

**EXPLANATORY MEMORANDUM TO**  
**THE SOCIAL SECURITY (MISCELLANEOUS AMENDMENTS No. 2) REGULATIONS**  
**2015**

**2015 No. 478**

**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 This instrument amends the Social Security (Contributions) Regulations 2001 (S.I. 2001/1004) (“the principal Regulations”) and various other statutory instruments. The amendments cover:

- Class 2 National Insurance contributions (“NICs”) following the coming into force of the National Insurance Contributions Act 2015 (“the 2015 Act”).
- The term “general earnings” which is replaced with “earnings” to make it clear who is an employed earner for the purposes of NICs.
- A disregard for payments made under the Armed Forces Early Departure Payment 2015 (EDP 15) Scheme in the calculation of earnings for the purpose of earnings related contributions.
- Employment-related securities (ERS) income earned by internationally mobile employees (IMEs). It introduces a further instance where payments are disregarded in calculating earnings to establish liability for earnings-related contributions. The new disregard applies to the proportion of ERS which is attributable to periods when the individual would not otherwise be within the UK social security system (either because domestic law residence conditions are not met or because the individual is subject exclusively to foreign social security legislation under international social security rules).
- Changes and amendments to the reporting of NICs agreements and elections in respect of Secondary Class 1 NICs.

2.2 All the changes within this instrument come into force on the 6 April 2015 except for the Armed Forces Early Departure Payment disregard which comes into force on the 1 April 2015.

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

None.

### **4. Legislative Context**

#### *Class 2 Reform*

4.1 The Regulations 2 to 6, 10 to 20 and 24 are being made as a consequence of the changes made in Schedule 1 to the 2015 Act that relate to the payment and collection of Class 2 NICs. Regulations 27 to 38 make consequential amendments to other instruments so as to align the language and legislative references with those in the 2015 Act.

#### *General Earnings*

4.2 The amendments made by Regulations 7 to 9, 22(1) to (4) and (6), 23, 25 and 26 of this instrument make clear that for the purposes of NICs an employed earner has to be in receipt of earnings as defined in accordance with sections 3, 4 and 112 of the Social Security Contributions and Benefits Act 1992 (“the 1992 Act”) and the Social Security Contributions and Benefits (Northern Ireland) Act 1992 (“the 1992 Northern Ireland Act”) and not general earnings as defined by both Acts as reference to section 7 of the Income Tax Pensions and Earnings Act 2003 (“ITEPA 2003”).

#### *Armed Forces Early Departure Scheme*

4.3 Regulation 21(2)(b) of this instrument amends paragraph 10A of Schedule 3 to the principal Regulations by inserting a reference to the Armed Forces Early Departure Payments Scheme Regulations 2014 (S.I. 2014/2328), which established the Early Departure Payment Scheme 2015. This provides that any payment made under the Early Departure Payment Scheme will also be disregarded from liability to Class 1 NICs.

#### *Payments made to internationally mobile employees*

4.4 Regulation 21(3) inserts new paragraph 18 to Part 9 of Schedule 3 of the principal Regulations to provide that income received by an employee or office-holder is taxed as ‘employment income’ within the meaning of section 7 of ITEPA 2003. In many cases a person’s employment income will consist wholly or mainly of ‘general earnings’. However, the legislation also identifies certain particular types of income known as ‘specific employment income’.

4.5 The complex forms which ERS can take mean that the general earnings charge may not capture all aspects of the taxable value of ERS. A special ERS taxation regime therefore applies to treat this additional value as specific employment income. This regime is found within Part 7 of ITEPA 2003.

4.6 Charges arising under Part 7 may arise at either the time of the acquisition of the ERS, or more commonly on the occasion of a post-acquisition 'chargeable event' (i.e. where value passes to the employee after acquisition, such as the exercise of a share option).

4.7 The principal charging provisions in Part 7 only apply if the employee was resident in the UK at the time of acquisition. It does not matter whether the employee was resident at the date of the later chargeable event.

