

EXPLANATORY MEMORANDUM TO
THE SOCIAL SECURITY (CONTRIBUTIONS) (AMENDMENT NO. 2)
REGULATIONS 2012

2012 No. 817

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.

2. Purpose of the instrument

2.1 This instrument amends the Social Security (Contributions) Regulations 2001 (S.I. 2001/1004) ("the Principal Regulations").

2.2 It makes changes as a consequence of the abolition of the Contracted-Out Money Purchase schemes (COMPS) in the Pensions Act 2007 and makes minor amendments to Part 6 of Schedule 3 (pensions and pension contributions) of the Principal Regulations.

2.3 It removes three National Insurance contributions (NICs) disregards. It removes the disregard from:

- (i) liability to pay Class 1A NICs on relocation expenses other than removal expenses where the employee started work in a new location before 6th April 1998;
- (ii) paying Class 1 NICs on specified payments in respect of employment as a mariner; and
- (iii) paying Class 1 NICs for certain apprentices and students coming to the UK who are not resident in the UK, where certain conditions are met.

2.4 It amends within the Principal Regulations the formulae used to calculate the return of NICs paid in excess of the annual maximum to reflect changes made in respect of the rates of NICs by the National Insurance Contributions Act 2011 ("the NICs Act 2011").

2.5 It introduces a disregard in the calculation of an employed earner's liability for Class 1 NICs for payments of the Continuity of Education Allowance (CEA) from the Ministry of Defence (MoD) to or in respect of members of the armed forces. It also updates the references to how payments of the Operational Allowance and Council Tax Relief are designated for the purposes of the disregard from NICs.

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

3.1 None.

4. Legislative Context

Abolition of certain types of contracted-out pension and minor amendments to Part 6 of Schedule 3 (pensions and pension contributions) of the Principal Regulations

4.1 Part 2 of these Regulations amend the Principal Regulations to take account of the abolition of contracting-out on a defined contribution basis from 6 April 2012. Abolition was included in the Pensions Act 2007.

4.2 Regulation 3 removes the references to COMPS from the definitions at the beginning of the Principal Regulations. Regulation 4 removes references to the abolished schemes from the earnings period rules that are applied when earnings have to be aggregated to calculate NICs liability.

4.3 Regulation 5 amends the information that employers need to record on deduction working sheets because COMPS will have been abolished.

4.4 Regulation 6 removes two redundant references to repealed tax provisions relating to registered pension schemes.

Amendments relating to the abolition of disregards

4.5 Part 3 of these Regulations amend the Principal Regulations to remove three NICs disregards which are no longer considered necessary as a result of a review of tax reliefs by the Office of Tax Simplification (OTS).

4.6 Regulation 7 removes:

- the disregard from paying Class 1A NICs on prescribed general earnings for relocation expenses other than removal expenses where the employee started work in a new location before 6th April 1998;
- the disregard from paying Class 1 NICs in respect of employment as a mariner by way of an advance, a payment to some other person of part of a mariner's earnings as allocated by the mariner to that person and payment of a special payment whilst sick abroad; and
- the disregard from paying Class 1 NICs for certain apprentices and students coming to the UK who are not resident in the UK, where certain conditions are met. The disregard is available where the UK employment occurs during a vacation from a course of full-time studies outside the UK and the temporary employment is of a nature similar or related to the course of study. It is also available where the UK employment is related to an apprenticeship which the individual is serving outside the UK and the employment in the UK began before the person was 25 and is of a nature similar or related to the apprenticeship outside the UK.

4.7 Regulation 10 amends the Social Security (Contributions) (Amendment No. 5) Regulations 2003) (S. I. 2003/2085) to remove redundant legislation from the statute book as a result of changes made by Part 3 of these Regulations.

Excess refunds

4.8 Part 4 of these Regulations amend the Principal Regulations to take account of changes in respect of the rates of NICs made by the NICs Act 2011. Earners who hold two or more separate employments can sometimes pay in excess of their annual maximum of NICs liability. Where such overpayments occur the excess is refunded to the earner under regulation 52A of the Principal Regulations. By amending the rates in respect of NICs, consequential changes are needed to the refund calculations in

regulation 52A of the Principal Regulations. The amendments have effect from 6th April 2012 in relation to contributions paid in respect of the tax year 2011-12 and subsequent tax years.

