

**EXPLANATORY MEMORANDUM TO
THE SOCIAL SECURITY (CONTRIBUTIONS) (AMENDMENT NO. 3)
REGULATIONS 2012**

2012 NO. 821

1. This explanatory memorandum has been prepared by HM Revenue and Customs (HMRC) and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 These Regulations make the amendments to the Social Security (Contributions) Regulations (S.I. 2001/1004) (the Principal Regulations) necessary for the introduction of HMRC's Real Time Information programme (RTI) from April 2012.

2.2 These Regulations also amend the Principal Regulations to provide HMRC with the power to require security or further security for the payment of sums due from an employer for Class 1 and 1A National Insurance contributions (NICs) and to set out the circumstances when that security may be required.

2.3 It also includes amendments to the Principal Regulations to:

- correct a minor omission in relation to returns where Class 1A NICs are payable on benefits in kind;
- substitute the existing definition of "general earnings" and insert a new definition of "relevant payments";
- make a minor change to the appropriate information to be recorded on a deductions working sheet arising from the fact that, from the 2011-12 tax year, the Primary Threshold (PT) and the Secondary Threshold (ST) are no longer aligned.

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

None.

4. Legislative Context

RTI

4.1 These Regulations amend Schedule 4 to the Principal Regulations, which contains provisions derived from the Income Tax (Pay As You Earn) Regulations 2003 (S.I. 2003/2682) (the PAYE Regulations) in relation to the way that Class 1 NICs are paid, accounted for and recovered.

4.2 Under the Pay As You Earn (PAYE) system, employers must report to HMRC after the end of each tax year what payments have been made to their employees and certain NICs data, which includes the NICs due in respect of those payments. They

must also report certain information in relation to statutory payments such as statutory sick pay.

4.3 Following the introduction of RTI, employers will be required to report payments to employees and the NICs data in respect of those payments to HMRC each time a payment of earnings is made. This will be done using a new form of return. The employer will be required to submit data about each payment of earnings and relevant NICs data, which will include NICs payable and data that may be used to calculate entitlement to contributory benefits. A separate new form of return will allow employers to report deductions from the amounts they are liable to pay to HMRC to take account of statutory payment related recoveries and the Regional Employer NICs Holiday for New Businesses.

4.4 These Regulations make the necessary amendments to the Principal Regulations to give effect to these changes and also contain a number of amendments consequential to the main changes. In particular, they insert into the Principal Regulations provisions which deal with the phasing in of RTI for different employers between April 2012 and October 2013.

4.5 In addition to income tax subject to PAYE and Class 1 NICs, the repayment of student loans by employees relies on the PAYE system, as does the income tax construction industry scheme (CIS). Amendments to the PAYE Regulations and the Income Tax (Construction Industry Scheme) Regulations 2005 (S.I. 2005/2045) are being made by HMRC at the same time as these Regulations to reflect the introduction of RTI. The Department for Business, Innovation and Skills is similarly making regulations amending the Education (Student Loans) (Repayment) Regulations 2009 (S.I. 2009/470).

Securities

4.6 Item 4B in section 684(2) of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) was inserted by section 85 of the Finance Act 2011. It allows the Commissioners for HMRC to make regulations for and in connection with the giving of security for the payment of tax under the PAYE system. Regulations are being made by HMRC at the same time as these Regulations in exercise of that power. Paragraph 6(1) of Schedule 1 to, respectively, the Social Security Contributions and Benefits Act 1992 and the Social Security Contributions and Benefits (Northern Ireland) Act 1992 allows similar regulations to be made in relation to NICs. These Regulations make that provision.

4.7 These Regulations amend the Principal Regulations to make provision allowing HMRC to require security for the payment of NICs for the purposes of protecting Class 1 and Class 1A contributions. They set out who security may be required from, the procedural requirements to be satisfied by HMRC when it seeks security and the appeal rights of those from whom security is required.

