EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY (CONTRIBUTIONS) (AMENDMENT NO. 2) REGULATIONS 2011

2011 No. [XXXX]

1. This explanatory memorandum has been prepared by H.M. Revenue and Customs and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

The purpose of this Statutory Instrument is to specify the levels of the Lower Earnings Limit (LEL) and Upper Earnings Limits (UEL) and the Primary Threshold (PT) and Secondary Threshold (ST) for Class 1 National Insurance contributions (NICs) for the tax year beginning 6 April 2011. The instrument also sets the monthly and annual prescribed equivalents of the UEL, PT and ST and specifies the reduced rate of primary contributions payable by eligible married women and widows.

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

This is the first use of the affirmative procedure for the setting of the LEL under section 176(1)(za) of the Social Security Contributions and Benefits Act 1992 and the Northern Ireland equivalent.

4. Legislative Context

4.1 This affirmative instrument is being made to give effect to the annual re-rating of the weekly limits and thresholds for NICs. It increases the level of the LEL, reduces the level of the UEL and increases both the level of the PT and ST for the purposes of calculating the amount of Class 1 NICs due for the tax year 2011-12.

4.2 It specifies the prescribed equivalents of the Class 1 NICs limits and thresholds for those earners who are paid otherwise than weekly.

4.3 It also increases the reduced rate of main primary percentage Class 1 contributions that are payable by eligible married women and widows. This increase reflects the increase that is being made to the main primary percentage of Class 1 contributions for other earners in the National Insurance Contributions Bill 2010.

4.4 This instrument is being made at the same time as the Social Security (Contributions) (Re-rating) Order 2011, which is an affirmative instrument that brings into force the annual re-rating of National Insurance rates and thresholds for Class 2, Class 3 and Class 4 NICs.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Exchequer 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. 2) Regulations 2011 are compatible with the Convention rights."

7. Policy background

- ***What is being done and why***

7.1 In the Pre-Budget Report of 24 November 2008 the previous Chancellor of the Exchequer announced an increase of 0.5% to the rates of Class 1 and 4 NICs paid by employers, employees and the self-employed from 6 April 2011. In the Pre-Budget Report on 9 December 2009 the previous Chancellor announced a doubling of the previously announced increases. Following the 2010 General Election the full 1% increase in each of the Class 1 and 4 NICs rates was confirmed by the Government in the Emergency Budget on 22 June 2010. At the same time it was announced that the PT and ST would increase by amounts above indexation in order to mitigate the effects of the 1% rise in rates on the lower paid and on employers.

7.2 In the Emergency Budget it was also announced that the income tax personal allowance would increase to £7,475 for the tax year 2011-12. To restrict the benefit of the increased personal allowance to basic rate tax payers only and to maintain previously secured tax and NICs alignment, the Emergency Budget also included an announcement that the basic rate limit for income tax and the UEL for Class 1 NICs would be reduced.

7.3 The NICs rates, limits and thresholds for the tax year 2011-12 were announced on 2 December 2010 by a Written Ministerial Statement (*Hansard – Written Ministerial Statements 2 December: Column 85WS)*. This instrument gives effect to the changes to the LEL, UEL, PT and ST for Class 1 NICs and the prescribed equivalents.

7.4 Section 5 of the Social Security Contributions and Benefits Act 1992, as amended by paragraph 1 of Schedule 9 to the Welfare Reform and Pensions Act 1999 requires that the earnings limits and thresholds for Class 1 NICs are specified for Great Britain for each tax year. Similarly Section 5 of the Social Security Contributions and Benefits (Northern Ireland) Act 1992, as amended by paragraph 1 of Schedule 10 to the Welfare Reform and Pensions Act 1999 requires that the earnings limits and thresholds for Class 1 NICs are specified for Northern Ireland.

7.5 Employees contributions are payable at the main primary percentage (currently 11%) on earnings between the PT and the UEL. Class 1 employee NICs have also been due at the additional primary percentage (currently 1%) on all earnings exceeding the UEL. The National Insurance Contributions Bill 2010 includes provisions to increase from 6 April 2011 the main primary percentage to 12% and the additional primary percentage rate to 2%.

7.6 Employers pay Class 1 NICs on their employees' earnings above the ST at a single percentage rate (currently 12.8%). There is no upper limit for payment of employers' NICs. The National Insurance Contributions Bill 2010 includes provisions to increase from 6 April 2011 the secondary percentage to 13.8%.