HM Forces

4.9 Part 5 of these Regulations inserts a new paragraph 12C in Part 8 of Schedule 3 to the Principal Regulations to provide a disregard from liability to pay Class 1 NICs for payments of the CEA from the MoD to or in respect of members of the armed forces.

4.10 Part 5 also amends paragraphs 12A and 12B of Part 8 of Schedule 3 to the Principal Regulations to include a reference to section 333 of the Armed Forces Act 2006 under which payments of the Operational Allowance and Council Tax Relief are now made.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

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

7. Policy background

- *What is being done and why*

Abolition of certain types of contracted-out pension and minor amendments to Part 6 of Schedule 3 (pensions and pension contributions) of the Principal Regulations

7.1 The abolition of contracting out on a money purchase or appropriate personal pension basis from 6th April 2012 requires minor changes to the Principal Regulations to reflect the abolition.

7.2 For NICs purposes where a person has more than one job each employment is treated separately. Exceptions to this general rule include instances where the person has two contracts with the same employer or with two employers who are carrying on business in association. Special NICs rules allow for the employments to be treated as one and the earnings to be aggregated. There are also special rules to determine the amount of NICs payable where earnings are aggregated but the intervals at which earnings in the separate employments are paid differ (for example weekly and monthly). Currently these rules take into account whether the employee is in a COMPS employment or holds an Appropriate Personal Pension (APP). Following abolition of contracting out on a defined contribution basis such references will no longer be necessary.

7.3 Similarly the information that employers need to report when making deductions of NICs will no longer include COMPS or APPs because they have been abolished.

7.4 These Regulations also make minor amendments to remove two redundant references to repealed tax provisions relating to registered pension schemes.

Amendments relating to the abolition of disregards

7.5 The OTS, an independent body set up in July 2010, was asked by the Government to consider whether tax reliefs contained within the taxes legislation still served any purpose. The OTS identified a number of reliefs where the policy rationale had weakened over time, were otiose or little used, created distortions in the tax system or were complex for business and/or HMRC to administer which they thought could be abolished.

7.6 Following the OTS's recommendations to the Chancellor, the Treasury consulted on the abolition of 36 reliefs, including the Class 1A NICs disregards for prescribed general earnings, the disregard for Class 1 NICs in respect of payments to mariners and the Class 1 NICs disregard for certain apprentices and students coming to the UK. As no compelling reasons were given to keep the disregards, it was decided they should be abolished from 6th April 2012.

7.7 The Government announced the changes on 6th December 2011. These Regulations give effect to that announcement.

The Class 1A NICs disregard for prescribed general earnings

7.8 No liability to pay Class 1A NICs arises on specified payments that are disregarded in the calculation of an employee's earnings. The specified payments are relocation expenses other than removal expenses. The exemption only applies if the employee started work in a new location before 6th April 1998 and the relocation expenses were agreed before that date.

7.9 As the exemption only applies to expenses incurred before April 1998, which is more than 13 years ago, there is no ongoing need to retain this disregard.

Certain payments to mariners to be disregarded for the purposes of Class 1 NICs

7.10 This is a long standing exemption that provides for a NICs disregard for payments to or in respect of mariners in the following circumstances:

- Interim payments to mariners by way of an advance;
- Payment to some other person of any part of such a mariner's earnings as allocated by him to that person; and
- A payment of a special payment whilst sick abroad (as defined by the National Maritime Board).

7.11 The interim payment of earnings referred to an advance of earnings typically paid at the end of the voyage (when the liability to NICs would arise), and the original rationale was to deal with circumstances where mariners would be paid in cash whilst at sea on account of wages. Before electronic communications it may not have always been practical to have accounted for NICs on such advances.

7.12 The reference to payments to some other person is understood to refer to situations where mariners used their own wages to make disbursements to others on a vessel; this practice is understood to have disappeared from the industry.

