

CHILD SUPPORT, PENSIONS AND SOCIAL SECURITY ACT 2000

EXPLANATORY NOTES

PART IV: NATIONAL INSURANCE CONTRIBUTIONS

Background

The current position

843. Earnings-related National Insurance contributions (NICs*) are paid by both employees and employers on all cash earnings which reach a set amount. These contributions go into the National Insurance Fund to pay for contributory benefits. However, employees pay no NICs on most non-cash earnings (payments, or benefits, in kind).
844. Since 1991, Class 1A NICs, which are an employer-only charge, have been liable on car and fuel benefits provided for the employee. But most other non-cash benefits are provided NIC-free. Some benefits, which are readily convertible assets, such as shares or gold bars, as well as non-cash vouchers, are already subject to Class 1 NICs paid by both employers and employees. Such benefits are set out in Schedules 1A, 1B and 1C to the Contributions Regulations 1979.
845. All benefits in kind are subject to income tax as emoluments either under section 19 or Part V of the Income and Corporation Taxes Act 1988 (ICTA).

Recent developments

Benefits in kind

846. The Chancellor announced in the March 1999 Budget that all taxable benefits in kind not already subject to NICs would become liable to a Class 1A charge from April 2000. This will align more closely the tax and NICs treatment of provided benefits such as private medical insurance, beneficial loans or assets transferred to the employee.
847. This will implement a recommendation of the Task Force chaired by Martin Taylor, ex-Chief Executive of Barclays plc., in the report *The Modernisation of Britain's Tax and Benefit System*.

Share options

848. Since 6 April 1999, gains made on share options granted after 5 April 1999, acquired by reason of employment, have been subject to Class 1 National Insurance Contributions (NICs). This does not apply, however, to share options awarded and exercised under an Inland Revenue approved scheme, nor to options where the shares, or the right to acquire shares, are not readily convertible assets, i.e. they are not readily convertible into cash.
849. Whilst companies can plan for NICs on regular pay, it is more difficult for them to plan for NICs on share option gains, particularly where the share price is volatile. Under

accountancy rules, companies are required to make a provision in their accounts for the anticipated NICs liability on share options, based on the market price of the shares on the date that they prepare the accounts. Employers have expressed concern that their exposure to a highly unpredictable NIC liability could put at risk their investment strategies, and even make some technically insolvent.

The measures in the Act

Benefits in kind

850. The new measures contain provisions which are intended to make all non-cash earnings received by directors or employees earning £8,500 or more per year subject to Class 1A (employer-only) NICs, unless they are already subject to Class 1 NICs, or Class 1B NICs (if they are minor benefits which are included in a PAYE Settlement Agreement, an administrative arrangement under which an employer accounts directly to the Revenue for tax and NICs on minor or irregular payments).
851. The extended Class 1A charge follows the shape of the existing charge on car and fuel benefits. The Class 1A due will be calculated using the valuation figures already required for tax purposes which an employer enters on a P11D form – a report to the Inland Revenue of the value of benefits in kind provided throughout the tax year* to each employee. This is intended to keep extra reporting requirements to a minimum.
852. The new measures provide powers for Treasury Ministers to make regulations to except particular items or reduce the Class 1A liability where appropriate. The sections also give powers to prescribe penalties for failure to pay Class 1A NICs correctly and other matters, such as dates and forms of records, surrounding collection of the NICs.
853. The Act also includes measures to move the liability for Class 1A NICs on benefits in kind provided by a third party from the direct employer of the recipient to the third party provider. Typically, this would arise where a manufacturer wishes to reward or incentivise the salespeople in retail outlets that sell his products, for example by providing them with holidays, goods or sometimes non-cash vouchers. The staff are likely to be employed by the retailer, not the manufacturer. Currently, the employer is liable for NICs on these benefits, possibly without his knowledge, and without any involvement in their provision. In general, the third parties have indicated their willingness to meet NICs liabilities of providing incentive awards, as they can do for tax.
854. The measures in the Act provide a mechanism to do this, by moving the liability for the Class 1A NICs on provided benefits and any related tax to that third party. This new liability is to be a voluntary commitment for the tax year 2000-2001. If the third party chooses not to pay the Class 1A NICs, the liability will rest with the employer, but in future tax years, the liability will be compulsory for the third party.
855. To remove all need for the employer to be involved, regulations came into force on 6 April 2000 to make non-cash vouchers that are provided by a third party liable to Class 1A NICs, rather than Class 1 NICs as at present ([SI 2000/761](#) in GB and [2000/758](#) in Northern Ireland).
856. A further provision allows any emolument received from employed earner's employment which is subject to Schedule E tax also to be treated as earnings for National Insurance. This is intended to be used to clarify the NICs treatment of items bought using a company credit card or similar form of purchase. It could also be used for tax/NICs alignment, such as to introduce the NICs regulations relating to the proposed new all-employee share plan.