4.8 Finance Act 2014 has amended these rules so that Part 7 will apply to all ERS income, whether or not the employee was resident in the UK at the time of acquisition. It has also introduced new Chapter 5B of Part 2 of ITEPA 2003 which establishes the period over which Part 7 income can be regarded as accruing (broadly, the time between acquisition and the later chargeable event). The Part 7 income is then apportioned. The apportionment is normally done on a time basis, with the part which relates to UK duties being subject to income tax, and the part which relates to overseas duties being excluded from the tax charge. These rules will come into effect on 6 April 2015.

4.9 Current NICs legislation provides that the full amount of the ERS income (calculated under Part 7) is treated as earnings and subject to earnings-related NICs. This legislation is unaffected by Chapter 5B of Part 2 of ITEPA 2003, so the full, un-apportioned, amount of the Part 7 income is subject to earnings-related NICs.

4.10 This amendment will ensure the tax and NICs position is aligned as far as possible. However, due to the conditions of various international social security treaties and agreements, the complete alignment of tax and NICs rules would create a risk of double charging for some IMEs.

4.11 New paragraph 18 to part 9 of Schedule 3 apportions the ERS income over the same period as Chapter 5B of Part 2 of ITEPA 2003. It then disregards the proportion of the ERS income which is attributable to days when the individual was not in the UK social security system (due to not meeting domestic law conditions relating to residence, or being exempt from NICs due to international social security legislation). That proportion of the ERS income will therefore not be subject to a NICs liability.

*Notification by employer of operation of NICs agreement and election in relation to Secondary Class 1 contributions*

4.12 Regulation 22(5) inserts new paragraph 23 to Schedule 4 of the principal Regulations to reduce and simplify reporting requirements on employers in relation to employment-related securities (such as employee shares) and NICs agreements and elections. Currently an employer has to give information about the amount of NICs paid by the employee to the employer, the date of that payment and the date these NICs are paid by the employer to HMRC. Following these changes an employer will only be required to report that a NICs agreement or an election has been operated to recover the secondary NICs liability from the employee.

## **5. Territorial Extent and Application**

This instrument applies to all of the United Kingdom.

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

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 2 Reform*

7.1 The Chancellor announced at Budget 2014 that the mechanism for collecting Class 2 NICs would be changing from 2015-16 tax year onwards. This aim of this change was to enable the self-employed to pay their Class 2 NICs through Self-Assessment (SA) alongside income tax and Class 4 NICs.

7.2 This change followed a recommendation by the Office of Tax Simplification (OTS) in their 2012 Review of Small Business that the Government review the National Insurance processes for the self-employed. HMRC subsequently consulted on this proposal in 2013 and received strong support for the proposal to bring the collection mechanism of Class 2 NICs into SA.

7.3 The aim of this change is to simplify the collection of Class 2 NICs to make it more simple and straight-forward for the self-employed to pay Class 2 NICs, reducing the administrative burdens on them and the Government. The change will take effect from the 2015-16 tax year onwards.

7.4 The structure of Class 2 will change from the existing liability that arises in respect of each week, or partial week, of self-employment to an annual liability which is triggered by reference to a self-employed earner's Class 4 profits (rather than earnings) and which is then calculated by reference to the number of weeks, or part weeks, of self-employment in the tax year. The 2015 Act also introduces a threshold – the small profits threshold (SPT) - below which there is no Class 2 NICs liability.

7.5 Consequential changes are required to regulations arising from the proposed reforms. These changes will update references in accordance with the 2015 Act and ensure that the mechanisms for payment of Class 2 NICs remain in place for those not paying via SA.

7.6 Regulation 3 provides a new definition of “due date” in regulation 1(2) of the principal Regulations. Under the 2015 Act, liability for Class 2 NICs is moving from a

weekly liability irrespective of earnings to an annual liability linked to trade profits chargeable to income tax in respect of which Class 4 NICs are payable. As collection of Class 2 NICs will now be through SA we needed to align the due date for Class 2 with the due date in SA for Class 4 NICs and income tax and amend the definition so that the original due date for Class 1 and Class 3 NICs is not disturbed.

