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National Insurance Contributions Bill

Bill 112 of 2013-14

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In his Budget speech on 20 March 2013 the Chancellor, George Osborne, announced the introduction of a new Employment Allowance: from April 2014 businesses, charities and community sports clubs would be entitled to claim up to £2,000 from their annual payment of secondary Class 1 National Insurance contributions (NICs). Class 1 NICs are paid by both employees and employers on the employee's earnings. The employee's share is known as the primary contribution, the employer's as the secondary contribution. Employers are liable to pay secondary Class 1 NICs at 13.8% on all employee earnings above the secondary threshold, set at £148 a week. This tax cut is estimated to cost £1.26 billion in 2014/15, rising to £1.73 billion by 2017/18.

The main purpose of the *National Insurance Contributions Bill 2013-14* is to implement the new allowance. The Bill also contains a number of miscellaneous measures announced in Budget 2013 relating to the scope of NICs.

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Summary

In his Budget on 20 March 2013 the Chancellor, George Osborne, announced the introduction of a new 'Employment Allowance' to reduce employers' costs in paying National Insurance contributions on their employees' earnings. From April 2014 businesses and charities would be entitled to claim up to £2,000 from their annual NICs bill. The cost of this tax cut is projected to be £1.73 billion by 2017/18.

The new allowance follows the end of an earlier NI relief for employers - the Regional Employers NI 'Holiday' – introduced in June 2010. By contrast with the Employment Allowance, the NI Holiday was restricted to new businesses only: successful applicants were entitled to deduct up to £5,000 from their employer NICs bill, for each of the first ten employees they took on in their first year of business. New businesses in Greater London, the South East Region and the Eastern Region were excluded from the scheme.

The Employment Allowance would be delivered for businesses and charities through standard payroll software and HMRC's Real Time Information system. Employers who wish to claim the allowance would be required to confirm their eligibility through their regular payroll processes. In turn, this confirmation would ensure that up to £2,000 would be deducted from their employer NICs liability over the course of the year's PAYE payments.

On 16 July 2013 HM Revenue & Customs published a draft *National Insurance Contributions Bill*. The Bill had three main elements, each of which had been announced in the 2013 Budget. The draft Bill was accompanied by two consultation documents on two of these components: strengthening legislation to prevent the use of offshore employment payroll companies to avoid employer NICs, and, removing the presumption for self-employment for members of limited liability partnerships. The third element was extending the General Anti-Abuse Rule to NICs. The draft Bill did not contain any clauses in relation to the Employment Allowance. These provisions were included when the final Bill was published

The *National Insurance Contributions Bill 2013-14* was published on 14 October. It is scheduled to have its Second Reading on 4 November 2013.

The *National Insurance Contributions Bill* extends to the whole of the UK. The Bill does not contain any provisions falling within the terms of the Sewel Convention, nor does it contain any provisions relating to devolved matters with regard to either Wales or Northern Ireland.

The text of the Bill, explanatory notes and details of the Bill's progress are collated on the Parliament Bill page at:

http://services.parliament.uk/bills/2013-14/nationalinsurancecontributions.html

1 The structure of NICs

National Insurance benefits are funded by a system of compulsory contributions on earnings, paid by employees, employers and the self-employed. Most of the income from these contributions – NICs, for short – goes into the National Insurance Fund, kept separate from revenue raised by national taxes. The Fund is used exclusively to pay for contributory benefits, including contributions-based jobseeker's allowance, incapacity benefit, retirement pensions and bereavement benefits. The Fund operates on a 'pay as you go' basis: broadly speaking, this year's contributions pay for this year's benefits. One portion of NICs receipts do not go into the Fund, but go directly into the National Health Service.

NICs is the UK's second biggest tax after income tax, in terms of the amounts of money it raises for the Exchequer. In 2012/13 NICs raised £102 billion, which compares with receipts of £152 billion for income tax, £101 billion for VAT and £41 billion for corporation tax.[1] It is projected that in 2013/14, NICs will raise just over £106.5 billion, of which £85.8 billion will go into the NI Fund and £20.8 billion will go to the NHS.[2]

NICs are divided into six classes:

- **Class 1** contributions, which are paid by both employees and employers on the employee's earnings. The employee's share is known as the primary contribution, the employer's as the secondary contribution.

  Employees are liable for primary Class 1 NICs on earnings above the 'lower earnings limit' (LEL), set currently at £109 a week. A zero rate of NICs is charged on earnings above the LEL up to the primary threshold (PT), set at £149 a week. The main rate of NICs, which is 12%, is charged on earnings above this threshold up to the 'upper earnings limit' (UEL), set at £797 per week. An additional rate of NICs set at 2% is charged on earnings above the UEL.

  Employers are liable to pay secondary Class 1 NICs at 13.8% on all employee earnings above the secondary threshold (ST), set at £148 a week. No upper limit applies to employer NICs.

  Employees contracted out of the state second pension (S2P) pay a reduced rate of NICs.[3]

- **Class 1A** contributions are payable annually by employers on most taxable benefits in kind. They are payable by employers only. Class 1A contributions are payable at a rate of 13.8%.

- **Class 1B** contributions are payable annually by employers on items which are dealt with under a PAYE Settlement Agreement (PSA) for income tax – usually minor or irregular expenses and benefits. Class 1B contributions are payable at a rate of 13.8% on the value of the items included in the PSA and on the total tax payable by the employer under the PSA.

[1] HM Revenue & Customs, H*National Statistics: HMRC receipts*H, September 2013

[2] Government Actuary's Department, H*Report … on the draft of the Social Security Contributions (Re-rating) Order 2013,*H January 2013 pp26-7

[3] This rebate applies for individuals paying into a salary-related scheme only (see, H*Contracting out of the State Second Pension*H, Library standard note SN4822, 23 March 2011). With the introduction of the single-tier pension, scheduled for April 2016, the additional State Pension will close and, by extension, the option to contract out of it (see, H*Single-tier state pension*H, Library standard note SN6525, 11 September 2013).

- **Class 2** contributions are paid by the self-employed at a flat rate of £2.70 per week – a self-employed person can apply to be exempted from liability where earnings are below £5,725 per year.

- **Class 3** contributions are paid on a voluntary basis, at a flat rate of £13.55 per week, by people who fall outside the scope of Class 1 and Class 2 contributions.

- **Class 4** contributions are paid annually by the self-employed on profits that are immediately derived from a trade, profession or vocation and which are chargeable to income tax. Class 4 NICs are payable at a rate of 9% on profits between £7,755 and £41,450 and 2% on profits above £41,450.

For the current tax year – 2013/14 – the rates of NICs are unchanged. By contrast, for 2013/14 the LEL, the PT and ST have each been increased in line with inflation, while the UEL has been cut by £20.[4]

The rates of NICs for employees and employers for 2013/14 are set out below:

Earnings[a] £ per week	**Employee (primary) NIC rate (per cent)[b]**	**Earnings £ per week**	**Employer (secondary) NIC rate (per cent)[c]**
Below £109 (LEL)	0%	Below £109 (LEL)	0%
£109 to £149 (PT)	0%	£109 to £148 (ST)	0%
£149 to £797 (UEL)	12%	Above £148	13.8%
Above £797	2%		

[a] *The limits are defined as LEL - lower earnings limit; PT - primary threshold; ST - secondary threshold; and UEL - upper earnings limit.*
[b] *The contracted-out rebate for primary contributions in 2013/14 is 1.4 per cent of earnings between the LEL and the upper accrual point (UAP) of £770 for contracted-out salary-related schemes (COSRS).*
[c] *The contracted-out rebate for secondary contributions is 3.4 per cent of earnings between the LEL and UAP for COSRS.*

Primary and secondary Class 1 contributions form the bulk of Exchequer receipts from NICs. It is projected that for 2013/14, they will raise £42.4 billion, and £60.7 billion, respectively.[5] As noted, total NIC receipts for 2013/14 are forecast to be £106.5 billion – so that Class 1 contributions paid by employers account for 57% of this total.

Further background on the National Insurance system is given in two Library standard notes:

- *National Insurance contributions : an introduction*, SN4517, 17 July 2013

- *National Insurance Fund: 1975-2010*, SN797, 14 June 2010

4 The basis for indexation is the Consumer Price Index (CPI) for the LEL and the PT, and the Retail Price Index (RPI) for the ST. The UEL is cut for 2013/14 so that it remains aligned with the point at which the 40% higher rate of income tax becomes payable. Changes to these thresholds were made by Order (SI 2013/558).

