

NATIONAL INSURANCE CONTRIBUTIONS ACT 2008

EXPLANATORY NOTES

INTRODUCTION

1. These explanatory notes relate to the National Insurance Contributions Act 2008 which received Royal Assent on 21 July 2008. They have been prepared by the Treasury in order to assist the reader of the Act. They do not form part of the Act and have not been endorsed by Parliament.
2. These notes need to be read in conjunction with the Act. They are not, and are not meant to be, a comprehensive description of the Act. So where a section or part of a section does not seem to require any explanation or comment, none is given.

TERMINOLOGY

3. At the end of these notes there is a glossary of some of the terms that are referred to in the notes. Social Security benefits are referred to by their common names rather than terms that appear in the legislation, for example basic state pension rather than Category A retirement pension.

OVERVIEW

4. In his 2007 Budget Statement, made on 21 March 2007, the Chancellor of the Exchequer announced a package of changes to the tax and benefits systems. This Act takes forward the National Insurance aspects of that package by enabling the upper earnings limit for Class 1 National Insurance contribution to be aligned, by secondary legislation, with the level of earnings at which higher rate income tax becomes payable. [*House of Commons Hansard, 21 March 2007, Vol 458, Column 827*]
5. In his 2007 Pre Budget Report Statement, made on 9 October 2007, the Chancellor of the Exchequer announced that to ensure that proposed changes to the state second pension occur as originally intended, following the alignment of the upper earnings limit with the higher rate income tax threshold, the start date for flat rating state second pension would be brought forward to April 2009. [*House of Commons Hansard, 9 October 2007, Vol 464, column 174*]

6. This is a short Act. It contains two substantive measures:
- The removal of the restriction on exercise of the delegated power to set the upper earnings limit for National Insurance contributions, in order to allow that limit to be aligned with the point at which higher rate income tax becomes payable in the future; and
 - The early introduction of the upper accrual point for state second pension that was included in the Pensions Act 2007, from 6 April 2009.

TERRITORIAL EXTENT

7. National Insurance contributions are a reserved matter in Scotland and Wales and an excepted matter in Northern Ireland. The provisions in this Act relating to contributions therefore extend to England and Wales, Scotland, and Northern Ireland. Section 2 mirrors for Northern Ireland the provisions made in section 1 for Great Britain. The Act therefore amends relevant Northern Ireland legislation relating to National Insurance contributions.
8. Social Security, child support and pensions (including the basic state pension and the state second pension) are reserved matters in Scotland and Wales but are transferred matters under the Northern Ireland Act 1998 and are the responsibility of the Department for Social Development. Section 3 and the Schedules which introduce the upper accrual point to replace the upper earnings limit from 2009-10 for state pension and contracted out rebate purposes apply to England, Wales and Scotland. Any legislation on these matters for Northern Ireland will be made by the Northern Ireland Assembly.

BACKGROUND

Specifying the amount of the Upper Earnings Limit

9. The National Insurance contribution rates and thresholds which include the upper earnings limit are reviewed each year and, where appropriate, changed each year in secondary legislation by reference to the retail price index. The power to set the upper earnings limit is conferred on the Treasury. The Treasury may increase or decrease the upper earnings limit; so far as increases are concerned, the power is limited in that the upper earnings limit can be set at no more than seven and a half times the primary threshold. The primary threshold is the point at which primary Class 1 contributions become payable on a person's earnings.

Changes

10. In his 2007 Budget speech the Chancellor of the Exchequer announced that from April 2009 the upper earnings limit would be aligned with the level at which higher rate income tax is payable. It is intended that this alignment will be achieved in two stages. The first stage was to increase the upper earnings limit by £75 per week above inflation for the 2008-09 tax year, by using existing powers. This increase was included as part of the normal 2008-09 up-rating exercise.
11. The second stage, subject to the usual Parliamentary process (which in this case would include Parliamentary approval) is to increase the upper earnings limit as part of the normal up-rating exercise, so that it is aligned with the level at which higher rate income tax becomes payable. To enable this second stage to take place, the existing restriction on the power to set the level of the upper earnings limit needed to be removed. The Act removes that restriction in relation to tax year 2009-10 and beyond.