7.7 Regulations 4, 5, 6, 10, 12, 15, 16, 19 and 20 make minor technical changes to the regulations.

7.8 Regulation 11 inserts new regulation 87AA. This introduces the new requirements to notify HMRC of commencement or cessation of self-employment for tax years for which Class 2 NICs will now be collected through SA.

7.9 Regulation 13 inserts new regulation 89A due to the consequential changes to regulation 89. Class 2 NICs are currently collected by direct debit in arrears. Now that Class 2 collection is moving into SA, this regulation is required to allow HMRC to collect the payments in respect of the 2014-15 year up to the end of July 2015.

7.10 Regulation 14 inserts new regulation 90ZA to deal with the exception cases for Maternity Allowance (MA) so that qualifying women (including their spouse or civil partner) can pay Class 2 NICs before their liability is established (on filing their SA return) to ensure the changes to due date of payment do not adversely impact this group.

7.11 Regulations 17 and 18 insert new regulations 148B and 148C. These consequential regulations deal specifically with a special group of self-employed earners who are liable to pay Class 2 NICs by virtue of EU Regulations but do not carry on a trade, profession or vocation, the profits of which (if any) would be chargeable to income tax under Chapter 2 of Part 2 of the Income Tax (Trading and Other Income) Act 2005, and are therefore not liable to pay Class 4 NICs or income tax and not required to file an SA return. These regulations provide for the treatment of overseas profits to be treated as if they were relevant profits under the Act and allows them to pay Class 2 NICs when they establish their liability and entitles them to pay when their profits do not reach the SPT. It also requires those liable to retain such records necessary to calculate relevant profits and to ensure that they are available to HMRC.

### *General Earnings*

7.12 ITEPA consolidated previous legislation relating to employment income (part of the Tax Law Rewrite project). Changes were also made at the same time the definition of earnings in the 1992 Act and the 1992 Northern Ireland Act and corresponding references in regulations were also made at the same time. These changes inserted a new definition of “general earnings”. The National Insurance Contributions Act 2014 amended the definition of “general earnings” in section 2(1)(a) of the 1992 Act and the 1992 Northern Ireland Act by omitting the word “general”.

7.13 Regulations 7 to 9, 22(2) to (4) and (6), 25 and 26 make corresponding changes to the principal Regulations, the Social Security (Categorisation of Earners) Regulations 1978 (S.I. 1978/1689) and the Social Security (Categorisation of Earners) (Northern Ireland) Regulations 1978 (S.R. 1978/401).

#### *Armed Forces Early Departure Scheme*

7.14 Early departure payments have been available since 6 April 2005 under the Armed Forces Early Departure Payment 2005 (EDP 05) Scheme, established by the Armed Forces Early Departure Payments Scheme Order 2005 (S.I. 2005/437); they are lump sum and periodical payments made to members of the armed forces who have left the forces and satisfy conditions relating to age and length of service.

7.15 Payments made under the EDP 05 Scheme are disregarded in the calculation of a person's earnings for the purpose of earnings related contributions. This treatment is applied to payments under the current scheme (EDP 05) by virtue of SI 2013/622, for tax years from 2013-14. Section 16 of the National Insurance Contributions Act 2014 applied this treatment to payments made under the EDP 05 Scheme for tax years from 2005-06 to 2012-13 inclusive. A new scheme will be introduced from 1 April 2015 and regulation 21(2)(b) ensures that this treatment will be applied to payments made under the EDP 15 Scheme.

#### *Payments made to internationally mobile employees*

7.16 The measures within Chapter 5B of Part 2 ITEPA will give effect to one of the recommendations made by the OTS in its report on 'unapproved employee share schemes' published in January 2013 to support the Government's objective to simplify the tax system.

