Tax Representation

Tax Faculty

TAXREP 35/04

NATIONAL INSURANCE CONTRIBUTIONS AND STATUTORY PAYMENTS BILL 2004, NOW ACT

Text of correspondence between Ministers and the Revenue and the Tax Faculty of the Institute of Chartered Accountants in England and Wales from March to August 2004

CONTENTS

NATIONAL INSURANCE CONTRIBUTIONS AND STATUTORY PAYMENTS BILL 2004, NOW ACT

A INTRODUCTION

This memorandum contains correspondence from the Tax Faculty to and replies from Ministers and the Revenue from March to August 2004 following the House of Lords Grand Committee debate on 15 March 2004. Previous correspondence was published in TAXREP 3/04 (memorandum sent in January 2004 to the Paymaster General, see http://www.icaew.co.uk/viewer/index.cfm?AUB=TB2I_60531), to which a reply was received in January 2004 (not published), and TAXREP 21/04 (memoranda sent to the Paymaster General and Opposition Spokesmen in the House of Lords during February and March 2004 respectively, see http://www.icaew.co.uk/viewer/index.cfm?AUB=TB2I_65809).

Our main concern was that whilst the Bill would help employers as far as it went, legislative opportunities were being missed in Clauses 1-2 to provide a statutory means for employers to recoup from employees the primary NIC liability for any type of emolument and in Clauses 3-4 to provide for the types of shares and securities currently used as incentives. Our representations have resulted in undertakings to carry out reviews and, in respect of the ability of employers to recover primary NIC, clarification of the easement in leaflet CWG2 described below, but there remain items that are covered neither by NICSPA 2004 nor by the easement, for example employer contributions to FURBS. We hope that the forthcoming reviews will provide means of rectifying these lacunae sooner than as part of the pension scheme changes in April 2006.

Clarification of CWG2 easement: NIC: late notification of marginal items of pay

Where a marginal item of pay (for example non-business expenses, subject therefore to Class 1 NIC) occurs after the last regular payment of wages/salary for a tax year, it is inconvenient to process this through the payroll for the correct tax year. Further, it is usually impossible (unless the individual contract of employment gives greater powers than are provided in Social Security Contributions and Benefits Act 1992) to recover from the employee the primary Class 1 NIC that arises – whether at the full rate, 1% additional rate only, or a mixture.

The Revenue allow employers to account to them for the NIC (and PAYE, if applicable) in the next pay period even when this is in the following tax year. Thus, by way of example, where an employer pays or reimburses an employee's personal telephone bill late in March (the final salary for the year having already been paid on, say, 20 March), he can calculate the Class 1 NIC on it when processing the employee's salary in April in the following tax year, and therefore recover the primary contribution in entirely the normal fashion at that time. This easement is in CWG2: 'Employers further guide to PAYE and NICs' from April 2004 page 7 Chapter 1 (reproduced in the Annex) and its application has been clarified in a letter dated 28 April 2004 to us from Lord McIntosh, Government Spokesman for HM Treasury (reproduced in section C below).

14-122-2
PCB
11.4.04

B LETTER SENT IN MARCH 2004 TO THE RT HON. THE BARONESS HOLLIS OF HEIGHAM DL, PARLIAMENTARY UNDER-SECRETARY OF STATE, DEPT OF WORK AND PENSIONS

1. On behalf of the Tax Faculty of the Institute of Chartered Accountants in England and Wales I am writing to raise with you one or two issues in relation to the recent debate on the NICSP Bill in Grand Committee. For ease of reference I include the relevant text of the debate with our comments below.

Clauses 1-2

15.3.04: Column GC4
'It is convenient to turn to the issue of telephone charges in that situation. If an employee pays a telephone bill and is reimbursed by the employer, there is a class 1A NICs charge—that is, the employer's charge—on the personal element of the telephone bill. This is an employer-only charge—a secondary NICs—so there is no problem with recovery of primary NICs from the employee. There may be other situations that the noble Lord has in mind, in which case perhaps he will reflect on them or write to me. Essentially the employer would be liable for the NICs only where there is a benefit in kind, which is the personal element of the telephone bill, because there is therefore no liability for the employee to pay.'