Bringing forward introduction of the upper accrual point

12. In broad terms, for any given tax year state second pension accrues on the portion of an employee's annual earnings between the annual value of the lower earnings limit and the upper earnings limit for Class 1 National Insurance contributions (called the "surplus earnings factor"). This amount is revalued in line with the growth in average earnings up to the last full tax year of a contributor's working life. The accumulated surplus earnings factors are then divided by the number of years in the person's working life since 1978 to produce a "lifetime average" which is multiplied by the relevant accrual rate and divided by 52 to produce a weekly rate of additional pension.
13. For state second pension purposes earnings are split into three different bands with entitlement accruing at a different rate in each earnings band. People earning, or treated as earning, at or above the annual lower earnings limit accrue state second pension on a cumulative basis depending on the level of their earnings. Earnings above the annual upper earnings limit do not accrue state second pension.
14. Under the provisions of the Pensions Act 2007, state second pension is to be restructured to provide a simpler, flat-rate system. That Act provides for an upper accrual point to replace the upper earnings limit for the purpose of capping entitlement to the state second pension. On introduction the upper accrual point will be frozen in cash terms, leading to a gradual erosion of earnings-related accruals.

15. The upper accrual point was to be brought in along with a flat rate accrual amount of around £1.50 a week that would replace accruals on earnings between the lower earnings limit and the low earnings threshold. Taken together, it was expected (when the Pensions Bill that led to the Pensions Act 2007 was introduced) that these two measures would deliver entitlement to the state second pension on a completely flat rate basis by around 2030.

Changes

16. Following changes to align the upper earnings limit with the higher rate tax threshold as announced in Budget 2007, the Act introduces the upper accrual point from April 2009, before the introduction of the flat rate accrual amount.
17. The effect of the Budget 2007 announcements would have meant that without intervention, the level of the upper accrual point upon introduction in 2012 (as previously planned) would be significantly higher than that forecast in the Regulatory Impact Assessment provided for the Pensions Act 2007. As a consequence state second pension would have accrued on a greater amount of earnings than intended.
18. Bringing forward the introduction of the upper accrual point to April 2009, and fixing it at an amount broadly equivalent to the level that the upper earnings limit was projected to be at in 2012 prior to the Budget announcement, re-aligns with the proposals to achieve flat rate accruals by around 2030, set out in the Government White Paper: *Security in retirement: towards a new pension system*.
19. The upper accrual point will replace the upper earnings limit as the weekly upper cap on earnings when determining entitlement to the state second pension. It is set at £770 per week, the level of the upper earnings limit for 2008-09. It will be frozen in cash terms and together with the flat rate accrual amount provided in the Pensions Act 2007 will remove earnings-related accruals within the original time-span.
20. These changes affect calculations relating to the contracted-out rebate. If a pension scheme member is opted out of state second pension they receive a "rebate", which is based on the amount of state second pension foregone. The rebate is calculated on the same band of earnings on which state second pension accrues, and the Act therefore amends the rebate arrangements so as to reflect the introduction of the upper accrual point.