Share options

857. The provision in the Act does three things. First, it allows employers and employees to reach an agreement that a secondary contributor (usually the employer) may recover from the employee some or all of the secondary NIC in respect of a gain made from a right to acquire shares. These gains usually take the form of the exercise of share options.
858. Second, as an alternative, the employer may make an application for approval of an election to the Board of Inland Revenue. If approval is obtained, the employer and employee can jointly elect to transfer all or some of the liability to pay the secondary NIC on the share option gain to the employee. Elections can only be made when the Board are satisfied that the election to be used will transfer the liability, and that the accompanying arrangements will ensure that the NIC liability transferred to the employee is paid.
859. Third, the provision strengthens the existing statutory bar that prevents the employer recovering any part of the secondary NIC in respect of all forms of earnings (subject to the new exception for rights to acquire shares). It extends the protection to the employee by ensuring that the person liable to pay the Class 1A (on benefits in kind) or Class 1B (on Pay As You Earn Voluntary Settlement Agreements) cannot recover his liability from the employee.

Commentary on Sections

860. Currently, employees pay primary Class 1 National Insurance contributions (NICs) on all cash earnings they receive between the Lower Earnings Limit* (LEL) and the Upper Earnings Limit* (UEL). Employers pay secondary Class 1 NICs on all cash payments above the earnings threshold (equal to the Single Person's Tax Allowance) which they pay to employees with no UEL applying. Non-cash benefits are excluded in regulations from the computation of earnings subject to Class 1. But some, such as bonds and gemstones, are brought back into a Class 1 NICs charge. Employers also pay Class 1A NICs – at a rate equivalent to the Class 1 secondary rate – on the value of car and fuel benefits which are provided to their employers for their private use. Employees pay no NICs on such benefits.

Section 74: Contributions in respect of benefits in kind (Great Britain)

861. This section enables all taxable benefits not yet subject to NICs to be brought within a Class 1A NICs charge.
862. *Subsection (1)* makes a change to section 1(2)(b) of the Social Security Contributions and Benefits Act 1992* (the "Contributions and Benefits Act") to reflect the fact that the Class 1A charge will no longer apply to car and fuel benefits.
863. *Subsection (2)* replaces section 10 of the Contributions and Benefits Act, which sets out the existing Class 1A charge, with a new section 10.

New section 10: Class 1A contributions: benefits in kind etc.

864. *New section 10(1)* defines the circumstances when a Class 1A contribution is due. An earner receives an emolument which is chargeable to tax under Schedule E from employed earners' employment to which Chapter II, Part V ICTA applies – i.e. the earner is a director or earns £8,500 per year or more. As all or some of the emolument received is exempted from, or not liable to, Class 1 NICs, then Class 1A NICs are due.
865. *New section 10(2) and (3)* provides that the person liable to pay the Class 1A NICs (usually the employer) is also the person who is liable to pay secondary Class 1 NICs in that tax year – or would be if there were any earnings liable to Class 1 NICs.

*These notes refer to the Child Support, Pensions and Social Security
Act 2000 (c.19) which received Royal Assent on 28th July 2000*