7.13 The reference to special payments whilst sick relates to an industry wide employment condition administered by the National Maritime Board. The National Maritime Board, and the payments that it defined, was abolished in 1990.

7.14 The circumstances in which the exemption would have applied all relate to situations which are now no longer current practice. Therefore the ongoing policy rationale for retaining the disregard has expired.

The Class 1 NICs disregard for payments made to certain apprentices and students coming to the UK

7.15 Generally, Class 1 NICs are payable by all employees if present, resident (but for temporary absence) or ordinarily resident at the time of their employment in the UK. However, an individual who is not ordinarily resident in the UK, and meets one of the following criteria, is not liable for Class 1 NICs:

- the UK employment occurs during a vacation from a course of full time studies outside the UK, and the temporary employment is of a nature similar or related to the course of studies; or
- the UK employment is related to an apprenticeship which the individual is serving under a person outside the UK and it began before he was 25.

The exemption runs for a continuous period of 52 contribution weeks from after the date of the person's last entry into the UK.

7.16 The policy objectives behind the exemption were twofold. First it allowed the UK to benefit from the work provided by these groups and for the individuals to acquire new skills to benefit their home country. Secondly, it ensured that those coming to the UK on this short term basis could not build up entitlement to contributory benefits.

7.17 The exemption dates from a time when the UK suffered from a shortage of labour and wished to encourage students from the Commonwealth to come to the UK to do vocational work and acquire skills to help build the economies of those countries.

7.18 The exemption does not apply to individuals from within the EEA or from countries with which the UK has a Reciprocal Agreement or Double Contribution Convention.

7.19 The rationale of supporting those from outside the EEA to come to work temporarily in the UK is less relevant now, given immigration rules prioritising EEA nationals. The Government therefore considers that the disregard has only limited use.

Excess refunds

7.20 There is a maximum amount of NICs that an earner with more than one employment is required to pay for any tax year. The Principal Regulations include a

series of mathematical calculations that provide the overall amount due. Where contributions have been paid in excess of the maximum amount required the excess is refunded. Following Royal Assent of the NICs Act 2011, which increased the rates in respect of Class 1 and 4 NICs by 1%, the excess refund mathematical calculations in regulation 52A of the Principal Regulations need to be updated to reflect the increases in rates in respect of NICs.

HM Forces

7.21 The CEA is paid to service personnel to provide a continuity of education for their children that would not otherwise be possible if they accompanied their parents on frequent assignments both at home and overseas. Under the current legislation the CEA is subject to income tax and NICs.

7.22 These Regulations introduce a disregard for NICs for the payment of the CEA to or in respect of members of the armed forces. This policy aims to support the principles of the Armed Forces Covenant and in particular the principle that service personnel and their families should not be put at any disadvantage from entering into military life. It seeks to mitigate the financial impact of providing a secure and continuing education acknowledging the particular circumstances in which these men and women serve and the particular difficulties they face.

7.23 These Regulations also update the disregards for payments of the Operational Allowance and Council Tax Relief to include a reference to section 333 of the Armed Forces Act 2006 under which payments are now made.

- ***Consolidation***

7.24 There are currently no plans to consolidate the Principal Regulations.

8. Consultation outcome

Amendments relating to the abolition of disregards

8.1 The Treasury consulted on the impact of removing 36 reliefs identified by the OTS in May 2011.

8.2 A total of 78 consultation responses were received from individuals, businesses and representative bodies. In general, interested parties were fully supportive of the OTS work in simplifying the complexities of the UK tax code; and agreed in removing reliefs where the policy rationale is no longer relevant.

8.3 Respondents to the consultation supported the repeal of the Class 1A NICs disregard for prescribed general earnings. There was a limited response to the proposal to remove the disregard for Class 1 NICs in respect of certain payments to mariners, although one response suggested that the exemption should be retained. However, industry representatives confirmed that the disregard was no longer needed.

8.4 Limited responses were received on the Class 1 NICs disregard for certain apprentices and students coming to the UK. Respondents considered that the disregard provides encouragement to some individuals to pursue an apprenticeship or career in

the UK. However, the rationale for supporting those from outside the EEA is less relevant now that immigration rules prioritise EEA nationals.

