

# STARTING UP IN BUSINESS

## Consultation on changes in the way self-employed people register with the Inland Revenue

### Summary of comments received on consultation paper

The consultation document "Starting up in business" was issued on 17 October 2000. The paper set out Inland Revenue's proposals relating to the recommendation in Lord Grabiner's report on the informal economy that there should be an effective requirement to notify the Inland Revenue on or soon after the start of business. The main elements of the proposals were :

- To make more effective the existing requirement for the newly self-employed to notify the Inland Revenue immediately of their liability to pay Class 2 National Insurance Contributions (NICs), by introducing a penalty if they fail to register by a prescribed deadline after starting up.
- The registration process should be streamlined by making the existing registration form shorter and easier to complete and providing telephone registration facilities. The registration for Class 2 NICs also to be treated as notification for tax and Class 4 NICs purposes.
- The registration would trigger the provision of a new Guide on tax/NICs liabilities; with options for direct support from Business Support teams and a dedicated helpline.

Comments were sought on 6 specific aspects of the proposals as well as any general comments. The closing date for comments was 11 December 2000.

We received a total of 63 responses to the proposals of which 13 were from national organisations and representative bodies, 11 were made by local organisations working with small businesses, mainly enterprise organisations and chambers of commerce, and 31 from accountants with localised practices. A further 8 were received from individuals or small businesses on their own account.

A full list of respondents is attached. The table below summarises the views expressed received and, where appropriate, provides the Inland Revenue's comments. Of necessity it has not been possible to include every point raised, but some of the general comments are covered at the end of the table.

Copies of individual responses (where respondents have indicated they agree) may be obtained by writing to or phoning Fatima Chowdhury on 020 7438 7812, room 439, 22 Kingsway, London WC2B 6NR. Or by e mailing [starting.business@ir.gsi.gov.uk](mailto:starting.business@ir.gsi.gov.uk)

Issued by Inland Revenue, 19 December 2000

## **Comments received on "Starting up in Business"**

**17 October 2000 – 11 December 2000**

National Organisations and Representative bodies	
1.	Association of Taxation Technicians
2.	British Chambers Of Commerce
3.	Chartered Institute of Taxation
4.	Construction Industry Joint Taxation Committee,
5.	Institute of Chartered Accountants, England and Wales
6.	Institute of Chartered Accountants, Scotland
7.	Institute of Directors,
8.	Institute of Payroll and Pensions Management
9.	National Farmers Union
10.	Prince's Trust
11.	Small Business Service
12.	TaxAid
13.	Taxation Committee of the London Society of Chartered Accountants
Enterprise Agencies / Chamber of Commerce, / Training and Enterprise	
14.	Andrew Bailey, Business Link Adviser
15.	Chamber Management services, Leeds, Bradford, York and North Yorkshire
16.	Chester-Le-Street and City of Durham Enterprise Agency
17.	Enterprise Link Coventry and Warwickshire
18.	Glasgow Chamber of Commerce
19.	Harrow Enterprise agency
20.	Leonard Cheshire, Newcastle Upon Tyne
21.	North Staffordshire Chamber / Enterprise Agency
22.	Small Business Counselling service, Milton Keynes and North Bucks Chamber of Commerce
23.	St Albans Enterprise Agency
24.	Trade and Industry, Lancaster
Accountants	
25.	Alan Kitson & Company, Leigh-on-Sea, Essex
26.	Anthony G Thorne, Chingford, London
27.	Bernard Rogers & Co., Kenilworth, Warwickshire
28.	Bloom Lester, Islington, London
29.	Callingham Crane, Leatherhead, Surrey
30.	C J Ohly, Cornwall
31.	Cook & Co., Glasgow
32.	David a McCann, Wilmslow, Cheshire
33.	David Kibel & Co, Cricklewood, London
34.	David R Jones, West Yorkshire
35.	Dover Childs Tyler..., London, W1
36.	Horwath Clark Whitehill, Manchester
37.	H R Anderson and Co., Bath
38.	J A Harris & Co, Southgate, London
39.	John Cooke Stockport Ltd,
40.	Jones & Co, York
41.	K T Paddock, Wadebridge, Cornwall
42.	Lewis Parker & Co., Brighton
43.	Midland Taxation Services Ltd., Nuneaton
44.	Phelan & Prescott, Newry
45.	Pierce Chartered Accountants, Blackburn, Lancashire

