

NEC CONTRACTS



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A closer look at employer National Insurance contributions in relation to NEC

National Insurance (NI) was created by the National Insurance Act 1911 and has continued to be a fundamental part of the welfare state in the United Kingdom. Payment of NI contributions creates an entitlement to receive certain benefits, primarily the state pension.

Change in the law

During the 2024 budget, the chancellor announced several changes to employer NI contributions for the 2025/26 financial year. In summary, these were:

- Employer NI contributions would be charged at a rate of 15% (up from 13.8%),
- A reduction to the secondary threshold levels for NI category A employees, from a yearly equivalent of £9,100 to £5,000 per year,
- An increase in the employment allowance from £5,000 to £10,500,
- Removal of the employment allowance eligibility threshold of £100,000.

Legislation

Most measures relating to taxation, including introducing new taxes, are legislated in the Finance Bill, although this is different for NI contributions as they are not paid into the government's consolidated fund for general taxation but into the National Insurance Fund, which, by constitutional convention, requires any changes to be made by separate legislation.

Consequently, on 13 November 2024 the 'National Insurance Contributions (Secondary Class 1 Contributions) Bill' was introduced to Parliament. Following numerous proposed amendments from the House of Lords, with final consideration and response to these, the bill received Royal Assent on 03 April 2025 to become an Act of Parliament.

Date of law change

A change in the law occurs when the formally recognised procedure for making such changes has been officially concluded, which for an Act of Parliament would be when it receives Royal Assent. This position may differ where secondary legislation, in the form of a commencement order or regulation, is required to give effect to a provision within an act, although for the changes to employer NI contributions this is not the case, with the date of change in the law being 03 April 2025.

NEC contracts

An NEC contract mechanism that expressly relates to changes in the law is option X2. Where this option applies to an NEC contract and is selected to be a condition of contract, then where a change in the law of the country occurs after the contract (or subcontract) date, and the law applies to the location stated, then option X2 states that the change in the law is automatically a compensation event.

As option X2 expressly states that changes to the law are compensation events, it is unclear whether lack of notification would cause the 'time bar' provisions, under clause 61.3, to apply (for the NEC4 ALC contract this does not apply). Unlike the list of events listed in clause 60.1, which require notification to turn the events into compensation events, in option X2 it is stated that a change in the law is already a compensation event.

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NEC contracts and the changes to employer NI contributions

How the employer NI contribution changes are dealt with under NEC4 contracts is dependent upon several important factors, including:

- The form of NEC contract.
- What main option, where applicable, is chosen.
- The selection of certain X options.

Taking account of the above information, there are numerous ways by which the change to employer NI contributions may affect the administration of an NEC4 contract.

1: Paid as part of the amount due

This would be the case with the following NEC contracts, irrespective of what X options are selected:

- Engineering and Construction Contract (ECC) with main option E.
- Engineering and Construction Subcontract (ECS) with main option E.
- Professional Service Contract (PSC) with main option E.
- Professional Service Subcontract (PSS) with main option E.
- Term Service Contract (TSC) with main option E.
- Term Service Subcontract (TSS) with main option E.
- Facilities Management Contract (FMC) with main option E.
- Facilities Management Subcontract (FMS) with main option E.

All of these contracts use the schedule of cost components (SoCC) to assess defined cost to determine the amount due. The SoCC includes component 13 (i), (or 11(a) for the PSC and PSS), which is for 'contributions, levies or taxes imposed by law', that would include employer NI contributions.

2: Paid as part of the amount due – but with a share adjustment

This scenario would apply to the following NEC contracts, notwithstanding any X options that are selected:

- ECC, ECS, PSC, PSS, TSC, TSS, FMC and FMS, all with main option C.
- ECC and ECS, both with main option D.
- Alliance Contract (ALC).

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This is similar to scenario 1 above although the total amount assessed for payment would be subject to a share calculation – also assuming that the FMC, FMS and ALC contracts include a share calculation within the performance table.

3: Adjustments made under option X2

This would apply to the following NEC contracts:

- ECC, ECS, PSC, PSS, TSC, TSS, FMC and FMS, all with main option C.
- ECC and ECS, both with main option D.
- ALC.

For these NEC contracts, the assessed and implemented amount of a corresponding compensation event changes the prices or budget (ALC).

Note that for option E contracts there may also be a corresponding assessment and implementation under option X2 which would increase the prices, although there is no correlation here with the amount paid.

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People rates

An issue to consider is where NEC contracts specifically use people rates, as the outcome under option X2 would be different.