5 Government Actuary's Department, January 2013 p27. Figures are net of contracted-out rebates.

2 The Employment Allowance

2.1 Budget 2013

In his Budget on 20 March 2013 the Chancellor, George Osborne, announced a new 'Employment Allowance' – to reduce employers' NIC costs:

> The cost of employing people is a burden on small firms. It is a real barrier to taking an extra person on. To help create jobs and back small businesses in this country, I am today creating the employment allowance. The employment allowance will work by taking the first £2,000 off the employer national insurance bill of every company. It is a tax off jobs. It is worth up to £2,000 to every business in the country. It will mean that 450,000 small businesses—one third of all employers in the country—will pay no jobs tax at all.
>
> For the person who has set up their own business and is thinking about taking on their first employee, a huge barrier will be removed. They can hire someone on £22,000, or four people on the minimum wage, and pay no jobs tax. Ninety-eight per cent. of the benefit of this employment allowance will go to small and medium-sized enterprises. It will become available in April next year, once the legislation has passed. We will also make it available to charities and community sports clubs.[6]

The Budget report gave some details of how the allowance would work in practice:

> **A new Employment Allowance for every business and charity**
>
> From April 2014, all businesses and charities will be eligible for a new £2,000 Employment Allowance. This will reduce their employer NICs bill. Up to 1.25 million employers will benefit, with over 90 per cent of the benefit going to small businesses. The scale of the allowance means that 450,000 of the UK's small businesses will no longer pay any employer NICs. On average, employers with fewer than 10 employees over the course of the year will see their employer NICs bill reduced by 80 per cent.
>
> The Employment Allowance will reduce the cost of taking on new staff for small businesses; supporting those with an ambition to grow by hiring their first employee or expanding their workforce. Every business will be able to employ one worker on a salary of £22,400, or four employees working full time on the adult National Minimum Wage, without paying any employer NICs at all.
>
> The Employment Allowance will be introduced from April 2014, delivered through standard payroll software and HMRC's Real Time Information system. To ensure maximum take-up, it will be simple to administer: employers will only need to confirm their eligibility through their regular payroll processes. This confirmation will ensure that up to £2,000 will be deducted from their employer NICs liability over the course of the year's PAYE payments.
>
> The Government will engage with business representative bodies on the details of the design and operation of the new allowance, in order to ensure the system is as simple and effective as possible.[7]

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[6] HHC Deb 20 March 2013 c944

[7] H*Budget 2013*H, HC 1033, March 2013 p43

The cost of this tax cut is projected to be £1.26 billion in 2014/15, rising to £1.73 billion by 2017/18.[8] Constituency-level estimates of those likely to benefit from the Employment Allowance are not available.[9]

By way of comparison the Government has cut the main rate of corporation tax in a series of steps over the last three years, so that the rate is set to fall from 28% in 2010/11 to 20% by 2015/16.[10] In the 2013 Budget the Government announced a 1% cut in the rate to 20% from 2015/16, and this is projected to cost around £800-900m a year.[11] It is worth underlining that all businesses will be entitled to claim the Employment Allowance, whereas this tranche of tax cuts only go to companies paying corporation tax.[12]

The new allowance follows the end of an earlier NI relief for employers - the Regional Employers NI 'Holiday' – introduced in the Coalition Government's first Budget in June 2010. By contrast with the Employment Allowance, the NI Holiday was restricted to *new businesses only*. Successful applicants were entitled to deduct up to £5,000 from their employer NICs bill, for each of the first ten employees they took on in their first year of business. In addition, new businesses in Greater London, the South East Region and the Eastern Region were *excluded* from the scheme. Finally, it is worth underlining that this relief was *conditional* on new businesses taking on new employees – whereas businesses will not have to change or modify their behaviour at all to be able to claim the Employment Allowance. In this respect, the Allowance is a straight tax cut.

When it was first announced the Government made it clear that the NI Holiday was strictly time-limited, and would be for three years only – ending on 5 September 2013. Initially the Government forecast that the NI Holiday would cost £940m in total over its three year lifespan.[13] It was estimated that 400,000 new businesses would benefit from the scheme, and the average benefit per business would be about £2,000.[14] At the time some commentators raised doubts about whether the scheme might be too small financially and too complex administratively to be this successful.

Statutory provision for the scheme was made in the *National Insurance Contributions Act 2011*. During the Bill's scrutiny, many Members raised the fact that the scheme would be geographically restricted, though the Government opposed extending the scheme on a UK-wide basis, on the grounds that the policy was designed to support new businesses in parts of the country that were most reliant on the public sector. HMRC have published statistics on the take-up of the NI Holiday up to December 2012. Over this period there have been 20,365 successful applications to join the scheme. In 2010/11 and 2011/12, NI rebates worth a total of £37m were paid.[15]

The history of the NI Holiday is discussed at more length in a Library standard note.[16]

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8 HHC 1033, March 2013 p64H (Table 2.1 – item 25)

9 HHC Deb 15 May 2013 c275W

10 H*Budget 2011*H HC 836, March 2011 para 1.74; H*Budget 2012*H HC 1853, March 2012 para 1.186; H*Autumn Statement*H Cm 8480, December 2012 para 1.130; H*Budget 2013*H HC 1033 March 2013 para 1.121.

11 HHC 1033, March 2013 p64H (Table 2.1 – item 26).

12 For a survey of the anatomy of corporation tax liabilities and payments see, Michael P. Devereux & Simon LoretzH, *Corporation tax in the UK*H, Oxford University Centre for Business Taxation, February 2011.

13 H*Budget 2010*H, HC 61 June 2010 p40 (Table 2.1 – item 10)

14 HMRC, H*Impact Assessment of the Regional Employer National Insurance Contributions Holiday for New Businesses*H, September 2010 p1

15 HMRC, H*Regional Employers National Insurance Contributions (NICs) Holiday for New Businesses Factsheet*H, March 2013 (Tables 1.1, 2.3 & 3.3)

16 H*The Regional Employer NI Holiday*H, SN6737, 11 October 2013

2.2 Initial reactions

Most commentary on the 2013 Budget focused on measures other than the proposed Employment Allowance,[17] though several business and accountancy groups welcomed the measure as helping small employers.[18]

In the Institute for Fiscal Studies' post-Budget presentation, the director of the IFS, Paul Johnson, noted that the new allowance "might be quite tightly targeted in two senses":

> First, most of the benefit will go to small employers. The cost is kept down because it is worth so little to large employers where the majority of people work. Second, relative to a straightforward cut in employer National Insurance Contributions it seems more likely that the incidence will be on the employer – it will be employers rather than their existing employees who benefit. Whether it will actually have any measurable effect on job creation we don't know. Given that it won't be piloted and will be almost impossible to evaluate the sad truth is we are likely never to know whether this will be money well spent.[19]

In his presentation on the tax measures in the Budget, Stuart Adam at the IFS noted that the £2,000 allowance would wipe out the potential NICs bill of an employer with one employee, if they were paid anything up to £22,450. Similarly, employers with two or three employees would not pay any NICs if each of those employees earned up to £15,200, or £12,790 respectively. Mr Adam went on to note that, as an alternative to increasing the earnings threshold for employer NICs, providing a cut in employer NICs this way would be more favourable to small employers, less favourable to low earners, and less likely to be passed on to employees in higher wages.[20]

When the Treasury Committee took evidence on the Budget, Mr Johnson reiterated his concerns that it would be difficult to assess the impact of this tax cut:

> There is some possibility that the national insurance change will have an effect on employment levels, particularly because they impact directly on the employer, and on smaller employers in particular, but I do not think that we have any way of estimating what that impact will be, and I fear the we will never know …
>
> Clearly [the new allowance will] ease things for those employers who are affected. The structure of employers is such that there are an awful lot who have only one or two employees, and they will be affected. Of course, there is a whole range of other things that will affect small and other employers, including the introduction of real-time information within the next month or two, and other things that will move in the other direction on the income tax system.[21]

Other witnesses raised concerns about the administration of the allowance. Carl Emerson, deputy IFS director, noted that the Treasury had estimated that the take-up of the scheme would be high, reaching 90% by 2017/18,[22] though this raised the question, "why is it not 100%? Is it something about how you have to apply for it? There might be some additional

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[17] See, H*Summary of the 2013 Budget*H, Library standard note SN6573, 26 March 2013 & H*Budget 2013 – Reaction*H, Lords Library note LN2013/007, 21 March 2013

[18] For example, Confederation of British Industry press notice, H*Budget 2013 – full CBI reaction*H, 20 March 2013; Chartered Institute of Taxation press notice, H*Tax advisers welcome new NICs employment allowance*H, 20 March 2013

[19] "HIntroductory remarks - Paul JohnsonH", *IFS 2013 Budget briefing*, 21 March 2013 p7

[20] "HBudget measures – Stuart AdamH", *IFS 2013 Budget briefing*, 21 March 2013 (slide 16)