4.8 Section 684(4A) of ITEPA, inserted alongside item 4B, provides that a person from whom security for PAYE is required commits an offence if they fail for a specified period to give that security. These Regulations apply that offence for NICs purposes and set out the time limits for providing security, after which an offence is committed.

Class 1A NICs returns

4.9 These Regulations amend the Principal Regulations in relation to the signatory to the declaration that is required by employers where Class 1A NICs are payable.

Other amendments to Schedule 4 of the Principal Regulations

4.10 These Regulations further amend Schedule 4 to the Principal Regulations.

4.11 Regulation 20(a) substitutes the definition of “general earnings” in the interpretation paragraph of Schedule 4 to the Principal Regulations. The substituted definition of general earnings makes clear that amounts which are “earnings” for NICs purposes (including payments treated as, or deemed to be, remuneration and earnings) may be collected in like manner as income tax under the PAYE Regulations.

4.12 Regulation 22 substitutes the definition of “general earnings” for the new definition of “relevant payments” in paragraph 9(2) of Schedule 4. It also inserts a new paragraph 9(3) which specifies that “relevant payments” has the meaning given in the PAYE Regulations. This ensures that notwithstanding the amendment to the definition of “general earnings”, an employee who would not otherwise be entitled to a Form P60 certificate (information to employees about payments and tax deducted for a tax year) in respect of tax for a tax year will continue to be entitled to such a certificate if the employee has paid, or is treated as having paid, primary Class 1 contributions.

PT and ST

4.13 Regulation 21 amends the Principal Regulations to change the appropriate information to be recorded on deductions working sheets to take account of the fact that the PT and the ST are no longer aligned.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As this 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*

RTI

7.1 PAYE has been operating in its current form for some 60 years. RTI is being introduced from April 2012 to bring PAYE into the 21st century by making it easier for employers, pension providers and HMRC to administer and over time, more

accurate for some individuals by improving the processes relating to joiners and leavers. RTI is being piloted from 6th April 2012 with all employers being RTI employers from 6th October 2013.

7.2 Under RTI employers and pension providers will tell HMRC about PAYE payments and deductions they make (tax, NICs, Student Loan repayments, etc) at the time they pay their employees, as opposed to the end of the year as happens now.

7.3 Instead of PAYE being a separate process for employers and pension providers, the RTI process will be integrated within the payroll process. RTI is expected to make the 'leaver' and 'joiner' process smoother which, over time, should mean that those who change jobs frequently will be more likely to pay the right amount of tax at the right time. Payroll software will collect the information and send it to HMRC electronically – with the smallest employers able to download HMRC's free 'Basic PAYE Tools'.

7.4 In addition, RTI will also support the operation of Universal Credit due to commence in October 2013. The Department for Work and Pensions will have access to necessary RTI information to identify earnings of Universal Credit claimants thereby ensuring the correct payment in line with fluctuations in earnings. This will require up to date information about employment and pension income so that claimants' welfare payments can be adjusted to reflect their circumstances. RTI will contribute to the delivery of this.

Securities

7.5 Schedule 11 to the Value Added Tax Act 1994 allows HMRC to require security for the payment of VAT. The amendments made to ITEPA by the Finance Act 2011 together with the powers mentioned in paragraph 4.6 give HMRC similar powers where there is a serious risk that employers will not meet their PAYE or NICs obligations.

7.6 HMRC requires businesses to provide security where it believes VAT or other indirect taxes are at risk. This is underpinned by a criminal sanction for trading without providing a security where one is required. The Government considers that equivalent risks exist in respect of NICs and that the same enforcement tools should be available. This supports the Government's priority of a fairer tax system by deterring non-payment of NICs and PAYE.