2. The basic rule is that where an employer pays direct to the telephone company a telephone bill that is in the name of the employee as subscriber, then this payment is discharging the pecuniary liability of the employee. To the extent of the private element (ie non-business calls and the rental where the line is used for both business and non-business calls), this payment is earnings liable to national insurance Class 1 primary (payable by employee but accounted for to Inland Revenue by employer in the first instance) and secondary (payable by employer) contributions. However, where the telephone contract is in the name of the employer who pays the entire bill and there is private use, then the employee is treated as receiving a benefit-in-kind (rather than earnings) and a Class 1A NIC liability arises on the whole amount paid by the employer except where private use is de minimis in which case it is disregarded.

3. In the more usual situation where the employee is the subscriber, then, in order that the business element is accepted as such by the Inland Revenue, it is necessary in practice for the employee to keep an itemised log of calls or the employer to have agreed a dispensation for income tax purposes with the Revenue. In the absence of this, the whole amount laid out by the employer will be treated as earnings. In our Example 2, Ben does not itemise calls and neither has his employer agreed a dispensation. Therefore the entire bill is treated as non-business and because the subscriber is the employee, the payment of the bill by the employer is earnings, liable to Class 1 NIC.

4. In the example you cited - a situation where an employee pays the telephone bill and the employer reimburses him - the contract with the telephone provider is likely to be with the employee. If the employer reimburses him, then this is a cash payment to the employee. It is therefore subject to Class 1 NIC primary and secondary liability to the

extent that the reimbursement does not cover only evidenced business calls but is in respect of the private element as well, rather than a Class 1A benefit-in-kind charge.

15.3.04: GC5
'Furthermore, the amendment, as it stands, would actually prevent us extending the time period for recovery of contributions beyond the next available cash payment.'

5. The amendment states: 'Page 1, line 15, at end insert "but only in the next succeeding pay periods in which there are sufficient amounts of monetary earnings"'. The use of the plural in 'periods' is designed to enable employers to recover the primary NIC from cash earnings in as many successive pay periods as is necessary. We would welcome clarification of your concern here.

15.3.04: GC6
'The noble Lord may be pleased to know that the Inland Revenue announced a consultative document on pensions issued in December 2003; that there will no national insurance liability on employer contributions to non-registered schemes—the successors to FURBS—in future. Therefore, the issue relating to the recovery of NICs will cease to be problematic.'

6. According to the Inland Revenue, there has been a Class 1 NIC liability enforced as such on payments into FURBS since 6 April 1998 (source: Contributions Agency press release dated 17 November 1997) and there will continue to be such liabilities up to the date that the measure that you refer to comes into effect, which will be the date of the implementation of the pensions reforms. On Budget Day earlier this month this date was set as 6 April 2006.

7. We cannot see how the implementation of the pension reforms in two year's time will resolve the problems encountered by employers in recovering employee NICs currently and up to April 2006. Also, irrespective of what any guidance says, employers will often want to make payments into FURBS as near as possible to the end of the tax year. Therefore recommending that they should make such payments at times that do not commercially suit them (as in column CG6) seems unrealistic. Could you please explain if you feel we have misunderstood the situation.

Clauses 3-4

15.3.04: GC12
'Under accession there is, so to speak, a knock-for-knock situation. Therefore, paying contributions here will add to an employee's contribution records at home. Employees will have such an entitlement. In that sense, a knock-for-knock situation on national insurance is part of worker rights. Therefore, in the same way that a worker can pay national insurance contributions and tax while working here, if he were sufficiently low paid he would be entitled, for example, to tax credits. Equally, he would be entitled to build up a contributory benefit towards a pension which he would not be able to draw, but it would allow him to have a complete record in terms of his ordinary residency in Germany. In that sense, the knock-for-knock situation is a consequence of the free migration of labour.'.

8. The 'knock for knock' metaphor here overlooks what is known as the totalisation procedure for calculating contributory state pensions in the European Union. There is no transfer of contributions from the social security system of one country to that of another as implied. An individual, possibly an overseas national, employed in the UK who pays Class 1 NICs will qualify for a proportion of a UK NI retirement pension, corresponding to the period of time he pays contributions in the UK but taking into account his contributions record in other countries in which he has paid equivalent social security contributions and he will qualify for a proportion of the other countries' pensions calculated on similar lines.

Conclusion

9. We welcome your commitment in Column GC6 that the Revenue will be reviewing paragraph 7, Schedule 4, Social Security (Contributions) Regulations 2001. We look forward to assisting on this, albeit that we hope that the problems encountered by employers that we have highlighted in our previous submissions will be considered with a view to making amendments to remove them.