46.	Roderick Gunkel FCCA & Associates, Perthshire
47.	Ross Brooke Ltd., Newbury Berkshire
48.	Silver & Co., Bridgnorth
49.	The Harris Partnership, West Yorks
50.	Tim Reed, "The Books", Co. Durham
51.	Tony Robbins , Southampton
52.	Underwood Barron, Chandlers Ford
53.	W Rowland Waller and Co, Sheerness, Kent
54.	William George, Bishop Stortford Hertfordshire
55.	Winburn Glass, Norfolk
Others	
56.	Alex Sampson
57.	Barbara Luty
58.	BH Beacham
59.	Glyn Roberts
60.	Hill Rogers
61.	Keith Bonney
62.	Phil Rees
63.	Steve Newman

## Comments on specific consultation questions

**1. Introduction and general :** 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.*

### Comments

Most commentators welcomed the proposals to reduce time and effort for new businesses, pointing out that many people were reluctant to talk to government departments until they were ready and knew what to expect. But some commentators feared that the penalty proposal would have little benefit and may make life more difficult for people starting businesses.

Some commentators thought that the argument that, by not registering, businesses' development would be restricted because of difficulty in getting access to advice and finance was flawed. One commentator said that he believed that people operating in the informal economy have no such difficulties. He thought the issue of help and advice needed to be divorced from the requirement to register.

On the question of additional costs to business, four commentators said that they did not believe the proposals created any additional costs. One suggested the self-employed may incur extra costs by engaging accountants/book-keepers because they were frightened of getting it wrong and being penalised; two commentators saw any potential penalty as an additional cost, one pointing out that Inland Revenue had failed to recognise that it is the complexity of the tax system which is the real underlying cost.

### Response

There is an existing requirement to notify the Inland Revenue immediately of liability to pay Class 2 National Insurance contributions (NICs). The consultation has identified that this is not widely known or understood, which is why, in enforcing the requirement, we believed it was necessary to combine the introduction of a sanction for failure with making registration more straightforward, providing immediate help and advice, and publicising the requirement.

Failing to pay Class 2 NICs can mean loss of contributory benefit entitlement. For example if someone who is not up to date with their Class 2 contributions becomes ill and needs to claim incapacity benefit, even if they make a lump sum payment of their arrears they will not be entitled to benefit immediately. And failing to pay Class 2 NICs on time it may result in additional costs because the arrears can be charged at a higher rate, and may well be associated with failure to notify chargeability to tax.

Additional measures to ensure that people notify on time, and so can get the appropriate payment arrangements sorted out does not add to the costs of compliance, and may have benefits. We will evaluate the impact of the effect of the proposals in improving early registration.

