

TAXREP 55/05

NATIONAL INSURANCE CONTRIBUTIONS

PENSIONS SCHEMES ACT 2003

REBATES AND REDUCED RATES OF NATIONAL INSURANCE CONTRIBUTIONS FOR MEMBERS OF CONTRACTED-OUT PENSION SCHEMES

Memorandum submitted in November 2005 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales commenting on issues arising from an invitation to comment issued in September 2005 by the Government Actuary's Department

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INTRODUCTION

1. We comment below on issues concerning the consultation announced on 19 September 2005, 'Rebates and reduced rates of National Insurance contributions for members of contracted-out pension schemes' published by the Government Actuary's Department at http://www.gad.gov.uk/pensions/contracting_out.htm.
2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex A.

KEY POINT SUMMARY

3. We recommend that, from 6 April 2007, the rebates between the Lower Earnings Limit and the Earnings Threshold should be abolished. This should be done on a population-wide financially-neutral basis and the rebate applied at a slightly different rate to that otherwise planned, but only from the Earnings Threshold to the Upper Earnings Limit.
4. At present, between the Lower Earnings Limit and the Earnings Threshold, the rebate gives negative National Insurance liability in some cases and a reduction in all remaining cases whilst main NI liability does not begin until the Earnings Threshold is reached. Not only is this conceptually difficult for employers and employees alike to grasp, the amounts involved are puny and are far outweighed by the cost to employers of calculating and recording the figures and explaining them to employees.

COMMENTS

Introduction

5. As accountants we have no actuarial skills and accordingly have no detailed comments to make on the future quantum of rebates. Others can comment far more adequately than us.
6. However, as accountants and tax advisers we are qualified to comment upon the effect that the existence of the rebate has on the administration required by employers. In particular, the notion that the rebate must apply between the Lower Earnings Limit and the Earnings Threshold, giving negative National Insurance liability in some cases and a reduction in all remaining cases whilst main liability does not begin until the Earnings Threshold is reached, is one that is conceptually difficult for employers and employees alike to grasp. Complexity and disproportionate compliance costs are contrary to our Ten Tenets for a Better Tax System (Annex B).

Tax Representation

The present position

7. While computer systems will usually be programmed to make the correct calculations, even this was not universally carried out correctly by some software providers when the Earnings Threshold first came into being. Further, computer output does need to be checked manually at various times for various reasons. Whilst the computer can carry out the correct calculations, it cannot explain unusual concepts to human beings. Equally, employees do sometimes check their deductions and, again, employers are sometimes unable to explain the odd calculations made by their payroll systems.
8. The amounts involved are puny. In 2005/06 the maximum annual amounts of contracted-out rebate between the Lower Earnings Limit and the Earnings Threshold for a monthly paid employee are approximately (subject to the precise method of calculation):

Contracted-out Salary Related Schemes ('COSR')	Employee	£9.98 pa
	Employer	£21.84 pa
Contracted-out Money Purchase Schemes ('COMP')	Employee	£9.98 pa
	Employer	£6.24 pa.

9. These amounts are less than 2.2% of the total rebate (and a much smaller percentage of actual National Insurance contributions) available to someone earning at or above the Upper Earnings Limit, though obviously a higher percentage to lower earners. Nonetheless in absolute terms the amounts are trifling.
10. Although the separate recording of these amounts pay period by pay period was no longer required from 6 April 2003, the adjustment nonetheless remains a feature of the calculation of overall contribution liability.
11. Whilst that small portion of rebate itself no longer has to be separately recorded, the separate bands of earnings do still require record-keeping in each and every pay period (columns 1a and 1b on paper versions of P11 and P14/P60). This can cause problems and it also seems from the latest edition of HM Revenue & Customs' leaflet CA93 that despite this burden placed upon employers the correct details still do not always get recorded onto contributors' individual National Insurance Accounts.

Recommendation

12. In view of the trifling amounts of money involved (compared with the cost to users and enquiring employees of understanding what is going on), we recommend that, from 6 April 2007, the rebates between the Lower Earnings Limit and the Earnings Threshold should be abolished on a population-wide financially-neutral basis and applied at a slightly different rate to that otherwise planned but only from the Earnings Threshold to the Upper Earnings Limit (although the effect may not even be as much as 0.1% of earnings).

Tax Representation

Implications of our recommendation

13. The effect would in any event be totally neutral in COMP arrangements, as the lack of the rebate from the Lower Earnings Limit and the Earnings Threshold would be reversed in the calculation of Minimum Contributions required from the employer and the employee. (For COMP employments there are two occasions where the current conceptually difficult arrangements cause confusion – first in verifying the National Insurance liability, then in understanding the calculations of Minimum Contributions).
14. Such an approach would lessen confusion for users of payslips – both employers and employees, generally simplify the system and be contribution cost-neutral.

How to achieve this

15. Such a plan would probably require primary social security legislation. Two possible such vehicles are currently before parliament – the Work and Families Bill and the National Insurance Contributions Bill. Other opportunities may arise within the next year also. Whilst we understand that Statutory Instruments setting out the rebates for 2007-2012 need to be made by 6 April 2006, this could be done in expectation of associated changes.

Longer term improvements

16. We also recommend that in the longer term some more effective way should be found to record whether employees qualify for contributory benefits without the need for employers to have to record – in every pay period – earnings up to the Lower Earnings Limit and – separately – earnings from the Lower Earnings Limit to the Earnings Threshold. Indeed, if our recommendation can be adopted, it ought to be possible to merge columns 1b and 1c at an early date.

Conclusion

17. We stress that in making these suggestions we are NOT suggesting any change to contributors' pension and other benefit rights or any change to the fact that State Second Pension, etc. entitlement should commence from the Lower Earnings Limit. The first of our two suggestions merely requires that National Insurance contributions are £nil right up to the Earnings Threshold – whether they be positive contributions (as is already the case) or negative contributions.
18. We appreciate that our comments go beyond the terms of the consultation issued, but believe that they are an intrinsic factor which need to be considered, rather than looking just at pension scheme entitlement in isolation. Further, the optimum time for our suggestion to be considered is now, at the time of the present quinquennial review of rebates.

PCB
7.11.05

ICAEW AND THE TAX FACULTY: WHO WE ARE

The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

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.