[21] Treasury Committee, H*Budget 2013*H, 20 April 2013, HC 1063 2012-13 para 118

[22] HMTH, *Budget 2013 – Policy Costings*H, March 2013 p8

burden on those who want to claim it, and have to jump through hoops to get it, but we have not seen that detail yet."[23]

For its part the Committee suggested that "the Government must ensure that the administrative structure of the scheme facilitates this, rather than resulting in additional administrative burden for employers."[24] In their response to the Committee's report, published in July, the Government stated that the "additional burden" to be placed on employers would be "minimised":

> Employers will be able to take the allowance all in one month or as soon as they can if their employer NICs liability in early months is less than the full £2,000, thereby helping improve their cash flow situation there and then. The Government will engage with representative bodies on the details of the new allowance, including the definition of an employer, to ensure the system is as simple and effective as possible.[25]

3 The Bill

Statutory provisions regarding National Insurance cannot be included in the annual Finance Bill. This is because the Bill's remit – as set out in its long title – specifically excludes any tax that does not raise money for financing central government *as a whole*. Usually the long title of the Finance Bill is of the form, "a Bill to grant certain duties, to alter other duties, and to amend the law relating to the National Debt and the Public Finance, and to make further provision in connection with finance." As a consequence the Bill cannot include provisions relating to NICs – since they are collated in the National Insurance Fund, to meet the costs of contributory benefits exclusively. Similarly the Finance Bill cannot impose a charge to finance other bodies in the public sector (such as local authorities), or to authorise borrowing.[26]

The introduction of primary legislation in the current Session to give effect to the Employment Allowance was confirmed in the Queen's Speech.[27] On 16 July 2013 HM Revenue & Customs published a draft version of the Bill. There were three main elements to the draft Bill, each of which had been announced in the 2013 Budget. The draft Bill was accompanied by consultation documents on two of these components:

- strengthening legislation to prevent the use of offshore employment payroll companies to avoid employer NICs, and
- removing the presumption for self-employment for limited liability partnership members.

The third element to the draft Bill was extending the General Anti-Abuse Rule to NICs. The draft Bill did not contain any provision for the Employment Allowance. These clauses were added when the final Bill was published.[28]

[23] HHC 1063, 20 April 2013 Q72H, Ev11. The Committee also noted concerns about the administration of the new allowance by Andrew Goodwin, Senior Economist at Oxford Economics, and the Institute for Chartered Accountants (H*op.cit.* p54H).

[24] HHC 1063, 20 April 2013 p55

[25] HHC 370 2013-14, 11 July 2013 p6

[26] For more details on these procedures see, H*The Budget and the annual Finance Bill*H, Library standard note SN813, 16 July 2013.

[27] HHC Deb 8 May 2013 c3

[28] HHC Deb 16 July 2013 c66WSH. Details of the draft Bill are Hcollated on the Gov.uk siteH.

3.1 The Employment Allowance (clauses 1-8)

Clause 1 sets out the main features of the Employment Allowance: that it may be claimed by those paying secondary Class 1 NICs, and that it is worth up to £2,000 a year. The scope of the Allowance is subject to certain exceptions, set out in **clause 2.** First, public sector employers will not be entitled to claim the Allowance, unless they have charitable status (**clause 2(1)-(2)**). Second, liabilities to pay secondary Class 1 NICs in some circumstances are defined as 'excluded liabilities' – so that they will not be entitled to relief: specifically:

- Contributions paid in connection with personal, family or household affairs – for example, when employing a nanny or gardener (**clause 2(3)**).

- Contributions paid when payments fall under the 'intermediaries legislation', known as the IR35 rules, where income paid to a personal service company is deemed to be earnings from employment for tax purposes (**clause 2(4)**).[29]

- Contributions paid as a consequence of a business, or part of a business, being transferred to an individual, in the year in which the transfer occurs (**clause 2(5)-(9)**).

- Contributions paid as a consequence of the individual using avoidance arrangements, so as to secure the Allowance: (**clause 2(10)-(13)**).

Clause 3 and **Schedule 1** restrict any claim to the Allowance in circumstances where two or more companies, or two or more charities, are connected with one another. If more than one of these connected entities qualifies for the Allowance, only one may claim it (**clause 3(3)**). It would be up to the companies or charities concerned to decide which of them makes a claim (**clause 3(4)**). **Schedule 1** sets out the rules for determining if companies, or charities, are connected to each other, for these purposes.

Clause 4 establishes the procedure by which the Allowance may be claimed. Individuals would be allowed to offset the Allowance against their payment of secondary Class 1 NICs. This deduction must be made, prior to any other deduction which employers can offset against their NICs bill, such as the payment of Statutory Maternity Pay (**clause 4(3)**).

HM Revenue & Customs may make administrative arrangements for deductions: this can include requiring the claimant to give notice to HMRC (**clause 4(4)**). HMRC may make repayments after the end of the tax year to those who have failed to deduct the full amount to which they are entitled (**clause 4(5)-(10)**). Claims for repayments have to be made no later than four years after the relevant tax year (**clause 4(8)**).

Clause 5 allows for changes to be made to these provisions by Order: to amend the value of the Allowance, and to amend the exceptions to the scope of the Allowance. Secondary legislation made under this provision is to be subject to the affirmative procedure, with the exception of an Order simply to increase the amount of the Allowance (**clause 5(6)**).[30]

Clause 6 allows for individuals to appeal a decision by HMRC as to a person's entitlement to the Allowance, and the amount to be deducted, or repaid.

Clause 7 specifies certain requirements to be placed on employers to retain records relating to the Allowance, and allows regulations to be made to this effect.

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[29] The IR35 rules are discussed below in relation to **clause 11** of the Bill. A short summary of their purpose is on HM Revenue & Customs site at: Hhttp://www.hmrc.gov.uk/ir35/H

[30] For details of the different procedures for approving statutory instruments see, H*House of Commons Background Paper: Statutory Instruments*H, SN6509, 18 December 2012.

Clause 8 specifies that the provisions relating to the Allowance are to come into force from 6 April 2014.

3.2 Application of the General Anti-Abuse Rule (GAAR) to NICs (clauses 9-10)

In the 2013 Budget the Government confirmed that "the UK's first General Anti-Abuse Rule will be introduced in *Finance Bill 2013* to provide a significant new deterrent to abusive avoidance schemes and strengthen HMRC's means of tackling them."[31]

UK tax law is specifically targeted rather than purposive: in tackling the exploitation of loopholes in the law, governments have legislated against individual avoidance schemes as and when these have come to light. Often the response to this legislation has been the creation of new schemes to circumvent the law, which in turn has seen further legislative action – an 'arms race' between the revenue authorities and Parliamentary counsel on one side, and on the other, individuals aided and abetted by the legal profession. Over the past twenty years many commentators have suggested introducing legislation to counter tax avoidance in general: by providing certainty for both sides as to the tax consequences of any transaction. A 'General Anti-Avoidance Rule' might dissuade the most egregious efforts to avoid tax, encourage taxpayers and legal counsel to redirect their energies to more productive activities and allow the authorities to simplify the law without fear of it being systematically undermined.

Many tax avoidance schemes seek to exploit loopholes in the tax code, by establishing a series of commercial decisions with little or no business purpose to the taxpayer. These decisions, when considered in the light of the law, deliver an anomalous tax result – such as converting a taxable gain into an allowable loss. Generally speaking, the courts are required to consider how the statutory rules determine the tax treatment of such a contrived chain of events – rather than look to the intention of these rules, even though their purpose stands to be deflected, subverted or entirely reversed. The existence of a general anti-avoidance rule would allow the courts to strike down any avoidance scheme that was found to contravene the rule, without having to consider, at each step of a transaction, how closely the scheme had adhered to the law.

In its first Budget in June 2010 the Coalition Government announced it would consult on this issue, and in December a study group, led by Graham Aaronson QC, was established to explore the case for a General Anti-Avoidance Rule. Mr Aaronson completed his report in November 2011, in which he recommended a narrowly focused rule targeted at 'abusive arrangements' only.[32] In June 2012 the Government launched a consultation exercise on introducing a General Anti-Abuse Rule (GAAR) with a view to bringing forward legislation in 2013.[33] The Government confirmed its plans at the time of the *Autumn Statement* in December 2012.[34] Provisions in the *Finance Bill 2013* for the new GAAR were agreed, without changes, and the new rule came into force on 17 July 2013.[35] These developments are examined at length in a Library note;[36] a second note looks at earlier debates over the case for a general anti-avoidance rule.[37]

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[31] H*Budget 2013*H, HC 1033, March 2013 para 1.211

[32] HHC Deb 21 November 2011 cc2-3WSH; HCommons Library Deposited Paper Dep2011-1844H, 21 November 2011

[33] HMRC, H*A General Anti-Abuse Rule (GAAR) - consultation document*H, June 2012

[34] H*Autumn Statement*H, Cm 8480 December 2012 para 1.178

[35] These now form part 5 (ss 206-215) and schedule 43 of *FA2013*.