7.17 The OTS recommended that there should be certain and consistent treatment of each type of award made to inbound and outbound employees. Also, that all share plans be treated consistently from a residence perspective – the OTS preferred option being to change the residence rules so that these rules apply on an earnings basis. The aim of the OTS recommendation being to align the tax treatment of ERS awarded to IMEs more closely with that for other forms of employment income earned by IMEs.

7.18 Specifically with regard to NICs, OTS pointed out that the consensus approach is to apply social security based on the economic activity in each country, which follows the Organisation for Economic Co-operation and Development model. The OTS also referred to work done by HMRC and external stakeholders which had identified a desirability of moving to apportionment for NICs to align as closely as possible with tax treatment, but acknowledged this had to be subject to international social security treaty requirements.

7.19 For income tax ERS income is apportioned on a time basis, with the part which relates to UK duties being subject to income tax, and the part which relates to overseas duties being excluded from the liability. Therefore, complete alignment between the tax and NICs creates unfairness and the risk of double-charging of NICs (for example, where income tax is chargeable on ERS in the UK, but the employee is still within a foreign social security scheme rather than NICs).

7.20 Regulation 21(3) amends Part 9 of Schedule 3 of the principal Regulations. This change ensures that any ERS income which is attributable to days when the individual was not in the UK social security system will be disregarded and not subject to a NICs liability. This introduces greater simplicity and fairness, and produces the best fit with international social security treaties which will mitigate the risk of a social security double charge.

#### *Notification by employer of operation of NICs agreement and election in relation to Secondary Class 1 contributions*

7.21 Regulation 22(5) amends Schedule 4 of the principal Regulations to simplify and reduce the reporting requirements on employers. It will be implemented alongside the online registration of employment-related securities schemes and arrangements as recommended by the OTS.

- *Consolidation*

7.22 There are currently no plans to consolidate the principal Regulations.

## **8. Consultation outcome**

### *Class 2 Reform*

8.1 HMRC consulted on this change in 2013 and received strong support to change the collection mechanism for Class 2 NICs. The Government's summary of responses can be viewed on the GOV.UK website on the following link:

<https://www.gov.uk/government/consultations/simplifying-the-national-insurance-processes-for-the-self-employed>

### *General Earnings*

8.2 The changes to the definition of "general earnings" in section 2(1)(a) of the 1992 Act and the 1992 Northern Ireland Act, which the amendments in this instrument correspond to, were published in draft on 16 July 2013 for consultation. No changes to the policy or draft legislation were identified as being necessary. HMRC has not consulted on the changes made by these Regulations.

### *Armed Forces Early Departure Scheme*

8.3 As this is an extension of an existing disregard and as it only applies to one employer (the Ministry of Defence) who is aware of the changes, HMRC has not consulted on the matter further.

### *Payments made to internationally mobile employees*

8.4 HMRC consulted on five recommendations made by the OTS in its review of non-tax advantaged (or ‘unapproved’) employee share schemes (including the measure relating to internationally mobile employees). Consultation took place from 14 May 2013 to 16 August 2013.

8.5 Each response was carefully considered and summarised in a government response to consultation document, which can be accessed at:

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/264669/131209\\_OTs\\_2\\_summary\\_of\\_responses\\_Final2.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/264669/131209_OTs_2_summary_of_responses_Final2.pdf)

A further consultation relating specifically to the amendment in this instrument was carried out between 24 July 2014 and 16 October 2014, which can be accessed at:

<https://www.gov.uk/government/consultations/internationally-mobile-employees-and-earnings-related-securities>

Each response was carefully considered and summarised in a government response to consultation document, which can be accessed at:

<https://www.gov.uk/government/consultations/internationally-mobile-employees-and-earnings-related-securities>

### *Notification by employer of operation of NICs agreement and election in relation to Secondary Class 1 contributions*

8.6 There has been no consultation on this simplification measure.

## **9. Guidance**

### *Class 2 Reform*

9.1 HMRC and Department for Work and Pensions (DWP) have already started to communicate with the self-employed and small businesses to inform them of the Class 2 change, what it means for them and the timetable for any action they may need to take. HMRC has also engaged with a number of stakeholder groups and representative organisations to ensure the self-employed and those that act for them are made aware of this change.