Class 1A NICs returns

7.7 Where an employee receives benefits in kind (such as a company car), Class 1A NICs are payable by the employer. In such cases, the employer is required to make a return no later than the 6th July following the end of the tax year. Regulation 80(3) of the Principal Regulations requires the signatory to the declaration to be the company secretary or director of a limited company. However, the legislation does not include partnerships and the self employed who may also have employees who may receive benefits in kind.

7.8 These Regulations correct the omission and ensure that partnerships and the self employed have their requirements in terms of who is responsible for signing the

Class 1A declarations specified. They ensure that there is certainty about who should sign the declarations to avoid confusion and maintain consistency with the requirements for limited companies. The change also ensures that those who choose to submit their returns by an approved method of electronic communication can have those returns authenticated by or on behalf of the employer in a manner approved by HMRC.

Other amendments to Schedule 4 of the Principal Regulations

7.9 ITEPA consolidated previous legislation relating to employment income (part of the Tax Law Rewrite project). Changes were also made at the same time to the definition of earnings on which NICs were collectable by virtue of Schedule 4 to the Principal Regulations. These Regulations clarify that notwithstanding those consequential changes, employers are still required to pay over NICs on all earnings (including payments treated as, or deemed to be, remuneration and earnings) to HMRC through PAYE.

PT and ST

7.10 The PT and the ST are the points at which employees and employers start to pay NICs. Prior to 6th April 2011 the value of the two thresholds were aligned. In order to ameliorate the effect of the 1% increase in the rates of Class 1 for employees and employers the PT and ST were increased by above indexation amounts but as a result the pre-existing alignment was broken. Minor changes are needed to legislation in relation to how employers record earnings for NICs purposes at these thresholds to reflect that they are no longer aligned.

- ***Consolidation***

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

8. Consultation outcome

RTI

8.1 HMRC have consulted widely on RTI and the responses to these consultations have been used to inform and develop our policy. The first discussion document was published in July 2010 with a subsequent consultation document published in December 2010. These documents are available at <http://customs.hmrc.gov.uk/ConsultationDocumentsRTI>. In total there were approximately 600 responses.

8.2 In accordance with the Government's Tax Consultation Framework, a draft of these Regulations was published on the HMRC website for comment from 14th November 2011 to 9th January 2012 together with draft CIS and NICs regulations. The draft regulations and accompanying technical note are available here: <http://customs.hmrc.gov.uk/ConsultationDocumentsRegs>.

8.3 There were no significant changes to the draft of these Regulations as a direct result of the consultation but changes were made to the draft amendments to the PAYE Regulations. The Regulations include a number of drafting adjustments to

ensure they operate as intended and for the sake of clarity. All consultation responses have been considered and HMRC will provide a written response to each representation.

Securities

8.4 The introduction of this power was the subject of consultations by HMRC on 9th December 2010, containing draft primary legislation and draft regulations relating to PAYE. A summary of the consultation responses was published and is available at: <http://www.hmrc.gov.uk/about/security-payee-nics.htm>

8.5 Following the consultation no changes were made to the primary legislation. The draft regulations were amended, taking account of comments received, in particular, to ensure that employers are made aware of the possibility of managing their debts to HMRC via Time to Pay arrangements at the time a security is required. A response document was published on 31st March 2011.

9. Guidance

RTI

9.1 Extensive guidance will be published on the HMRC website for employers that join RTI.

Securities

9.2 HMRC will publish operational guidance on 5th April 2012 on the HMRC internet site.

Class 1A NICs returns

9.3 HMRC guidance will be updated to reflect the change.

Other amendments to Schedule 4 of the Principal Regulations

9.4 No changes to HMRC guidance are required since the purpose of the amendment is to make clear that amounts which are “earnings” for NICs purposes (including payments treated as, or deemed to be, remuneration and earnings) may be collected under the provisions of the PAYE Regulations. This is already reflected in guidance.

PT and ST

9.5 The PT and ST ceased to be aligned from 6th April 2011. Software developers were informed in the Pre Budget Report on 24th November 2008 and in subsequent guidance that they would part company. This minor change aligns the legislation with the current practice in relation to recording earnings on PAYE documentation that employers have followed since 6th April 2011.

