

COMPLIANCE COST REVIEW

National Insurance Contributions - Offshore Manning

The Social Security (Categorisation of Earners) (Amendment No 2) Regulations 2003

The Social Security (Categorisation of Earners) (Amendment No. 2) (Northern Ireland) Regulations 2003

1. Introduction

1.1 Background

In line with Government commitments to reduce the compliance burdens that are placed on businesses, HM Revenue & Customs (HMRC) assesses the likely change in compliance costs whenever a policy is introduced or changed. The results of that analysis are published in a final Regulatory Impact Assessment (RIA) when the associated legislation is laid before Parliament.

This document summarises the outcome of a post-implementation review of the final RIA that was published in September 2003 for the above-mentioned measure by the Inland Revenue. The measure was implemented with effect from 13 October, 2003. A copy of the published final RIA is attached.

This review re-assesses the compliance cost analysis published in the original RIA and addresses two main questions:

- whether the estimates of compliance costs used in the RIA were correct, with hindsight; and
- whether the processes used to estimate compliance costs were appropriate and reasonable, given the circumstances at the time.

HMRC intend to use this review to improve the RIA process, and also to assist in future policy development and evaluation work in general. As such, the emphasis is on identifying learning points for future assessment of compliance costs. The review does not revisit the original policy decision.

2. The published RIA

2.1 Description of the policy change

The purpose of this measure was:

- To ensure fairness between employers by ensuring that companies operating in UK category waters pay NI on the same basis as other UK employers;
- To resolve a lack of clarity in the previous law relating to companies using UK resident mariners; and
- To keep the administrative burden of the change to a minimum

To do this, the legislation was changed so that:

- Where mariners provide their services wholly or mainly outside UK category waters (Category A, B, C or D waters under the Merchant Shipping (Categorisation of Waters) Regulations 1992), the shipping companies would not be liable for employer National Insurance (NI); and
- Where mariners provide their services wholly or mainly within UK category waters (i.e. within 12 miles of the UK coast) the shipping companies would be liable for employer NI on the same basis as other UK employers.

The measure was intended to counter perceived NI avoidance for mariners working wholly or mainly within UK waters who were employed by an overseas company who did not pay employer NI contributions. This would ensure fairness with other employers in the UK who are required to pay employer NI contributions.

2.2 Anticipated compliance costs or savings

In the overall scheme of things this is a relatively small measure affecting a small number of businesses. The anticipated costs set out in the RIA were that:

- UK shipping companies choosing to end their offshore manning arrangements would incur a one-off transitional cost in transferring employees to their UK payroll and normal payroll administrative costs thereafter. This cost was not quantified;
- They would also receive the benefit (which the RIA envisaged would offset any costs) of not having to pay any further offshore manning company fees; and
- In borderline cases, shipping companies could apply to HMRC for clearance not to pay employer NI.

For the respondent shipping company that was affected, the costs incurred were:

- Re-employment of mariners working within category A-D waters by the UK company;

- Additional time spent by members of staff in order to facilitate the relevant employees becoming employed by the UK company; and
- Transferring staff to the payroll system in order to ensure that UK NI was accounted for.

The RIA stated that the precise cost would depend on the number of mariners transferred and that it may have a disproportionate impact on those operators with relatively high payroll costs. The RIA estimated that the measure would affect 2500-3000 mariners out of a total of around 25,000.

The RIA also considered the costs to those companies who were uncertain about the liability. The costs included:

- identifying mariners and providing details to the Inland Revenue (Name, NI number),
- details of the vessels; and
- providing information on the past/ future pattern of activities of the vessel to establish that the mariner is likely to be wholly or mainly outside relevant UK waters.

The RIA stated that the number of companies likely to be affected by the clearance routine was small and that costs had been minimised by using existing company records.

3. Conduct of the review

Each compliance cost review is conducted individually, and the review process is adapted to suit the particular circumstances applying in each case. The emphasis is on making sure that the review itself - and any burden of consultation - is sufficient to meet the objectives of the review, but proportionate to the likely benefits.

In this case, the review was led by an HMRC project team supported by consultants. The staff in the review team were completely independent of those involved with the original policy change.

An essential element of the review was consultation with those actually affected, and consultants were commissioned to carry out a small number of targeted in-depth interviews with some of those affected and their trade bodies. The research was not intended to deliver any degree of statistical robustness (to do so would have been costly and impractical) but instead to provide indicative findings. Reflecting the limited impact of the measure, a small number of businesses and trade bodies were interviewed. Coupled with the consultants' own knowledge and expertise, this has allowed the research to identify the major issues and any associated learning points.