866. *New section 10(4)* provides that the amount of Class 1A due is the amount of the emolument not subject to Class 1 - as per subsection (1) - multiplied by the Class 1A rate for the tax year.
867. *New section 10(5)* provides that the rate for Class 1A is the same as that for secondary Class 1 NICs.
868. *New section 10(6)* provides that Class 1A is not due on any emoluments which have been included in a PAYE Settlement Agreement for tax and NICs purposes.
869. *New section 10(7)* provides that, for section 10 only, the emolument subject to Class 1A shall amount to the valuation of the benefit for tax purposes.
- New section 10(7)(a)* disapplies reliefs or allowances which, for income tax purposes, the employee may be able to claim against their tax under ICTA sections 198, 201, 201AA or 332(3), which allow deductions for certain types of expenses. These will not affect the valuation for Class 1A NICs purposes where the benefit is provided partly for business and partly for private use.
- New section 10(7)(b)* excludes from Class 1A charge those benefits where the whole amount of the emolument would be deductible for tax because it has been provided wholly for business purposes. An example would be a fax machine provided only for use when engaged in the employed earner's employment.
870. *New section 10(8)* provides regulation-making powers for the Treasury to amend the effect of 10(7). It will allow, should this be needed, the matching by regulations of any alterations to relevant tax legislation. For example, if a new ICTA section introduced a new relieving provision which needed to be included for the coherence of the Class 1A NICs scheme this could be done in regulations.
871. *New section 10(9)* provides regulation-making powers for the Treasury to exempt certain persons or types of emolument from Class 1A liability or reduce Class 1A liability. The Government anticipates using these powers, for example, to mirror items already exempted from Class 1 NICs, such as certain forms of training; or to reduce liability where the cost of providing a benefit is split between more than one company.
872. *Subsection (3)* of section 74 introduces new subsection 4(6) of the Contributions and Benefits Act. This provides regulation-making powers for the Treasury to treat any amount, which is the value of a benefit subject to Schedule E tax, as earnings from employed earner's employment. As such, it will maintain the existing use of the power in subsection 4(6) in relation to the provision of conditional and convertible shares. It further allows the Treasury to prescribe the time and manner in which the earnings are to be treated as being paid.
873. An example of how this power could be used is to prescribe that where an employee buys or obtains goods or services by use of a company credit card which are immediately transferred from the company to that individual the amount involved in the purchase shall be liable to Class 1 NICs. Also, it would permit future alignment of the tax and NIC treatment of payments to employed earners. For example, it is possible that this power may be used to mirror in NIC legislation the tax provisions relating to the new all-employee share plan, proposed in the 1999 Budget.
874. *Subsections (4) to (7)* make consequential changes to existing legislation.
875. *Subsection (8)* provides that the Class 1A charge shall come into effect from 6 April 2000 to match the beginning of the tax year 2000-2001.
876. *Subsection (9)* provides that statutory instruments made under any of the powers in the new section 10 may be backdated to the beginning of the tax year in which they are made. This will allow the details of the Class 1A charge to become operative from the beginning of the tax year. This provision is likely only to be used in future years to mirror a change in tax legislation in a Finance Act for that year.

Section 75: Third party providers of benefits in kind: GB

877. **Section 75** concerns the provision of benefits in kind (BIKs) to employees by somebody other than their own employer – a third party. The new measure only operates where the employer has not arranged or facilitated the provision of the BIKs.
878. In the case of a third party provider, the term “benefits in kind” includes non-cash vouchers, which will be moved from a Class 1 to a Class 1A NICs liability in regulations.
879. The section moves the liability for Class 1A NICs on third party provided BIKs from the employer to the third party.
880. On Royal Assent this provision takes retrospective effect to 6 April 2000. In the first year the third party may choose to meet the Class 1A liability on BIKs he provides. From 6 April 2001 the Class 1A liability becomes compulsory on the third party provider.
881. *Subsection (1)* introduces new sections 10ZA and 10ZB into the Contributions and Benefits Act.

New section 10ZA: Liability of third party provider of benefits in kind

882. *New section 10ZA(1)* lists the elements necessary for this measure to take effect. The employee or a member of his family must receive a taxable emolument that attracts a Class 1A charge under the new section 10; the BIK is provided by someone other than the employer; and the employer has not arranged or facilitated the provision.
883. *New section 10ZA(2)* provides that where the third party also pays a sum to meet the employee’s tax liability on the BIK, that payment also is subject to Class 1A NICs, rather than Class 1 as it would be if the employer had paid it.
884. *New section 10ZA(3)* moves the liability for the Class 1A NICs on the relevant benefit and any associated tax from the employer and onto the third party, except in the circumstances in *subsection (4)*.
885. *New section 10ZA(4)* provides that for the tax year commencing 6 April 2000 the third party needs to elect to pay the Class 1A NICs and notify the Revenue in writing.
886. *New section 10ZA(5)* gives the Treasury power to prescribe in regulations the meaning of “arranged or facilitated”.
887. *New section 10ZA(6)* defines members of an employee’s family as carrying the same meaning as in s.168(4) ICTA.

New section 10ZB: Non-cash vouchers provided by third parties

888. This section applies where the third party provider is awarding non-cash vouchers, as defined in section 141 of the Income and Corporation Taxes Act 1988 (ICTA).
889. *New section 10ZB(2)* provides that a Class 1A NICs charge is liable on all vouchers provided to employees by third parties no matter whether they earn over the £8,500 limit set for other benefits or below that level.
890. *Subsection (2)* of section 75 inserts a new subsection (3A) into 110ZA of the Social Security Administration Act 1992. This includes the premises of third party providers in the list of premises liable to inspection by Revenue officers.
891. *Subsection (3)* brings new section 10ZA into force from 6 April 2000 on Royal Assent.
892. *Subsection (4)* allows any regulations made under the power in new section 10ZA to be retrospective back to the commencement of the tax year in which they are made.