[36] H*Tax avoidance: a General Anti-Abuse Rule*H, SN6265, 11 October 2013

[37] H*Tax avoidance: a General Anti-Avoidance Rule – background history*H, SN2956, 15 March 2013.

HM Revenue & Customs collates material on the operation of the GAAR on its site.[38] It may be helpful, to put this part of the Bill in context, to reproduce one section of the official guidance: this sets out the safeguards which exist for taxpayers, and, in particular, the 'double reasonableness' test for determining when tax arrangements may be found to be abusive, and thus contravening the GAAR:

> B12.1 : To ensure that, in effect, the taxpayer is given the benefit of any reasonable doubt when determining whether arrangements are abusive, a number of safeguards are built into the GAAR rules. These include:
>
> - Requiring HMRC to establish that the arrangements are abusive (so that it is not up to the taxpayer to show that the arrangements are non-abusive).
> - Applying a 'double reasonableness' test. This requires HMRC to show that the arrangements "cannot reasonably be regarded as a reasonable course of action". This recognises that there are some arrangements which some people would regard as a reasonable course of action while others would not. The 'double reasonableness' test sets a high threshold by asking whether it would be reasonable to hold the view that the arrangement was a reasonable course of action. The arrangement falls to be treated as abusive only if it would not be reasonable to hold such a view.
> - Allowing the court or tribunal to take into account any relevant material as to the purpose of the legislation that it is suggested the taxpayer has abused, or as to the sort of transactions which had become established practice at the time when the arrangements were entered into.
> - Requiring HMRC to obtain the opinion of an independent advisory panel as to whether an arrangement constituted a reasonable course of action, before they can proceed to apply the GAAR.
>
> B12.2 : … These safeguards (and particularly the 'double reasonableness' test) would prevent the GAAR operating in relation to arrangements entered into for the purpose of avoiding an inappropriate tax charge that would otherwise have been triggered by a more straightforward transaction. Tax charges of this sort (sometimes referred to as 'bear traps') can be encountered from time to time. For example where a taxpayer has to take what appear to be contrived steps in order to ensure that they are not taxed on more than the economic gain, such an arrangement would not generally be regarded as abusive.[39]

In his report, Graham Aaronson recommended that a GAAR should apply only to the main direct taxes - income tax, corporation tax, capital gains tax and petroleum revenue tax – as well as NICs, "although this would require separate enactment as NICs are not regarded as a tax for the purposes of Parliamentary procedure."[40] In its consultation on GAAR the Government agreed,[41] and in Budget 2013 noted that separate legislation would be introduced to this effect after the passage of the Finance Bill.[42] While the decision to

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[38] Hhttp://www.hmrc.gov.uk/avoidance/gaar.htmH

[39] HMRC, H*GAAR Guidance*H *(Parts A-C)*, 15 April 2013 pp 10-11. Parts D & E to this guidance give specific examples, and set out the procedure for applying the GAAR. Interested readers are also referred to the discussion of the GAAR in the report of the Lords Economic Affairs Committee, when this legislation was published in draft (*The draft Finance Bill 2013*, 13 March 2013, HHL Paper 139 2012-13H).

[40] H*GAAR Study: report by Graham Aaronson QC*H, 11 November 2011 para 5.44

[41] H*A General Anti-Abuse Rule*H …, June 2012 para 3.43

[42] HMT/HMRC, H*Overview of Tax Legislation and Rates*H, 20 March 2013 para 1.59. Appendix A to this document includes a tax information and impact note on the GAAR (HTIIN4754H).

introduce a GAAR has generated a great deal of comment in the tax profession, the question of extending its scope to NICs would appear to be uncontroversial.[43]

The Budget report estimated that the GAAR would increase revenues by £60m in 2014/15, which is relatively small compared with other avoidance provisions.[44]

The main provisions for the GAAR in the *Finance Bill 2013* were debated and approved by Committee of the Whole House on 17 April 2013.[45] Speaking for the Opposition, Catherine McKinnell welcomed the new rule in principle, but moved two amendments, in light of concerns about how it would work in practice: first, that there should be a formal review of the GAAR's operation two years after it came into force; and second, that the Government should review how the GAAR might be used to provide information on tax avoidance schemes used by multinationals that affected revenues for other nations – in particular, developing countries. The Exchequer Secretary, David Gauke, opposed both of these measures: first, in the Government's view, "a two-year period would not be practical for a general evaluation … just because of how our tax system operates"; second, that "as a matter of practicality it is difficult for HMRC to perform the roles required by [this amendment] as [it would require] assessments not of our tax rules but of the tax rules of developing countries. That takes us outside what HMRC can realistically do."[46] Both amendments were negatived, and these GAAR provisions agreed without any further changes.

Those taxes covered by the GAAR are set out in s206(3) of the *Finance Act (FA) 2013*.[47] **Clause 9** of the Bill extends the scope of this 'Tax GAAR' to NICs. When assessing if specific tax arrangements fall foul of GAAR, it is obligatory to take into account any other arrangements to which they are a part (under s207(3) of *FA2013*). Under **clause 9(7)** the GAAR applies only to arrangements relating to NICs entered into or after Royal Assent. In the case where arrangements relating to NICs form part of arrangements relating to other taxes agreed *before* this date, **clause 9(9) & (10)** specify that the latter may only be taken into account as evidence that these NICs arrangements are *not* abusive.

Clause 10 provides for the Treasury to make regulations to ensure that the way that the GAAR applies to NICs is kept in line with its application to other taxes. This may be necessary if amendments to the GAAR provisions in part 5 of *FA2013* have only encompassed the taxes listed that Act. The scope of these regulations is limited to this purpose. Secondary legislation made under the provision will be subject to the affirmative procedure, if it amends or repeals primary legislation (**clause 10(4)**).

3.3 Oil and gas workers (clause 11)

Clause 11 provides for the introduction of a certification scheme for offshore employers of oil and gas workers. It is one of three interconnected measures relating to the payment of tax and NICs by offshore employers, following a consultation exercise in summer 2013 on the role of intermediary companies providing workers' services, and the potential for tax avoidance by means of companies being located outside the UK. The other two elements of

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43 As noted, the draft version of the Bill published in July included this measure, but this appears not to have generated substantive comment from interested parties.

44 HHC 1033, March 2013 p65H (Table 2.1 – item 51). The report makes no mention of the extension of GAAR to NICs making any change to this estimate.

45 HHC Deb 17 April 2013 cc406-456

46 HHC Deb 17 April 2013 cc446-7

47 Specifically, income tax; capital gains tax; inheritance tax; corporation tax; any amount chargeable as if it were corporation tax, or treated as if it were corporation tax, such as a CFC charge, the bank levy, the oil supplementary charge and tonnage tax; petroleum revenue tax; stamp duty land tax; and the annual tax on enveloped dwellings (H*GAAR Guidance*H *(Parts A-C)*, 15 April 2013 p9).

this package are to be introduced by way of secondary legislation, and provisions to be included in the *Finance Bill 2014*.[48]

To put this measure in context, the following paragraphs look in some detail at the problems that intermediary companies may pose for the revenue authorities, before giving an outline of this consultation, and the problems which it sought to address.

Individuals working in a number of fields often provide their services to clients through a personal service company (PSC), rather than taking up employment with that client. The client pays the service company for the work they have done, without deducting income tax under PAYE or NICs. There are several possible tax advantages to this type of arrangement. First, a PSC may be able to claim a wider range of expenses against tax than an employee. Second, there will be a cash-flow benefit in avoiding tax being deducted at source each month. Third, the individual may be in a position to receive dividends out of their service company, as an alternative to only being paid a salary, and this form of income would not be subject to NICs.

After a long and contentious consultation exercise, provisions were introduced in the *Finance Act 2000* with effect from the 2000/01 tax year.[49] These are usually called the 'IR35' rules after the number of the Budget press notice that first announced this change. The rules cover any engagement where:

- a worker provides services under a contract between a client and an intermediary; and,
- but for the presence of the intermediary, the income arising would have been treated as coming from an office or employment held by the worker under the existing rules used to determine the boundary between employment and self-employment income for tax purposes, if the individual had contracted directly with the client.

In these cases, the intermediary is required to account for tax on this payment in just the same way as employee earnings (ie, charge income tax under PAYE and Class 1 NICs).

