EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY (CONTRIBUTIONS) (RATES, LIMITS AND THRESHOLDS AMENDMENTS AND NATIONAL INSURANCE FUNDS PAYMENTS) REGULATIONS 2020

2020 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Revenue and Customs on behalf of HM Treasury and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument gives effect to the annual re-rating of various National Insurance contributions (NICs) rates, limits and thresholds for the purposes of calculating Class 1, Class 2, Class 3 and Class 4 NICs liability (or voluntary payment) for the tax year beginning 6 April 2020. It also allows for payment of a Treasury Grant not exceeding 5 per cent of the estimated benefit expenditure for the 2020-21 tax year to be made into the National Insurance Fund, and makes corresponding provision for Northern Ireland.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 The territorial application of this instrument varies between provisions.

3.3 The powers under which this instrument is made cover the entire United Kingdom (see section 177 of the Social Security Contributions and Benefits Act 1992 ("the Contributions Act"), section 173 of the Social Security Contributions and Benefits (Northern Ireland) Act 1992 ("the Northern Ireland Contributions Act"), section 192 of the Social Security Administration Act 1992 ("the Administration Act"), section 168 of the Social Security Administration (Northern Ireland) Act 1992 ("the Northern Ireland Administration Act") and section 5 of the Social Security Act 1993) and the territorial application of this instrument is not limited either by the respective Acts or by this instrument.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the United Kingdom.

4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

5.1 The Financial Secretary to the Treasury, Jesse Norman MP, has made the following statement regarding Human Rights:

"In my view the provisions of the Social Security (Contributions) (Rates, Limits and Thresholds Amendments and National Insurance Funds Payments) Regulations 2020 are compatible with the Convention rights."

6. Legislative Context

6.1 This instrument is being made to effect the annual re-rating of NICs rates, limits and thresholds. It specifies:

- the rate of Class 2 contributions that are payable by the self-employed;
- the small profits threshold (SPT), which is the level of taxable profits at which the self-employed become liable to pay Class 2 NICs;
- the rate of Class 3 contributions, which eligible persons can choose to pay to satisfy the conditions for certain contributory benefits;
- the lower profits limit (LPL), which is the level of profits at which the self-employed begin to pay Class 4 NICs at the main Class 4 percentage rate;
- the upper profits limit (UPL), which is the level of profits at which the self-employed begin to pay Class 4 NICs at the additional percentage rate;
- the lower earnings limit (LEL), which is the level of earnings at which employees start to gain access to certain contributory benefits;
- the primary threshold (PT), which is the level of earnings above which employees begin to pay primary Class 1 NICs (known as "employee contributions") at the main percentage rate;
- the upper earnings limit (UEL), which is the level of earnings above which employees begin to pay primary Class 1 NICs at the additional percentage rate;
- the secondary threshold (ST), which is the level above which employers begin to pay secondary Class 1 NICs (known as "employer contributions") in respect of their employees' earnings;
- the upper secondary threshold (UST), which is the level of earnings above which employers of employees under the age of 21 are no longer eligible for the age-related secondary percentage of Class 1 NICs, which is 0%;
- the apprentice upper secondary threshold (AUST), which is the level of earnings above which employers of relevant apprentices under the age of 25 are no longer eligible for the apprentice-related secondary percentage of Class 1 NICs, which is 0%;
- and the prescribed equivalents of the LEL, UEL, PT, ST, UST and AUST for those earners who are paid otherwise than weekly.

6.2 Each tax year the Treasury is required, by section 141 of 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 legislation should be made under that section to determine the rates and thresholds applying to Class 2, 3 or 4 NICs for the following tax year. This instrument satisfies the requirement for such legislation.

6.3 It is a condition precedent to laying legislation under section 141 of the Administration Act that a copy of the report by the Government Actuary, or the Deputy Government Actuary, be laid before Parliament on the effect which, in the Actuary's opinion, the making of the legislation would have on the National

Insurance Fund. If legislation is made under section 141 of the Administration Act, it may also make a corresponding provision for Northern Ireland under section 129 of the Northern Ireland Administration Act.

7. Policy background

What is being done and why?

7.1 It was announced at Budget 2011 that the basis of indexation of most NICs rates, limits and thresholds would be by reference to the Consumer Price Index (CPI). An exception to this was the ST, which was linked to the Retail Price Index until 2015-16, and is now linked to CPI. For the year to September 2019, CPI increased by 1.7%.

