EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY (CONTRIBUTIONS) (AMENDMENT No. 5) REGULATIONS 2014

2014 No. 3196

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs (HMRC) on behalf of the Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 Class 4 National Insurance Contributions (NICs) are charged on profits as they are earned rather than when they are received. An unfunded NICs charge can therefore arise when profits of an individual partner in an Alternative Investment Fund Manager partnership (AIFM firm) are deferred in line with new regulatory requirements. The instrument provides for the deferment of the Class 4 NICs charge in respect of such profits and the imposition of the charge when those profits subsequently vest in individual partners.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 The instrument has retrospective effect to the beginning of the tax year 2014/15. The power to make regulations with retrospective effect is contained in section 18A(3) of the Social Security Contributions and Benefits Act 1992, and section 18A(3) of the Social Security Contributions and Benefits (Northern Ireland) Act 1992 (both inserted by section 13 of the National Insurance Contributions Act 2014).

4. Legislative context

4.1 This instrument has effect for the tax year 2014-15, and all subsequent tax years.

4.2 The instrument modifies the law relating to Class 4 NICs in respect of partners in AIFM firms, to take into account changes to Income Tax (Trading and Other Income) Act (ITTOIA) 2005 made by section 74 of, and Part 3 of Schedule 17 to, the Finance Act 2014.

4.3 The instrument provides that where an AIFM firm elects under section 863H ITTOIA 2005 for the special tax treatment for alternative investment fund managers to apply, and a partner accordingly allocates their profits to the

AIFM firm under section 863I ITTOIA 2005, then no Class 4 contributions are payable at the time of that allocation.

4.4 The instrument then provides that Class 4 contributions are payable when those profits subsequently vest in the individual partner, if that partner is carrying on the AIFM trade at the time of vesting.

5. Territorial extent and application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Financial Secretary to the Treasury, David Gauke, has made the following statement regarding Human Rights:

In my view the provisions of the Social Security (Contributions) (Amendment No. 5) Regulations 2014 are compatible with the Convention rights.

7. Policy background

- **What is being done and why**

7.1 The Partnerships Review measure, which this instrument forms a part of, has two strands: the first deals with the disguising of employment in limited liability partnerships, while the second seeks to prevent tax-motivated allocations of business profits and losses in partnerships with both individual and corporate partners (mixed membership partnerships).

7.2 The interaction of the Alternative Investment Fund Managers Directive (2011/61/EU) (AIFMD) and tax and NICs rules means that partners would be subject to tax and NICs on certain profits they cannot access at the time the liability arises, because these profits will be deferred by 3-5 years in accordance with the AIFMD rules. Legislation introduced in the Finance Act 2014 addresses this issue without allowing AIFMs to make tax-motivated allocations by using mixed membership partnerships. The NICs Act 2014 introduced a new power to allow related changes to be made to the NICs rules.

7.3 If an AIFM firm has made an election for the special tax provisions to apply, a partner in the firm may allocate profits to the firm, and the firm will be liable to income tax at that time. Those allocated profits may subsequently vest in the individual partner, at which time no further tax is payable.

7.4 These Regulations make related changes in relation to NICs, where an AIFM firm has made an election for the special tax provisions to apply. The Regulations provide that no Class 4 NICs will be charged on the allocation of the profits to the firm. However, Class 4 NICs will be charged when the allocated profit vests in the individual partner.

- **Consolidation**

7.5 There are currently no plans to consolidate the instrument that is being amended.

8. Consultation outcome

8.1 HMRC carried out a formal consultation between May and August 2013 on changing certain partnership tax rules - *Partnerships: A review of two aspects of the tax rules:* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/200503/130520_Pships_Condoc_FinalVersion.pdf.

8.2 About 110 responses were received. The new AIFM mechanism proposed in the consultation document was very well received.

8.3 A response document was published on 10 December 2013 (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/264652/partnerships_-_a_review_of_two_aspect_of_the_tax_rules.pdf) alongside draft Finance Bill 2014 legislation.

8.4 Technical consultation on this draft legislation concluded on 4 February 2014. Revised draft legislation was introduced to Parliament in Finance Bill 2014 on March 2014, and Royal Assent was received on 17 July 2014.

8.5 These draft Regulations were published for technical consultation on 11 December 2013 which concluded on 5 March 2014. No responses were received.

9. Guidance

9.1 The latest guidance on the new partnerships legislation made as part of the Finance Act 2014 was published on 27 March 2014 and is available on the GOV.UK website: https://www.gov.uk/government/publications/mixed-membership-partnership-aifms-and-asset-disposal-rules-legislation-day-technical-note-and-guidance. That guidance also covers the NICs changes made by this instrument.

10. Impact

10.1 There will only be an impact on alternative investment managers who operate as partnerships. The Partnerships Review measure comprises a number of elements which will bring in total tax and NICs revenue of £3.27 billion over the forecast period to 2018-19.

10.2 A Tax Information and Impact Note covering this instrument was published on 5 December 2013 and is available on the HMRC website at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/263833/131205_NICs_Bill_Partnerships_TIIN.DOC. This remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 This statutory instrument will impact across alternative investment fund managers which operate as partnerships and this can include small business. It would not be fair to exclude small businesses from using the new mechanism.

12. Monitoring and review

12.1 The purpose of this instrument is to defer a Class 4 contributions charge on individual partners until the time when profits are vested in them.

12.2 HMRC will monitor the effectiveness of this instrument to ensure the Government objectives are met.

13. Contact

13.1 Adrian Dixon at HMRC (Tel: 03000 586934 or email: Adrian.Dixon@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.