Although IR35 has remained controversial, there has been a marked reluctance on the part of Ministers to amend or abolish these provisions. In July 2010 the Coalition Government announced a review of small business taxation, including IR35, to be undertaken by a new independent body: the Office of Tax Simplification (OTS).[50] The OTS completed its report just before the 2011 Budget in which it argued that one approach would be to merge income tax and NICs, making IR35 obsolete. In the absence of such a major structural change the OTS suggested that the rules might be suspended with a view to being abolished, or amended to exempt certain businesses from their scope.[51] In the Budget the Government announced that IR35 would be retained "as abolition would put substantial revenue at risk," though it wished to make "clear improvements in the way IR35 is administered."[52]

In the 2013 Budget the Government announced that it would consult on proposals to tackle tax avoidance by intermediary companies, based offshore, who provided labour services to UK companies. A review of these arrangements had found that at least 100,000 individuals

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[48] It is anticipated that draft provisions for the *Finance Bill 2014* will be published on 10 December 2013 (HHC Deb 17 October 2013 c63WSH).

[49] The history to the introduction of the IR35 rules is set out in a Library standard note: H*Personal service companies : introduction of the IR35 rules*H, SN914, 20 May 2011.

[50] HHM Treasury press notice 29/10 20 July 2010

[51] Office of Tax Simplification, H*Small business tax review*H, March 2011 pp5-6

[52] HC 836 March 2011 para 2.203. This review is discussed at more length in a second Library note: H*Personal service companies : recent debate*H, SN5976, 17 July 2013.

were employed through an intermediary company that had no presence, residence or place of business in the UK.[53] In many cases employees were unaware that their payroll was located offshore and tax was being avoided on their earnings.[54] Subsequently HMRC estimated that "at least £100m" was not being remitted.[55]

A consultation paper on the detail of these changes was published on 30 May 2013.[56] In this the Government identified two difficulties in ensuring that the correct amounts of tax were being paid in these circumstances. First, complex structures involving several intermediaries in a chain of arrangements between the employer and the end client meant HMRC might be unable to pinpoint who the end user actually was. Second, offshore employers were able to exploit the different tests, set out in tax and NICs legislation, for determining liability:

> **Tax Legislation**
>
> Section 689 of the *Income Tax (Earnings and Pensions) Act (ITEPA) 2003* applies where there is an offshore employer who is supplying workers who are working in the UK for a UK business. Under this legislation the UK business will be responsible for making deductions of income tax and remitting this to HMRC through the Pay As You Earn (PAYE) system, where the offshore employer has not already made these payments.
>
> Although the legislation places responsibility onto the UK business, that business is often unaware that the employee is being paid by an offshore employer. It is also difficult for HMRC to establish that the employee is being paid by an offshore employer and so compel the UK business to operate PAYE.
>
> If there is no UK place of business then, under Section 7 *Taxes Management Act (TMA) 1970* the worker will be responsible for making a return through self assessment to account for their income tax. However, the worker is often unaware of the arrangements that are in place or that there is a requirement on them to make a return.
>
> **National Insurance Legislation**
>
> Paragraph 9 of Schedule 3 to the *Social Security (Categorisation of Earners) Regulations 1978* (SI 1978/1689), known as the "host regulations", may apply where there is an offshore employer but the worker is working in the UK for a UK company … [The regulations place] the requirement to pay employer and deduct employee NICs on the UK end user of the labour/end client where the worker provides their personal service. Offshore employers will often claim that there is no requirement for personal service of the worker, or that they are supplying a composite service, so the host regulations do not apply …
>
> As with PAYE the UK end client may not know that the worker is supplied by an offshore employer and HMRC has difficulty in identifying such cases.[57]

Although offshore employers might decide to make *voluntary* payments of income tax and employee NICs for the workers they supply, HMRC had "little power to check that these are correct or to ensure that they are made on time."[58]

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53 The review was launched four months before: H*Autumn Statement*H, Cm 8480, December 2012 para 2.104

54 HC Deb 18 March 2013 c34WS

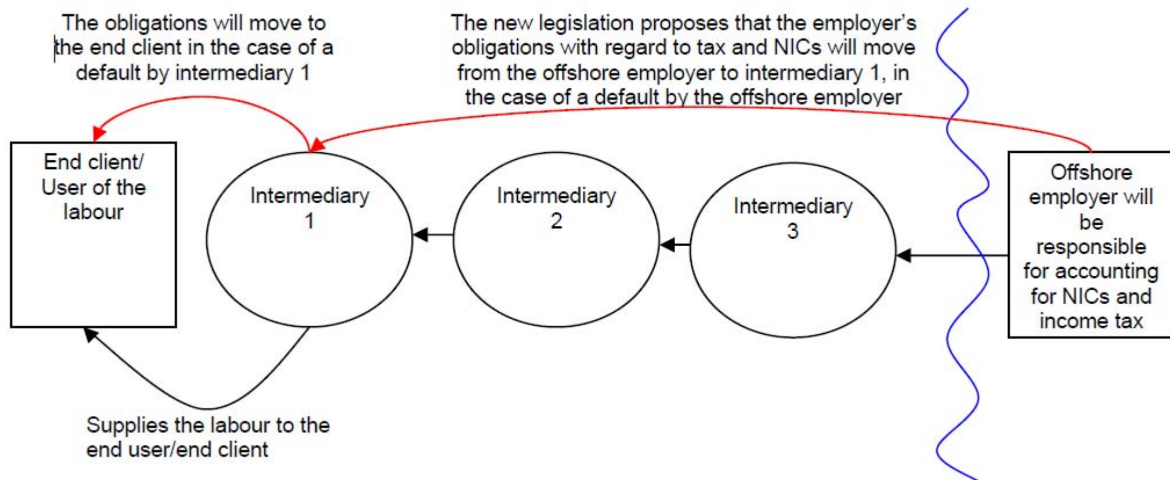
55 H*Offshore employer intermediaries – summary of responses*H, October 2013 para 3.15

56 HMRC, H*Offshore employment intermediaries –consultation document*H, May 2013

57 *op.cit.* pp10-11. Further to the host regulations, there are also reciprocal social security arrangements which apply to employers based in other European countries (*op.cit.*p11)

58 *op.cit.*p9

To tackle this problem the Government proposed a new two-part test: in the first instance, the offshore employer would be responsible for accounting for tax and NICs. Should the offshore employer default on these obligations, the responsibility would pass to the business that contracted directly with the end client – 'Intermediary 1' as shown in the diagram below:



If the worker's services were provided by an offshore employer *without* any intermediary, the obligations to pay tax and NICs would pass to the end client.

To help HMRC's enforcement of these rules, intermediaries would be required to hold information about the way in which workers they placed were paid and engaged, and to make quarterly returns of this information.[59]

In October the Government published a summary the responses to the consultation, and, in the light of these, a revised approach.[60] A majority of respondents had raised three concerns about this two-part test:

- Offshore employers might willingly default on their obligations, knowing these would pass to the relevant intermediary or the end user. Other intermediaries in a supply chain would have no incentive to reveal the true nature of a worker's engagement, because they would never be liable for any debts.
- The requirements placed on businesses in the supply chain to keep records and submit returns would be onerous, especially where these arrangements were complex.
- The proposals would add complexity to the existing law.

As an alternative approach the Government proposed that in these circumstances 'Intermediary 1' would be wholly and immediately responsible for accounting for the tax and NICs of all workers ultimately engaged by an offshore business:

> The Government has evaluated the role of employment businesses and agencies, and concluded that it is reasonable to expect employment businesses and agencies to undertake due diligence. Their role is supplying temporary labour to businesses and the Government believes that it is reasonable for the end client to expect that the appropriate amount of tax and NICs has been paid in respect of those workers. This is

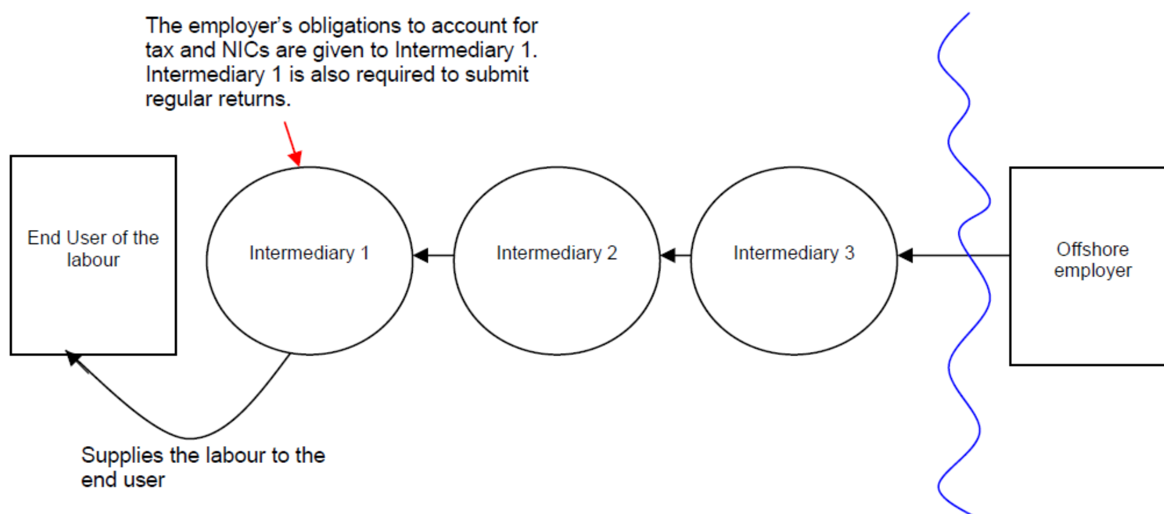
59 Provisions to this effect, with regard to NICs, were set out in clauses 3-5 of the draft *National Insurance Contributions Bill*, published in July 2013.