7.2 The PT is increasing above inflation in line with the Conservative manifesto commitment to increase the level of earnings at which individuals begin to pay NICs. The LPL will also increase above inflation to maintain alignment with the PT.

7.3 Earnings above the Lower Earnings Limit (LEL) confers entitlement to contributory benefits and builds State Pension entitlement. The LEL is due to rise in line with inflation as is standard. The increase to the PT will take lower earners out of paying NICs, while the standard LEL increase protects their eligibility for contributory benefits effectively increasing the number of people who pay zero NICs but are treated as having paid NICs.

7.4 It was announced at Budget 2007 that the UEL and UPL would be aligned with the income tax higher rate threshold (HRT) from April 2009. The UST and AUST are also aligned to this level.

7.5 It was announced at Budget 2018 that the income tax HRT would increase to £50,000 a year in 2019-20, and would remain at £50,000 in 2020-21. The UEL is aligned with the HRT, and so rose to £962 a week in 2019-20 and will remain at £962 a week in 2020-21. Three other NICs thresholds are aligned with the UEL, and they will also remain at the 2019-20 level in 2020-21; these are the UST, AUST and UPL.

<u>*Class 2, 3 and 4 contributions*</u>

7.6 Self-employed earners pay Class 2 and Class 4 NICs. Class 2 contributions are payable by self-employed earners at a weekly flat rate when profits exceed the SPT. Both the weekly flat rate and the SPT are increased by CPI. The weekly flat rate will be increased from £3.00 to £3.05. The SPT will be increased from £6,365 to £6,475 per year.

7.7 Class 4 NICs are payable by self-employed earners at the main percentage rate (currently 9%) on taxable profits between the LPL and the UPL and at the additional Class 4 percentage rate (currently 2%) on all profits above the UPL.

7.8 The LPL is set at the same level as the PT for Class 1 NICs and will be increased from £8,632 to £9,500 from 6 April 2020 in line with the Conservative manifesto commitment, as explained at paragraph 7.5. The UPL is set at the same level as the UEL for Class 1 NICs and will remain at £50,000 to maintain alignment both with the UEL and the HRT for income tax, as explained at paragraph 7.3.

7.9 Class 3 NICs are voluntary payments paid at a flat rate of £15.00 per week for the tax year 2019-20. These will be increased to £15.30 per week from 6 April 2020 in line with CPI.

Class 1 earnings limits and thresholds

7.10 Section 5 of the Contributions Act requires earnings limits and thresholds for Class 1 NICs to be specified for Great Britain each tax year. Similarly, section 5 of the Northern Ireland Contributions Act requires there to be earnings limits and thresholds for Class 1 NICs for Northern Ireland.

7.11 The LEL is the level of earnings at which employees start to gain access to certain contributory benefits. From 6 April 2020 the LEL will be increased from £118 to £120 per week in line with CPI.

7.12 Since April 2009, the UEL (the level of earnings up to which employees pay NICs at the main percentage rate of 12% and thereafter the additional percentage rate of 2%) has been aligned with the HRT for income tax.

7.13 At Budget 2018, it was announced that the income tax personal allowance would be £12,500 and the basic rate limit would be £37,500 from 6 April 2019, giving a higher rate threshold of £50,000 per annum. The UEL is aligned with the HRT, and so rose to £962 a week in 2019-20. As explained at paragraph 7.3, the UEL will remain £962 a week in 2020-21, in line with the freeze to the HRT which was announced at Budget 2018.

7.14 Primary Class 1 NICs (known as "employees' contributions") are payable at the main primary percentage (currently 12%) on earnings between the PT and the UEL. Secondary Class 1 NICs (known as "employers' contributions") are payable by employers on their employees' earnings above the ST at a single percentage rate (currently 13.8%). There is no upper limit for payment of employers' contributions.

7.15 The UST sets the level of earnings above which employers of employees under the age of 21 are no longer eligible to pay secondary Class 1 contributions at the age-related secondary percentage, which is 0%. The UST is set at the same level as the UEL and will remain at £962 a week in 2020-21.

7.16 The AUST sets the level of earnings above which employers of relevant apprentices under the age of 25 are no longer eligible to pay secondary Class 1 contributions at the apprentice related secondary percentage, which is 0%. The AUST is set at the same level as the UEL and will remain at £962 a week in 2020-21.

