

STARTING UP IN BUSINESS

Introduction

Last November the Chancellor of the Exchequer asked Lord Grabiner QC to conduct an investigation into the informal, or hidden, economy and to make recommendations for how to move economic activity out of the hidden economy¹. One of his concerns was that people in business can simply drift into the hidden economy. They then find it increasingly difficult to put their affairs in order and so to take advantage of the support, advice and business opportunities available to those operating in the formal economy. Lord Grabiner therefore recommended that more assistance should be given to the newly self-employed at the outset to avoid trouble later on with the revenue departments (and perhaps other regulatory bodies) and that, to facilitate this, there should be an effective requirement to notify the Inland Revenue on or soon after the start of business. The Chancellor accepted these recommendations².

This paper puts forward proposals for:

- streamlining the process for the newly self-employed to register for National Insurance Contributions (NICs) purposes, and for this registration to trigger provision of information and support to them;
- improving that information and support; and
- making the existing requirement for newly self-employed people to register for NICs purposes more effective by imposing a fixed penalty if it is not done within a reasonable time.

We are inviting comments on the sort of help that new businesses would find most useful and the fairest way to enforce notification. Overall we think that the proposals here will reduce the time, effort and cost to new businesses of finding out about their obligations and ensuring they meet them. We have not identified any additional costs. We welcome comments on the general approach and your views on the overall effect of the proposals on compliance costs for small business.

¹ The Informal Economy – A Report by Lord Grabiner QC. March 2000.

² Financial Statement and Budget report – March 2000. Box 4.5

We will also be holding two meetings with representatives from small business to obtain direct feedback. If you are interested in attending such a meeting it would be helpful if you could let me know before 10 November 2000

Comments on the proposals in this paper should be sent to

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To arrive no later than 11 December 2000

Under the principles of openness and access to Government information, responses to this paper may be made available to members of the public, unless confidentiality is specifically requested by the respondent. But please note that any list of those who have commented will identify those who have asked that their views be treated as confidential.

Further copies of this document may be obtained from
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Or from the Inland Revenue website at
www.inlandrevenue.gov.uk

Overview of proposals

From January 2001 we will introduce simpler procedures to encourage new businesses to tell the Inland Revenue as soon as they start up. To do this we will make sure that the existing requirement for the newly self-employed to register for flat rate Class 2 NICs purposes is simpler. Registration will trigger the provision of more help for new businesses. As well as information about contributions, that help will extend to information about income tax, including the tax deductions available to business, VAT and the availability of working families' tax credit. Failure to register in time may lead to a penalty.

- Notification : The existing form "CWF1" which is used to make a written application to pay Class 2 NICs will be replaced by a simpler form, accompanied by a short explanatory leaflet. The leaflet will be widely available - from Job Centres and benefit offices, Citizen's Advice Bureaux, Chamber of Commerce, Training and Enterprise Councils (TECs) etc. as well as from the Inland Revenue and HM Customs and Excise offices and helplines. It will also be available on the internet and notification will be accepted by telephone. The self-employment contact centre at National Insurance Contributions Office (NICO) will handle all notifications and, from April, their dedicated telephone advice service will be able to answer queries about tax as well as NICs. An example of the details required on the new form is attached at Annex A.
- The Class 2 NICs notification will trigger the issue of a comprehensive "Starting up in Business Guide" which will give advice about tax (including allowances, reliefs and tax credits), NICs (including information about Small Earnings Exception and how paying contributions can count towards entitlement to state pension and other benefits), setting up payrolls, VAT and where to go for more help and advice about tax and other regulatory matters. The guide will also be available on request from the Inland Revenue and Customs and Excise helplines and Web Sites. Annex B gives further information.
- The guide will provide a simple step-by-step guide to what someone setting up in business needs to do, some common pitfalls and where to go for further help including that on offer from our Business Support Teams.

- In order to offer this support it is essential that self employed people register with the Inland Revenue as early as possible. At present over a third leave it for three months or more – and therefore could be storing up problems in the form of unpaid debt, or unbudgeted for liabilities. Some people say they are unaware of the necessity to register for Class 2 NICs. So we will improve publicity about the need to do so, and we will give people a reasonable amount of time to notify us, rather than insisting it is “immediate” as the present notification requirement states.

- We will enforce the notification requirement by introducing a fixed penalty if a newly self-employed person does not notify the Inland Revenue within the period allowed, and there is no good reason for the delay.