**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.*

<u>Comments</u>	<u>Response</u>
<p>All seventeen of the comments made on the proposals for simplifying the form CWF1 were in favour of this move. Individual comments stressed the importance of having a single registration process for tax and National Insurance. Others said that forms should ask for information that is needed rather than what might be useful at a later date, pointing out that is frustrating if information is requested but not used, only for the same information to be requested at a later date. The widespread availability of the new form was considered an important requirement.</p>	<p>A new short leaflet, which incorporates a registration form, "Thinking of working for yourself" will be issued in the new year. The leaflet / registration form will be available at all the usual Inland Revenue outlets and also a wide variety of outside organisations who have contact with the self-employed. It will count both for tax and NICs registration.</p> <p>The form has deliberately been kept to the most basic information for ease of completion. This means there might be a need for Inland Revenue officers to contact people for more details following registration (for example if their name has changed since the last entry on the National Insurance number record). We will evaluate the form in terms of how it is viewed by people who have to complete it and whether the balance between ease of completion and need for renewed contact for further information is satisfactory.</p>
<p>Six comments were received on the issue of electronic notification (by telephone, email or fax). All were in favour of this development, however three of the commentators were concerned that someone registering would have no proof of their call in the event of a dispute in a case where a penalty was imposed. Two commentators suggested that callers should be given a unique code to keep until they have received their first quarterly bill or paid their first direct debit payment. One was concerned that there would be double handling because not all the information could be taken by phone, so further details would be sought by the local office (as with the New Employers' helpline).</p>	<p>The helpline for the newly self-employed will be able to take telephone registrations from 10 January 2001. Calls will be charged at local rates and the line will be open 7 days a week from 8am to 8pm. Calls will be recorded and the information received will be entered and stored onto the database, thus providing confirmation of the calls. The current software does not support issuing unique an identifying number for calls, but such a facility should be available in the near future. People who prefer to register in writing will continue to be able to use the form. Or those registering by phone may find it useful to complete the form during the phonecall for their own records.</p>
<p>On the second point, as to whether the proposals were clear as to who is required to notify Inland Revenue when they start up in business, one commentator said that the proposals were clear on who needed to register. However eighteen commentators were particularly</p>	<p>We agree that it is not always straightforward to pin down a start date for a developing business. This question already crops up in relation to Class 2 National Insurance contributions as liability arises from the Sunday at the beginning of the week in which self-employment starts.</p>

concerned about the associated issue of when a business should be treated as having started. They saw the difficulty of defining a date for the start of business as a particular flaw in the proposals. Several particular activities in the pre-trading period were identified as possible points at which business could be said to have commenced and several commentators drew attention to the situation where a person drifted into self-employment in an activity that had started as a hobby. The general view was that it is important for a specific start point to be defined if the notification requirement is to be reinforced with a penalty for failing to do so within a time limit.

Several commentators referred to the difficulties concerning the status question i.e. whether someone is self-employed or an employee of a major client. They suggested that leaflet IR 56 be sent with the form CWG1

Our experience is that this has not caused difficulties in the past and a common sense approach, mainly relying on the self-employed person's own perception has been effective. But in recognition of this the time limit for registration will be calculated from the end of the calendar month in which someone starts self-employment, rather than a specific day.

We recognise that in some business sectors there are potential pitfalls around the status issue. Both the new leaflet/revised CWF1 and the new Guide will draw attention to this issue and will advise people to read IR56 if they have doubts about status, explaining where they should go for more in depth discussion on status issues.

**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 CD Rom. *Comments invited on that as a medium for delivery.***

<u>Comments</u>	<u>Response</u>
<p>Seventeen comments were received about the proposed new guide most of which welcomed the issue of comprehensive guidance on tax, NICs and VAT. Four commentators expressed concerns that the new guide would merely replicate similar guidance issued by the banks and accountant. One commentator thought accountants and business advisers should be able to issue the guidance and a further commentator thought that notification of the start of self-employment should act as a trigger to issue of the Guide.</p>	<p>The new Guide "Starting up in Business" is to be available from 10 January. It incorporates existing leaflets in one easy to follow folder. The guide provides a time line explaining to people what they need to do when starting, maintaining and expanding their business. It gives plain English guidance about tax and National Insurance responsibilities, and the records that should be kept. And it gives signposts to further advice both from Inland Revenue and other agencies. We think that the information the Inland Revenue can, and should provide is distinct from that provided by financial advisers. Our research (and some of the responses to the consultation) indicates that the rules around tax / NICs liabilities are not well understood. Whilst we continue work to simplify the rules, we also have a responsibility to pull together guidance in an accessible way. Unless a person says otherwise, notification of the start of self-employment will trigger the issue of a copy of the Guide.</p>
<p>Views on the benefits of the CDRom were mixed. Seven commentators welcomed the proposal whilst three were against the idea. Those in favour saw the possibility of using the CDRom in conjunction with other business planning documents, whilst those against the proposal felt that it offered little value. People with PCs could obtain it from the IR website and people without the kit could not use it in any event.</p>	<p>Offering the Guide on CDRom does not appear a high priority, and this is backed up by our own research. The Guide will initially be available in a paper copy and on the Inland Revenue website. When someone registers as self-employed they will be sent a copy - unless they tell us that they already have one. We will continue to monitor the most appropriate media.</p> <p>A video will be available to people who are thinking of becoming self-employed. This outlines the record keeping, tax and NICs issues they need to consider and where they can find further help.</p>