7.7 The LEL which is the level of earnings at which entitlement to contributory benefits begins to accrue has been legislatively linked to the amount of basic State Pension since 1975. However, the Pensions Act 2007 committed the Government to increasing the basic State Pension by earnings before what at the time would have been the end of the next Parliament (and what is now the current Parliament) at the latest. Without consequential changes to the manner in which the LEL is set each year a large increase in the basic State Pension (triggered by re-establishment of the earnings link) could result in a large number of low paid workers being taken out of benefit entitlement altogether. This potential problem was resolved by arranging for the removal of the statutory link between the LEL and the level of the basic State Pension. Sections 7 and 8 of the Pensions Act 2007 amended Section 5 of the Social Security Contributions and Benefits Act 1992 and the Social Security Contributions and Benefits (Northern Ireland) Act 1992 respectively and allowed the Treasury through affirmative regulations to set the level of the LEL without fetter when the earnings link was restored.

7.8 In the Emergency Budget on 22 June 2010 the Chancellor announced that from April 2011 the basic State Pension will be re-linked to earnings and that pensioners would be protected by a guarantee that the basic State Pension would rise in line with earnings, prices or a 2.5 per cent increase – whichever is the greater. Following the removal of the statutory link between the LEL and basic State Pension these regulations increase the LEL to £102 per week.

7.9 The PT and ST are currently aligned at £110. The PT is increased to £139 per week for 2011-12. The ST is increased to £136 for 2011-12.

7.10 Since April 2009 the UEL has been aligned with the level at which the higher rate of income tax is payable. Changes were made to Section 5 of the Social Security Contributions and Benefit Act 1992 and Section 5 of the Social Security Contributions and Benefits (Northern Ireland) Act 1992 by Sections 1 and 2 of the National Insurance Contributions Act 2008 respectively to achieve this alignment. The UEL for the tax year 2011-12 was confirmed as £817 per week, involving a reduction on the previous year's level in order to maintain the alignment between the level at which the higher rate of income tax is payable and the UEL.

7.11 These regulations include prescribed equivalents of the PT, ST and UEL where the earnings period is a month or a year. The monthly and annual equivalents of the UEL are £3,540 and £42,475 respectively. The monthly and annual prescribed equivalents of the PT are £602 and £7,225 respectively. The monthly and annual prescribed equivalents of the ST are £589 and £7,072 respectively. The prescribed equivalents of the LEL are calculated by formula already provided for in the Social Security (Contributions) Regulations 2001 (S.I. 2001 No. 1004).

7.12 These regulations also increase the reduced rate of main rate primary contributions to 5.85% for women who were married or widowed on 10 April 1977 and are eligible to pay a reduced rate of main rate primary contributions.

- ***Consolidation***

7.13 These amendments will make only a small amendment to the Social Security (Contributions) Regulations 2001 which are very large and complex (the printed text ran to around 150 pages in 2001). H.M. Revenue and Customs has no current plans to consolidate these Regulations. On the last occasion it was a task involving 18 months work and contributions from four different Government departments.

8. Consultation outcome

No consultation has been undertaken.

9. Guidance

9.1 These Regulations do not impose any new obligation.

9.2 The NICs Rates and Thresholds for 2011-12 were announced on 2 December 2010 in a Written Ministerial Statement and can be found on HMRC's website.

10. Impact

10.1 There is no impact on business, charities or voluntary bodies.

10.2 There is no impact on the public sector.

10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 To minimise the impact of the requirements on firms employing up to and including 9 employees, the approach taken is as follows. There will be a 2011-12 P11 calculator on HMRC's Basic PAYE Tools (formerly available on the Employer CD-ROM) at www.businesslink.gov.uk/basicpayetools. This is provided free of charge and will contain the new limits and thresholds and which will minimise the burden on employers if they choose to take advantage of it. Small businesses will need to acquaint themselves with the new limits and thresholds in order to calculate their National Insurance liabilities for the 2011-12 tax year.

12. Monitoring & review

These Regulations make changes to existing rates and thresholds and are usually reviewed annually.

13. Contact

Hasan Mustafa at HM Revenue & Customs, Tel: 0207 147 2508 or e-mail: hasan.mustafa@hmrc.gsi.gov.uk can answer any queries regarding the instrument.