

# **WELFARE REFORM AND PENSIONS ACT 1999**

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## **EXPLANATORY NOTES**

### **COMMENTARY**

#### *Commentary*

#### **Part III**

#### *Sections 75 and 76: Earnings of workers supplied by service companies etc.*

#### **Background**

Section 75 provides for a new power to counter the risk of avoidance of National Insurance contributions where an individual (the worker) provides personal services through an intermediary. It is intended that the provisions in this Act will be matched by tax legislation that will, in specified circumstances, require the intermediary to operate Pay As You Earn (PAYE) on the payments made to, or in respect of, the worker. The Chancellor of the Exchequer announced in his Budget that these measures would take effect from 6 April 2000. Consequently, the regulations to be made under Section 75 will come into force from that date. Equivalent provisions for Northern Ireland are contained in Section 76.

Section 75 concerns the situation where the worker is engaged by a business (the client) through a third party (such as a service company). In the absence of such a third party, the relationship between a client and a worker would determine the employment status for the purposes of both tax and National Insurance. Liability would then be assessed according to whether the person was employed or self-employed. However, where a worker is engaged through one or more third parties, it is possible to escape any direct contractual relationship between client and worker. This provides scope for the avoidance of tax and National Insurance contributions (NICs).

The powers in section 75 are intended to deal with the situation where the relationship between a client and a worker would be one of employer and employee, but for the intermediary. They provide for a specified amount of the payments made in respect of the worker to be treated as earnings paid to an employee – and therefore liable for NICs. Regulations under the section will ensure that specified amounts will be regarded as paid to the worker for the purposes of primary Class 1 NICs and the intermediary will be liable for the corresponding secondary Class 1 NICs. The regulations will identify how the amount to be treated as earnings paid to the worker will be calculated.

In order to minimise the administrative burden, the Chancellor announced that certain details of the new rules would only be finalised after discussion with representative bodies. An outline of the proposed new rules was circulated to those who had expressed an interest in this measure and there have been a number of discussions with business representatives on the original proposals.

In the light of this consultation, the Paymaster General announced various changes to the proposal on 23 September 1999. The main changes were:

to make the intermediary rather than the client responsible for operating the new rules and deducting and accounting for NICs where required;

to ensure that the conventional test used to distinguish between employment and self-employment for individuals not using intermediaries would also apply in cases covered by the new legislation; and

to allow a deduction for certain expenses in determining the amount of money which is to be treated as earnings subject to Class 1 contributions in cases where the new rules apply.

These new proposals are reflected in the section.

Section 75 will enable NICs regulations to take effect at the same time as the proposed new tax rules without the need for retrospection. It sets out the general powers on the face of the Act and allows for the technical detail to be contained in regulations. This approach is consistent with current social security legislation.

For example, section 4(6) of the Social Security Contributions and Benefits Act 1992 enables regulations to be made for the purpose of treating as earnings certain forms of employee shares (conditional and convertible shares) and the [Social Security \(Contributions\) Regulations 1979 \(S.I. 1979/591\)](#) (“the Contributions Regulations”) provide all the consequential technical detail. Regulation 18 of the Contributions Regulations provides the basis on which the amount of earnings comprised in a payment of conditional or convertible shares is to be ascertained and regulation 19 provides when such shares are to be disregarded from earnings. This section takes the same approach, which also has the advantage that it provides the flexibility to enable changes to be made more easily should the parallel tax provisions or business practice change in the future.

### **Commentary**

*Subsection (1)* sets out the circumstances in which the regulation-making power is to operate. Regulations will set out which arrangements involving a worker hired through an intermediary will be caught by the provision.

The normal range of tests to decide a worker’s status, which have developed through the courts and the principles of common law, will be used to determine whether the relationship between the client and the worker should be subject to the new rules.

Subsection (1) also enables regulations to specify (i) what payments and benefits are to be treated as earnings paid to the worker in respect of employed earner’s employment for the purposes of the Contributions and Benefits Act, and (ii) the extent to which they are to be so treated.

It is intended that regulations will provide that, in addition to payments that are earnings by virtue of section 3 of the Contributions and Benefits Act, payments treated as earnings by virtue of section 4 of that Act (for instance, conditional and convertible shares) will be treated as earnings under this provision.

It is intended that the regulations will prescribe how to calculate the amount to be treated as earnings. This follows the existing practice whereby regulations made under section 3(2) of the Contributions and Benefits Act provide for the calculation of the amount of earnings comprised in specified payments (see regulation 18 of the Contributions Regulations); and regulations made under section 3(3) of that Act specify what payments that are to be exempt from that calculation (see regulation 19 of the Contributions Regulations).

*Subsection (2)* defines the meaning of an “intermediary” for the purposes of the provision. It is intended that regulations should provide for the intermediary to be either the company that employs the worker or a partnership in which he is a partner.

*Subsection (3)* then provides specific, but non-exhaustive, illustrations of what the regulations made under the section may provide.

*These notes refer to the Welfare Reform and Pensions Act 1999  
(c.30) which received Royal Assent on 11 November 1999*

*Subsection (3)(a)* enables regulations to specify that a worker is to be treated as employed in employed earner's employment for the purposes of the Contributions and Benefits Act in respect of his "attributable earnings".

"Attributable earnings" are a specified amount of the "relevant payments and benefits" made or provided in connection with the services the worker performs for the client. They will be a minimum amount, which must be treated as salary paid to the worker by the intermediary within the tax year and subject to Class 1 NICs.

*Subsection (3)(b)* enables the intermediary (whether or not he fulfils the prescribed conditions about residence and presence in Great Britain) to be treated as *the* secondary contributor in respect of the worker's attributable earnings.