COMMENTARY ON SECTIONS

Section 1: Amount to be specified as upper earnings limit: Great Britain

21. Section 1 amends sections 5 and 176(1) of the Social Security Contributions and Benefits Act 1992 (“the SSCBA 1992”).
22. The effect of *subsection (1)* of this section is to remove the current restriction that prevents the upper earnings limit from being set by secondary legislation at an amount greater than seven and half times the primary threshold. This will allow the upper earnings limit to be aligned, by secondary legislation, with the higher rate income tax threshold in the future.
23. *Subsection (2)* inserts new paragraph (zb) in section 176(1). This provides that draft regulations which set the upper earnings limit must be laid before Parliament and approved by resolution of both the House of Commons and the House of Lords before the regulations can be made. The purpose of this is to compensate for the removal of the restriction on the exercise of the power currently provided by section 5(3) of the SSCBA 1992. This approach is similar to that for the change made by section 7(5) of the Pensions Act 2007 in respect of the power to set the lower earnings limit once the level of the basic state pension is linked to earnings (the lower earnings limit is the point at which earnings start to count for benefit purposes).
24. *Subsection (3)* provides that the changes made by subsection (1)(b) and (2) have effect in relation to regulations that specify the level of the upper earnings limit for all tax years from 2009-10 onwards.

Section 2: Amount to be specified as upper earnings limit: Northern Ireland

25. Section 2 replicates the provisions of section 1 in respect of the equivalent Northern Ireland legislation.

Section 3: Additional pension: upper accrual point to replace upper earnings limit from 2009-10

26. Currently an employee builds up entitlement to the state second pension on earnings up to the upper earnings limit and on which Class 1 National Insurance contributions have been paid or, in the case of a person earning between the lower earnings limit and the primary threshold, have been treated as paid. Such earnings give rise to earnings factors that are used in the calculation of state second pension entitlement.
27. Section 3 brings forward introduction of the upper accrual point (as to which see paragraphs 16 to 20 above).

28. *Subsection (2)* amends the definition of the “applicable limit” in section 22(2B) of the SSCBA 1992 replacing “the flat rate introduction year” (as introduced in the Pensions Act 2007 and which was to have been set by order) with the tax year in which the upper accrual point is to be introduced — the 2009-10 tax year. The effect of the amendment is to provide for the upper accrual point, as the cap on earnings factors in the state second pension, to be switched on from 2009-10. Prior to 2009-10 the applicable limit will remain as the upper earnings limit.
29. *Subsection (3)* amends section 44(7)(c) of the SSCBA 1992, as above, replacing “the flat rate introduction year” with “2009-10”.
30. *Subsection (4)(a)* replaces the definition of the “upper accrual point” and sets it at £770, which is the level of the upper earnings limit for 2008-09.
31. This subsection provides for a weekly upper accrual point in contrast to the annual limit as originally defined in section 12 of the Pension Act 2007. This caters for situations where, for example, there are more or less than 52 earnings periods in a tax year. The provision of a weekly upper accrual point also maintains the current alignment between the earnings that count for state second pension and those that count for rebate purposes, and lends itself more easily to the calculation of the relevant upper accrual point figure where an employee is paid other than on a weekly basis.
32. *Subsection (4)(b)* inserts subsection (6A) and (6B) into section 122 of the SSCBA 1992. Subsection (6A) is a regulation making power, to be exercised by the Treasury, which allows for regulations to be made that prescribe equivalents to the upper accrual point in relation to earners paid otherwise than weekly, for example monthly paid employees. Subsection (6B) ensures that the prescribed equivalents once calculated can be rounded to a whole pound figure. As the upper accrual point, once introduced, will be fixed, so too will the prescribed equivalents.
33. *Subsection (4)(c)* repeals subsections (7) and (8), which were inserted by the Pension Act 2007 and which defined the upper accrual point and allowed the Secretary of State to vary by order the rate of the upper accrual point before its introduction.

