



HM Revenue  
& Customs

# Consultation on Employee Share Schemes: NIC elections

**Summary of Responses**  
October 2016

# Contents

1	Introduction	3
2	Responses	4
3	Next steps	6
4	List of stakeholders consulted	7

## 2. Introduction

### The Consultation

On 21 April 2016 HMRC launched a consultation to gather views and evidence from companies with non tax-advantaged share schemes about whether there is a need for the continued availability of a NIC election.

### Background

When an employee makes a gain on exercise of an employment-related securities option, or realises some other chargeable event under sections 426, 438 or 479 Income Tax (Earnings and Pensions) Act 2003 (ITEPA), this is treated as earnings liable for Class 1 National Insurance Contributions (NICs) under section 4(4)(a) Social Security Contributions and Benefits Act 1992 (SSCBA). There will be a liability to pay both a primary and secondary Class 1 NIC. For simplicity, the terms ‘employee’ and ‘employer’ are used, whereas the law stipulates these to be the ‘earner’ and ‘secondary contributor’ respectively. A primary Class 1 contribution is payable by the employee with a secondary Class 1 contribution payable by the employer. There are occasions however, when the employee meets the secondary Class 1 NICs liability. At present there are two routes for the secondary Class 1 NICs liability to be met by the employee by either:

- a NIC agreement; or
- a NIC election

Schedule 1 paragraph 3A SSCBA provides for the employer and employee to enter into a “NIC agreement”. Alternatively, Schedule 1 paragraph 3B SSCBA provides for the employer and employee to enter jointly into a “NIC election”. Unlike a NIC agreement, a NIC election constitutes the legal transfer of liability for payment of secondary Class 1 NICs from the employer to the employee. The law requires that any such election must be approved by HMRC.

The Department found the consultation responses constructive and helpful, and are very grateful to all the organisations and individuals who took the time to respond to this consultation.

## 3. Responses

### **Question 1 – Are there any continuing accounting or other advantages to companies of NIC elections as opposed to NIC agreements? If so, what are they?**

Respondents made a number of points about the difference between NIC elections and agreements. It was agreed that NIC elections transfer the liability to pay secondary Class 1 NIC and that NIC agreements do not transfer the liability. It is apparent from some respondents that companies already using agreements are doing so successfully. However, it is clear from the responses that NIC elections give companies more protection than NIC agreements that secondary Class 1 NIC obligations will be paid by employees.

With regards accounting advantages some respondents were aware of changes to US accounting rules in 2005, and some were not aware of changes. HMRC looked further into this change in US accounting rules. US accounting changed with effect from mid-2005 with the introduction of Financial Accounting Standards Board 123R. This meant that the NIC treatment of the employee was no longer relevant to the accounting.

### **Question 2, Are secondary Class 1 NIC liabilities in connection with securities options usually handled through the payroll?**

There was broad agreement amongst respondents to this question. Yes, secondary Class 1 NIC liabilities in connection with securities options are usually handled through the payroll.

### **Question 3, Should the ability to make NIC elections be removed?**

Respondents' comments to this question were mixed and disagreed as to whether the ability should be removed or retained. It was suggested by one respondent that if the NIC election facility is removed, companies must consider the legal implications of only having the facility to enter into NIC agreements, and perhaps the implementation of 'sell to cover' to guard against liability exposure.

Some respondents go further by stating that NIC elections still maintain a purpose due to the fact that they are a legally binding protection for employers. One respondent said that 'should they be removed, there may be an increased risk for employers not recovering secondary Class 1 NIC from employees'. One respondent also said that 'in some instances the prospect of such a liability might act as a deterrent to offering share awards, particularly by fast growth SMEs contemplating a sale or flotation exit event as a trigger for option exercise'.

It was also suggested by one respondent that there might be income tax disadvantages for employees if a NIC agreement is used but the NIC is reimbursed late (e.g. for reasons outside of the employee's control).

One individual responded by stating that NIC elections should be removed.

**Question 4 – What are the benefits in retaining a NICs agreement only? Would this create any problems for the employer and/or employee?**

Respondents saw both the advantages and disadvantages to removing NIC elections. Amongst the responses it was highlighted that if NIC agreements were the only option available, they would still provide a mechanism for transferring the secondary Class 1 NIC obligation. This process would not need to be approved by HMRC and could be incorporated into the normal plan documents as opposed to having a stand-alone document.

However, it was also noted that if NIC agreements were the only mechanism available there would be a lack of a legally binding document. Several respondents said that this could contribute to fears concerning the NIC liability risk. Similar to a comment given under question 3, one respondent said that there could also be a potential loss of income tax relief on late reimbursement of NIC.

**Question 5 – Do you have any views on the assessment of impact set out in Chapter 3 of this document, and in particular the equality impacts?**

There were some points made by respondents about the assessment of impacts set out in Chapter 3 of the consultation document. It was suggested by one respondent that 'three elections per week is not insignificant and we feel that this number justifies retaining the ability to make an election'. It was also stated that 'as NIC agreements will continue to be available, employees and employers should not be significantly impacted' however 'concerns in relation to the lack of a legally binding document should be considered for fast growth SME employers, in particular those offering discounted Enterprise Management Incentives options, or non-tax advantaged options with an exit-only exercise provision'.

One respondent stated that they 'are surprised that the digital strategy cannot accommodate the submission of a NIC election'. One respondent also asked if the retention of the election would have affected Apprenticeship Levy arising on employment related securities.

## 4. Next steps

Government has carefully considered the responses generated by this consultation. Whilst there has been a change to the US accounting rules, it is clear that there is still a need to retain the NIC elections facility. They provide a protection that is not provided under NIC agreements. Therefore Government is to take no further action and retain the facility to make NIC elections.

# Annexe A: List of stakeholders consulted

Baker Tilly

Abbiss Cadres

Eversheds

Simmons & Simmons

Macfarlanes

DIAGEO/CBI

Thomson Reuters Practical Law

EY

Freshfields

Pett Franklin

Traverssmith

Wolters Kluwer

ICAEW

Baker & McKenzie

Deloittes

Grant Thornton

PwC

Pinsent Masons

Linklaters

Freshfields

Mishcon de Reya

Gabelle

Ashurst

Nabarro