*Subsection (3)(c)(i)* enables regulations to specify what deductions are to be made in calculating the amounts on the payments that are treated as earnings paid to the worker in respect of the *services* provided to the client. Regulations would allow for the deduction of certain allowable expenses currently exempt for the purposes of other parts of the Act.

An example of this is found in regulation 18(4)(b) of the Contributions Regulations, where identifiable payments towards expenses incurred by an employee in carrying out his employment are exempted from NICs.

*Subsection (3)(c)(ii)* enables regulations to specify how the amount of earnings that the worker is to be treated as having been paid is to be calculated or estimated. It will be for the intermediary to *calculate* the earnings caught by the provision and what deductions can be made.

*Subsection (3)(d)* enables *regulations* to set out how the worker's "attributable earnings" may be aggregated with any other earnings he has, in order to calculate the full year's NICs liability correctly.

*Subsection (3)(e)* provides for regulations to determine the date by which contributions payable under *the* provision have to be paid and accounted for.

*Subsection (3)(f)* enables regulations to specify how relevant payments and benefits are to be apportioned. It is intended to specify in regulations how an aggregate payment in respect of two or more workers is to be apportioned (including apportionment in cases where one or more of that number would be regarded as in employed earner's employment with the client other than by virtue of the regulations). In circumstances where, at the time of payment, it is not possible for the intermediary to identify the amount attributable to each worker/individual, it is proposed that the regulations will provide for apportionment on a just and reasonable basis, and for contributions to be calculated on the "apportioned" earnings.

This is consistent with the approach found in regulation 18 of the Contributions Regulations. Regulation 18 already includes an apportionment calculation following section 48 of the Social Security Act 1998 (which amended section 3 of the Contributions and Benefits Act by inserting a new subsection (2A)). Paragraph (21) and (24) of regulation 18 of the Contributions Regulations, which were made under the power in the new subsection (2A), specify the basis of apportionment in respect of payments to two or more employed earners in the form of a contribution to an unapproved retirement benefit scheme and a non-cash voucher (paragraphs (21) and (24) respectively).

*Subsection (3)(g)* will enable the worker's employment with an intermediary or otherwise to be disregarded *for* NIC purposes.

*Subsection (3)(h)* enables regulations to be made to ensure that a relevant payment or benefit is not subject to a double National Insurance liability. This may be necessary in cases where an amount to be treated as earnings by virtue of the new rules would otherwise be liable to NICs under other provisions.

*Subsection (3)(i)* enables regulations to specify the extent to which two or more connected persons should be treated as a single person for the purposes of the regulations.

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This is necessary, for example, to deal with cases where a worker is engaged to work for the client via a connected party (such as an associate company), within the meaning of section 839 of the Income and Corporation Taxes Act 1988, and no contract exists between the intermediary and the associate for the worker's services. It is intended that regulations will determine whether the client and the associate are to be treated as single persons and consequently, whether the new rules should apply to them. Regulations may specify persons of any other specified description as being single persons for the purposes of the provision.

*Subsection (3)(j)* will ensure that the new rules are still applicable where the contract is not made by the client but someone "connected" to him.

*Subsection (3)(k)* allows for *regulations* to modify or exclude the application of the new rules.

*Subsection (4)* enables the regulations to set out what expenses may be deducted by the intermediary when calculating a worker's attributable earnings. The Government has proposed that 5 per cent of the intermediary's receipts from relevant engagements should be deducted, to cover general expenses. In addition, any employer's pension contributions to an approved scheme in respect of the worker and any secondary Class 1 contributions paid by the employer will be deductible.

*Subsection (5)* enables regulations to specify that terms and conditions of a contract or arrangement may be disregarded for the purposes of applying the new rules. It is intended to use regulations to ensure that the substance of the relationship will determine whether the worker should be treated as being in employed earner's employment for the purposes of the Contributions and Benefits Act.

*Subsection (7)* ensures that the reference in subsection (1)(a) above to a worker being under an obligation to perform services is carried through.

*Subsection (8)* provides that any regulations made under the provision by the Treasury will require the concurrence of the Secretary of State for Social Security. This reflects the interaction between contributions and contributory benefits. The latter are the responsibility of the Secretary of State.

The regulations implementing this measure will come into force on 6 April 2000 and will parallel the tax clauses due to be introduced in the Finance Bill 2000. However, in order to ensure the simplest possible systems for business to operate, it is necessary to keep the tax and NIC rules in line with each other.

*Subsection (9)* therefore gives a power to enable this section to be adapted by order if the parallel tax provisions change.

There are a number of precedents for a use of this type of power. One example of the modification of primary legislation by order is found in section 10 of the Contributions and Benefits Act. Section 10 provides for a Class 1A contribution to be paid annually by an employer in respect of the provision of a car or fuel to an employee. The Class 1A charge applies where, for any tax year, an income tax benefit is chargeable under Schedule E by virtue of sections 157 and 158 Income and Corporation Taxes Act 1988 (ICTA) in respect of the provision of the car and/or fuel. Section 10 includes a modification power at subsection (7) to enable the Secretary of State to make regulations modifying section 10 where it is necessary or expedient to do so in consequence of any alteration to section 157 and 158 ICTA.

The annual Finance Bill means that changes to the tax legislation could occur annually, subject to Parliamentary approval. There is no equivalent annual legislation available to make changes to primary legislation covering National Insurance contributions. So, without this subsection, it would be difficult to amend the Contributions and Benefits Act to mirror the changes to the Finance Act.