

2003 No. 2085

SOCIAL SECURITY

**The Social Security (Contributions) (Amendment No. 5)
Regulations 2003**

<i>Made</i> - - - -	<i>11th August 2003</i>
<i>Laid before Parliament</i>	<i>11th August 2003</i>
<i>Coming into force</i> - -	<i>1st September 2003</i>

The Treasury, with the concurrence of the Secretary of State, in exercise of the powers conferred upon them by sections 3(2), 4(6) and (7), 10(9) and 175(3) of the Social Security Contributions and Benefits Act 1992(a) and, with the concurrence of the Department for Social Development, in exercise of the powers conferred upon them by sections 3(2), 4(6) and (7), 10(9) and 171(3) of the Social Security Contributions and Benefits (Northern Ireland) Act 1992(b), and the Commissioners of Inland Revenue in exercise of the powers conferred upon them by paragraph 6(1) of Schedule 1 to each of those Acts(c), make the following Regulations:

Citation and commencement

1. These Regulations may be cited as the Social Security (Contributions) (Amendment No. 5) Regulations 2003 and shall come into force on 1st September 2003.

Interpretation

2. In these Regulations “the principal Regulations” means the Social Security (Contributions) Regulations 2001(d).

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- (a) 1992 c. 4 (“the 1992 Act”). Relevant amendments to section 3 were made by paragraph 3 of Schedule 3 to the Social Security Contributions (Transfer of Functions, etc.) Act 1999 (c. 2: “the Transfer Act”). Relevant amendments to section 4 were made by section 50(2) of the Social Security Act 1998 (c. 14: “the 1998 Act”), paragraph 4 of Schedule 3 to the Transfer Act, section 74(3) of the Child Support, Pensions and Social Security Act 2000 (c. 19: “the 2000 Act”), paragraph 172(4) of Schedule 6 to the Income Tax (Earnings and Pensions) Act 2003 (c.1: “ITEPA 2003”). Section 10 was substituted by section 74(2) of the 2000 Act: the relevant amendment is that made by paragraph 174(12) of Schedule 6 to ITEPA 2003.
- (b) 1992 c. 7 (“the 1992 Northern Ireland Act”). Relevant amendments to section 3 were made by paragraph 4 of Schedule 3 to the Social Security Contributions (Transfer of Functions, etc.) (Northern Ireland) Order 1999 (S.I. 1999/671: “the Transfer Order”). Relevant amendments to section 4 were made by Article 47(2) of the Social Security (Northern Ireland) Order 1998 (S.I. 1998/1506 (N.I. 10): “the 1998 Order”), paragraph 5 of Schedule 3 to the Transfer Order, section 78(3) of the 2000 Act and paragraph 193(4) of Schedule 6 to ITEPA 2003. Section 10 was substituted by section 78(2) of the 2000 Act: the relevant amendment is that made by paragraph 195(12) of Schedule 6 to ITEPA 2003. The functions of the Department of Health and Social Services for Northern Ireland under the 1992 Northern Ireland Act were transferred to the Department for Social Development by Article 8(b) of, and Part II of Schedule 6 to, the Departments (Transfer and Assignment of Functions) Order (Northern Ireland) 1999 (S.R. 1999 No. 481).
- (c) Paragraph 6 of Schedule 1 to the 1992 Act was amended by paragraph 77(8) of Schedule 7 to the 1998 Act, paragraph 35(2) of Schedule 3 to the Transfer Act and paragraph 185 of Schedule 6 to ITEPA 2003. Paragraph 6 of Schedule 1 to the 1992 Northern Ireland Act was amended by paragraph 58(8) of Schedule 6 to the 1998 Order, paragraph 34(2) of Schedule 3 to the Transfer Order and paragraph 204 of Schedule 6 to ITEPA 2003.
- (d) S.I. 2001/1004: relevant amendments are made by S.I. 2001/2412, 2002/307 and 2003/1059 and 1337. Regulation 156(3) provides a rule of construction in relation to Northern Ireland for references in the principal Regulations to enactments applying only to Great Britain.

