EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY (CONTRIBUTIONS) (AMENDMENT No X) REGULATIONS 2016

2016 No. [XXXX]

1. This explanatory memorandum has been prepared by H.M. Revenue and Customs and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

This instrument makes consequential amendments the Social Security (Contributions) Regulations 2001 (S.I. 2001/1004) (the "Principal Regulations") as a result of the Pensions Act 2014.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

These Regulations are being made as a consequence of the changes made in Schedule 13 of the Pensions Act 2014 that abolishes contracting-out for occupational pension schemes.

5. Extent and Territorial Application

5.1 This instrument extends to all of the United Kingdom.

5.2 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***

7.1 Employees who are members of salary related occupational pension schemes currently receive a 1.4% rebate (known as the “contracted-out rebate”) on payments of Class 1 National Insurance Contributions (NICs) if their employer makes an election to contract-out of the State Second Pension. Where this is the case, their employer will also receive a 3.4% rebate on NICs paid in respect of that employee. The rebate is calculated on the employee’s earnings between the Lower Earnings Limit, currently £112 per week, and the Upper Accrual Point (UAP) which is fixed at £770 per week. Those who pay NICs at the contracted-out rate receive only the basic State Pension and do not build up entitlement to the State Second Pension.

7.2 From 6 April 2016, the Pensions Act 2014 ends the two-tier pension system, by introducing a flat rate new State Pension and abolishes the contracted-out rebate for both employees and employers.

7.3 These Regulations amend the Principal Regulations to take account of the abolition of the contracted-out rebate.

7.4 Regulation 3 amends regulation 6 of the Principal Regulations so as to remove the rules relating to the aggregation of earnings from separate employments where one or more of these employments is contracted-out. Where a person has more than one job, each employment is treated separately for the purposes of calculating the amount of NICs payable. The exception to this is where the person has two contracts with the same employer or with two employers who are carrying on business association, in which case special NICs rules allow for the employments to be treated as one and the earnings to be aggregated. There are also special rules to determine the amount of NICs payable where earnings are aggregated but the intervals at which earnings from the separate employments are paid differ (for example weekly and monthly). Currently these rules take into account whether the employment is contracted-out, however Regulation 3 removes this as it will no longer be necessary.

7.5 Regulation 4 amends regulation 11 of the Principal Regulations which sets out the prescribed equivalents of the NICs limits and thresholds including the Upper Accrual Point for those individuals paid other than weekly, as the UAP is being abolished from 6 April 2016.

7.6 Regulations 6 and 9 amend regulations 21 and 100 of the Principal Regulations as they no longer need to refer to contracted-out contributions. Class 1 NICs are payable by employees at the Class 1 main rate of 12% on earnings up to the Upper Earnings Limit (UEL). Class 4 NICs are payable by the self-employed at the Class 4 main rate of 9% up to the Upper Profits Limits (UPL). Any earnings or profits that exceed the UEL/UPL are paid at 2%. Regulations 21 and 100 of the Principal Regulations set out the maximum amount of NICs that can be paid at the main rate and are being amended so that they no longer take account of the possibility that a person has paid some or all of their Class 1 NICs at the contracted-out rate.

7.7 Regulation 7 amends regulation 52A of the Principal Regulations so as to remove the rules relating to refunds of NICs paid at the contracted-out rate. Where a person has more than one job or is employed and self-employed in the same tax year each employment and any self-employment is treated separately for the purposes of calculating the amount of NICs payable. Where, as a result of this, a person pays overall NICs which exceed the annual maximum Regulation 52A of the Principal Regulations sets out the formula for calculating any refund.

7.8 Regulation 8 removes regulation 54 of the Principal Regulations so as to as to remove the rules relating to an employer paying Class 1 NICs at the not contracted-out rate and requiring a refund of the rebate amount (as the rebate will no longer exist from April 2016).

7.9 Regulation 10 removes references to contracted-out contributions for mariners.

7.10 Regulation 11 amends regulation 155A(2) of the Principal Regulations which allows decisions to be made regarding late applications for the refund of Class 1 contributions paid at the non-contracted out rate.

7.11 Regulation 12 provides that from 6 April 2016 employers will report earnings from the Primary Threshold (the rate at which Class 1 NICs become payable by an employee) to the UEL. Under Real Time Information (RTI), employers currently report earnings from the Primary Threshold to UAP and the UAP to the UEL. This will no longer be necessary following abolition of the UAP.

7.12 Regulation 13 removes the need for employers to report reference information (the Pension Scheme Contracted-out Number and Employer's Contracted-out Number) where an employment is contracted-out. This will no longer need to be reported once the contracted-out contribution rates have been abolished.

- ***Consolidation***

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

8. Consultation outcome

The Department for Work and Pensions published a White Paper on the 14 January 2013 ("The Single-tier pension: a simple foundation for saving") with proposals for a simpler State Pension. This included the abolition of contracted-out contribution rates.

9. Guidance

Guidance has been published on the changes relating to employer reporting requirements due to the abolition of contracted-out contribution rates. Internal guidance will be amended to take account of the abolition of the contracted-out contribution rates.

10. Impact

10.1 The impact on business, charities or voluntary bodies is negligible.

10.2 The impact on the public sector is negligible.

10.3 A Tax Information and Impact Assessment covering this instrument has been published and is available on the GOV.UK website. It covers the changes to the reporting requirements under RTI and not the increase in NICs rates arising for the abolition of contracted-out contribution rates which was covered in the Pensions Act 2014 impact assessment.

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/254151/a-pensions-bill-single-tier-ia-oct-2013.pdf

11. Regulating small business

These changes are expected to have a negligible impact on small businesses. The changes will need to be incorporated into all employer's payroll process, but this will be part of annual updates to National Insurance parameters.

12. Monitoring & review

These are minor changes and will not be subject to review.

13. Contact

Hasan Mustafa at HM Revenue & Customs, Tel: 03000 586 718 or e-mail: hasan.mustafa@hmrc.gsi.gov.uk can answer any queries regarding the instrument.