60 H*Offshore employer intermediaries – summary of responses*H, October 2013

why obligations will fall immediately and wholly to Intermediary 1, and in the case of a default, will not be passed on to the end user.

Where there are no onshore intermediaries, in a similar way to the existing legislation, the end user of the labour will be liable for the accounting and payment of employment taxes. Intermediary 1, or in certain cases the end user, will be responsible for making returns in respect of these obligations through Real Time Information (RTI).

This new approach is illustrated below: [61]



The consultation document had asked about the implications of its proposals for the oil and gas sector, where very many individuals will be working offshore. Respondents raised two particular concerns: first, that the use of 'Joint Operating Agreements' to govern the organisation of oilfields made it very difficult to apply this model – in particular, distinguishing between an end user of the labour, and Intermediary 1:

> 3.23 A number of respondents commented on the problems in applying these two definitions to oil and gas contractual chains due to the prevalence of Joint Ventures (JVs) for the operating of oilfields. Joint oilfield licensee holders will sign a Joint Operating Agreement (JOA) to regulate the organisation of an oilfield between them.
>
> 3.24 As one respondent explained: *"The principal aim of a JOA is to regulate the relationship between the two main classes of parties to the JV: the operator and non-operator. Traditionally, the operator is responsible for performing the day to day operations on behalf of the consortium, while the non-operators are responsible for contributing to the financial commitments and expenses of the joint venture ... In the case of a typical JOA, the operator will be simultaneously a joint principal along with the other parties to the JOA as well as acting agent."*
>
> 3.25 As a result, it is possible, using the definitions in the original proposal, that an oilfield operator could be viewed as both the end user and Intermediary 1, making it difficult to apportion responsibility. Different views were expressed about appropriate definitions and approaches to implementation. It was also suggested that the date legislation would be effective should be delayed for the sector to allow time for further discussion.[62]

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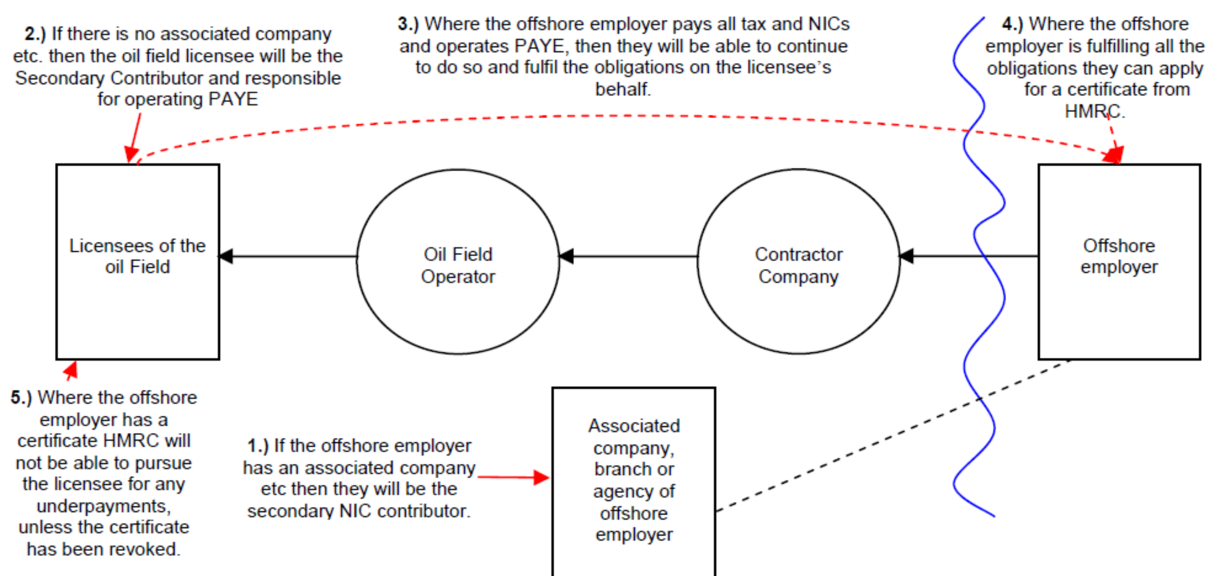
[61] *op.cit.* p10. The document gives a series of worked examples (Annex B, pp22-25).
[62] *op.cit.* pp11-2

The second concern was that the contractural chains in the oil and gas sector were highly complex, with hundreds of contracts and sub-contracts used in a single installation.

As an alternative, the Government proposed specific legislation for this sector. In the first instance, where an offshore employer had a corporate presence in the UK, this entity would assume liability. If this was not the case, the licensee of the oil field would be responsible, but would be able to pass this to the offshore employer if certified by HMRC:

> 3.30 A large proportion of offshore employers in the oil and gas sector retain a presence or have an associated company in the UK. The Government has therefore decided that where the offshore employer has an associated company, agency or branch based in the UK …that associate will be liable for the NICs and tax of their associate offshore employer.
>
> 3.31 In the infrequent cases where there is no associated company, branch, agency or presence in the UK for the offshore employer, the licensees will be responsible for accounting for tax and NICs. The majority of consultation responses from the oil and gas sector, particularly those representing companies in the sector, requested some kind of certification scheme to reduce the administrative burden. This would be similar to the one currently operating in the sector in respect of the payment of tax (under Part 7A, Section 77B-77K, of the *Taxes Management Act (TMA) 1970*). In recognition that the licensees are generally removed from the operation of the oil field and that complex chains of employment would significantly increase the administrative burden on the sector, the Government has agreed to implement a certification scheme.
>
> 3.32 Therefore, where the licensees are responsible, they will be able to ask the offshore employer to fulfil these obligations on their behalf. Where the offshore employer is properly paying and accounting for all tax and NICs obligations, including Secondary Contributions, for its workers, they will be eligible for a certificate from HMRC. Whilst there is a certificate in place the licensees will not be held liable for any failure by the offshore employer. However, HMRC will be able to revoke the certificates by notifying the offshore employer, or their agent, and the licensee in writing. Certificates will be renewable on an annual basis. Once the certificate has been withdrawn the licensee will be responsible for accounting for tax and NICs, including all relevant payments from the date of withdrawal [as illustrated below].[63]



63 *op.cit.* pp12-3. Annex B to the document gives a worked example (pp24-25).

Clause 11 of the Bill allows for the Treasury to bring forward secondary legislation to establish this certification system.

As mentioned above, other elements of this package of reforms are to be delivered *outside* the Bill – either in regulations (for NICs) or in the *Finance Bill 2014* (for tax, and for the new requirements regarding record-keeping and returns). Alongside this Bill the Government has published an updated assessment of the impact of these changes *as a whole* – which put the Exchequer saving from these changes at £80-£90m a year.[64]

3.4 Partnerships (clauses 12-13)

In Budget 2013 the Government announced that it would consult on proposals to prevent the misuse of partnerships for the purposes of tax avoidance; specifically measures to:

- remove the presumption of self-employment for limited liability partnership (LLP) partners, to tackle the disguising of employment relationships through LLPs; and
- counter the artificial allocation of profits to partners (in both LLPs and other partnerships) to achieve a tax advantage.[65]

It was anticipated that these changes would take effect from 6 April 2014. The Budget report estimated that the Exchequer gains would be £125m in 2014/15, rising to £365m in 2015/16.[66] A consultation paper was published on 20 May 2013; the document summarises these two issues as follows:

> **Issue one: Salaried members of LLPs**
>
> Current tax rules mean that individuals who are members of an LLP are taxed as if they are partners in a partnership established under *Partnership Act 1890* (traditional partnership) even if they are engaged on terms closer to those of employees. This produces unfairness in the tax system as an individual member of an LLP who is treated as a partner receives more favourable treatment of income tax and National Insurance Contributions ("employment taxes") than an individual who is an employee engaged on similar terms. As a result, LLPs can be used to disguise employment and to avoid employment taxes … If left unchecked, these arrangements will continue to distort the LLP purpose and ultimately threaten its future use.
>
> To preserve fairness and prevent avoidance through LLPs, the Government will make changes to employment taxes rules to:
>
> a) remove the presumption that all individual LLP members are treated as partners and hence self-employed for tax purposes; and
>
> b) set out the factors which will be taken into account in deciding whether an individual member of an LLP should be treated as an employee for the purposes of employment taxes ....