Amendment of the principal Regulations

3. The principal Regulations are amended as follows.

4. In regulation 1(2) (interpretation)—

- (a) omit the definition of “convertible shares”;
- (b) in the definition of “readily convertible asset” for the words from “section 203F” to the end substitute “section 702 of ITEPA 2003(a) as amended by the Finance Act 2003;”;
- (c) after the definition of “regular interval” insert—
““restricted securities” and “restricted interest in securities” have the meanings given in sections 423 and 424 of ITEPA 2003(b) as substituted by the Finance Act 2003;”;
- (d) after the definition of “secondary contributor” insert—
““securities” and “securities option” have the meaning given by section 420 of ITEPA 2003(c) as substituted by the Finance Act 2003;”.

5.—(1) Amend regulation 22 (payment to be treated as earnings)(d) as follows.

(2) In the heading for “Payment” substitute “Amounts”.

(3) In paragraph (1) for “(2) to (5)” substitute “(2) to (8)”.

(4) For paragraphs (3) to (5) substitute—

“(3) The amount specified in this paragraph is the amount equal to the cash equivalent in respect of car fuel which is treated as earnings from the employment of the earner for income tax purposes by virtue of section 149 of ITEPA 2003.

(4) The amount specified in this paragraph is the amount which is treated as earnings from the employment of the employed earner by virtue of section 222(2) of ITEPA 2003(e).

(5) The amount specified in this paragraph is the amount which counts as employment income of the employed earner under Chapter 2 of Part 7 of ITEPA 2003 computed in accordance with section 428 of ITEPA 2003(f) in respect of conditional shares or interests in conditional shares acquired before 16th April 2003.

References in this paragraph and paragraph (6) to ITEPA 2003 are to that Act as originally enacted.

(6) The amount specified in this paragraph is the amount which counts as employment income of the employed earner by virtue of Chapter 4 of Part 7 of ITEPA 2003 (shares: post-acquisition charges) in respect of shares or interests in shares acquired before 16th April 2003.

(7) The amounts specified in this paragraph are those—

- (a) which count as employment income of the employed earner in relation to employment-related securities (within the meaning given by section 421B(8) of ITEPA 2003(g)); and
- (b) to which section 698 of ITEPA 2003 (PAYE: special charges on employment-related securities) (h) applies.

References in this paragraph to ITEPA 2003 are to that Act as amended by Schedule 22 to the Finance Act 2003.

(a) Section 702 is amended by paragraph 15 of Schedule 22 to the Finance Act 2003 (c. 14). Schedule 22 to that Act is referred below as “Schedule 22”. The definition of “ITEPA 2003” was inserted into section 122(1) of the 1992 Act by paragraph 178, and into section 121(1) of the 1992 Northern Ireland Act by paragraph 199, of Schedule 6 to ITEPA 2003.

(b) Sections 423 and 424 are substituted by paragraph 3(1) of Schedule 22.

(c) Section 420 is substituted by paragraph 2(1) of Schedule 22.

(d) Regulation 22 was amended by regulation 4 of S.I. 2002/307.

(e) Section 222 was amended by section 144 of the Finance Act 2003.

(f) Section 428 is substituted by paragraph 3(1) of Schedule 22, subject to the saving contained in paragraph 3(2) of that Schedule in relation to securities and interests in securities acquired before 16th April 2003.

(g) Section 421B was inserted by paragraph 2(1) of Schedule 22.

(h) Section 698 is substituted by paragraph 12(1) of Schedule 22, subject to the saving in sub-paragraph (2) of that paragraph.

- (8) The amount specified in this paragraph is the amount—
- (a) which counts as employment income of the employed earner by virtue of sections 500 to 508 of ITEPA 2003; and
 - (b) in respect of which income tax is recoverable in accordance with PAYE regulations.”.

6.—(1) Amend regulation 40 (prescribed emoluments in respect of which Class 1A contributions not payable)(a) as follows.