10. We also welcome your commitment in GC9-10, and as acknowledged by Lord Higgins at GC11, that the reviews on residence and domicile and security-based earnings will take into account issues raised in our submissions and highlighted by Lord Higgins. Again, we hope that the reviews will resolve the issues raised.

11. In both cases, we look forward to contributing to these reviews and helping to achieve law and procedures that are fair, transparent and well thought through, which are simple to comply with and at the same time are capable of accommodating future developments.

C REPLY RECEIVED IN APRIL 2004 FROM THE RT. HON. LORD MCINTOSH OF HARINGEY, HM TREASURY SPOKESMAN, HOUSE OF LORDS

Thank you for your letter of 25th March 2004. Baroness Hollis has passed it to me as the minister responsible for the Bill. I will address your points in the order that you made them.

As you say at points 2-4, a payment in connection with a phone bill can be liable for either Class 1 NICs or Class 1A NICs dependant on how the phone is provided. In the example that Baroness Hollis gave Grand Committee, if the contract was between the provider and the employer, but the employee paid the bill and was then reimbursed, there would be a Class 1A NICs liability on the provision of the phone (assuming there is private use). This liability would be solely that of the employer. The reimbursement made to the employee would not be earnings for NICs purposes. It would be more in the way of the employer reimbursing the employee in a personal capacity for paying the employer's debt to the phone provider. You are correct in pointing out that if the bill was in the name of the employee who was then reimbursed by the employer, it would be earnings and liable for Class 1 NICs with both an employee and employer liability.

In cases where the payment of a phone bill attracts a liability for Class 1 NICs the employer should not have to meet the primary National Insurance liability themselves. This should be the case even if the phone bill has to be paid before the end of the tax year, but after the last payment of cash earnings to the employee.

The Inland Revenue already accepts that there will be some cases where an employer's payroll section may receive late notification of some marginal payments of earnings, such as payment of this phone bill. For practical reasons the department accepts that in these cases it would be time consuming to revisit the earnings paid and re-calculate the National Insurance that is due.

We therefore allow the employer to calculate the National Insurance in the next earnings period even if this falls within the next tax year. Therefore the employer could calculate and pay the National Insurance with the employee's salary in April in the following tax year, if the payment of a phone bill had arisen at the end of March for instance. They would then have the rest of the tax year to recover the National Insurance from the employee's cash earnings.

The guidance for this is in Chapter 1, Page 7 of "The Employers Further Guide to PAYE and NICs" published in 2003. The commitment that Baroness Hollis made for Inland Revenue officials to look at the guidance regarding recovery will be helpful to employers and their representatives as we examine whether we can make them more aware of these provisions.

At point 5 you ask me to clarify our concerns about the amendments that you proposed for Clauses 1 and 2. At present, where there are specific problems for the employer in recovering NICs from the employee, for instance payments of share based earnings, we can allow an additional tax year for that recovery to take place by making changes through regulations. The amendment that you propose would restrict primary power for such regulations so that we could only allow the employer to

recover the primary NICs from the next sufficient monetary earnings. An employer may find it more convenient to recover the NICs later on in the following tax year. We do not wish to restrict their ability to choose when to make the recovery from the employee in the specific circumstances where we think additional time is appropriate.

You are correct that (in the Inland Revenue's view) there is a Class 1 NICs liability on any payments that have been made into a FURBS since 6 April 1998. This liability will continue up to 5 April 2006 - after which the current proposals are that the liability will be swept away as part of the reforms of the tax treatment of pension schemes.

This change will not, of course, resolve any existing difficulties encountered by employers in recovering these employee NICs. But the reform will mean that such problems will not develop after April 2006 - which I would hope you would welcome. In the meantime, I would imagine that most employers who make contributions to FURBS, even if they choose to make such contributions towards the end of the tax year, can time such contributions so that it is possible to recover the primary NICs from payments made direct to the employee.

With regard to point 8 - you are quite right to refer to totalisation. The European Social Security co-ordinating regulation (Regulation 1408/71) talks of aggregating insurance records where necessary.

In every Member State where a person is insured, his insurance record is kept until he reaches pension age. Insurance is not transferred to another Member State but used to assess benefit entitlement under the relevant social security scheme. The only time when a pension contribution record will be transferred is when the insurance is for less than one year and no pension could be paid under national legislation - and another Member State will use these contributions to enhance the pension that they will pay.