#### **4. Enforcing the notification requirement – general comments**

##### Comments

The proposals concerning the application of a penalty where a person failed to notify Inland Revenue that they had started in self-employment attracted the most comment. Several commentators questioned whether a penalty would have any real effects on the informal economy. Eight commentators expressed outright opposition to any form of penalty, suggesting that the proposals were draconian. Points they made included that small business is already subject to innumerable regulatory requirements, the tax penalty regime should be sufficient and that faced with a possible penalty people would not declare the true date they started in business.

##### Response

The introduction of a penalty for failing to register is in response to widespread non-compliance with the notification requirement. The longer someone puts off informing the Inland Revenue of their position, the more likely it is that they will stay in the informal economy - either because they fear tax and NICs liabilities may be more than they really are, or because they believe they can undercut legitimate businesses by saving on normal business costs. Neither of these situations is acceptable and we believe this is an appropriate way to address the problem.

**5. 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.**

Comments

On the issue of the period allowed for registration, two commentators thought that 1 month was sufficient; sixteen thought that it should not be less than three months. Eight commentators said that three months was an inadequate period because of the amount of work involved in setting up the business and uncertainty as to whether it would prove to be viable.

Suggested alternative periods ranged from six to twelve months whilst eight commentators said that the period for registration for Class 2 NICs should be the same as that for notifying chargeability of income tax (i.e. 6 October following the end of the tax year in which trading commenced) pointing out that the maximum amount of accrued Class 2 debt in these cases would be £164 at the present Class 2 rate.

Response

A deadline of three calendar months for registration appears to strike the right balance. As stated above the three month period will begin at the end of the month in which self-employment starts. Thus someone starting self-employment on 10 January 2001, for example, would have until 30 April 2001 to notify the Inland Revenue. We believe the suggestions that the deadline should be substantially longer do not take account of the fact that basic records need to be maintained from the outset in order for the self-employed person to be able to calculate their profits accurately at the end of the tax year. And they need to be aware of allowances or tax credits they may be entitled to as early as possible if they are to take full advantage of them. In addition if Class 2 NICs were not paid until the date for notifying chargeability to tax, as social security legislation stands, the contributor would be excluded from benefit entitlement in that year.

**6. 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.***

Comment

The proposal that no penalty would be applied in cases where a person's earnings fell below the Small Earnings Exception (SEE) was discussed and considered appropriate by six commentators. They also raised various points on this exemption including how this will work in practice, the difficulty of projecting whether income would be below the SEE limit, and whether it would be possible to taper the penalty where earnings slightly exceeded the SEE limit. Two commentators said that the no penalty should be imposed where there was no Class 2 NICs payable i.e. people paying the maximum Class 1 who had subsidiary self-employment earnings.

Response

We agree that there should be no penalty for late notification if there is no liability to pay Class 2 NICs. Thus someone who pays maximum Class 1 NICs has no liability for Class 2 NICs on their subsidiary earnings from self-employment and would not be penalised if they were late in notifying them. The exemption for people with low earnings will be in addition to that. Someone with low earnings is still liable for Class 2 NICs unless they have applied for Small Earnings Exception (SEE) which of course would mean that they had registered. So the penalty exemption will not be linked to holders of SEE only, but to the fact that their earnings during the period of self-employment had been at or below that level. Hence a person who decides to pay Class 2 NICs for earlier periods, even though their income was within the SEE, to preserve their contributions record would not be penalised.