8.5 The Government published a detailed response to the consultation which can be viewed in the Consultation Response Document on the HMT website (http://www.hm-treasury.gov.uk/d/condoc_responses_tax_reliefs.pdf).

HM Forces

8.6 The MoD has been consulted on the proposals but there has been no public or wider consultation.

8.7 In accordance with the Government's Tax Consultation Framework (<http://www.hmrc.gov.uk/consultations/tax-consultation-framework.pdf>), HMRC published the instruments for the amendments relating to the abolition of disregards and HM Forces in draft.

Abolition of certain types of contracted-out pension and excess refunds

8.8 No consultation has been undertaken on the contracted out and excess refund changes because these are minor consequential changes arising from the abolition of COMPS and increases in rates introduced as part of the NICs Act 2011 respectively.

9. Guidance

9.1 These Regulations do not impose any new obligations. The changes to contracted-out are minor changes that update the legislation to reflect the abolition of COMPS. Employers operating COMPS will no longer have to consider COMPS when aggregating earnings, guidance will need to be updated to reflect this. The updating of the excess contributions calculations does not impose any new obligations on individuals or employers.

9.2 The relevant HMRC guidance in the "CWG 2 Employer Further Guide to PAYE and NICs" and on HMRC's website will be amended to reflect changes made by these Regulations to the abolition of disregards and HM Forces.

10. Impact

10.1 In respect of the provisions in this instrument relating to repeal of the Class 1A NICs disregard for prescribed general earnings and the disregard for Class 1 NICs in respect of certain payments to mariners, there is no impact on business, charities or voluntary bodies since these provisions refer to matters that are no longer current practice. However, there may be an impact in respect of the provision relating to the Class 1 NICs disregard for payments made to certain apprentices and students coming to the UK where it is still in use. With regard to the provisions in this instrument relating to HM Forces, there is no impact on business, charities or voluntary bodies. The provisions in this instrument in relation to excess refunds has no impact on business, charities or voluntary bodies whereas the impact of the changes arising from the abolition of COMPS and APPs will be negligible as the rules relating to earnings periods when earnings have to be aggregated will be simpler.

10.2 There is no impact on the public sector.

10.3 Tax Information and Impact Notes covering the amendments relating to the abolition of disregards and HM Forces in this instrument were published on 6th December 2011 alongside the autumn statement 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.

10.4 A Tax Information and Impact Note covering the contracted out changes and excess refunds will be published on the HMRC website at <http://www.hmrc.gov.uk/thelibrary/tiins.htm>.

11. Regulating small business

11.1 Small businesses may be affected by the proposal in this instrument that relates to the Class 1 NICs disregard for payments made to certain apprentices and students coming to the UK. In respect of the other provisions that are being repealed, there will be no impact since they refer to matters that are no longer current practice.

11.2 Operating the Class 1 NICs disregard for payments made to certain apprentices and students coming to the UK would have had an impact on small firms (those with fewer than 20 employees) when it was available but the consultation clearly suggests that it is of limited use and that there will, therefore, be no significant impact on small firms from its abolition. Abolishing the disregard will remove complexity for almost all employers affected by it, since they will almost certainly be operating a payroll and reporting to HMRC. These employers will no longer have to apply different procedures to different employees.

11.3 With regard to the provisions in this instrument relating to HM Forces, these do not apply to small business. Small businesses are unlikely to be affected by interaction of the abolition of COMPS and the impact on earnings periods where there is aggregation.

11.4 To help minimise any impact of the requirements on firms employing up to and including 9 employees, the approach taken is as follows. HMRC provides the Basic PAYE Tools which includes a P11 Calculator that will work out and record an employee's tax, NICs and Student Loan deductions every payday. This free computer software package is available to download from www.hmrc.gov.uk/payee/tools/basic-payee-tools.htm. This is provided free of charge and will minimise the burden on employers if they choose to take advantage of it. For those businesses which do not have access to computers or payroll software HMRC provides manual tables.

12. Monitoring & review

12.1 HMRC will monitor the practical effects of this legislation to ensure the objectives of it are met.

13. Contact

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