Section 76: Collection etc. of NICs: Great Britain

893. Currently the payment of Class 1A National Insurance contributions may be made by one of two methods – via the Inland Revenue Pay As You Earn (PAYE) system, or direct to the Inland Revenue National Insurance Contributions Office. With the extension of Class 1A to all taxable benefits, there will be a new single payment and collection method. Employers will make one annual return for their Class 1A to the Accounts Office where they already send their PAYE payments, accompanied by a separate payment slip.
894. This section makes minor amendments to current legislation to support the operation of the new method. The detail of the new payment method will be in regulations.
895. *Subsection (1)* explains that the following subsections (2) to (5) make amendments to Schedule 1 to the Contributions and Benefits Act.
896. *Subsection (2)* amends paragraph 7(2)(b) to include the application of section 5 of the Taxes Management Act 1970 (evidence in cases of fraudulent conduct), in relation to certain penalties. This brings the PAYE payment method (for payment mostly of Class 1 contributions) and the new Class 1A payment method into alignment.
897. *Subsection (3)* substitutes a new paragraph 7B(2)(e) to provide for regulations to determine the date from which interest is to be calculated, in cases where a Class 1A contribution is not paid by the due date. This aligns with the wording in paragraph 6, which relates to NICs collected with PAYE tax.
898. *Subsection (4)* inserts a new sub-paragraph (5A) into paragraph 7B, which provides for regulations to be made which may apply provisions contained in Part X (Penalties, etc.) of the Taxes Management Act 1970.
899. *Subsection (5)* inserts a new paragraph 7BA which provides for regulation-making powers to prescribe the circumstances under which a payment or repayment of contributions or interest due to a person under Schedule 1 may be offset against any other contributions liabilities which the person may have. For example, a Class 1A overpayment might be offset from a secondary Class 1 liability.
900. *Subsection (6)* removes paragraph (1)(j) from section 8 of the Social Security Contributions (Transfer of Functions etc.) Act 1999. This removes from the list of decisions by officers of the Board of Inland Revenue the question of liability to pay interest under paragraph 7B(2)(e) of Schedule 1. The application of interest to late paid Class 1A contributions will apply automatically, as it does for tax and Class 1 contributions collected with PAYE tax.
901. *Subsection (7)* provides that the effect of subsection (6) is only in relation to interest which accrues on Class 1A contributions due in respect of the tax year beginning 6th April 2000 and subsequent years (meaning, therefore, Class 1A contributions due under provisions in the new section 10 of the Contributions and Benefits Act (see section 74(2) above).

Section 77: Liability of earner for secondary contributions: Great Britain

902. This section provides for the treatment of National Insurance contributions on share option gains.
903. *Subsection (1)* amends Schedule 1 to the Contributions and Benefits Act 1992. It omits sub-paragraph (2) of paragraph 3 of Schedule 1 to that Act, which deals with prohibition on deduction or recovery of Class 1 Contributions.
904. *Subsection (2)* inserts new paragraphs 3A and 3B into Schedule 1 to the Contributions and Benefits Act 1992.

New paragraph 3A: Prohibition on recovery of employer's contributions

Sub-paragraph 3A(1) prevents any person who is liable to pay any secondary Class 1 contributions, or any Class 1A or 1B contribution, from recovering these in any way. This reinforces that an employer may not under any circumstances compel an employee to pay any part of the secondary liability. It also strengthens the existing position by ensuring that the employer can recover neither of the two existing employer-only National Insurance charges, namely Class 1A (due on benefits in kind) and Class 1B (due on items included in PAYE settlement agreements). However, this new sub-paragraph is subject to the exception allowed under new sub-paragraph 3A(2).

Sub-paragraph 3A(2) allows an exception to sub-paragraph 3A(1). It allows a secondary contributor to recover some or all of his secondary Class 1 liability in relation to share option gains from the employee, but only where the employee agrees to this. *Sub-paragraph 3A(3)* makes it clear that such agreements will only be allowed if they are made after the date of announcement of this measure, namely 19 May 2000.

New paragraph 3B: Transfer of liability to be borne by earner

Sub-paragraph 3B(1) allows a secondary contributor and an employee to make a joint election to transfer to the employee the liability for some or all of the secondary contributor's Class 1 contributions relating to gains on share options. For such an election to be valid, prior approval must be sought from the Inland Revenue. This approval will be given for both the form of the election and the arrangements made for securing that the payments required to meet the liability transferred by the proposed election will be paid and paid on time.