- (2) In the heading, and in paragraph (1), for “emoluments” substitute “general earnings”(b).
- (3) In each of paragraphs (2) to (6) for “emoluments”—
 - (a) where it occurs for the first time substitute “general earnings”; and
 - (b) where it occurs for the second time substitute “those”.
- (4) For paragraph (4)(b) substitute—

“(b) are not removal expenses to which section 271 of ITEPA 2003 applies.”.
- (5) Omit paragraph (6)(a).
- (6) After paragraph (6) insert—

“(6A) The general earnings prescribed by this paragraph are those by way of any benefit—

 - (a) pursuant to a retirement benefits scheme which is not “non-approved” for the purpose of section 387(2) of ITEPA 2003; or
 - (b) to which section 386 of ITEPA 2003 (charge on payments to non-approved retirement benefits schemes) does not apply by virtue of section 390 of that Act.”.
- (7) In paragraph (7)(c)—
 - (a) for the words from the beginning of the paragraph to “by virtue of” substitute—

“The general earnings prescribed by this paragraph are so much of any general earnings as are not charged to income tax as employment income by virtue of”;
 - (b) omit sub-paragraphs (b), (d) and (g) to (o); and
 - (c) for the words from “Sub-paragraphs (b) and (q) do not” to the end of the paragraph substitute—

“Sub-paragraph (f) applies only to Scotland and sub-paragraph (q) does not apply to Northern Ireland.”.
- (8) In paragraph (8) omit the definition of “emolument”.

7.—(1) Amend Schedule 2 (calculation of earnings for the purposes of earnings-related contributions in particular cases) as follows.

- (2) In paragraph 5 for “the amount of income likely to be chargeable to tax under Schedule E”, in each place where it occurs, substitute “the amount of general earnings”.
- (3) For paragraph 7 and the heading preceding it substitute—

“Convertible and restricted interests in securities and convertible and restricted securities

7. The amount of earnings comprised in any payment by way of the conferment of—
- (a) a convertible interest in securities;
 - (b) a restricted interest in securities; or

(a) Regulation 40 was amended by regulation 3 of S.I. 2001/2412.

(b) A definition of “general earnings” was inserted into section 122(1) of the 1992 Act and section 121(1) of the 1992 Northern Ireland Act by the provisions noted in footnote (a) on page 2.

(c) Sub-paragraph (a) was omitted by regulation 3 of S.I. 2001/2412.

- (c) an interest in convertible or restricted securities,

falling to be taken into account in computing a person's earnings from employed earner's employment shall be computed in the same manner, and shall be taken into account at the same time, as applies under Chapters 1 to 5 of Part 7 of ITEPA 2003, as substituted or inserted by Schedule 22 to the Finance Act 2003(a), for the purpose of computing his employment income.”.

- (4) Omit paragraphs 8 to 10.
- (5) For paragraph 11 and the heading preceding it substitute—

“Exercise of a replacement right to acquire shares, obtained as an earner before 6th April 1999

11.—(1) This paragraph applies if—

- (a) an earner obtained, before 6th April 1999, a right to acquire shares in a body corporate;
- (b) the earner subsequently obtained a replacement right (within the meaning given in paragraph 16A(3) of Part 9 of Schedule 3(b));
- (c) the replacement right is exercised;
- (d) paragraph 11A of this Schedule(c) does not apply; and
- (e) paragraph 16A of Part 9 of Schedule 3 does not apply because sub-paragraph (4) of that paragraph is not satisfied.

(2) If this paragraph applies, the amount of earnings comprised in any payment realised by the exercise of the replacement right shall be calculated or estimated in accordance with sub-paragraph (3).

(3) The basis for calculating the amount of a gain realised by the exercise of the replacement right shall be the best estimate that can reasonably be made of the amount found as follows.

Step One

Find the amount (if any) by which the sum of—

- (a) the market value of the shares acquired by the exercise of the replacement right; and
- (b) the market value of any other benefit in money or money's worth obtained by the exercise of the replacement right;

exceeds the amount required to be paid for the exercise of that right.

(a) See paragraphs 2 to 10 of Schedule 22.

(b) Paragraph 16A is inserted by regulation 12(13) of this instrument as part of the substitution for the former paragraph 16.

(c) Paragraph 11A was inserted by regulation 3 of S.I. 2003/1059.

Step Two

Find the amount (if any) by which the market value of the shares, which were the subject of the right assigned or released on the first occasion in respect of which the condition in paragraph 16A(4) of Part 9 of Schedule 3 is not satisfied, exceeds the amount required to be paid for the exercise of that right immediately before that time.

Step Three

Subtract the amount found by Step Two from the amount found by Step One.

