

**EXPLANATORY MEMORANDUM TO
THE SOCIAL SECURITY (CONTRIBUTIONS) (AMENDMENT NO. 3)
REGULATIONS 2011**

2011 No. 797

1. This explanatory memorandum has been prepared by HM Revenue and Customs 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 (“the Principal Regulations”). It:
- (i) Provides for the repayment of Class 1A National Insurance contributions (NICs) paid on an amount treated as earnings which is now exempt from income tax;
 - (ii) Provides that those liable to pay Class 2 NICs must make such payments on or before 31 January and 31 July each year and makes provision in relation to those who are entitled, but not liable, to pay such contributions; and
 - (iii) Introduces a disregard in the calculation of an employed earner’s liability to Class 1 NICs in respect of subsistence allowances paid to persons who are seconded as experts by their employer to specified bodies of the European Union (EU) located in the UK.

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

- 3.1 Due to a clerical error an incorrect version of this instrument was laid before Parliament. HMRC apologises for this error. The delay caused by withdrawing and relaying the instrument meant that it was not possible to lay the instrument before Parliament more than 21 days before the instrument comes into force.

4. Legislative Context

- 4.1 Part 2 of these Regulations relates to Class 1A NICs and inserts a new regulation 55A into the Principal Regulations. This regulation provides for the repayment of a Class 1A contribution which was paid on an amount treated as earnings which is no longer treated as earnings in accordance with the provisions of sections 100A and 100B of the Income Tax (Earnings and Pensions) Act 2003. This effectively allows for a refund of NICs subject to the same conditions as a specific exemption from tax.
- 4.2 Part 2 also amends regulations 51 and 57 respectively to include reference to the new regulation 55A. Regulation 57 is also amended to include a cross reference to regulation 55 to clarify the existing position that regulation 57 is subject to regulation 55.
- 4.3 Part 3 of these Regulations relates to Class 2 and Class 3 NICs. They amend regulation 89 of the Principal Regulations to change the payment of Class 2 NICs to a bi-annual regime of 31 January and 31 July to align with the payment dates for income tax and Class 4 NICs under the Self Assessment system. They

also make provision in relation to those who are entitled, but not liable, to pay such contributions.

- 4.4 Part 4 of these Regulations relates to Class 1 NICs and inserts a new paragraph 15A and table in part 8 of Schedule 3 to the Principal Regulations to provide a disregard in the calculation of an employed earner's liability to Class 1 NICs in respect of subsistence allowances paid to persons who are seconded to an EU body located in the UK because of their expertise in matters relating to the subject matter of the functions of the EU body. The relevant bodies are listed in the table.

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*

Class 1A NICs

- 7.1 Some UK resident individuals have set up or acquired companies to own a property abroad, generally for holiday use. When individuals use these arrangements, they become a director of the company. Since the house is a company asset, when it is available for their personal use an employment benefit in kind tax charge arises. Class 1A NICs (employer only) will also be due on the benefit.
- 7.2 Potentially hundreds of thousands of people who use these arrangements could therefore have had an income tax liability for several years that they were unaware of. The Government therefore decided to introduce a provision in Finance Bill 2008 to remove that benefit in kind tax charge where certain qualifying conditions are satisfied.
- 7.3 Section 45(1) of the Finance Act 2008 introduced sections 100A and 100B to the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). The tax exemption applies where an overseas property is owned by a company that is owned by individuals and whose sole activity is holding that property for occupation and / or letting. It also included ownership through foreign companies.
- 7.4 Section 45(2) provided that the amendment is treated as always having had effect. Refunds have therefore been made in cases where tax was paid prior to the Finance Act 2008. However, a similar provision was not made in respect of Class 1A NICs which are still due for periods prior to the introduction of the Finance Act 2008. This amendment allows HMRC to make refunds of Class 1A NICs where those contributions have been paid.

Class 2 & 3 NICs

- 7.5 The Chancellor announced in the Pre-Budget report of 9 October 2007 a series of simplification reviews and measures designed to reduce the administrative burdens on small business and to simplify the tax system. One of these measures was for the payment dates for Class 2 NICs to coincide with those for Income Tax Self Assessment and Class 4 NICs.
- 7.6 Both Class 2 NICs and Class 4 NICs are paid by the self-employed. Class 2 NICs are a flat rate payment, payable quarterly on receipt of a bill from HMRC or monthly by direct debit. They provide entitlement to certain benefits. Class 4 NICs are profits based and collected with income tax under a Self Assessment. They do not provide any entitlement to benefits.
- 7.7 The purpose of the changes is to align the payment dates for Class 2 NICs with those for Self Assessment liabilities: 31 January and 31 July. Individuals who are currently sent quarterly bills for Class 2 NICs will, under the new system, be sent such requests twice a year. Contributors will also be offered the option to pay monthly or twice yearly by direct debit. Those customers not paying by direct debit will be encouraged to do so.
- 7.8 Contributors who currently pay by monthly direct debit will need to have their payments aligned with the new January and July dates. This transition is being achieved by an initial four month period where no payments will be collected.
- 7.9 The change in collection dates has no effect on the rate of Class 2 NICs applicable and the payment gap period will be recouped on cessation of business.