Sub-paragraph 3B(2) makes it clear that any liability which has been transferred by such an election is treated for the purposes of this Act, the Administration Act and Part II of the Social Security Contributions (Transfer of Functions, etc.) Act 1999 as a liability falling on the earner.

Sub-paragraph 3B(3) states that an election under new sub-paragraph 3B(1) continues in force until it ceases to have effect in accordance with its terms, it is revoked jointly by both parties or the approval of the election is withdrawn by the Inland Revenue in relation to options not yet granted. Where more than one of these events occur the election will cease to be in force of the date of earliest of these events.

Sub-paragraph 3B(4) allows the Inland Revenue to give approval to multiple elections relating to a particular secondary contributor as well as single ones. It can approve elections between a particular secondary contributor and particular earners or a particular class of earners, or elections made by a particular secondary contributor in certain circumstances.

Sub-paragraph 3B(5) defines the grounds on which the Inland Revenue can refuse approval of an election. It allows the Inland Revenue to refuse approval if it appears that adequate arrangements to make sure that the liability will be met have not been made, or if the Inland Revenue feels that it does not have enough information to decide on this.

Sub-paragraph 3B(6) allows the Inland Revenue to withdraw approval if they feel that the arrangements for making sure that the liability is met are proving inadequate, or if they feel that an election they have approved is likely to result in the avoidance or non-payment of secondary Class 1 contributions.

Sub-paragraph 3B(7) states that the Inland Revenue may withdraw general approval in relation to a particular secondary contributor, or withdraw approval for a single election or multiple elections in accordance with 3B(6). It states that such a withdrawal of approval means that any existing election made under the approved arrangements has no effect on contributions due on any right to obtain shares obtained after the approval is withdrawn.

Sub-paragraphs 3B(8) and (9) allow the person who applied for (or received) approval the right of appeal in the case of its refusal or withdrawal. This appeal is to the Special Commissioners. Where approval is withdrawn and elections made under that approval are effected in relation to future option grants, the employee also has a right of appeal.

Sub-paragraph 3B(10) makes it clear that elections cannot apply to contributions made on gains realised before the election was made. This is, however, subject to sub-paragraph 3B(12) below.

Sub-paragraph 3B(11) allows the Inland Revenue to make regulations in respect to elections made under sub-paragraph 3B(1). These regulations may in particular deal with the matters contained in such an election, the manner in which the election may be made and the manner of applications for approval.

Sub-paragraph 3B(12) provides a limited allowance for elections to apply to contributions made on gains realised before the election was made. If an election is made within 3 months of this Act receiving Royal Assent, it may relate to such liabilities arising on or after 19 May 2000.

Sub-paragraph 3B(13) clarifies that references to contributions on share option gains by the earner mean any secondary Class 1 contributions payable in respect of a gain treated as remuneration derived from employment under section 4(4)(a) of the Contributions and Benefits Act 1992.

905. *Subsection (3)* amends the Contributions and Benefits Act 1992. In section 6(4), it replaces the words from “paragraph 3” with the words “paragraphs 3 to 3B of Schedule 1 to this Act”.

906. *Subsection (4)* also amends the Social Security Contributions and Benefits Act 1992. It inserts new sub-paragraph (ca) into paragraph 8(1) of Schedule 1 to that Act. This new sub-paragraph extends the general regulations to require a secondary contributor to inform an earner to whom liability for secondary Class 1 contributions has been transferred whenever a transferred liability arises, and the amount of that liability.

907. *Subsection (5)* amends the Social Security Contributions (Transfer of Functions, etc.) Act 1999. It inserts new paragraph (ia) into paragraph 8(1) of that Act. This new paragraph extends the powers of the Inland Revenue to decide whether or not to grant, or withdraw, approval for an election under new sub-paragraph 3B(1) above. *Subsection (6)* inserts a new subsection (2A) in section 10 and amends section 10(1). The new subsection (2A) provides that decisions falling within the new section 8(1)(ia) will not be covered by regulations made under section 10.

908. *Subsection (7)* further amends the Social Security (Transfer of Functions, etc.) Act 1999. It amends section 12(4) of that Act, which deals with appeals to be heard by the General Commissioners, to include a reference to the right to appeal to the Special Commissioners given in new sub-paragraph 3B(8) above.

Sections 78, 79, 80 and 81

909. These sections mirror the provisions in, respectively, sections 74, 75, 76 and 77, for Northern Ireland.