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[64] HMRC, H*Offshore Employment Intermediaries: proposed NICs changes for Oil and Gas Workers*H, October 2013. These estimates are unchanged from Budget 2013: HC 1033, March 2013 p65 (Table 2.1 – item 46).

[65] HHC 1033, March 2013 para 1.HH209

[66] HHC 1033, March 2013 p65H (Table 2.1 – item 47). See also, HM Treasury, H*Budget 2013 – policy costings*H, March 2013 p44. The projected yield is estimated to be £285m by 2017/18.

Issue two: Allocation of partnership and LLP profits and losses

> The second area of review, partnership allocations, concerns schemes where partnerships allocate profits or losses in order to reduce tax. These schemes often involve partnerships (not just LLPs) where there is a mixture of individual and company members. The Government's objective is that tax advantages will not arise where there are inappropriate partnership allocations to a company or similar vehicle.
>
> The partnership model allows significant flexibility in the way that profits and losses are allocated to partners and members of LLPs. In this context, the term "partnership" refers to general and limited partnerships as well as LLPs …
>
> HMRC is seeing increasing use of particular partnership structures to reduce tax combined with some aggressive interpretations of the law. These include the exploitation of differences between corporation and income tax rates, sheltering tax charges and optimising the use of losses.[67]

It was anticipated that changes to tax law would be made by provisions in the *Finance Bill 2014*, while changes to NICs would be made in the *NICs Bill*. Further to this, the Office of Tax Simplification was commissioned in summer 2013 to review the taxation of partnerships. The review is ongoing but is separate to this issue of avoidance.[68]

During the consultation a separate issue arose relating to the operation of the partnership tax rules. In July 2011 EU Member States agreed new rules to monitor and supervise risks posed by the management of 'Alternative Investment Funds' – such as hedge funds, private equity funds, retail investment funds, investment companies and real estate funds. Member States were required to transpose these rules into national legislation by 22 July 2013. The implementation of the Alternative Investment Fund Managers Directive (AIFMD) in this country is the responsibility of the Financial Conduct Authority (FCA), and the FCA's site has detailed guidance on the timetable for these changes and their impact.[69]

Some respondents raised concerns that the interaction of the AIFMD with the rules for taxing partnerships: specifically, partners could be subject to tax and NICs on certain profits they would be unable to access in the base year because these profits would be deferred for 3-5 years in accordance with the AIFMD rules. The Government now proposes that a statutory mechanism should be introduced to address this issue, without risking avoidance through profit allocation (the second issue raised in the consultation document).[70] Further details of this mechanism were published by the FCA in September 2013.[71]

Clause 12 provides for HM Treasury to introduce regulations, so as to amend Class 4 NICs legislation for this purpose. The explanatory notes to the Bill underline that these will be introduced once the associated income tax rules - to be included in *Finance Bill 2014* - become law.[72] Both the new tax and NICs legislation would take effect from 6 April 2014. **Clause 12** specifies that regulations made for this purpose may have retrospective effect, but cannot have effect before the beginning of the tax year in which they are made.

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[67] H*Partnerships: A review of two aspects of the tax rules*H, 20 May 2013 pp5-6. Further information on these proposals was published on the HGov.uk siteH. For a discussion of the proposals see, "Mixing it up", *Taxation*, 8 August 2013.

[68] The OTS' terms of reference were Hpublished in July 2013H.

[69] The FCA's site has details at: Hhttp://www.fca.org.uk/firms/markets/international-markets/aifmdH

[70] HMRC, H*Partnerships review: proposed NICs changes for (i) Disguised Employment and (ii) Profit Deferral under Alternative Investment Fund Managers Directive (AIFMD)* (Tax Information & Impact Note)H, 15 October 2013

[71] FCA, H*Quarterly consultation: No.2 CP13/9*H, September 2013 (see chapter 14).

[72] Bill 112-EN, October 2013 para 16

Clause 13 relates to the first issue raised in the consultation document: the disguising of employment using LLPs. The consultation document gives more detail as to how the current rules are being misused:

> The original tax policy aim was to place members of LLPs in the same position for tax purposes as partners in a traditional partnership. However, the relevant tax legislation goes further than that by deeming an LLP member to be a partner for all the activities of the LLP.[73] This legislation applies only to LLPs and is the legislative basis for treating LLP members as self-employed in all cases …
>
> There is evidence that the current rules are not producing the desired policy outcome across a range of sectors and income groups. At one end of the scale, groups of low paid workers who would normally be regarded as employees are being taken on as LLP members as a condition for their obtaining work. Unlike becoming a member of a traditional partnership, accession to membership of an LLP is not likely to be seen as a career aspiration or sign of status. This may instead have downsides such as the loss of certain benefits and protections associated with employment. In some cases, employees of a company are being transferred wholesale to the LLP as members.
>
> At the other end of the scale, individuals who would normally be regarded as employees in high-salaried professional areas such as the legal and financial services sectors are benefitting from self-employed status for tax purposes as a consequence of the arrangements in place, which then leads to a loss of employment taxes payable.[74]

The paper proposed that a new test for determining if a member of a LLP was a 'salaried member', and thus liable to tax and Class 1 NICs as an employee. Individuals would be classed this way if they met either of two conditions:

> **The first condition:**
>
> *A "salaried member" of an LLP is an individual member of the LLP who, on the assumption that the LLP is carried on as a partnership by two or more members of the LLP, would be regarded as employed by that partnership.*
>
> Whether this condition is met would be determined by reference to normal tests, as set out in the Employment Status Manual published on the HMRC website[75] …
>
> **The second condition:**
>
> *A "salaried member" of an LLP includes an individual member of the LLP who does not meet the first condition but who:*
>
> *(a) has no economic risk (loss of capital or repayment of drawings) in the event that the LLP makes a loss or is wound up;*
>
> *(b) is not entitled to a share of the profits; and*
>
> *(c) is not entitled to a share of any surplus assets on a winding-up.*[76]

The paper gave some examples of how these rules would apply in practice:

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[73] For example, section 863 of *Income Tax (Trading and Other Income) Act 2005*

[74] H*Partnerships: A review of two aspects of the tax rules*H, 20 May 2013 p9

[75] This Manual is HonlineH; guidance on determining a person's employment status is set out from Hpara0500H.

[76] *op.cit.* pp10-11

Example 1: Member A receives a salary of £200,000. This is guaranteed so it is payable irrespective of the level of profits or losses. There is no requirement to contribute capital, no right to participate in profits and no requirement to repay salary in the event that the partnership is not profitable for the period of account. On the facts given, Member A is a salaried partner.

Example 2: Member B receives a salary of £50,000, which may be reduced if the profits are insufficient to pay all the agreed members' salaries. In addition, Member B receives a 10% share of profits remaining after members' salaries have been paid. Member B is genuinely exposed to the risk of loss of entitlement to the salary and enjoys the prospect of benefitting from partnership profits. Accordingly, Member B is not a salaried partner.

Example 3: The facts are as for Example 1, but in addition, Member A will receive 10% share of the profits if the profits exceed a figure that is many times the actual turnover of the business. The intention is that Member A will only ever receive the guaranteed salary, and the profit-sharing entitlement is intended to prevent the legislation from applying. On the facts given, Member A is a salaried member.[77]

As with the reforms to the tax and NICs treatment of offshore employers – of which **clause 11** is just one element - **clause 13** makes one, limited change, as part of this package of measures.

Section 4(4) of the *Limited Liability Partnerships Act (LLPA) 2000* provides that a member of an LLP shall not be regarded as an employee "unless, if he and the other members were partners in a partnership, he would be regarded for that purpose as employed by the partnership." **Clause 13** amends s2 of the *Social Security Contributions & Benefits Act (SSCBA) 1992* - which provides for individuals to be categorised as either employees or self-employed for the purposes of NICs – to disapply s4(4) of *LLPA 2000* for the purposes of the Act. An equivalent amendment is made to the legislation which establishes the NI system in Northern Ireland.

To date the Government has not published a summary of the responses it had to the consultation, though it has confirmed that draft tax legislation will be published in the autumn, with a separate tax information and impact note.[78]

3.5 Other provisions / general (clauses 14-20)

Clauses 14-17 of the Bill make a number of miscellaneous changes to NICs. Each of these measures were included in the draft version of the Bill published in July 2013, and do not appear to have raised any substantive concerns from respondents.