9.2 Associated guidance both in paper format and online will be updated including information and guidance on GOV.UK.

#### *General Earnings*

9.3 No changes to HMRC guidance are required since the purpose of these amendments 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 Income Tax (Pay As You Earn) Regulations 2003 (S.I. 2003/2682). This is already reflected in HMRC guidance.

#### *Armed Forces Early Departure Scheme*

9.4 There were no requirements for guidance because this disregard mirrors the disregard for EDP 05 and does not impose any new obligations.

#### *Payments made to internationally mobile employees*

9.5 HMRC will update the guidance it provides to employers, employees and agents as appropriate.

#### *Notification by employer of operation of NICs agreement and election in relation to Secondary Class 1 contributions*

9.6 Existing guidance on the completion of annual employment-related securities returns will be amended to reflect these changes.

## **10. Impact**

#### *Class 2 Reform*

10.1 This change impacts the self-employed and small businesses who will now be able to pay their Class 2 NICs alongside income tax and Class 4 NICs, through one process.

10.2 There is a small impact on pregnant women who wish to claim Maternity Allowance (MA) and an exception process has been developed by HMRC and DWP so that there is no monetary disadvantage to those wishing to claim MA.

10.3 This change does not impact the amount of Class 2 NICs a self-employed person may have to pay.

10.4 There is a small number of people who do not have to report their income through the self-employed section of the SA process. HMRC will retain a process to allow these groups to continue paying Class 2 NICs under the new arrangements.

10.5 A [Tax Information and Impact Note](#) was published on 17 July 2014 about the impact of the changes to Class 2 NICs arising from these reforms. It remains an accurate assessment of the impact of these changes.

#### *General Earnings*

10.6 The provisions in this instrument clarify the law with relation to the collection of NICs through Pay As You Earn (PAYE). Consequently, there is not likely to be a significant impact on businesses, charities or the voluntary sector.

10.7 There is no impact on the public sector.

10.8 A Tax Information and Impact Note covering the changes included in the National Insurance Contributions Act 2014 was published on 16 July 2013 and is available at:

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/222505/130312\\_General\\_Earnings\\_TIIN\\_F\\_2\\_.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/222505/130312_General_Earnings_TIIN_F_2_.pdf).

It remains an accurate summary of the impacts that apply to these changes.

#### *Armed Forces Early Departure Scheme*

10.9 An impact assessment has not been prepared as there is expected to be no impact on business or charities.

10.10 There are no public sector implications.

10.11 A Tax Information and Impact Note cover this measure was published on 10 December 2014 alongside the draft Finance Bill and is available on the GOV.UK website at:

<https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins#finance-bill-2015-10-december-2014>.

It remains an accurate summary of the impacts that apply to this change.

#### *Payments made to internationally mobile employees*

10.12 An impact assessment has not been prepared as there is expected to be a negligible impact on business.

10.13 This measure is one of a package which simplifies the legislation used by businesses which operate unapproved share schemes.

10.14 The costs or savings for HMRC in implementing these changes are expected to be negligible.

10.15 A Tax Information and Impact Note covering this measure was published on 10 December 2013 alongside the draft legislation for Chapter 5B of Part 2 of ITEPA 2003, and is available on the HMRC website at:

<http://www.hmrc.gov.uk/thelibrary/tiins.htm>.