This means that, if a person has been insured in more than one Member State, he or she will be entitled to a separate pension from each Member State where they have been insured. Therefore, if a person has been insured in three Member States, they will receive a pension from each one provided that there is entitlement in the Member State concerned.

Aggregation of insurance records becomes important when an individual does not qualify for a Member State's pension on the basis of their record there. The state concerned uses the record to help meet the qualifying conditions and then pay a pension that is proportionate to the length of time that the individual was insured in that state.

I am pleased to hear that you look forward to contributing to the reviews announced by Baroness Hollis at Grand Committee. I hope you will find them useful. Please address any further queries to Chris Davis, Room S9, West Wing, Somerset House, London WC2R 1LB.

I am copying this letter to Lord Higgins and Baroness Hollis at DWP.

D FURTHER LETTER SENT IN JUNE 2004 TO THE REVENUE

1. I am replying to the letter dated 28 April from Lord McIntosh, who asked me to write to you … The references in this letter are those in our letter dated 25 March.

2. We are grateful for the detailed reply from Lord McIntosh. Our main concern is that certain Ministerial statements during the debates may have resulted in the Lords considering the Bill on the basis of misapprehensions.

Clauses 1-2
Col GC4

Lord McIntosh's second paragraph

3. The example that we provided in our memorandum dated 8 March 2004 was specifically the normal situation where the employer reimburses the home telephone bill of the employee (Ben in our example) which is in Ben's name; the NIC liability here is to Class 1. The Parliamentary Under-Secretary gave the impression that a Class 1A charge was the normal outcome where an employee pays a telephone bill and is reimbursed by the employer. These would include situations where an employee settles a home telephone bill which is in the name of the employer and then seeks reimbursement from the employer. Cases where an employee is reimbursed by the employer for settling a home telephone bill that give rise to Class 1A liability are the rare exception, and we consider that it was misleading when providing an explanation of what happens generally in practice to give the impression that Class 1A is the normal outcome.

Lord McIntosh's third to sixth paragraphs

4. We welcome the statements by Lord McIntosh in his third to fifth paragraphs which clarify how the CWG2 Chapter 1 page 7 easement referred to in his sixth paragraph applies. Our concern was that there is a statutory obligation on employers to account for NIC in the pay period in which the Class 1 liability arises but where the pay period is the last one of the tax year, there is no statutory way in which an employer can recoup from an employee the primary contribution that arises where the employee has already been paid his final regular salary for the year except in the restricted situations provided for in SSCBA 1992 (as now expanded by NICSPA 2004).

5. Lord McIntosh's reassurances about the application of the easement are most helpful and in order to assist in making employers and advisers more aware of these provisions, we intend to insert the attached note (see Annex A) in our monthly newsletter 'TAXline'. We would also welcome your confirmation that you have no objection to our publishing the text of the letter from Lord McIntosh, along with our letter dated 25 March and this letter, as a technical release.

6. Does the same approach apply where an employer makes a contribution to a Funded Unapproved Retirement Benefits Scheme?

GC5
Lord McIntosh's seventh paragraph

7. Noted, thank you.

GC6
Lord McIntosh's eighth and ninth paragraphs

8. We have nothing to add to our comments in our letter dated 25 March.

Clauses 3-4
GC12
Lord McIntosh's tenth to twelfth paragraphs

9. We have nothing to add to our comments in our letter dated 25 March.

Lord McIntosh's final two paragraphs

10. Please contact me if you would like our further input to the reviews. As a general point, we consider that payroll taxes should comply with our Ten Tenets for a Better Tax System (see Annex B) so that employers are able to administer their payrolls and provide simple benefits-in-kind and account to the Revenue and recover from employees the correct amount of NIC with as little need as possible to refer to guidance or seek professional advice on what should be straightforward transactions such as paying telephone bills or pension contributions.

11. I am copying this reply to Lord Higgins, Baroness Hollis and Lord McIntosh.

Annex A

Proposed draft item for TAXline

[*See Clarification of CWG2 easement in Section A above*]

Annex B

The Tax Faculty's Ten Tenets for a Better Tax System

The tax system should be:

1. **Statutory**: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. **Certain**: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. **Simple**: the tax rules should aim to be simple, understandable and clear in their objectives.

