These notes refer to the Welfare Reform and Pensions Act 1999 (c.30) which received Royal Assent on 11 November 1999

WELFARE REFORM AND PENSIONS ACT 1999

EXPLANATORY NOTES

OVERVIEW

National Insurance contributions (NICs)

Background

In his 1998 Budget, the Chancellor of the Exchequer announced a package of reforms to the structure of NICs. Most of these changes were introduced in the Social Security Act 1998, and came into effect in April 1999. As a result:

The point at which *employers* start to pay NICs (the employer earnings threshold) is set at the same level as the single person's tax allowance (currently £83 a week) rather than the Lower Earnings Limit (currently £66 a week);

Employees no longer have to pay any contributions on earnings up to and including the Lower Earnings Limit, and *employers* do not pay any contributions on earnings below the employer earnings threshold;

The four employer rates of contributions have been replaced by a single rate of 12.2%, and Class 1B contributions have been introduced. Class 1B contributions are paid by employers who enter into a PAYE Settlement Agreement with Inland Revenue for tax.

The Chancellor also announced in 1998 that he would raise the point at which employees start to pay NICs to the level of the single person's tax allowance as soon as measures were in place to protect people against the benefit losses that would otherwise result. These changes were confirmed in the 1999 Budget. In his 1999 Budget statement, the Chancellor also announced that the Upper Earnings Limit (UEL) for employee contributions would be raised to £535 a week in 2000, and £575 in 2001; and that changes would be made to counter National Insurance avoidance where services are provided through an intermediary.

The measures in the Act

These Budget changes, including protection for benefit rights on earnings between the Lower Earnings Limit and the new threshold, were introduced as amendments to the Bill at Commons Committee and Report. The Act also contains various other minor NICs measures.

The NICs measures in the Act are contained in sections 73-78 and 81; and Schedules 9-11). Section 73 introduces Schedule 9, which:

Introduces a new primary earnings threshold from which employees will start to pay NICs. In two stages, the threshold will be raised to the single person's tax allowance. It is being set at £76 a week in April 2000, with full alignment in April 2001;

Protects benefit rights for earnings between the Lower Earnings Limit and the new threshold. This will ensure that people with earnings below the new threshold are not prevented from building up their entitlement to contributory benefits; and

Provides for the Upper Earnings Limit (UEL) for employee contributions to be set as a multiple of the new threshold. This will enable it to be raised to £535 a week in 2000 and £575 in 2001, in line with the Chancellor's Budget statement.

Section 74 introduces Schedule 10, which makes corresponding provision for Northern Ireland.

Sections 75 and 76 contain new measures to counter National Insurance avoidance, where services are provided through an intermediary. Most employers engage staff direct under a contract of service, paying Class 1 NICs, and income tax through Pay As You Earn (PAYE). They may also hire staff under a contract for services where the person being hired is self-employed. Sections 75 and 76 concern the situation where an individual is hired through a third party (such as a service company) in order to escape any direct contractual relationship between the client and the worker. This provides scope for avoiding tax and National Insurance, and can also lead to a loss of the worker's legal employment rights. Section 75 gives the power to ensure that, if the normal tests of employment and self-employment show that the worker would otherwise be an employee of the client, any payments made by the client in respect of that worker may be treated as earnings for National Insurance purposes. Section 76 makes corresponding provision for Northern Ireland. Matching tax proposals will be made in the Finance Bill introduced in 2000.

The Act also contains three further minor NICs measures. These:

alter the way in which the Class 1B rate of NICs payable on items employers include in PAYE settlement agreements (PSAs) is set (sections 77 & 78). The previous legislation allowed the Government to vary the rate in regulations independently of the main employer's rate. Now the rate of Class 1B is tied directly to the rate of employer (Class 1) contributions;

remove references in existing legislation to the payment of NICs by means of adhesive stamps (Schedule 13, Parts VI & VII); and

make a number of minor amendments and corrections arising from the Social Security Contributions (Transfer of Functions, etc.) Act 1999 (section 81, which introduces Schedule 11). The amendments do not in any way affect the intention of this Act, which transferred NICs policy and the Contributions Agency to the Inland Revenue.