Details

Who must notify the Inland Revenue ?

- People who become liable to pay Class 2 NICs such as:
 - People who become self-employed for the first time, or re-commence self employment.
 - People moving from employment to self-employment
 - People who carry out business on their own account as well as being employed by someone else.
 - People who form or join a business partnership
- People who are already self-employed but have not yet registered to pay Class 2 NICs.

1. The Government is keen to keep regulatory burdens to a minimum. And it recognises that many people may be trapped in the hidden economy because they are not aware of the legitimate opportunities that are available. Therefore it is proposed that, rather than adding a new rule for all businesses, the existing requirement to notify self-employment for the purposes of Class 2 NICs will be built on and strengthened³.
2. The notification requirement therefore applies to all individuals who are classed as self-employed (Class 2) for NICs purposes – including those carrying on a trade or profession on their own account and each member of a partnership. It will not apply directly to those without Class 2 liability such as people who set up a limited company and are directors of that company. If someone is not sure whether they are covered by the notification requirement they will be able to get advice from the NICO self-employment contact centre.

³ People entering self-employment are required to notify the Inland Revenue immediately under Social Security (Contributions) Regulations 1979 (SI 1979.591) regulation 53A. However, as currently drafted, there is no definition of “immediately” and there is no specific penalty for failure to notify.

What do we mean by self-employed?

- A self-employed person is someone who works on their own account, or in partnership, rather than for an employer. They may sometimes hold two jobs – one for themselves and one for an employer⁴
- Some people are treated as self employed by specific legislation – for example for NICs - examiners, moderators and invigilators⁵; and for tax - divers⁶.

3. No change is proposed to the current understanding of self-employment for tax and NICs purposes. In most cases it is obvious to someone whether they are employed or self-employed. Self-employment typically applies to someone who is in business on their own or in partnership; they could be running a shop, or buying and selling goods or providing services direct to the public. Leaflet IR56 “Employed or self employed? A guide for tax and National Insurance” provides further advice. It is available from the Inland Revenue helplines. In addition each Inland Revenue tax office has someone responsible for enquiries about employment status who can give more detailed advice.

⁴ Section 2(1)(b) of the Social Security Contributions and Benefits Act

⁵ Regulation 2(3) and paragraph 6 in column (A) of Part II of Schedule 1 to the Social Security (Categorisation of Earners) Regulations 1978.

⁶ Section 314 Income and Corporation Taxes Act 1988.

What if the profits from self-employment are too low to be taxable or the self-employment is only part time?

- Even those with low incomes from self-employment should register
- Notification of part time self-employment is still required unless the person is :
 - under 16 or over state retirement pension age or
 - in full-time education and undertakes self-employed work in their spare time

4. Notification of all self-employment for NICs purposes is required, but it does not mean everyone has to pay NICs, whatever their circumstances. Those with profits below £3825 a year (or who have a reasonable estimate that they will be) may apply to be excepted from paying the contribution under the Small Earning Exception scheme (SEE). Details about how to apply for Exception will be in the Starting up in Business Guide. However, as paying the flat rate Class 2 NICs (currently £2 per week) enables people to build up entitlement to incapacity and maternity benefits and qualifying years for their state retirement pension, many choose to pay it even if their profits are below the SEE.
5. In addition self-employed people with low incomes may find that they are entitled to help through tax credits. By making sure they notify the Inland Revenue as soon as they start self-employment they will get information about tax credits, and be able to apply straight away. Tax credits can only be paid from the date of the application – so if someone is not aware of the sort of help they may be entitled to from the outset they could lose out.

6. Those in regular self-employment would normally also need to register even if it was part time. But the provision of some minor occasional service would not trigger the need to do so, for example occasional baby sitting or doing domestic odd jobs. The NICO self-employment contact centre will be able to provide further advice.
7. Some married women may also be exempt from paying Class 2 NICs because they hold a valid election to pay their contributions at the reduced rate. However, if starting self employment they are still required to notify the Inland Revenue for tax purposes and, in any event, notification will enable them to get access to help and advice too.

Comments invited on whether further clarification is needed on who is required to register for Class2 (self-employed) NICs

What will make the Starting in Business Guide different from the current leaflets available such as “Starting your own Business?”