We will not require additional evidence of earnings over and above that which is required for SEE entitlement at present. Again a common sense approach will be used - particularly in the early days when we expect people who have been involved in low-income self-employment for lengthy periods to register for the first time. The Inland Revenue is committed to enabling people to meet their liabilities and will apply the rules with a particularly light touch in the first year.

**7. 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.**

Comment

With regard to whether the proposed £100 penalty was appropriate and provided sufficient incentive to notify within the time limit, eight commentators thought it was about the right level and was consistent with the amount of SA fixed penalties. However, ten commentators thought the amount too high, several made the point that a £100 penalty is disproportionate in relation to the amount of Class 2 debt that has accrued when the time limit expires and that the amount is equivalent to a whole year's Class 2 liability.

Views were mixed as to whether the penalty was sufficient incentive. Some commentators made the point that those people who had no intention to register would not be dissuaded from this course by a penalty. On the other hand many newly self-employed people, who had every intention of paying all their liabilities, only approach an accountant at the end of their first year's trading. For people who failed to register because of their ignorance of the time limits the £100 penalty would be the cause of much aggravation and that the weakness in the proposals lay in making the self-employed aware of their responsibilities.

Two commentators suggested that there should be further consultation/debate on whether the size of the penalty was adequate and whether it should vary between those who deliberately concealed their earnings from self-employment, and those who were simply late in voluntarily notifying the Inland Revenue of it.

Response

We will set the penalty at £100. Evidence of the £100 penalty for late self-assessment returns indicate that it is an effective incentive to compliance. We will publicise the requirement widely to reduce the situation arising where someone fails to register out of ignorance.

We have considered carefully the view that there should be a scale of penalty depending on lateness or the degree to which someone deliberately concealed their earnings from self employment – rather than simply was late in voluntarily notifying the Inland Revenue of it. On balance we have decided that a simple, easy to understand and administer penalty of £100 for lateness, whatever the circumstances, with a right of appeal is most appropriate. Long term non-compliance could result in tax geared penalties and serious frauds could result in criminal prosecution.

**General : A number of general points were made on the consultation**

**Publicity and timing**

Four commentators expressed concern that in view of the intention to implement the proposals in the New Year, they had been given little publicity.

One commentator thought that the proposed start date was too early if proper consideration was to be given to the points raised by the consultation exercise. They thought the new regime should not start until 6 April 2001 so as to allow adequate time for the publicity.

On the other hand, five commentators welcomed the fact that there would be publicity surrounding the introduction of the proposals. But it was also pointed out that there was a need for continuing publicity to ensure people who subsequently became self-employed did not through ignorance fall foul of the penalty regime.

**"Reasonable excuse"**

Two commentators said that there needs to be clarification as to what would be regarded as reasonable excuse for failing to notify. And a further commentator said that there should be publicly funded support for people who receive a penalty and wish to appeal against it, he thought that it was unsatisfactory that people should have to rely on tax office staff for support on this matter.

**Response**

The Inland Revenue will launch an advertising campaign in the new year to tell people of the need to register, and about the Helpline for the Newly Self-Employed. There will be further publicity when we approach the deadline for notification for those who had started self-employment in January 2001 or earlier, 30 April 2001.

The new penalty will not be implemented until 30 April at the earliest for non-notifiers who started self-employment in January 2001 or earlier. This gives adequate time to ensure the requirement is widely publicised.

The requirement to notify self-employment and the penalties for failing to do so will be prominently displayed in our literature. We will monitor levels of compliance and mount further publicity if appropriate.

**Response**

The reasonable excuse criteria will be as currently set out in the leaflet "Self Assessment, Penalties for late returns". We will provide similar advice for the late notification of self-employment penalty.

