payable by the employer under the PSA.

   - Class 2 contributions are paid by the self-employed at a flat rate of £2.75 per week for the 2014-15 tax year. Class 2 contributions are paid either monthly or six monthly. An individual whose earnings from self-employment are below a set level, which is £5,885 for 2014-15 (referred to as the small earnings exception (SEE)) and which is approximately equivalent to the exception limit that applies to employed earners[1], may apply for exception from Class 2 contributions on the grounds of low earnings.

- Class 3 contributions are payable at a flat weekly rate of £13.90 per week for the 2014-15 tax year by people who are not otherwise liable to pay Class 1 or Class 2 contributions, to protect entitlement to State Pension.

- Class 4 contributions are paid annually by the self-employed on profits chargeable to tax as trading income. Class 4 NICs are payable at a rate of 9% on profits between a lower and upper profits limit and 2% on profits above the upper profits limit.

9. An additional class of NICs (Class 3A) was introduced in the Pensions Act 2014 (section 25) and will be payable on a voluntary basis for a limited period by those who reach state pension age before 6 April 2016.

Zero-rate secondary Class 1 contributions for apprentices under 25

10. The Government announced at Autumn Statement 2014 that it would introduce a zero-rate of secondary Class 1 NICs on earnings paid to apprentices under the age of 25 from 6 April 2016. Secondary Class 1 NICs are the contributions paid by employers and others who pay earnings. The zero-rate will apply to earnings up to the upper secondary threshold (to be provided for in regulations), for those employees.

11. The Act introduces the zero-rate and also provides for regulation-making powers exercisable by the Treasury to:

- define apprentice;
- vary the age group for which the zero-rate applies; and
- introduce an earnings threshold above which the zero-rate would not apply.

Simplifying NICs paid by the self-employed

12. At Budget 2014 the Government announced that the collection of Class 2 NICs would be moved into self-assessment (SA) so that the self-employed could deal with their Class 2 NICs together with their income tax and Class 4 NICs. This followed a 2012 recommendation by the Office of Tax Simplification and a consultation published in July 2013 entitled *Simplifying the National Insurance Processes for the Self-Employed*, which sought views on proposals to simplify Class 2 NICs.

13. This simplification will:

- change the way in which Class 2 NICs are structured;
- change the means by which Class 2 NICs are collected; and
- change the means by which Class 2 NICs are enforced with changes to associated appeal rights.

14. An overview of the way NICs currently works for the self-employed is contained in Annex A to these Explanatory Notes, together with a summary of the changes being made.

Follower notices and accelerated payments

15. The Government confirmed at Autumn Statement 2013 that it would introduce a new measure where HMRC would send a 'follower notice' to users of avoidance schemes that have failed in another party's litigation, setting out HMRC's view that they should settle their tax dispute. If they decide not to settle the dispute they would risk a penalty.

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1 Employed earners do not pay NICs until their earnings reach the Primary Threshold but they are treated as having paid NICs from a lower threshold referred to as the Lower Earnings Limit (LEL). Employed earners pay no NICs below the LEL.

16. The Government also announced at Autumn Statement that a taxpayer who chose not to settle on receipt of a follower notice would be required to make an accelerated payment of the tax in dispute.

17. The consultation paper *Tackling marketed tax avoidance* was published on 24 January 2014. It set out the proposals and draft legislation for the further stages of the accelerated payment measures.

18. A follower notice sets out HMRC's view that a judicial decision determines a taxpayer's case and will invite them to settle their case. They will face a tax-geared penalty if they unsuccessfully continue with their case and cannot show either it was materially different from the other party's litigation or that they had reasonable grounds to continue the dispute.

19. Accelerated payments may be required from taxpayers in the following circumstances:

- Where a follower notice has been issued and the taxpayer decides not to settle their dispute;
- Where taxpayers are involved in schemes subject to disclosure under the Disclosure of Tax Avoidance Schemes (DOTAS) rules; or
- Where taxpayers have used arrangements that HMRC decides to counteract under the General Anti-Abuse Rule (GAAR), and where the Advisory Panel gives its opinion that the arrangements are not a reasonable course of action.

20. This Act applies the Finance Act 2014 (FA 2014) provisions to NICs ensuring that there is a single follower notices regime and accelerated payments regime for tax and NICs.

High risk promoters of avoidance schemes

21. FA 2014 includes legislation that will allow HMRC to issue conduct notices to promoters of tax avoidance schemes and monitor promoters who breach them. This Act applies FA 2014 provisions to promoters of NICs avoidance schemes ensuring that equivalent provision is made in respect of NICs.

22. Monitored promoters will be subject to new information powers and penalties which will also apply to intermediaries that continue to represent them after the monitoring commences. The monitored promoter will be named by HMRC, details of the breach of the conduct notice will be published and the promoter will be required to inform its clients that it is being monitored by HMRC. Clients of monitored promoters will also be subject to certain obligations (with a penalty for non-compliance) and extended time limits for assessments.

Targeted Anti Avoidance Rule to prevent people from circumventing new legislation tackling avoidance involving employment intermediaries

23. The temporary labour market is quick to react to any legislative changes and to find new ways of reducing income tax and NICs. Stakeholders have indicated that intermediaries involved in the facilitation of false self-employment may use avoidance vehicles and set up structures specifically designed to circumvent the legislation introduced by amending the Social Security (Categorisation of Earners) Regulations 1978 (as amended by the Social Security (Categorisation of Earners) (Amendment) Regulations 2014). This Act includes a targeted anti-avoidance rule (TAAR) to deter such avoidance focussing on:

- the motive for setting up the arrangements – that they are set up with the motive of avoiding NICs under certain provisions themselves aimed at counteracting avoidance through false self-employment, intermediaries and structures involving overseas elements; and
- what it achieves – does it result in less NICs being paid?