8. The Inland Revenue and Customs and Excise produce a number of helpful guides already for new businesses – but we need to look continually at whether there are improvements that can be made and whether we can offer better access to the material. We have conducted more research and looked at what other countries produce to come up with improvements in presentation and design.
9. Our new package of help will comprise :
 - an introductory leaflet, explaining what the Guide can offer and how to access it. The leaflet, which will be made widely available, will include the registration form and registration helpline number
 - a video available on request explaining what the Guide covers and the additional personal help available from Inland Revenue and Customs & Excise
 - the printed version of the Guide
 - a web-based version of the Guide

We are currently considering offering it on CD Rom. and welcome comments on that as a medium for delivery.

What will happen to people who don't notify the Inland Revenue when they start a new business ?

10. Our intention is to ensure that people are fully aware they must notify the Inland Revenue when they start a new business, and the consequences of not doing so. At present there is no penalty for failure to notify for Class 2 NICs and people may therefore drift into the informal economy almost by default, and feel trapped there. As well as being unfair in principle that people should not pay their dues, the failure to notify self-employment may well be to the direct disadvantage of many of those who fail to do so. They may find the development of their business restricted by their exclusion from the support and opportunities available to those in the formal economy, for example in the form of finance or business advice. As well as offering our own information and assistance to those starting in business we therefore intend to under-pin the requirement to notify the Inland Revenue by imposing a penalty on those who nevertheless choose to default.

When will penalties be applied?

- A penalty to be applied if notification is not received within the time limit.
- The time limits being considered are 1, 2 or 3 months from the end of the month in which self-employment started.

11. By law all self employed people between 16 and 60/65 are obliged to register for Class 2 NICs purposes immediately they start in business, irrespective of anticipated or actual profit from that business . Class 2 NICs liability is calculated from the Sunday at the start of the week in which self employment starts.

12. We want people to continue to tell us as soon as they start in business, and to make it easy and straightforward for them to do so. We can help them understand and therefore budget for any tax, NICs and VAT liabilities before sums appear to mount up to unmanageable proportions. And we can help make sure that any allowances and tax credits that they may be entitled to are fully explained and assist in them being applied for in time.
13. But we do not want to penalise people for short delays in telling us about their business. We want to strike a balance between encouraging people to get help and advice from the outset and giving them a reasonable time to see that their affairs are in order.

Options for the period from the start of self-employment within which notification required to avoid a penalty

- (i) 1 month (4 weeks) aligns with the period of grace for the payment of many liabilities in the commercial world such as payment for utilities, invoices etc. It is short enough to ensure the useful start up information is made available quickly. But is it long enough to allow for hectic beginnings and the uncertainty of whether the business will continue?
- (ii) 3 months (13 weeks) aligns with the period when first quarterly payment of the Class 2 NICs becomes due. It allows time for the self-employed person to make an estimate of anticipated profit levels. But would it mean that, without sufficient information or knowledge, debt could start to build up ?
- (iii) 2 months (8 weeks) is a half way house between the two – short enough for help to be available from near the outset but with a bit of time for the new business to be established.

Comments are invited on a reasonable deadline for notification of the start of self employment.

What penalties would be applied ?

- The new penalty for failure to notify self employment for Class 2 NICs purposes in time will be a flat rate £100 (unless certain circumstances apply – see below)
- There are existing penalties for failures in respect of non-disclosure of untaxed income which may also apply:
 - Failing to notify liability to tax by 6 October after the tax year in which liability first arises, to obtain a tax return.
 - Failing to make a return when issued with one
 - Fraudulently or negligently making an incorrect return.

14. We want people to comply with their obligations to notify us and to be aware of the seriousness of not doing so. We think a £100 penalty is appropriate to the level of Class 2 NICs likely to be due, and provides a sufficient incentive to ensure notification is made on time.

15. This penalty will only apply in respect of initial notification for the purposes of Class 2 National Insurance contributions. Where a business does not provide the Inland Revenue with details for the purposes of tax other penalties now exist and will continue. However, if someone registers for Class 2 NICs they will not need to ask us separately for a Self Assessment form as we will send one out automatically if it is appropriate.

16. The existing tax penalties are:

- Failing to notify liability to tax by 6 October after the tax year in which liability first arises, so that a tax return form can be issued for completion⁷.
- Fraudulently or negligently making an incorrect return⁸.

These penalties are geared to the amount of tax that is owed.

- Failing to make a return when issued with one⁹

Will all late notifiers be penalised ?

- If profits have been below the Small Earning Exception limit no penalty will be applied.
- If a self-employed person has a reasonable excuse for their late notification no penalty will be applied.

