EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY (CONTRIBUTIONS) (AMENDMENT No. 5) REGULATIONS 2011

2011 No. 2700

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs (HMRC) on behalf of the Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument amends the Social Security (Contributions) Regulations 2001 (S.I. 2001/1004) ("the SSCR 2001"). It provides that amounts chargeable to income tax under Part 7A of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA 2003") will be treated as earnings for the purposes of National Insurance contributions ("NICs") if they would not already be earnings and includes provision to prevent a double liability for NICs on such amounts. It also amends the NICs disregard in relation to qualifying childcare vouchers, to which Class 1 NICs would otherwise apply; and makes miscellaneous amendments as a consequence of amendments made to the Finance Act 2004.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 Regulations 4 and 5 of this instrument correct an error contained in the Social Security (Contributions) (Amendment No. 4) Regulations 2011 (S.I. 2011/1000) ("the 2011 Regulations") which was reported by the Joint Committee on Statutory Instruments in the Twenty-third Report of Session 2010-2012 (HL Paper 162, HC 354-xxiii, published on 21st June 2011).

4. Legislative Context

Employment Income Provided Through Third Parties

4.1 New regulation 22B of the SSCR 2001 is inserted by regulation 3. To the extent they would not otherwise be, this treats as earnings for NICs purposes amounts which count as employment income under Part 7A of ITEPA 2003. Part 7A was inserted by Schedule 2 to the Finance Act 2011 ("FA 2011") and imposes an employment income tax charge on certain rewards, recognition or loans provided to an employee by a third party rather than their employer.

4.2 Schedule 2 to FA 2011 includes anti-forestalling rules which will treat certain transactions that took place prior to Part 7A of ITEPA coming into effect as giving rise to amounts which count as employment income under that Part on 6th April 2012. New regulation 22B will not treat these amounts as earnings for NICs purposes, by virtue of regulation 1(2) of this instrument.

4.3 Regulation 7 of this instrument inserts new paragraph 2A into Schedule 3 to the SSCR 2001. Schedule 3 provides that certain amounts are to be disregarded from the calculation of earnings for the purpose of assessing liability for earnings-related NICs. New paragraph 2A provides that in cases where an amount is treated as earnings under new regulation 22B of the SSCR 2001 ("the regulation 22B amount"), the payment of a subsequent amount which:

- is earnings for NICs purposes on ordinary principles; and

- represents or arises or derives from the regulation 22B amount,

is to be disregarded to the extent that it does not exceed the regulation 22B amount. In determining whether the amount of a payment exceeds the regulation 22B amount, new paragraph 2A requires that all previous payments which have represented or arisen or derived from the regulation 22B amount must be taken into account. The purpose of these provisions is to ensure that amounts treated as earnings under regulation 22B are not subsequently subject to NICs a second time, and to ensure amounts that have not previously been subject to NICs will not benefit from the new disregard.

Reduction In Childcare Relief For High Earners

4.4 This instrument also allows the NICs treatment of certain non-cash vouchers to be aligned with the tax treatment of such vouchers. The particular amendments to the disregard made by this instrument concern childcare vouchers made available through an employer-supported childcare scheme. The relevant tax changes were introduced in FA 2011 having been proposed by the previous government. The 2001 Regulations were amended by the 2011 Regulations to reflect those changes.

4.5 The amendments made by the 2011 Regulations closely mirrored the policy and wording for the related tax relief for childcare vouchers in sections 270A and 270B of ITEPA 2003, as inserted by Schedule 8 to FA 2011. Regulations relating to the tax relief (S.I. 2011/1798) came into force on 11th August 2011 with effect from 6th April 2011. This instrument further amends the 2001 Regulations to align, so far as possible, the NICs position with the tax position.

4.6 This instrument also corrects an error identified by the Joint Committee on Statutory Instruments in its Twenty-third Report of Session 2010-12. The Committee identified a lacuna in the 2011 Regulations in the case of an employee who joined a childcare voucher scheme before 6th April 2011 and went through a continuous period of 52 weeks without receiving vouchers (before or after that date). This instrument clarifies that such individuals will fall within paragraph 7 of Schedule 3 to the amended 2001 Regulations if the 52 week continuous period ends before 6th April 2011 and within paragraph 7A if the continuous period ends on or after 6th April 2011. The instrument also clarifies that those who were previously employed by the employer and who are subsequently re-employed by the same employer will fall within paragraph 7 if they re-joined the scheme before 6th April 2011 or within paragraph 7A if they re-joined the scheme on or after 6th April 2011.

Miscellaneous Amendments as a Consequence of Amendments made to the Finance Act 2004

4.7 Regulation 6 of this instrument makes other miscellaneous amendments to Schedule 3 to the SSCR 2001 in connection with pension schemes. Part 6 of Schedule 3 provides that certain payments to and by pension schemes are disregarded in the calculation of earnings for the purposes of earnings-related contributions. Paragraph 7 of Part 6 covers contributions paid to pension schemes that are given tax relief under UK double taxation agreements. Paragraph 10 of Part 6 covers payments from employer-financed retirement benefit schemes as defined in section 393B of ITEPA 2003 and other arrangements that would be such schemes but for the fact that they pay pensions charged to tax under Part 9 of ITEPA 2003 only.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 As the instrument is subject to the negative resolution procedure and does not amend primary legislation, no statement is required.

7 Policy background

What is being done and why?