Clause 14 amends an expression used in NICs legislation to clarify the law as to who is to be regarded as an "employed earner". Section 2(1)(a) of the *Social Security Contributions & Benefits Act (SSCBA) 1992* defines this term as "a person who is gainfully employed in Great Britain either under a contract of service, or in an office (including elective office) with *general earnings*" (*emphasis added*). **Clause 14** removes the word "general", from this expression; consequential amendments are made to other legislation by **Schedule 2**.

HMRC state that this amendment is "to make clear that in order to be regarded as an employed earner, an office holder has to be in receipt of earnings as defined for NICs

[77] *op.cit.* p12
[78] H*Partnerships review: proposed NICs changes* (Tax Information & Impact Note)H, 15 October 2013

purposes and gainfully employed in either Great Britain or Northern Ireland." The term "earnings" is defined for NICs purposes by s3(1) of *SSCBA 1992*, as "any remuneration or profit derived from employment." The change is not anticipated to have any significant revenue impact.[79] This change would come into force two months after Royal Assent (**clause 14(4)**). The term "general earnings" was coined as part of the Tax Law Rewrite Project, allowing the more archaic term "emoluments" to be dropped. In turn NICs law was revised in line with this word change.[80]

Clause 15 retrospectively disregards Armed Forces early departure payments (EDPs) from liability for NICs in the tax years 2005/06 to 2012/13 inclusive. Certain payments and grants paid to members of the armed forces are disregarded as 'earnings' for the purposes of NICs.[81] In April 2005 the Ministry of Defence introduced a scheme for 'early departure payments' (EDPs): the scheme provides a framework for making payments to qualifying service personnel who leave the armed forces between the age of 40 and the pension age for MoD personnel specified in the Armed Forces Pension Scheme.[82]

These payments were not liable to NICs when introduced. However, changes to the NICs treatment of pension schemes made from April 2006 had the effect of requiring a specific exemption for NICs to be provided for in legislation. In March 2013 the Government confirmed that this change would be made by secondary legislation, with effect from 6 April 2013.[83] **Clause 15** backdates this disregard to 6 April 2005. This change is not anticipated to have any significant revenue impact. HMRC noted that "the total number of individuals who have received payment under the scheme from 2006/07 to June 2012 is 2,374. The impact of these individuals' benefit entitlement by removing EDPs from the scope of NICs is considered to be negligible.[84]

Clause 16 repeals two reliefs relating to Class 4 NICs that are considered to be redundant. In March 2011 the Office of Tax Simplification published a survey of current tax reliefs, in which it made the case for abolishing a number of reliefs which, in its view, were outdated, little used, over complex, or in some other way unnecessary.[85]

In the 2011 Budget the Government launched a consultation on abolishing a number of these, including one provision relating to Class 4 NICs: self-employed persons were entitled to offset certain losses incurred by themselves or their spouse against the amount of profits chargeable to Class 4 NICs. The relief pre-dated the introduction of independent taxation in 1990, under which all individuals are assessed separately for tax, irrespective of their being married. The consultation paper set out the case for abolishing this particular relief as follows:[86]

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[79] HMRC, H*Changing the definition of 'Employed Earner'* (Tax Information & Impact Note)H, 15 July 2013

[80] HMRC's H*National Insurance Manual*H gives more details on this change: see para NIM00005 "H*Tax law rewrite - implications for national insurance contributions*H".

[81] HMRC's *National Insurance Contributions Manual* gives a list at Hpara 32006H.

[82] Payments are made provided individuals have sufficient years of service in the forces. For more details see, H*Armed forces pension reform, 1995-2005*H, Library standard note SN5892, 4 March 2011 pp12-13.

[83] This was done under reg 40(b) of SI 2013/622.

[84] HMRC, H*Early Departure Payments made to members of the Armed Forces by the MoD* (Tax Information & Impact Note)H, 15 March 2013

[85] Office of Tax Simplification, H*Review of tax reliefs - Final report*H, March 2011 (in the case of the first of the reliefs discussed, see pp183-4).

[86] HM Treasury, H*Consultation on the abolition of 36 tax reliefs*H, March 2011 p28

Relief name & legislative reference	Class 4 NICs – allows deduction in the next tax year of losses incurred in 1989/90 or previous tax year where losses from income other than a trade or profession or vocation: Social Security Contributions Regulations 2001 Sch 2 Para 3
General description of relief	Liability for Class 4 NICs is generally determined on the same amount of profits as is used for income tax, and this allows for certain losses to be deducted in calculating the chargeable amount. For 1989/90 there was a provision that applied for certain losses that arose either to a self-employed person, or their spouse, from income other than that from a trade, profession or vocation to be set off against the amount of profits chargeable to Class 4 NICs. Following the introduction of independent taxation of spouses from 1990/91 (s32 Finance Act 1988), changes were made for 1990/91 onwards so that only the losses of the self employed person (and not their spouse) could be deducted for these purposes. Schedule 2 paragraph 3(3) of the Social Security Contributions & Benefits Act 1992 provided that any losses incurred under the previous rules could be carried forward and used against the Class 4 liability. The relief was a transitional provision and maintained the loss relief determined under previous rules. The loss can be carried forward indefinitely, but must be given against the profits of the earliest year possible.
Rationale for abolishing the relief:	As more than twenty years have elapsed since the latest year in which the relevant losses could have been incurred, the use of this relief is likely to be small; however it may still be relevant in a very small number of cases. The OTS has recommended that the relief should be abolished as the last year in which relevant losses could have been incurred was 1989/90.
Proposed changes and transitional arrangements:	Abolition of this relief will require primary legislation. As a measure on its own, it would not merit a National Insurance Contributions Bill. Therefore abolition of the relief will be taken forward together with other measures that may be included in the next available NICs legislation.
Who is likely to be affected?	We do not anticipate significant impact from the abolition of this relief.
Impact on businesses / employers:	HMRC does not hold records of the relevant self-employed losses from the period. The use of the relief is thought to be minimal, and limited to a very small number of cases. The impact is therefore thought to be negligible.
Impact on individuals:	None
Equalities impact:	We do not expect that there will be any impact on equalities given anticipated negligible impact.
Other impacts:	None
Exchequer impact:	The Exchequer impact of abolishing this relief will be confirmed at a future Budget. We expect it to have a negligible impact on receipts.
Consultation responses sought:	HMRC has no data available relating to the numbers of taxpayers impacted by this relief. The administrative burden is considered to be negligible as the relief is likely to be relevant in only a small number of cases. The consultation provides an opportunity to confirm with taxpayers and accountancy bodies that the relief is no longer relevant.

A summary of the responses was published in December that year. In this case, respondents supported the repeal of this particular relief: "no evidence was provided to contradict the Government's assessment of likely take up going forward. Therefore, the Government's decision to abolish this relief remains."[87]

When the draft Bill was published in July 2013, it included provision to abolish this relief, and a second relief that the Government considered to be redundant as well. Details of this second relief were given in a tax information note:

> Paragraph 9 Schedule 2 *SSCBA* contains a provision that enabled certain losses that arose to a self employed person, from income other than a trade, profession or vocation to be set off against the amount of profits chargeable to Class 4 NICs for the tax year 1989-90 and previous years of assessment. This was a transitional provision and the need for it has now expired. It does though set out the order of set-off for trading losses in calculating the amount of profits of gains on which Class 4 NICs is due. However Para 3(5) Schedule 2 *SSCBA* sets out the allowable reliefs and the order of set-off for Class 4 NICs.[88]

Clause 16 abolishes both these reliefs. It is not anticipated to have any significant revenue impact.

Clause 17 makes minor changes to the *Social Security Contributions and Benefits (Northern Ireland) Act 1992*. The National Insurance system in Northern Ireland matches that in the rest of the UK – as established by the *SSCBA 1992*. However, it has been identified that the former does not provide for the use of the negative procedure in certain circumstances, akin to its use under the *SSCBA 1992*. This clause rectifies that anomaly.[89]

The remaining clauses of the Bill make provision for HMRC's administrative expenses in relation to its provisions (**clause 18**), define abbreviations used in this legislation (**clause 19**), give its short title and specify its territorial extent (**clause 20**).

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[87] H*The abolition of 36 tax reliefs: response to consultation*H, December 2011 p13

[88] H*Class 4 NICs - Repeal of certain Class 4 National Insurance contributions Reliefs* (Tax Information & Impact Note)H, 2 July 2013

[89] HMRC, H*Minor changes to the Social Security Contributions and Benefits (Northern Ireland) Act 1992* (Tax Information & Impact Note)H, 2 July 2013