Class 1 NICs

- 7.10 Experts seconded to an EU body located in the UK will be paid by their parent organisation and their salaries will be taxed according to relevant UK legislation or to provisions in Double Taxation Agreements. In addition, seconded experts will often be paid subsistence allowances by the EU body located in the UK.
- 7.11 Under the current UK legislation, subsistence payments made to experts seconded to an EU body in the UK will be subject to income tax and NICs in the UK because the payment is made in the UK for duties carried out in the UK. These Regulations introduce a disregard for NICs for any payment made to seconded experts in respect of these subsistence allowances. The primary legislation introducing a new tax exemption for the same payment will be introduced in the Finance Bill 2011.
- 7.12 Without a change in the law, there is a potential to create a disparity between EU bodies located in the UK and EU bodies located in some other Member States, leaving those experts on secondment to bodies in the UK at a disadvantage. This change will help maintain parity with EU bodies located in other Member States and ensure that the EU bodies located in the UK can attract high-quality secondees.

- ***Consolidation***

- 7.13 There are currently no plans to consolidate the Principal Regulations.

8. Consultation outcome

- 8.1 No consultation was undertaken regarding the minor amendments in respect of Class 1A or Class 1 NICs.
- 8.2 In respect of Class 2 NICs, a consultation document was issued on 12 March 2008 by HMRC in order to seek views on the scope for simplifying the collection of NICs from the self-employed.
- 8.3 In response to the views received to the consultation document, the Chancellor announced on 24 November 2008 that the Government intended to simplify the collection of Class 2 National Insurance contributions by adopting the more favoured ideas, including:
- co-ordinating payment dates for Class 2 NICs and Self-Assessment liabilities;
 - reducing the number of Class 2 NICs bills for those not paying by direct debit; and
 - encouraging the take-up of the direct debit option while expanding the variety of direct debit options.

9. Guidance

- 9.1 HMRC will update their published guidance relating to Class 1A NICs to include reference to this legislation and to provide advice on how customers can claim a refund of NICs if they think they are entitled to one. HMRC will contact anyone who is known to have paid NICs and also those who claimed a refund of tax to invite them to claim a refund of NICs.
- 9.2 In respect of changes to Class 2 NICs, HMRC issued a mailshot to existing customers in November 2010 and published information on its website about the proposed changes. Further targeted messages will be issued in January, February March and April 2011.
- 9.3 HMRC will update its guidance relating to subsistence payments to reflect the Class 1 NICs position relating to experts seconded to an EU body.

10. Impact

- 10.1 An impact assessment has not been produced in respect of the changes to Class 1A NICs as they have no impact on business, charities or voluntary bodies. A full and final impact has not been produced in respect of the changes to Class 1 NICS as a negligible impact on the private sector is foreseen.
- 10.2 No impact on the public sector is foreseen in respect of the two amendments.
- 10.3 In respect of the changes to Class 2 NICs, the impact on business will largely affect small and medium sized enterprises run by self-employed individuals. We anticipate the effects will be positive. Charities or voluntary bodies will be similarly impacted but only where self-employment occurs.
- 10.4 The impact on the public sector we anticipate to be negligible.
- 10.5 An Impact Assessment may be accessed from the following link:
<http://www.hmrc.gov.uk/better-regulation/ia.htm>

11. Regulating small business

- 11.1 The Class 1A changes apply to small businesses.
- 11.2 To minimise the impact of the requirements on firms employing up to 20 people, the approach taken is to legislate to allow them to claim a refund of Class 1A NICs where a tax liability that previously existed has been removed. Going forward Class 1A will not be due because the legislation contained in ITEPA that removes the income tax liability also removes the charge to NICs.
- 11.3 The basis for the final decision on what action to take to assist small business was reached following discussion with representatives of those affected.
- 11.4 The Class 2 NICs changes apply to small business. Small business will benefit from having a set of rules relating to common dates for payment of Class 2 NICs and income tax self assessment/Class 4 NICs liabilities. Additionally, HMRC will reduce the number of Class 2 bills issued to those who do not pay by direct debit and extend the variety of direct debit payment options.
- 11.5 HMRC sought the views of small business during its consultation process. The Class 2 NICs changes have been developed taking into account consultation responses received from the self employed, agents and representative bodies.
- 11.6 The Class 1 NICs changes do not apply to small businesses, rather to specified bodies of the EU located in the UK.

12. Monitoring & review

- 12.1 HMRC will undertake an internal review of the repayment of Class 1A NICs scheme after 24 months to ensure that the intended outcome is achieved.
- 12.2 HMRC will monitor the practical application of the changes to Class 2 NICs payment dates and the payment position, particularly in terms of improved levels of timely payment and the increased take up of the direct debit payment method.
- 12.3 No formal review is planned of the Class 1 NICs changes as they are unlikely to create any difficulties for employers or employees.

13. Contact

The following persons can answer any queries regarding the instrument: in respect of the Class 1A NICs, Paul Harris at HMRC Tel: 020 7147 2528 or email: pa.harris@hmrc.gsi.gov.uk; in respect of the Class 2 NICs, Jim Fedigan at HMRC Tel: 0151 703 8585 or email: jim.fedigan1@hmrc.gsi.gov.uk; and , in respect of the Class 1 NICs, Basil Rajamanie at HMRC Tel: 020 7147 2384 or email: basil.rajamanie@hmrc.gsi.gov.uk