17. We recognise that, in spite of planning, commitment and plain hard work there may be self-employed people who have been operating “informally” but with low profits for some time. We do not want to provide a disincentive to those people to come forward and legitimise their business affairs. Since June we have been running a confidential tax and benefits helpline because we realised that some people think that they are in more of a mess with their tax and NICs than is really the case. The phone line provides them with an opportunity to find out on a no names basis exactly where they stand – and tells them about the support available.¹⁰

⁷ Section 7, Taxes Management Act 1970

⁸ Section 95, Taxes Management Act 1970

⁹ Section 93, Taxes Management Act 1970

¹⁰ Tax and Benefits Confidential Helpline – 0845 608 6000

18. So we will also advise people that – where profits have been below the Small Earnings Exception (currently £3825 per year) – there is no requirement to pay NICs and there may be no tax liability either if a person does not have much taxable income from other sources. We will not apply the Class 2 NICs penalty to people who have failed to notify us of their self-employment and their income from self-employment has been below the SEE level.

19. We also accept that there may sometimes be a good reason for lateness in making the notification. So – as with other penalties for failing to do something - someone who feels they have a “reasonable excuse”¹¹ for failing notify on time will be able to appeal against the penalty on those grounds. We will consider their situation carefully and will often be able to agree that no penalty is due. (If we do not agree the Tax Appeal Commissioners can be asked to settle the point.)

Comments are invited on the criteria for applying penalties.

What constitutes a reasonable excuse?

20. We will consider each case on its merits as we do for other penalties. We provide guidance in the leaflet “Self Assessment, Penalties for late returns” (SA/BK6) which gives examples of the sort of circumstances where a reasonable excuse may be accepted. The same criteria will be applied to penalties for failure to notify the start of self-employment.

¹¹ Section 118(2) Taxes Management Act 1970.

When will the new scheme start ?

- Notification for Class 2 NICs using the short form will be available from January 2001
- As will the new Starting up in Business Guide.
- The telephone registration facility will be available on a pilot basis from January – with national coverage planned by April 2001.
- All newly self employed people (or those who have not already registered) should make sure they notify the Inland Revenue for Class 2 NICs purposes within the deadline after 1st January, or they could receive financial penalties.

21. The Starting in Business Guide is designed to help new businesses. We are looking to see how we can expand further the support we can give new businesses and will announce plans in due course.

22. Between now and January 2001 we will be publicising the requirement to ensure people are fully aware of the need to register new businesses.

23. Regulations will be laid before Parliament introducing the new penalty. These will replace the existing rule for breach of the Contributions Regulations,¹² which do not specify in sufficient detail what contributors who do not comply can expect.

¹² Regulation 132, Social Security (Contributions) Regulations 1979/591

LIST OF ANNEXES

- A Notification form – comparison between CWF1 and proposed new form
- B Starting in Business Guide – outline specification
- C Summary of questions for comment

Annex A

| CURRENT - CWFI | NEW – STARTING SELF EMPLOYMENT |
|---|--|
| <p>Advice on what to do: Send to NICO</p> <p>Use this form to tell IR and C&E that you have started self-employment</p> | <p>Advice on what to do: Telephone xxx or Take to IR office or Send to NICO</p> <p>Use this form to tell IR and C&E that you have started self-employment</p> <p>If you do not register within xxx weeks of starting business you may incur a penalty</p> |
| Mark X if you think you need to be registered for VAT | Yes |
| <p><u>Yourself</u> :</p> <p>Title; current surname; previous surname; first name Date of Birth Home address; home phone number National insurance number</p> | Yes – plus mobile phone number and E Mail address if appropriate |
| Women only : Marital status; date of marriage/widowhood or divorce | No |
| Tax office to which last return sent and reference | Yes |
| <p><u>Your business</u></p> <ul style="list-style-type: none"> • Date business started • Type of self employment • Mark X for share fishing • Advice to contact tax office for CIS registration • Business name and address, phone, and fax numbers • Position in business | <p><u>Your business</u></p> <ul style="list-style-type: none"> • Date business started • Type of self employment – with examples eg “IT consultant / share fishing / construction worker. • Business name and address, phone, and fax numbers (plus mobile phone number and E Mail address if appropriate) |
| Business partner’s (if any) name address and NINO | No – just note that “if you have business partner(s) each must ensure they have registered for Class 2 NICs “ |
| Mark X if not paying by direct debit | Yes – otherwise fill in attached DD form |
| Mark X for more information about low earnings | Yes - Mark X if you estimate earnings to be less than £3825 (Small Earnings Exception) <i>so we can ensure penalty not issued for late registration. Info for SEE application in guide</i> |
| Mark X for more information about deferment if you are both employed and self-employed | No – info in guide |

