EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY (CONTRIBUTIONS) (RE-RATING) ORDER 2012

2012 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

2.1 The purpose of this Statutory Instrument is to specify the rates of Class 2 and Class 3 National Insurance contributions (NICs) and the amount of earnings below which an earner may be excepted from liability for Class 2 contributions.

2.2 The Order also specifies the Lower Profits Limit (LPL) for Class 4 NICs payable at the main Class 4 percentage rate.

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

None.

4. Legislative Context

4.1 In each tax year the Treasury is required, by section 141 of the Social Security Administration Act 1992 ("the Administration Act"), to conduct a review of the general level of earnings in Great Britain taking into account changes in that level since their last review with a view to determining whether an order should be made under that section to have effect for the following tax year.

4.2 It is a condition precedent to laying such an order under section 141 of the Administration Act that a copy of a report by the Government Actuary or the Deputy Government Actuary be laid before Parliament on the effect which, in that Actuary's opinion, the making of the order would have on the National Insurance Fund. A copy of the report can be found on the Government Actuary's Department website at http://www.gad.gov.uk/Publications/index.html. If an order is made under section 141 of the Administration Act, the order may also make a corresponding provision for Northern Ireland under section 129 of the Social Security Administration (Northern Ireland) Act 1992.

4.3 The report also covers the effect of the draft Social Security (Contributions) (Limits and Thresholds) (Amendment) Regulations 2012 No**.0000** which specifies the levels of the Lower and Upper Earnings Limits and the Primary and Secondary Thresholds for Class 1 NICs for 2012-13. The prescribed equivalents of the Primary and Secondary Thresholds where the earnings period is a month or a year are also specified in those regulations.

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) (Re-rating) Order 2012 are compatible with the Convention rights."

7. Policy background

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

7.1 In the Budget on 23 March 2011 it was announced that the basis for indexation of the NICs rates, limits and thresholds would be by reference to the Consumer Price Index (CPI). The exceptions are as follows: the Secondary Threshold (the point at which employers start to pay NICs) which will continue to be set by reference to the Retail Price Index (RPI); and the Upper Earning Limit / Upper Profits Limit (UPL) which will continue to be aligned with the point at which higher rate tax is paid. For September 2011, the rates of the CPI and RPI were 5.2% and 5.6% respectively.

7.2 Class 2 contributions are payable by the self-employed and are a flat rate weekly contribution. This Order increases the rate of Class 2 contributions to £2.65 per week.

7.3 Self-employed earners whose earnings from self employment are below the Small Earnings Exception can apply to be exempt from the payment of Class 2 contributions. The Small Earnings Exception is increased to £5,595 per year.

7.4 Class 4 contributions are payable in addition to Class 2 contributions by those who are self-employed earners and whose taxable profits exceed the LPL. Class 4 contributions are payable at the main Class 4 percentage rate (currently 9%) on profits between the LPL and UPL and at the additional Class 4 percentage rate (currently 2%) on all profits above the UPL.

7.5 The LPL is increased to £7,605 from 6 April 2012 in line with the CPI. The UPL is set at the same level as the Upper Earnings Limit for Class 1 contributions and is being kept at £42,475 to maintain alignment both with the Upper Earnings Limit and with the point at which higher rate income tax becomes payable and so is not to be changed by this Order.

7.6 Class 3 contributions are payable on a voluntary basis and are also a flat rate weekly contribution. Class 3 contributions are payable by those who wish to protect their entitlement to certain contributory benefits. This Order increases the rate of Class 3 contributions to £13.25 per week.

8. Consultation outcome

No consultation has been undertaken. This instrument relates to routine changes to limits, rates and thresholds as part of the annual NICs re-rating exercise.

9. Guidance

9.1 This Order does not impose a new obligation.

9.2 The NICs Rates and Thresholds for 2012-13 were announced on 29 November 2011 in the Autumn Statement and can be found on HMRC's website.

10. Impact

A Tax Information and Impact Note covering this instrument was published on the 23 March 2011 alongside Budget 2011. This has been updated as a result of changes to the impacts as a result of this instrument and is available on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm.

11. Regulating small business

The changes to the Small Earnings Exception, Class 2 rate and Class 4 limits in this Order apply to small businesses in so far as the proprietor(s) are self employed. These changes have no impact on employees.

12. Monitoring & review

Section 141 of the Administration Act requires the Treasury to conduct in each tax year a review of the level of general earnings in Great Britain. This Order makes changes to existing limits and thresholds as a result of that review and will not be subject to any further or specific monitoring and review.

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.