Class 1 prescribed equivalents and Treasury Grant provision

7.17 Sections 5(4) and (5) of the Contributions Act and the Northern Ireland Contributions Act provide that the prescribed equivalents of the LEL, PT, ST, UEL, UST and AUST (as set out above) may be set at an amount which is no greater than £1 above the arithmetical equivalent of the weekly LEL, PT, ST, UEL, UST and AUST. The monthly arithmetical equivalent can be calculated by multiplying each of the weekly limits and thresholds by 4⅓. The annual arithmetical equivalent can be calculated by dividing each of the weekly limits and thresholds by 7 and multiplying each result by 365. The monthly and annual prescribed equivalents of the LEL, PT, ST, UEL, UST and AUST are all no greater than £1 above the arithmetic equivalent of those limits or thresholds.

7.18 These Regulations include prescribed equivalents of the UEL, PT, ST, UST and AUST where the earnings period is a month or a year. The monthly and annual equivalents of the UEL are £4,167 and £50,000 respectively. The monthly prescribed equivalent of the PT is £792 and the annual prescribed equivalent of the PT is £9,500.

The PT is increasing above inflation in line with the Conservative manifesto commitment, as explained at paragraph 7.5. The monthly and annual prescribed equivalents of the ST are £732 and £8,788 respectively. The monthly and annual equivalents of the UST are £4,167 and £50,000. The monthly and annual equivalents of the AUST are £4,167 and £50,000 respectively.

7.19 These Regulations also make provision under section 2(2) of the Social Security Act 1993 for payment of a Treasury Grant not exceeding 5 per cent of estimated benefit expenditure for the coming tax year to be paid into the National Insurance Fund, if necessary. They also make corresponding provision in respect of the Northern Ireland National Insurance Fund under article 4(3) of the Social Security (Northern Ireland) Order 1993.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 There are currently no plans to consolidate the Regulations or the primary legislation which are amended by this instrument.

10. Consultation outcome

10.1 There was no consultation because the instrument relates to routine changes to rates, limits and thresholds as part of the annual NICs re-rating exercise.

11. Guidance

11.1 Guidance is not required as these Regulations do not impose a new obligation.

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies, except for routine changes in payroll.

12.2 There is no, or no significant, impact on the public sector, except for routine changes in payroll.

12.3 A Tax Information and Impact Note has not been prepared for this instrument as it gives effect to previously announced policy and it relates to routine changes to rates, limits and thresholds. A Tax Information and Impact Note covering related changes to income tax thresholds (remaining at 2019/20 levels in 2020/21) is available at: https://www.gov.uk/government/publications/income-tax-personal-allowance-and-basic-rate-limit-from-2019-to-2020/income-tax-personal-allowance-and-basic-rate-limit-from-2019-20.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses due to the changes to the rate of Class 2, LPL, UPL and SPT in so far as the proprietor(s) are self-employed. These small businesses will need to acquaint themselves with the new rate and limits in order to calculate their National Insurance liabilities from 6 April 2020. The changes to Class 1 NICs applies to small businesses with employees.

13.2 To minimise the impact of the requirements on small businesses (employing up to 50 people), the approach taken is that employers can use HMRC's Basic PAYE Tools to work out their payroll deductions and submit payroll information online.

13.3 The Basic PAYE Tools work out the tax and NICs for employees every time they are paid and can be used to report this information to HMRC. This free computer package is available to download from https://www.gov.uk/basic-paye-tools.

13.4 Alternatively, small businesses can find out more information on other HMRC – recognised payroll software to manage RTI payments and deductions from https://www.gov.uk/payroll-software. Small businesses will need to ensure that the new rates, limits and thresholds are used to calculate their National Insurance liabilities from 6 April 2020.

14. Monitoring & review

14.1 The approach to monitoring of this legislation is that this instrument makes changes to existing rates, limits and thresholds, which are reviewed annually.

15. Contact

15.1 Lowri Barber at HM Revenue and Customs Telephone: 03000 563 479 or email: lowri.barber@hmrc.gov.uk can be contacted`1 with any queries regarding the instrument.

15.2 Rachel Nixon, Deputy Director for National Insurance, at HM Revenue and Customs can confirm that this Explanatory Memorandum meets the required standard.

15.3 Financial Secretary to the Treasury, Jesse Norman MP at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.