| CURRENT - CWFI | NEW – STARTING SELF EMPLOYMENT |
|---|---|
| <p><u>More about the business</u></p> <p>Mark X for any employees – if “yes” mark X if earning</p> <ul style="list-style-type: none"> • £66 - £83 pw (£286 - £361pm) • More than £83pw (£361pm) • More than £1 pw and have other employment <p>If took over existing business – who from (name and full address)</p> | <p>No – info about who to go to and what do if you have employees in guide</p> |
| <p>If you are doing all work for one person or firm give name and full address</p> | <p>Yes – <i>needed to identify possible erroneous categorisation as self-employed – for further investigation</i></p> |
| <p>Previous employment:</p> <p>Mark X if you were</p> <ul style="list-style-type: none"> • employed – give name and address of employer and employment ended • self employed – business name and address and date ceased trading • full time education – date education finished <p>Attach part 2 and 3 of P45 (if any)</p> | <p>No</p> |
| <p><i>Tax returns</i></p> <p>Mark X if any other paid employment or also running existing business</p> <p>If so name and address of existing employer/business</p> | <p>No</p> |
| <p>If any - Agent's name, address and phone number</p> <p>Have you completed Agent's authorisation ?</p> | <p>Yes</p> |
| | <p>Note that may need to obtain further info to confirm if properly treated as self employed.</p> |
| <p>Signed and dated declaration</p> | <p>Signature not necessary for phone applications</p> |

STARTING IN BUSINESS GUIDE

The aim is to produce an information pack giving businesses in the process of starting up practical advice and guidance on income tax, VAT and payroll issues. The strategic driver behind this is supporting compliance - helping businesses get on the right track from the outset by paying the right tax and National Insurance at the right time. The Government is aware that the burden of complying with legislation falls heaviest on small businesses, and is committed to minimising that burden. This pack will support and contribute to that goal (eg by reducing the time spent on corrective action further down the track).

The pack will be:

- Integrated - it will contain all the essential information with effective signposting.
- Relevant - it will focus on what businesses need to know and avoid bombarding them with superfluous information.
- Easy to understand and navigate - it will be formulated with the user's perspective in mind, customer-focused, accessible and inviting.
- Helpful - the pack will signpost other sources of advice and support, including workshops, one-to-one visits from Inland Revenue Business Advisers, helplines and other agencies.
- Persuasive - it will motivate businesses to comply with the legislation and convince them of the benefits of good practice.

Contents will include :

- Guidance as to whether self-employed
- General record-keeping requirements
- Self-employed National Insurance contributions
- Self-employed income tax self-assessment procedures
- Partnerships
- Employing other people
- VAT – whether, why and when you should register
- Timetable for completing SA returns and paying tax and NICs
- Tax credits information

Summary of areas for comment

- 1. Introduction :** Overall we think that the proposals here will reduce the time, effort and cost to new businesses of finding out about their obligations and ensuring they meet them. We have not identified any additional costs. *Comments invited on this assumption.*
- 2. Notification :** We want the new form to be easier to complete quickly – in writing or over the telephone. We think people will find it more useful to be able to telephone through details than post in a form. In due course it will be possible to send the notification in electronically. *Comments invited on whether businesses think these proposals will assist. Comments are also invited on whether the explanation here about who is required to notify the Inland Revenue when they start up in business is clear.*
- 3. New Starting in Business guide :** In addition to printed versions and access through the Inland Revenue Website we are considering offering the Guide on CDRom. *Comments invited on that as a medium for delivery.*
- 4. Enforcing the notification requirement :** We want to strike a balance between encouraging people to get help and advice from the outset and giving them a reasonable time to see that their affairs are in order. *Comments are invited on whether 4, 8 or 13 weeks provide a reasonable deadline.*

Failure to notify-self employment in time would result in a fixed penalty unless the self-employed person could show that their profits had been below the small earnings exception level (currently £3825 per annum) or they had a reasonable excuse. *Comments are invited on the criteria for applying the penalty.*

The proposed penalty will be fixed at £100. There will be no continuing penalty. *Comments are invited on whether this is an appropriate level and provides sufficient incentive to notify for Class 2 NICs in time.*

General comments are also welcome.