4. **Easy to collect and to calculate**: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. **Properly targeted**: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. **Constant**: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. **Subject to proper consultation**: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. **Regularly reviewed**: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. **Fair and reasonable**: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. **Competitive**: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99; see http://www.icaew.co.uk/taxfac/index.cfm?AUB=TB2I_43160,MNXI_43160.

E REPLY RECEIVED IN JULY 2004 FROM THE REVENUE

Thank you for your letter of 23 June 2004. I refer to the points raised in your letter.

Paragraph 3

Either Class 1 or Class 1A National Insurance (NICs) can be liable on phone bills and this is dependent on how the phone is provided. During the debate at Grand Committee in the Lords the issue of how the phone was provided was never discussed. Baroness Hollis gave an example of a situation where Class 1A NICs would be due but for the clarity of the debate did not go into the specific technical circumstances of how the liability arose. She did also add that there could be "other situations that the Noble Lord has in mind"[1]. As Lord McIntosh's letter of 28 April acknowledged, there are other circumstances where Class 1 NICs would be liable on payments of phone bills.

Paragraphs 4-7

We are happy for you to publicise this administrative easement in your press release along with the text of Lord McIntosh's letter.

I am afraid that we do not think the same approach should apply where an employer makes a contribution to a Funded Unapproved Retirement Benefits Scheme (FURBS). We would not generally regard such a contribution as a marginal payment, to be afforded the same latitude in treatment as settlement of a phone bill. A contribution to a FURBS will usually constitute a much larger proportion of an employee's earnings, and its timing will be very much within the employer's control.

Paragraph 11

I am pleased to hear that you would like to have input into the reviews announced by Baroness Hollis in Grand Committee on 15 March 2004. I will forward them to you for comment when they become available. Thank you also for sending me a copy of your "Ten Tenets for a Better Tax System". I hope that you agree that the measures introduced in the National Insurance Contributions and Statutory Payments Act should make the administration of National Insurance easier for employers, removing red tape and reducing costs.

[1] Hansard Monday 15 March 2004 Volume 659 Column GC4

F FURTHER LETTER SENT IN AUGUST 2004 TO THE REVENUE

Thank you for your letter dated 23 July …

Thank you for agreeing that we can publish Lord McIntosh's letter along with our other correspondence. We have combined this in TAXREP 35/04 and I attach a copy for your information. Thank you also for agreeing our explanatory note about the easement.

We have one final point. If FURBS are not included within the CWG2 easement, then we suggest that a change in legislation is needed. There has since 1998 never been a mechanism to enable employers to recover employees' NIC from employees and given that since 5 April 2003 any employee, ie including those above the upper earnings limit, who 'benefits' from an employer contribution to a FURBS will, the Inland Revenue states, have a NIC liability, some way to enable employers to recover employee NICs where FURBS payments are made at the end of the tax year is now needed more than ever. The promise of a change of law in two years time as part of the pensions reforms is not satisfactory and perhaps this could be resolved more quickly as part of the forthcoming review. We agree that the Act does make the administration of NIC easier for employers but it is but a small step down a long road.

ANNEX

EASEMENT IN CWG2 FROM APRIL 2004

Reproduced below is the easement in Revenue leaflet CWG2, Page 7, Chapter 1; see http://www.inlandrevenue.gov.uk/guidance/cwg2.pdf

Late notification of marginal items of pay

Occasionally, employers' payroll sections don't get to know about certain marginal items of pay, for example expenses, until some time after they have been paid. So some calculate the NICs due on these payments in a later earnings period because it is time consuming to have to revisit the correct earnings period and recalculate the NICs due. We accept that it is sensible to allow employers to use the later earnings period to calculate the NICs due.

Similarly, we accept that on the very rare occasion when such payments are notified so late that the most convenient earnings period falls within the next tax year, it is sensible to allow employers to use the later earnings period to calculate the NICs due.

Our employer compliance officers will only ask the employer to recalculate the Class 1 NICs and allocate the payment to the correct earnings period where:

- it appears to the employer compliance officer that the employer is deferring the calculation in order to avoid or reduce NICs
- the deferred calculation has had a material effect on an individual's benefit entitlement. So employers should take particular care to ensure payments to employees earning around the Lower Earnings Limit or to employees with variable earnings are assessed for Class 1 NICs as soon as possible.