The external research was complemented by an internal review of HMRC paperwork and electronic files.

4. Were the original estimates of compliance costs accurate?

This section addresses two main aspects – the nature of the change in compliance costs (i.e. what did people have to do differently) and the monetary impact of that change (what did it cost or save them).

Question	Comments
<p>Were the specific types of cost and benefit identified in the RIA (e.g. reading legislation, filling in forms, updating IT systems, saving time etc.) incurred?</p>	<p>Interviews suggested that companies still incurred fees for employees working outside of the relevant UK waters (and hence were not covered by the change).</p> <p>Also, the RIA did not consider that the off-shore manning company may actually be a subsidiary of a multinational company operating in UK waters. In this case the company would incur the costs of moving the employment of the mariners back to the UK, but not the benefits of no longer having to pay off-shore manning company fees.</p>
<p>Were costs/savings incurred at the expected time?</p>	<p>Costs were incurred as expected by the companies interviewed.</p> <p>Although the change was primarily implemented to prevent avoidance of National Insurance liability, there were benefits set out in the RIA. However, these were not realised by any of the interviewees affected by the legislation. For one respondent, this was because they did not end their offshore manning arrangement, as it was with one of the UK company's overseas entities. Consequently, benefits were not received by no longer having to pay offshore manning fees.</p>
<p>Were costs/savings incurred by the expected people?</p>	<p>For companies transferring employees back to the UK company, only one-off payroll setup costs were considered. However, there may also have been additional on-going compliance costs</p>
<p>Were any other costs/savings, not identified in the RIA, incurred?</p>	<p>Respondents affected by the legislation reported that no unforeseen costs were incurred; however, respondents did suggest areas that the RIA should have discussed, even though the</p>

	<p>actual impact was minimal. These included the possible impact on overseas offices, and of offshoring manning companies themselves. These are not UK businesses and so are technically outside the scope of a UK RIA.</p> <p>The consultants struggled to find businesses affected by the change. An unaffected respondent commented that, had they implemented an offshore manning arrangement, the effect would have been much more significant. They believed that it would have taken a substantial amount of time and resources for the company to classify which of its employees were working mostly outside or inside category A-D waters. This would have represented a large administrative burden and would have had substantial cost implications for the business, particularly as they are a small company. They felt the RIA did not sufficiently address the potential impact on small businesses. It should be stressed through that this comment was not based on actual business experience.</p>
<p>If the type of costs/savings varied from the original estimates, why was that?</p>	<p>The RIA did not include ongoing additional payroll costs, and did not consider that multinational companies affected may not realise the expected benefits.</p>
<p>Could such variances have been foreseen at the time?</p>	<p>Yes.</p>
<p>What is the assessment now of the total value of costs and savings?</p>	<p>No quantification is possible as the businesses interviewed were unable to provide estimates of the actual monetary costs of the change. Although the cost to smaller businesses is likely to be larger than for large companies, it is unlikely that any small companies had offshore manning contracts in place at the time the legislation was introduced.</p> <p>It is also possible that the compliance costs and benefits are much smaller than originally expected due to a smaller number of businesses affected than was originally anticipated. Based on the interviews, it is questionable whether offshore manning arrangements were as widespread as was implied by the RIA.</p>

If different from the original RIA, what has caused the discrepancies?	It has not been possible to quantify the actual change in costs as businesses interviewed were unable to provide estimates of the actual monetary costs of the change.
With hindsight, were the compliance cost estimates accurate?	Overall, we believe that the costs provided were partially reasonable and accurate, although there is an issue as to whether the benefits to business were achieved.

5. Was the process used to estimate compliance costs reasonable?

Irrespective of whether the analysis turned out to be correct, the review has considered whether the original analysis was completed in a reasonable way.

Question	Comments
Who worked on the original RIA?	Members of the Policy Team, the Better Regulation Unit and the department's analysts worked on the RIA.
Was an adequate audit trail maintained?	The audit trail was fairly thorough, but there was little consideration at the time that the RIA might be reviewed after implementation. This is reflected in the RIA, which is vague on how the policy change might be monitored. However, systems have improved since this RIA was done and the learning points have been addressed to a large extent.
Was Cabinet Office and/or internal HMRC guidance on RIAs followed correctly?	Yes. Cabinet Office mentioned the RIA in one of their best practice newsletters as an example of Cabinet Office and the policy team working closely together.
How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?	Some effort was expended attempting to estimate the number of mariners affected, based on administrative records and responses from industry. Given the small scale of the measure this seems to have been proportionate.
Were the right people (both internal and external) consulted, and were their views reflected appropriately?	The RIA states that "Representatives of the shipping industry and trade unions have been consulted on the proposed administrative arrangements." The external research suggested that more consultation with industry was required, and specifically with smaller businesses. The paper files show interactions between the policy team and the major trade bodies which helped to minimise the burden of the new policy. The files also show that trade