Schedule 1: Consequential amendments

34. Schedule 1 contains consequential amendments arising as a result of the introduction of the upper accrual point.
35. Paragraphs 1 to 6 amend the SSCBA 1992.
36. Paragraph 2 inserts new section 22(9). This is a minor technical change that provides that when calculating earnings factors derived from an employee's earnings for an employee paid other than weekly, any reference to earnings not exceeding the upper earnings limit or from 2009-10 the upper accrual point is to be read as a reference to earnings that do not exceed the prescribed equivalent.
37. Paragraph 3(3) inserts new section 23(3A), which provides that for the purpose of calculating additional pension from the tax year 2009-10 onwards the upper accrual point replaces the upper earnings limit as the cap on earnings factors.
38. Paragraphs 4 amends section 44A by replacing the reference to the upper earnings limit, as the ceiling on deemed earnings factors for state second pension purposes, with a reference to the "applicable limit" provided in section 44.
39. Paragraph 5 amends section 44B(2)(a) by replacing the now superfluous reference to the applicable limit with a reference to the upper accrual point. As the upper accrual point will be introduced from 2009-10 it will be the only ceiling relevant for earnings factors derived under the new deeming provisions for state second pension that take effect from 2010-11 onwards.
40. Paragraph 6 makes amendments to paragraph 1 of Schedule 1, which deals with the calculation of National Insurance contributions where an earner is employed in more than one employment, to reflect the introduction of the upper accrual point from 2009-10. Where earnings from two or more employments are aggregated, the separate earnings are afforded a priority order. At present any contracted-out rate contributions are assessed on contracted-out earnings up to the upper earnings limit. The amendment, which takes into account earlier amendments made to paragraph 1 by the Pensions Act 2007, ensures that where earnings from two or more employments are aggregated after 6 April 2009, any contracted-out rate contributions are assessed on contracted-out earnings up to the upper accrual point.
41. Paragraphs 7 to 13 amend the Pension Schemes Act 1993 as a result of bringing forward the introduction of the upper accrual point and setting it at the level of the 2008-09 upper earnings limit.

42. Paragraphs 8, 11 and 12 cover changes required to the contracting-out arrangements for defined contribution (money purchase) schemes as a consequence of the changes to the state second pension. The amendments have the effect of mirroring the change to the band of earnings on which state second pension accrues (ie the upper accrual point replacing the upper earnings limit as the maximum amount of earnings on which state second pension accrues) in certain calculations connected with the contracted-out rebate. The amendments ensure that this change is reflected in:
- the definition of “minimum payments” (paragraph 8);
 - the band of earnings on which reduced rate of Class 1 contributions and rebates are paid in respect of members of money purchase contracted-out schemes (paragraph 11);
 - the band of earnings on which “minimum contributions” are paid to members of appropriate personal pension schemes (paragraph 12).
43. Paragraphs 9, 10 and 13 cover the changes required to the arrangements for defined benefit (salary related) schemes as a consequence of the decision to introduce the upper accrual point from 2009-10. These amendments revise those made in the Pensions Act 2007 when the upper accrual point introduction date was planned for 2012. The amendments ensure that the change is reflected in:
- the calculation of reference scheme test benefits (paragraph 9);
 - the band of earnings on which reduced rates of Class 1 contributions are paid in respect of members of salary related contracted-out schemes (paragraph 10);
 - the band of earnings on which the rebate is paid in cases of bankruptcy where the employer must make, as a priority, a payment to the scheme of outstanding contributions in relation to the rebate (paragraph 13).

FINANCIAL EFFECTS OF THE ACT

44. HMRC has conducted an Impact Assessment on the measures contained in this Act. The assessment provides information on the financial effects of the Act. A copy of the Assessment can be found on the HMRC internet at: -
<http://www.hmrc.gov.uk/ria/nics-bill-ia.pdf>

COMMENCEMENT

45. Section 6 provides that the provisions of the Act come into force two months after Royal Assent, except for:

- paragraph 6(3) of Schedule 1,
- the repeals in Schedule 2 that are mentioned in paragraph 6(3) of Schedule 1,

both of which relate to the abolition of contracting out for defined contributions schemes and both of which will come into force on such day as the Secretary of State may appoint under section 30(2) of the Pensions Act 2007 for the coming into force of paragraph 45(2) of Schedule 4 to that Act. This is because on that day contracted out employment in defined contribution schemes will cease to exist and will no longer need to feature in the aggregation calculations set out in paragraph 1(3) of Schedule 1 to the SSCBA 1992.