Step Four

Subtract from the result of Step Three—

- (a) any amount taken into account in computing the earner's earnings for the purposes of Class 1 contributions at the time of the grant of the first right; and
- (b) any amount given by or on behalf of the earner as consideration for the acquisition of the first right or any replacement right, but "consideration" does not include the value of any right assigned or released in exchange for the acquisition of a replacement right.

Subject to the following qualification, the result of this step is the amount of earnings referred to in sub-paragraph (2) above.

If the result of this step is a negative value, it is treated as nil for the purposes of computing the earner's earnings.

(4) In this paragraph—

- (a) "market value" means the price which the shares which are the subject of the right in question might reasonably be expected to fetch on a sale in the open market;
- (b) neither the consideration given for the grant of any right to acquire shares, nor any entire consideration, shall be taken to include the performance of the duties in connection with the office or employment by reason of which the right was granted;
- (c) no amount or value of the consideration given for the grant of a right to acquire shares shall be taken into account more than once;
- (d) "shares" includes stock;
- (e) "body corporate" includes—
 - (i) a body corporate constituted under the law of a country or territory outside the United Kingdom; and
 - (ii) an unincorporated association wherever constituted; and
- (f) references to the release of a share option include agreeing to the restriction of the exercise of the option."

(6) In paragraph 11A(2) after "paragraph 16" insert "or 16A".

(7) Omit paragraph 12.

8. Amend Schedule 3 (payments to be disregarded in the calculation of earnings for the purposes of earnings-related contributions) in accordance with regulations 9 to 13.

9. In Part 1 (introductory), in paragraph 1(5)(d), for "share incentives" substitute "incentives by way of securities".

10.—(1) Amend Part 3 (payments by way of readily convertible assets which are not disregarded as payments in kind) as follows.

(2) For paragraphs 1 and 2 substitute—

“1. A readily convertible asset within the meaning of section 702 of ITEPA 2003(a).

2. An asset which, in accordance with section 697 of ITEPA 2003 (PAYE: enhancing the value of an asset), would be treated, for the purposes of section 696 of that Act, as a readily convertible asset.”.

11. In Part 4 (payments by way of specific assets not disregarded as payments in kind)—

(a) for paragraph 1 and the heading preceding it substitute—

“Securities

1. Securities.”;

(b) omit paragraphs 2 to 5;

(c) omit paragraphs 7 and 8; and

(d) in paragraph 11(a) (certificates conferring rights in respect of assets) for “1 to 4” substitute “1”.

12.—(1) Amend Part 9 as follows.

(2) For the heading substitute—

“INCENTIVES BY WAY OF SECURITIES”.

(3) For paragraph 1 and the heading preceding it substitute—

“Certain payments by way of securities, restricted securities and restricted interests in securities, and gains arising from them, disregarded

1. Payments by way of securities, restricted securities and restricted interests in securities, and gains arising from them, are disregarded in the calculation of an employed earner’s earnings to the extent mentioned in this Part.”.

(4) Omit paragraph 2.

(5) For paragraph 3 (rights to acquire shares) and the heading preceding it substitute—

“Rights to acquire securities

3. A payment by way of a right to acquire securities.”.

(6) Omit paragraphs 3A(b) and 4.

(7) For paragraph 5 and the heading preceding it substitute—

“Priority share allocations

5. A payment by way of an allocation of shares in priority to members of the public in respect of which no liability to income tax arises by virtue of section 542 of ITEPA 2003.”.

(8) In paragraph 6 for “paragraph 34 of Schedule 8 to the Finance Act 2000.” substitute “paragraph 44 of Schedule 2 to ITEPA 2003.”.

(9) For paragraph 7 and the heading preceding it substitute—

“Shares under share incentive plans

7. A payment by way of an award of shares under a share incentive plan within the meaning of Schedule 2 to ITEPA 2003.

(a) Subsections (5A) to (5D) were inserted, and subsection (6) amended, by paragraph 15(2) and (3) of Schedule 22.

(b) Paragraph 3A was inserted by regulation 5 of S.I. 2001/2412.

Securities and interests in securities which are not readily convertible assets

7A. A payment by way of the acquisition of securities, interests in securities or securities options in connection with employed earner's employment if, or to the extent that, what is acquired is not a readily convertible asset.