People rates is a defined term and is used with certain NEC4 contracts to assess defined cost for a compensation event, as follows:

- ECC, ECS, PSC, PSS, TSC, TSS, FMC and FMS, all with main option A.
- ECC and ECS, both with main option B.
- Supply Contract (SC).
- Design Build and Operate Contract (DBOC).
- Engineering and Construction Short Contract (ECSC).
- Engineering and Construction Short Subcontract (ECSS).
- Professional Service Short Contract (PSSC).
- Term Service Short Contract (TSSC).
- Facilities Management Short Contract (FMSC).
- Facilities Management Short Subcontract (FMSS).
- Supply Short Contract (SSC).

Where people rates apply there is an entry in the contract (or subcontract) data that is populated with information relating to the category of person, applicable unit and rate for that person. The people rates are used either in accordance with the definition of defined cost or with the short schedule of cost components, whichever is stated to apply.

Option X2 may be selected for the following contracts that use people rates:

- ECC, ECS, PSC, PSS, TSC, TSS, FMC and FMS, all with main option A.
- ECC and ECS, both with main option B.
- SC.

The DBOC contract does not include option X2, although the procedure is included as a compensation event at clause 60.1 (15), which operates in a similar way. Part of the defined term for people rates expressly states 'unless later changed in accordance with the contract' (or subcontract). This phrase is specifically used in relation to more than 20 defined terms throughout the NEC4 contracts, including service areas, activity schedule, incentive schedule, performance table, client's requirements and key dates.

Where the phrase is included within a defined term, the contract specifically provides for when and how a change occurs. For people rates, the contract only provides for such a change within the compensation event procedure in relation to the inclusion of a new category of person.

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The change to the employer NI contributions would affect a component part of the people rates, although a compensation event for changes in the law under option X2 would not result in an assessment of people cost unless a new category of person is included where the rate incorporates this change.

4: Option X1 with no option X2

Where option X1 has been selected then a price adjustment for inflation (PAF) calculation is made – which is used as follows:

To determine an amount for price adjustment to be paid.

- ECC, ECS, PSC and PSS, all with main option A.
- ECC and ECS, both with main option B.
- SC.

To calculate an amount for price adjustment which is added to the prices – used to assess a share amount.

- ECC, ECS, PSC and PSS, all with main option C.
- ECC and ECS, both with main option D.

To change the rates and prices using the PAF calculation – used for payment assessments.

- TSC, TSS, FMC and FMS, all with main option A.

To change the rates and prices using the PAF calculation – used to assess a share amount.

- TSC, TSS, FMC and FMS, all with main option C.

Certain NEC contracts do not include option X1, although a price adjustment for inflation procedure is found within the core contract conditions, as follows:

- Clause 52 – TSSC, FMSC and FMSS, (note that the procedure is optional).
- Clause 54 – DBOC.

An increase in the employer NI contributions may influence a PAF calculation under option X1, although the extent would be determined by the indices chosen, the proportions specified and how a PAF calculation is applied.

The actual 'value' associated with this would be exceptionally difficult to ascertain, not least because it is not generally known how the indices are actually determined.

5: Option X1 and option X2

Where a contract includes people rates to determine defined cost then a compensation event under option X2 would not provide for an assessment of people cost. For other contracts, however, the procedural mechanism under both option X1 and option X2 could be applied, which would relate to the following contracts:

- ECC, ECS, PSC, PSS, TSC, TSS, FMC and FMS, all with main option C.
- ECC and ECS, both with main option D.

It has been suggested that as a PAF calculation may include for the effects of a change in employer NI contributions, then it cannot be 'additionally recovered' via a corresponding compensation event under option X2. Both options, however, serve a particular purpose under the contract and are applied independently of one another.

Although the procedural outcome of both options is the same for certain contracts, that is where the prices are changed, the respective procedures to determine the outcome values are very different. The only connection between option X1 and option X2 is the requirement for compensation event prices to relate to a specific point in time, as detailed in clause X1.5.

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Conclusion

Any entitlement, in relation to the increase in employer NI contributions, depends upon the form of NEC4 contract, the main option chosen, where applicable what X options are selected, whether the form of contract provides for this change and whether the contract procedures conclude in some form of compensation.

Notwithstanding the contract issues, the calculation in relation to employer NI contributions is not straightforward and may be complicated by numerous factors, including:

- Employees with different NI category allocations.
- Calculation of class 1A and 1B NI contributions.
- How the law change affects people who are not directly employed, including consultants and agency workers, where people may operate through either a limited company or a managed service ('umbrella') arrangement.
- A corresponding assessment for subcontractors or subsubcontractors.
- How the employment allowance is factored into a calculation.
- Issues of confidentiality.

Consideration of the issues noted is required to determine what entitlement may exist under a particular form of NEC4 contract and whether the relevant contract procedure provides for this.

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