HANSARD REFERENCES

46. The following table sets out the dates and Hansard references for each stage of this Act's passage through Parliament.

Stage	Date	Hansard reference
<i>House of Commons</i>		
Introduction	12 November 2007	Vol. 467 Col 399
Second Reading	17 December 2007	Vol. 469 Cols. 637-672
Committee	15 January 2008	Hansard General Committee
Report and Third Reading	31 January 2008	Vol. 471 Cols. 514-548
<i>House of Lords</i>		
Introduction	4 February 2008	Vol. 697 Col 845
Second Reading	30 April 2008	Vol. 701 Cols. 298-315
Committee	9 June 2008	Vol. 702 Cols. GC111-GC132
Report	2 July 2008	Vol. 703 Cols. 243-255
Third reading	9 July 2008	Vol. 703 Col 752
<i>Ping Pong</i>		
Commons consideration of Lords amendments	15 July 2008	Vol. 479 Col 146
Lords consideration of Commons Reasons	21 July 2008	Vol. 703 Col 1513

Royal Assent – 21 July 2008

House of Lords Hansard Vol. 703 Col 1579

House of Commons Hansard Vol. 479 Col 553

GLOSSARY

Term	Explanation
Additional Pension	This is the earnings related element of state pension – accrued from 1978 to 2002 under SERPS (“State Earnings Related Pension Scheme”) and since 2002 under the S2P (“State Second Pension”) scheme (see sections 44, 44A, 45 of and Schedule 4A to the SSCBA 1992).
Basic State Pension	This is the flat rate element of state pension (see section 44 of the SSCBA 1992).
Class 1 contributions	These are contributions paid by employees and employers on earnings that exceed the primary and secondary thresholds (which are set at the same level).
Contracted-out rate	Contracted-out rate contributions are contributions payable in respect of earnings paid to earners who are in contracted-out salary related or contracted-out money purchase employments.
Lower Earnings Limit	Historically the lower earnings limit (see section 5 of the SSCBA 1992) was both the point at which a liability to pay National Insurance Contributions arose and the point at which entitlement to contributory benefit began. It is also the point at which contracted-out rebates become payable. In 2001 the point at which contribution liability arises was changed to a new earnings threshold, aligned with the income tax personal allowance. Despite this change, the lower earnings limit retains both its contributory benefit and contracting-out rebate purposes.
Primary Threshold	The primary threshold (see section 5 of the SSCBA 1992) is the point at which employees begin to pay National Insurance contributions.

Secondary Threshold	The secondary threshold (see section 5 of the SSCBA 1992) is the point at which employers begin to pay National Insurance contributions.
State Second Pension	This is the name for the earnings related element of state pension from 2002.
State Pension	This is the generic name for retirement pension payable under the SSCBA 1992.
Upper Accrual Point	The upper accrual point (see section 122 of the SSCBA 1992) is a new threshold which from April 2009 replaces the upper earnings limit as a feature in state second pension and contracted-out rebate calculations. The Act provides for the upper accrual point to be a weekly figure for both state second pension and contracted-out rebate purposes. Once introduced the amount of the upper accrual point will be frozen.
Upper Earnings Limit	Historically the upper earnings limit (see section 5 of the SSCBA 1992) was both the point at which a liability to pay primary Class 1 contributions ended and the point at which entitlement to contributory benefit was capped. It was also the point at which contracted-out rebates were capped. In 2003 an additional Class 1 contribution liability on earnings in excess of the upper earnings limit was introduced and it became the point at which liability for Class 1 contributions at the main primary percentage ceased. Despite this change, the upper earnings limit retained both its contributory benefit and contracting-out rebate purposes. Following the introduction of the upper accrual point the upper earnings limit will no longer be of relevance in the calculation of state second pension or contracting out rebates.

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8/2008 406933 19585