<p><u>Administration</u></p> <p>Several commentators drew attention to particular problems experienced by clients with the existing arrangements, in particular they perceived problems with the onward transfer of information from NICO to individual tax offices.</p> <p>Two commentators thought where the form CWF1 was sent by an agent the form should be treated in a like manner to a form 64-8, which is used to authorise Inland Revenue to provide information to the taxpayers agent or alternatively there should be scope within the CWF1 to provide that authority.</p>	<p><u>Response</u></p> <p>As part of the “re-vamping” exercise for new registrations, we are looking closely at our internal arrangements for handling and distributing information between our constituent parts. The comments about difficulties faced currently by self-employed people will be fed into our programme for improving the service offered to tax payers and contributors. Similar consideration will be given to the procedures for handling agents’ authorisation. Our aim is to reduce the amount of unnecessary double contact with the Inland Revenue on tax and NICs issues.</p>
<p><u>Timetable for the consultation exercise</u></p> <p>Two commentators drew attention to the fact that the 8 weeks provided for the comments on this consultation paper did not comply with the Cabinet Offices Code of Conduct on consultation published in November 2000, which requires a 12 week consultation period.</p>	<p><u>Response</u></p> <p>The consultation document was published on 17 October 2000, before the advice was issued to Departments that consultation should be over 12 weeks where possible. In fact 80% of the responses to this consultation document were received in the first four weeks.</p>

<b><u>Issues outside scope of consultation</u></b>	
<p><u>Class 2 Liability</u></p> <p>Ten commentators suggested that Inland Revenue should consider either greater harmonisation the NICs and tax systems or the abolition of Class 2 in favour of Class4 NICs. It was pointed out that with the changes made to Class 4 NICs liability, a business with profits in excess of £5,870 per annum would now pay a greater amount of Class 4 than Class 2. The emphasis of a penalty regime on Class 2 rather than Class 4 was therefore incorrect.</p>	<p><u>Response</u></p> <p>This raises issues beyond the scope of the consultation, but the aim of this measure is to ensure the self-employed notify us early on. If the NICs structure were to be changed there would still be a case for requiring early notification of self-employment.</p>
<p><u>Registration and low earnings</u></p> <p>Some commentators considered it absurd that people with earnings below the SEE should be required to register and then be excepted from paying Class 2 NICs. They suggested that it was more sensible to treat the SEE as an earnings limit below which registration was not required. One proposal was that there should be an automatic rebate of Class 2 NICs if earnings failed to reach the necessary limit</p> <p>An associated comment suggested that the amount of the SEE should be aligned with the single person' s income tax allowance.</p>	<p><u>Response</u></p> <p>Again wider issues are raised by the comments.</p> <p>Unless people fall into certain prescribed categories no credits are awarded if someone has Small Earnings exception. For this reason many may feel it is better to pay the Class 2 NICs at £2 per week, rather than take advantage of their SEE entitlement.</p> <p>The amount of the SEE is reviewed each year along with the rates for all (NICs). For 2001/2002 it will be raised by the RPI to £3,955.</p>
<p><u>Incentives</u></p> <p>Several commentators suggested that rather than a penalty regime to punish non-registration, there should be financial incentives to encourage registration including the proposal that there should be a £100 grant towards start-up costs.</p>	<p><u>Response</u></p> <p>There are a number of incentives for new businesses in terms of the allowances available. We will also look at introducing incentives for on-line registration when that is made available.</p>
<p><u>The benefit system</u></p> <p>A commentator suggested that the benefit system was a major cause</p>	<p><u>Response</u></p> <p>Self-employed people currently have access to a number of in-work</p>

of people drifting into the informal economy saying that benefits are stopped when people go into business. The commentator suggested that people should be able to remain on benefit for a maximum of 1 year whilst starting a business and that Inland Revenue could subsequently recover the benefit paid in the early days of the business from profits over a 2-3 year period.

benefits, in particular Working Families Tax credit (WFTC) and Disabled Persons Tax credit.(DPTC) Information about these will be covered fully in the new Starting up in Business guide. From 2003 the new integrated system of support for children will be introduced, bringing together support for children currently contained in WFTC, DPTC, Income Support and Jobseeker's Allowance and the Children's Tax credit. This will be complemented by an employment tax credit. Both these credits will be available to self-employed people and the Government intends to extend the employment tax credit to families without children.