	bodies themselves highlighted the need to consult with smaller businesses. However, with hindsight it is not clear how many smaller businesses were actually affected by the change, if any.
Did those who were consulted when the RIA was written express views on the reasonableness of the process?	The review of the files has provided evidence of early representations from business which helped refine the policy measure and improve the impact assessment, for example by providing estimates of numbers affected.
Have those who have been consulted now as part of this compliance cost review expressed views on the reasonableness of the process?	Businesses interviewed would have liked to have seen more consultation, particularly with smaller businesses.
Were compliance costs estimated for all options mentioned in the RIA?	No. Compliance costs were only considered for the lead option. However, there were sub-options for how to implement clearance procedure on whether mariners were mainly based in UK waters, and compliance costs were a key issue in deciding which option to pursue.
Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?	No. Only high level costs and savings were considered. However, the possible positive competition impact on small businesses was noted (less of a cost advantage accruing to larger firms who used offshore manning contracts).
Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?	Advice from Analysis and Research Division was sought on both the drafting of the RIA and the likely numbers of businesses and mariners affected.
Was there sufficient time to produce a robust assessment of compliance costs?	There is no evidence of problems here.
Were any assumptions reasonable, given the circumstances at the time?	Ideally, the cost-benefit profile of multinational operators would have been discussed separately from other operators to account for the differences. However, given the small scale of the measure the approach used was reasonable.

Were any estimates of compliance costs caveated appropriately?	Although the costs were not quantified, the RIA did present a range of estimates for the number of mariners affected. It also attempted to give reasons why costs may be higher for some companies than others.
Were any risks correctly identified, addressed and explained?	Risks were considered as part of the policy formulation process. No risks to the policy were identified and there is no evidence to disagree with that.
Were any disagreements identified and reflected appropriately (e.g. if the figures were disputed by businesses, or if more than one set of figures was available)?	There is no evidence of problems here.
Would HMRC do anything differently if the exercise was repeated, and hence could the RIA process have been improved?	There were a number of costs that could have been anticipated and commented on in the RIA and consequently the compliance costs estimated are not as accurate as they could have been. Wider consultation may have identified these issues and also given a better indication of the scale of the problem. But it should be borne in mind that this was as anti-avoidance measure aimed at safeguarding the Exchequer and ensuring fairness with other employers in the UK who could not use these types of arrangements to avoid employers NICs. It is also worth noting that the final regulatory solution was reached through consultation.

6. Learning points arising from the review

6.1 Learning points for future work in this policy area

- No partial impact assessment was published for this policy. A partial RIA may have facilitated consultation with business and prevented HMRC from appearing to be on the back foot.
- External research has highlighted that the assumption regarding small firms' costs was questionable. In future we should endeavour to ensure that small businesses are fully consulted.
- Businesses would like more detail on the underlying causes of the costs and benefits, and how they develop after implementation.
- The remaining learning points are not specific to the Mariners RIA and follow below.

6.2 Learning points for the RIA and compliance cost process in general

- Compliance cost estimates should start by considering the sectors likely to be affected, and considering how they may differ.
- Costings should be provided for all viable options, not just the lead one.
- The review and monitoring section of the RIA should be considered in more depth.
- HMRC should ensure that consultation with business identifies all of the sectors and types of business affected by the proposal.
- For future measures HMRC may wish to consider how it advertises changes to specialist areas of tax legislation to ensure that (a) those businesses affected by the change are aware of it and (b) those businesses not affected by it are not troubled.
- Costs and benefits listed in the RIA should be both described and quantified where possible to help businesses identify the likely impact. Where quantification is not possible, the RIA should aim to give a thorough description of the likely changes in business process required.

7. The way forward

Comments are invited on any aspect of this report or the wider compliance cost review programme.

The learning points are being fed into the policy development process directly if particular to one RIA or policy area. More generic recommendations are being collated across the review programme overall, and will be used to create an action plan for HMRC to take forward to improve the RIA process and development.

8. Contact points for further information

For issues relating to National Insurance contributions of mariners specifically:

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THE PUBLISHED REGULATORY IMPACT ASSESSMENT

[National Insurance Contributions – Offshore Manning \(PDF 32K\)](#)