*Notification by employer of operation of NICs agreement and election in relation to Secondary Class 1 contributions*

10.16 A Tax Information and Impact Note covering this amendment was published on 10th December 2013 alongside Finance Bill 2014 draft legislation on employee share schemes and is available on the Gov.uk website at

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/264595/5.Tax\\_advantaged\\_employee\\_share\\_schemes.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/264595/5.Tax_advantaged_employee_share_schemes.pdf)

It remains an accurate summary of the impacts that apply to this measure.

## **11. Regulating small business**

### *Class 2 Reform*

11.1 This change applies to self-employed people. They will have to cancel their direct debit agreements with their bank, if they pay by direct debit currently, and include their Class 2 NICs in their SA return. They will have the option to make regular payments towards their tax and NICs under SA using HMRC's Budget Payment Plan facility.

11.2 The self-employed will no longer have to apply for a deferment of their Class 2 NICs, on the basis they will pay sufficient Class 1 NICs.

11.3 This change sees the abolition of the Small Earnings Exception (SEE) certificate. The SEE threshold is replaced by the SPT and those that have profits below the SPT will not be liable for Class 2 NICs. Therefore, no exception to liability will be necessary – formerly the SEE process. Those with no profits or profits below the SPT will continue to have the option to pay Class 2 NICs on a voluntary basis in order to protect their contributory benefit entitlement.

### *General Earnings*

11.4 The provisions relating to general earnings in this instrument clarify the law with relation to the collection of NICs through PAYE. Consequently, there is not likely to be a significant impact on small business.

### *Armed Forces Early Departure Scheme*

11.5 This legislation does not apply to small business.

### *Payments made to internationally mobile employees*

11.6 The provisions will apply to all businesses that award employment-related securities (such as shares) or employment-related securities options to internationally mobile employees, and the internationally mobile employees who receive these awards. It will also be of interest to payroll and share plan administrators.

### *Notification by employer of operation of NICs agreement and election in relation to Secondary Class 1 contributions*

11.7 This change could reduce the administrative burden on businesses of all sizes that award employment-related securities and make a NICs agreement or election. No particular impacts or issues are anticipated for small businesses.

## **12. Monitoring and review**

### *Class 2 Reform*

12.1 In respect of the Class 2 changes the success criteria will be measured by a reduction in administration for the self-employed who no longer have to apply for a SEE certificate or request a deferment of Class 2 NICs. HMRC anticipate a reduction in customer contact volumes as a result of this change.

12.2 For the remainder of the changes in this instrument HMRC will monitor the practical effects of the changes to ensure that the objectives are met.

## **13. Contacts**

### *Class 2 Reform*

**Shell Makwana** at HMRC on Telephone: 03000 586 480 or email: [shell.makwana@hmrc.gsi.gov.uk](mailto:shell.makwana@hmrc.gsi.gov.uk) for any queries regarding the changes to Class 2 NICs.

### *General Earnings*

### *Payments made to internationally mobile employees*

**Raj Nayyar** at HMRC, Tel: 03000 586 543 or e-mail: [raj.nayyar@hmrc.gsi.gov.uk](mailto:raj.nayyar@hmrc.gsi.gov.uk) for any queries regarding the changes in respect of general earnings, payment to internationally mobile employees and independent advice in respect of conversions and transfers of pension scheme benefits disregard.

*Armed Forces Early Departure Scheme*

**Hasan Mustafa** at HMRC, Tel: 03000 586 718 or e-mail:  
[hasan.mustafa@hmrc.gsi.gov.uk](mailto:hasan.mustafa@hmrc.gsi.gov.uk) for any queries regarding the Armed Forces Early  
Departure Scheme disregard.

*Notification by employer of operation of NICs agreement and election in relation to  
Secondary Class 1 contributions*

**Hasmukh Dodia** at HMRC, Tel: 03000 585 201 or e-mail:  
[hasmukh.dodia@hmrc.gsi.gov.uk](mailto:hasmukh.dodia@hmrc.gsi.gov.uk) for any queries regarding the changes to the notification  
by employer of operation of NICs agreement and election in relation to Secondary Class 1  
contributions.