Here "acquisition" includes acquisition pursuant to an employment-related securities option within the meaning of section 471(5) of ITEPA 2003 as substituted by the Finance Act 2003(a).".

(10) Omit paragraph 8.

(11) For paragraph 9 and the heading preceding it substitute—

"Restricted securities and restricted interests in securities

9.—(1) A payment by way of the acquisition of restricted securities, or a restricted interest in securities, where those securities are, or that interest is, employment-related, if no charge to income tax arises under section 425 of ITEPA 2003(b) other than by virtue of subsection (2) of that section.

This is subject to the following qualification.

(2) This paragraph does not apply if an election has been made as mentioned in subsection (3) of section 425 of ITEPA 2003.

(3) References in this paragraph to section 425 of ITEPA 2003 are to that section as substituted by paragraph 3(1) of Schedule 22 to the Finance Act 2003.".

(12) Omit paragraphs 10 to 15.

(13) For paragraph 16 and the heading preceding it substitute—

"Exercise of options acquired before 6th April 1999

16.—(1) A gain realised by the exercise (in whole or in part) of a right, obtained before 6th April 1999, to acquire shares in a body corporate unless paragraph 17(c) applies, but only to the extent that the gain realised consists of the shares acquired.

(2) In this paragraph and paragraphs 16A and 17—

"shares" includes stock; and

"body corporate" includes—

(a) a body corporate constituted under the law of a country or territory outside the United Kingdom; and

(b) an unincorporated association wherever constituted.

Exercise of replacement share options where original option acquired before 6th April 1999

16A.—(1) A gain realised by the exercise of a replacement right to acquire shares in a body corporate where the original right was obtained before 6th April 1999 provided that—

(a) sub-paragraph (4) is satisfied, and

(b) paragraph 17 does not apply,

The disregard conferred by this paragraph is subject to the following limitation.

(2) Only the value of the shares acquired by the exercise of the replacement right shall be disregarded.

(a) Section 471(5) is substituted by paragraph 10(1) of Schedule 22.

(b) Section 425 is substituted by paragraph 3(1) of Schedule 22.

(c) Paragraph 17 was inserted by regulation 4 of S.I. 2003/1059.

(3) In this paragraph and paragraph 17—

“the original right” means the right, acquired before 6th April 1999, to acquire shares in a body corporate; and

“replacement right” means a right to acquire shares, obtained, whether as the result of one transaction or a series of transactions, and whether directly or indirectly, in consequence of—

- (a) the assignment or release of the original right; or
- (b) the assignment or release of a right which was itself obtained in consequence of the assignment or release of that right.

(4) This sub-paragraph is satisfied in respect of a transaction through which the replacement right was obtained if **A** is not substantially greater than **R**.

Here—

A is the market value of the shares which may be obtained by the exercise of the right acquired on that occasion, less any consideration which would have to be given on that occasion by or on behalf of the earner if that right were to be exercised immediately after its acquisition (disregarding any restriction on its exercise); and

R is the market value of the shares subject to the right assigned or released on that occasion, immediately before that occasion, less any consideration which would have been required to be given by or on behalf of the earner for the exercise of that right, disregarding any restriction on its exercise, subject to the following qualification.

If a transaction involves only a partial replacement of an earlier right, the amount of the earlier consideration to be deducted in computing **R** shall be proportionately reduced.”.

(14) In paragraph 17—

- (a) in sub-paragraph (1)(b) after “paragraph 16” insert “or 16A”;
- (b) in sub-paragraph(2)(b)—
 - (i) for “subsequent right” substitute “replacement right”; and
 - (ii) for “the replacement right and any subsequent replacement right.” substitute “a replacement right.”.

13. In Part 10 (miscellaneous and supplemental)(a)—

- (a) in paragraph 1 for “2 to 16” substitute “2 to 17”; and
- (b) at the end add—

“Payment of PAYE tax in respect of notional payment

17. A payment by way of income tax for which the employer is required to account to the Board under section 710(1) of ITEPA 2003 (notional payments: accounting for tax).”.

14.—(1) Amend Schedule 4 (provisions derived from the Income Tax Acts and the Income Tax (Employments) Regulations 1993) as follows.