Employment Income Provided Through Third Parties

7.1 These changes are being made to ensure that employment income provided through third parties that is the subject of employment income tax is equally treated as earnings for NICs purposes.

7.2 Third party arrangements are used as tax and NICs avoidance devices to provide a variety of rewards, recognition or loans to employees and persons connected to employees. Part 7A of ITEPA 2003 tackles this tax avoidance by imposing a tax charge on such arrangements if they would not give rise to earnings on ordinary principles.

7.3 Part 7A of ITEPA 2003 includes a number of exclusions and special valuation provisions which are targeted at innocent remuneration arrangements and guard against double taxation. To the extent that these exclusions and special valuation provisions result in the amount which counts as employment income for tax purposes being reduced, the same reduction will flow through to the amount which counts as earnings for NICs purposes under this instrument.

7.4 In line with provisions included in Part 7A of ITEPA 2003 to prevent double tax charges, this instrument includes provision to ensure that once a NICs liability has arisen on an amount treated as earnings under this instrument, there is no second liability if a later payment which represents or arises or derives from that amount does in fact become “earnings” under normal NIC rules.

Reduction In Childcare Relief For High Earners

7.5 This instrument also reflects changes made to the tax relief for childcare vouchers which were made to support the Government’s policies on providing support for childcare costs in order to encourage parents to work.

7.6 In particular, this instrument further aligns the NICs disregard with the tax treatment of employees who join employer-supported childcare schemes on or after 6th April 2011.

Miscellaneous Amendments as a Consequence of Amendments made to the Finance Act 2004

7.7 This instrument ensures that payments made out of contributions to a non-UK pension scheme that have been given relief under a double taxation agreement are treated the same for NICs purposes as payments by a registered pension scheme. They additionally make consequential changes to cross-references to the Finance Act 2004 in line with amendments made to that Act since 2007.

8. Consultation outcome

8.1 Schedule 2 to FA 2011 was the subject of consultation, along with the rest of FA 2011, between 9th December 2010 and 9th February 2011. As a consequence of comments received during that consultation and subsequently, the draft legislation was amended prior to its introduction to Parliament and again during its passage through Parliament.

8.2 In accordance with HMRC's Tax Consultation Framework (http://www.hmrc.gov.uk/consultations/tax-consultation-framework.pdf), the Department published the provisions of this instrument relating to employment income provided through third parties and the amendments in consequence of changes to the Finance Act 2004 in draft for comment for a period of four weeks starting on 25th August 2011.

8.3 For the employer supported childcare measure no consultation was carried out specifically in relation to these Regulations. It was considered appropriate not to do so because these changes closely follow the tax legislation, and the related tax changes were consulted on as part of the Finance Act process.

8.4 HMRC published a Technical Note in February 2010 and again when draft Finance Bill provisions were published in December 2010. This can be found on the HMRC website at http://www.hmrc.gov.uk/employers/employersupportedchildcare.pdf

9 Guidance

9.1 The relevant HMRC guidance in the "National Insurance Manual" will be amended to reflect the position as a result of this instrument. HMRC guidance on the application of Schedule 2 to FA 2011 will be incorporated into the "Employment Income Manual" in autumn 2011.

10. Impact

10.1 The impact of this instrument on business, charities or voluntary bodies is negligible.

10.2 No impact on the public sector is foreseen.

10.3 For the employment income measure a Tax Information and Impact Note covering this instrument was published on 23rd March 2011 alongside the

Budget and is available on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm. It remains an accurate summary of the impacts that apply to this instrument.

10.4 For the employer supported childcare measure two Tax Information and Impact Notes relating to this instrument were published in December 2010 alongside draft Finance Bill 2011 provisions and are available on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm. They remain an accurate summary of the impacts that apply to this instrument.

10.5 For the amendments relating to the Finance Act 2004, a Tax Information and Impact Note has not been prepared as there is no substantive change to tax policy.

11. Regulating small business

Employment Income Provided Through Third Parties

11.1 The legislation applies to small business. To exclude small businesses from the legislation would create unfairness and further opportunities for tax avoidance.

11.2 To minimise the impact of the requirements on firms employing up to 20 people, the approach taken is the publication of comprehensive guidance on the application of the new rules.

11.3 The basis for the final decision on what action to take to assist small business was that most businesses will discontinue the use of these arrangements, compliance costs to business overall are thought to be insignificant.

Reduction In Childcare Relief For High Earners

11.4 The legislation on employer-supported childcare applies to all types of business.

11.5 To minimise the impact of the requirements on firms employing up to 20 people, the approach taken is to provide suitable guidance on employer-supported childcare.

11.6 Some of the stakeholders involved in the consultation process for the changes to employer-supported childcare represent both large and small employers and no distinction was drawn on the ability of smaller employers to implement the changes.

12. Monitoring & review

12.1 The impact of the provisions in relation to employment income though third parties will be monitored through disclosures of new avoidance schemes to circumvent the measure, and through regular communication with taxpayers and practitioners affected by the measure and HMRC’s risk management and interventions functions.

12.2 HMRC will monitor the impact of the provisions in relation to childcare provisions and will review after 24 months.

13. Contact

13.1 The HMRC contact in relation to employment income through third parties is Pete Robinson, telephone: 020 7147 2423 or email: peter.w.robinson@hmrc.gsi.gov.uk.

13.2 Mrs Su McLean-Tooke, telephone: 020 7147 2665 or email: susan.mclean-tooke@hmrc.gsi.gov.uk is the HMRC contact for queries regarding the employer supported childcare measure.