

**EXPLANATORY MEMORANDUM TO**  
**THE SOCIAL SECURITY (REDUCED RATES OF CLASS 1 CONTRIBUTIONS,**  
**REBATES AND MINIMUM CONTRIBUTIONS) ORDER 2006**

**2006 No. 1009**

1. This explanatory memorandum has been prepared by Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.
2. **Description**
  - 2.1 This Order sets the level of the reduced rate Class 1 National Insurance contributions and rebates of National Insurance contributions paid for those who contract out of the state second tier pension scheme, currently known as the State Second Pension (S2P) and previously the State Earnings Related Pension Scheme (SERPS).
3. **Matters of special interest to the Joint Committee on Statutory Instruments**
  - 3.1 None
4. **Legislative Background**
  - 4.1 This draft Order, to be made by the Secretary of State under sections 42, 42B and 45A of the Pension Schemes Act 1993 (c.48)<sup>1</sup> sections 38(1), 38B and 41A of the Pension Schemes (Northern Ireland) Act 1993<sup>(2)</sup>.is laid before Parliament for resolution of each House of Parliament. It is due to come into force on 6 April 2007. Under the primary powers, an Order must be laid at least every five years. The previous Order was laid on 1 March 2001. In addition an Order may not have effect for any tax year earlier than the second after that in which it is made. This is to ensure a full tax year between the Order being made and coming into force so as to give pension schemes sufficient time to adapt to the new rates.

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<sup>1</sup> As amended by the Pensions Act 1995 (c.48), the Social Security Act 1998 (c.14), the Social Security Contributions (Transfer of Functions, etc) Act 1999 (c.2), the Welfare Reform and Pensions Act 1999 (c.30), and the Child Support, Pensions and Social Security Act 2000 (c.19) as detailed in the footnotes to the draft Orders.

<sup>(2)</sup>1993 c.49. Section 38 was substituted by article 134(3) of the Pensions (Northern Ireland) Order 1995 (S.I. 1995/3213 (N.I. 22)) ("the 1995 Order") and amended by paragraph 51 of Schedule 1 to the Social Security Contributions (Transfer of Functions, etc.) (Northern Ireland) Order 1999 (S.I. 1999/671) ("the 1999 Order"). Section 38B was inserted by article 134(4) of the 1995 Order and amended by paragraph 53 of Schedule 1 to the 1999 Order. Section 41A was inserted by article 135(5) of the 1995 Order and amended by paragraph 57 of Schedule 1 to the 1999 Order.

4.2 In accordance with sections 42(1), 42B(1) and 45A(1) of the Pension Schemes Act 1993 and section 181(9A) of the Pension Schemes (Northern Ireland) Act 1993 the draft Order is laid together with reports by the Government Actuary and the Secretary of State (Cm 6758). The Government Actuary's report sets out any changes since his last report in the factors which he considers affect the cost of providing benefits of an actuarial value equivalent to those in the state scheme.

## **5. Extent**

5.1 This instrument extends to all of the United Kingdom.

## **6. European Convention on Human Rights**

The Minister of State for Pensions Reform, Stephen Timms, has made the following statement regarding Human Rights:

In my view the provisions of the Social Security (Reduced Rates of Class 1 Contributions, Rebates and Minimum Contributions) Order 2006 are compatible with the Convention rights.

## **7. Policy background**

### Salary related schemes

7.1 Section 41 of the Pension Schemes Act 1993 (and section 37 of the Pension Schemes (Northern Ireland) Act 1993) provide for the reduction of Class 1 National Insurance contributions payable in respect of an earner whose employment qualifies him for a pension provided by an occupational salary related contracted-out scheme.

7.2 Article 2 of the Order specifies an increased percentage to be deducted from secondary contributions (paid by the employer) for the tax years 2007/08 to 2011/2012. The percentage is now 3.7%. The percentage to be deducted from primary contributions (paid by the employee) remains unchanged at 1.6% and is not specified in the Order, because only changes to the existing percentages need to be specified.

### Money purchase contracted-out schemes

7.3 Section 42A of the Pension Schemes Act 1993 (and section 38A of the Pension Schemes (Northern Ireland) Act 1993) provide for the reduction of Class 1 National Insurance contributions payable in respect of an earner whose employment qualifies him for a pension provided by an occupational money purchase contracted-out scheme, and for payments to be made in relation to that earner by HM Revenue and Customs to the trustees or managers of the scheme. The contributions are to be reduced by an amount equal to the "appropriate flat-rate percentage" of the earnings between the lower and upper earnings limits, and the payments by HM Revenue and Customs are to be the

amount by which the “appropriate age-related percentage” of those earnings exceeds that flat-rate amount.

- 7.4 Article 3 of the draft Order specifies a new flat-rate percentage and new age related percentages for the tax years 2007/2008 to 2011/2012. For the appropriate flat-rate percentage, the percentage to be deducted from secondary contributions (paid by the employer) is increased to 1.4% while the percentage to be deducted from primary contributions (paid by the employee) remains at 1.6%. The new age related percentages are set out in Schedule 1 to the draft Order. The age related percentages will continue to be capped but the appropriate figure will change to 7.4%.

#### Appropriate personal pension schemes

- 7.5 Section 45 of the Pension Schemes Act 1993 (and section 41 of the Pension Schemes (Northern Ireland) Act 1993) provide that, where an earner is a member of an appropriate personal pension scheme, HM Revenue and Customs may pay, in relation to that earner, minimum contributions to the trustees or managers of the scheme. Section 45 of the Pension Schemes Act (and section 41 of the Pension Schemes Act (Northern Ireland) 1993) provide for the amount of those contributions to be an amount equal to the “appropriate age-related percentage” of earnings between the lower and upper earnings limit paid to that earner.
- 7.6 Article 4 of the draft Order provides for new age-related percentages for the tax years 2007/2008 to 2011/2012, as set out in the Tables in Schedules 2-6 to the draft Order. The age related percentages will continue to be capped but the appropriate figure will change to 7.4%.
- 7.7 There is one table for each of the five years covered by the draft Order, and there are three percentages specified for each age. The three percentages relate to the three earnings bands in State Second Pension, as set out in Schedule 4A to the Contributions and Benefits Act 1992. Earnings between the lower and upper earnings limits are divided into three bands. The percentage for earnings in the lower band (Column B in Schedules 2 to 6) is double what it would have been if SERPS had continued. The percentage for earnings in the middle band is half what it would have been if SERPS had continued (Column C in Schedules 2 to 6). And the percentage for earnings in the highest band is the same as it would have been if SERPS had continued (Column D in Schedules 2 to 6). This gives lower and moderate earners with an appropriate personal pension a higher rebate than they would have received if SERPS had continued. Higher earners will receive the same.
- 7.8 The current system of reviewing contracted out rebate rates at least quinquennially has been in place since contracting out was introduced for salary related schemes, in the Social Security Act 1975 (and for DC pensions in 1988). The legislation requires the Government Actuary to review the level of rebates that he thinks are required to reflect the cost of providing benefits that are actuarially equivalent to the additional state pension foregone by

contracting out. The SoS considers the rates proposed by the GA and decides what rates to include in the Order. Although the GA's recommendations are often accepted, exceptions have been where an incentive has been paid in addition to the proposed rates (for example on the introduction of personal pensions) and when a cap was placed on age related rebates for appropriate personal pensions and contracted-out occupational money purchase schemes in order to constrain costs in 1997.

## **8. Impact**

- 8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it is expected to have only negligible impact on business, charities or voluntary bodies.
- 8.2 The Regulations are expected to have only negligible impact on the public sector.

## **9. Contact**

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