10. Impact

RTI

10.1 All employers including charities or voluntary bodies will be required to use RTI. It is expected that there will be a reduction in administrative burdens resulting from abolition of some current reporting requirements. However these savings will be partially offset by the new requirements for employers to collect and submit information each time employees are paid.

10.2 The impact on the public sector is the same as for any other employer.

Securities

10.3 The impact on business, charities or voluntary bodies is not expected to be significant.

10.4 The impact on the public sector is anticipated to bring a cost saving as requiring a security can be cheaper than alternative debt enforcement measures.

10.5 A Tax information and Impact Note covering this instrument was published on 9th December 2010 alongside draft legislation and is available on the website <http://www.hmrc.gov.uk/budget-updates/autumn-tax/tiin910.pdf>
It remains an accurate summary of the impacts that apply to this instrument.

Class 1A NICs returns

10.6 No significant behavioural or wider economic impacts are anticipated from these changes. They will provide certainty and clarity for employers who are self-employed or in a partnership.

Other amendments to Schedule 4 of the Principal Regulations

10.7 The changes clarify the law with relation to the collection of NICs through PAYE. There is not likely to be a significant impact on businesses, charities or the voluntary sector.

PT and ST

10.8 This change aligns going forward the legislation with the current practice that employers have been following since 6th April 2011. Therefore there is a negligible impact on businesses administrative burdens from these changes.

10.9 Tax Information and Impact Notes covering the amendments made by this instrument in relation to RTI, the other changes to Schedule 4 to the Principal Regulations, Class 1A returns and the PT and ST will be published on the HMRC website at <http://www.hmrc.gov.uk/thelibrary/tiins.htm>.

11. Regulating small business

RTI

11.1 The legislation applies to small business.

11.2 RTI aims to reduce administrative burdens for all employers, including small employers (upon whom the current burden of PAYE currently falls disproportionately). The aim is to achieve this by integrating employee payment and reporting to HMRC into a single payroll process.

11.3 Small employers are already required to submit returns to HMRC electronically, but those who do not currently use payroll software are expected to find the move to RTI most difficult. However, HMRC's existing free Basic PAYE Tools software will be updated and available for all employers with 9 or fewer employees to use.

11.4 A number of small firms are taking part in the RTI pilot and HMRC's research into employer impacts. The resulting findings will inform the support HMRC needs to offer to small employers to migrate on to RTI.

Securities

11.5 The legislation applies to small business.

11.6 It is only likely to affect those firms employing up to 20 full time employees, where they pose a significant risk of failing to pay their NICs to the Exchequer. To exclude them would not meet the policy objective.

Class 1A NICs returns

11.7 The changes provide clarity for small businesses about who should sign the declaration on the return and do not increase the burdens on business.

Other amendments to Schedule 4 of the Principal Regulations

11.8 The provisions in this instrument clarify the law with relation to the collection of NICs through PAYE. There is not likely to be a significant impact on small businesses.

PT and ST

11.9 The minor changes that relate to the PT and ST no longer being aligned apply to small business. Small businesses will have needed to acquaint themselves with the PT and ST no longer being aligned and information on earnings between the Secondary and Primary not being required.

11.10 To help minimise the burden on employers, 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 takes account of the fact that PT and ST are not aligned. This free computer software package is available to

download from www.hmrc.gov.uk/payee/tools/basic-payee-tools.htm. For those businesses which do not have access to computers or payroll software HMRC provides manual tables.

12. Monitoring & review

12.1 RTI will be piloted from April 2012 and HMRC will monitor and review these Regulations alongside that pilot and make amendments where necessary.

12.2 The power to require a security will be reviewed by an implementation oversight forum which has a majority of external members. The remaining changes are minor changes and will not be subject to review.

13. Contact

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