- (2) In paragraph 7(5A)(b) (b) for “shares” substitute “securities”.
- (3) In the heading preceding paragraph 23(additional return by employer at end of year where liability transferred to employed earner: share option gains) for “share option gains” substitute “gains from securities options”.
- (4) In paragraph 23(2) for “92 days” substitute “7th July”.

(a) Part 10 was amended by S.I. 2001/2412 and 2002/2924.
(b) Sub-paragraph (5A) was inserted by regulation 2(4) of S.I. 2003/1337.

Jim Murphy
Joan Ryan

11th August 2003
The Secretary of State concurs.
Signed by authority of the Secretary of State

Two of the Lords Commissioners of Her Majesty's Treasury

Malcolm Wicks
Parliamentary Under-Secretary of State
Department for Work and Pensions

The Department for Social Development concurs.
Sealed with the Official Seal of the Department for Social Development on 31st July 2003.



John O'Neill
Senior Officer of the Department for Social Development

Nick Montagu
Helen Ghosh

6th August 2003

Two of the Commissioners of Inland Revenue

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations amend the Social Security (Contributions) Regulations 2001 (S.I. 2001/1004: “the principal Regulations”), mainly in consequence of changes to the taxation of share-based earnings introduced by Schedule 22 to the Finance Act 2003 (c. 14) and the rewriting of the law on income tax by the Income Tax (Earnings and Pensions) Act 2003 (c. 1: “ITEPA 2003”).

Regulation 1 provides for the citation and commencement of the Regulations, and regulation 2 for interpretation.

Regulation 3 introduces the amendments to the principal Regulations.

Regulation 4 amends regulation 1(2) of the principal Regulations by amending, inserting or deleting definitions consequent on the following amendments.

Regulation 5 amends regulation 22 of the principal Regulations by substituting new paragraphs (paragraphs (5) to (8)) for the existing paragraphs (3) and (4) to reflect changes made to the provisions on the taxation of share-based income in ITEPA 2003 by the Finance Act 2003. It also amends regulation 22 to treat as earnings sums on which an employee is taxable under section 222 of ITEPA 2003 (the new regulation 22(4)), and re-enacts the original regulation 22(5) as regulation 22(3).

Regulation 6 amends regulation 40 of the principal Regulations by substituting references to “general earnings” for references to “emoluments”. The expression “general earnings” is defined in section 122(1) of the Social Security Contributions and Benefits Act 1992 (c. 4) and section 121(1) of the Social Security Contributions and Benefits (Northern Ireland) Act 1992 (c. 7), having been inserted by ITEPA 2003 (see paragraphs 178 and 199 of Schedule 6 to ITEPA 2003). It also omits, from regulation 40(7), references to a series of Extra Statutory Concessions which were replaced by statutory disregards from general earnings by ITEPA 2003 (and accordingly fell outside the scope of Class 1A contributions). It also restructures the original paragraph (6) of regulation 40 in the light of the different approach taken to the taxation of contributions to retirement benefit schemes by ITEPA 2003.

Regulation 7 amends Schedule 2 to the principal Regulations to reflect changes made to the income tax charges on share-based earnings by Schedule 22 to the Finance Act 2003 and the abolition, by ITEPA, of Schedule E, formerly set out in section 19 of the Income and Corporation Taxes Act 1988 (c. 1: “the Taxes Act”).

Regulations 8 to 13 amend Schedule 3 to the principal Regulations.

Regulation 8 introduces the amendments.

Regulations 9 and 11 amend Parts 1 and 4 respectively of the Schedule consequent upon the changes made to Part 9 by regulation 12. Regulation 10 amends paragraph 2 of Part 3 of the Schedule to reflect the re-enactment of section 203FB of the Taxes Act as section 697 of ITEPA 2003.

Regulation 12 makes amendments to Part 9 which mirror the new treatment of share-based income for income tax purposes introduced by Schedule 22.

Regulation 13 amends Part 10 to provide a disregard in respect of any amount actually paid by an employer in respect of the income tax liability.

Regulation 14 makes amendments to Schedule 4 to the principal Regulations consequent on the changes in the taxation of share-based earnings for income tax purposes.

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SOCIAL SECURITY

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