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OPERATIONAL IMPACT ASSESSMENT FOR EMPLOYMENT STATUS INDICATOR (ESI)

Purpose and Intended Effect of Measure

The Policy Objective

5.1 ESI is an online interactive guidance tool designed to help determine whether someone is employed or self-employed. The product, which has been the subject of extensive testing internally and externally, is available on the HMRC web site. Customer advisers also have access to ESI to support customers when they contact us.

5.2 ESI users will be able to reach the right practical answer consistently and accurately, without needing to understand how the rules work. It is designed to give an answer in all but the most complex cases. Such cases will require the intervention of one of HMRC's Status Inspectors.

Background

5.3 ESI is one of the products developed by the HMRC Better Guidance Programme (BGP). This programme supports the department's PSA targets and other key business objectives by establishing corporate standards and processes for producing and maintaining guidance which:

- enables everyone to understand and receive what they are entitled to and to understand and pay what they owe;
- is provided by an infrastructure that produces and delivers guidance which is usable, easily maintained and managed as a departmental asset; and
- promotes business efficiency by enabling improved customer contact through clear, consistent, accurate and up to date information via media which suit all customer needs.

5.4 Employment status is a notoriously difficult area of the tax system, with a considerable body of arcane case law. The ESI interactive guidance tool effectively shields the user – whether an HMRC customer adviser or an external customer – from the complexity of the rules, while still providing an accurate and consistent answer on employment status in all but the most complex cases.

5.5 ESI is the first deployment by HMRC of interactive guidance using innovative 'rulebase technology' provided by RuleBurst (Europe) Limited. Earlier forms of interactive guidance typically use 'case based reasoning' or similar techniques. These take as a starting point the same FAQs as static guidance, and incorporate only those aspects of the rules needed to answer those questions. In contrast rulebase technology is used to develop a rulebase for a complete set of rules (whether legislation or business processes). This guides the user to the right issue, and the resolution of that issue, through simple interactions on factual questions.

5.6 The rulebase identifies what further questions are prompted or excluded by the answers to previous questions and continues the investigation until a definite conclusion is reached. And it provides the user with a complete explanation of the outcome.

5.7 Interactive guidance using rulebase technology is still relatively new in the UK. But it has been very successfully deployed in Australia, resulting in significant improvements in customer service and increased productivity.

5.8 ESI is now available to HMRC customer advisers who can use it to provide callers with a definitive answer to their status enquiries (provided that the information supplied is accurate and complete). And it is available via the HMRC web site for external customers to obtain a provisional view of employment status. Later in 2006/07 we hope to deploy an enhanced version of the tool, which will give external customers binding status decisions (provided that the information supplied is accurate and complete) without any need to contact the department. To enable HMRC to give a binding opinion we require the taxpayer's personal details and it is this element the current web site version cannot capture.

Rationale for Government Intervention

5.9 Employment status has long been one of the most difficult areas of direct tax law. In all but the most straightforward cases, it is necessary to weigh up a number of complex aspects of an individual contract in order to reach a decision. For HMRC and private sector tax advisers this is a resource-intensive process, requiring highly trained specialists. As a result:

- it is an expensive service for HMRC to provide;
- it increases the compliance costs of individual taxpayers, employers and their advisers; and
- it increases the risk of inconsistency in status decisions in individual cases.

5.10 Although the question of employment status can arise in most areas of work, it is particularly relevant to the construction industry, which has long been heavily reliant on sub-contracted labour. The new construction industry scheme, which will be introduced in April 2007, will result in two main changes, which will increase the number of status enquiries:

- at present contractors must obtain a sub-contractor's identification card or certificate only at the start of a contract. From April 2007, contractors will have to verify the tax payment status of a sub-contractor before making any payments; and
- instead of using vouchers to account for payments and tax deducted under the current scheme, contractors will have to make monthly returns, containing a declaration that the contractor is satisfied that payments made in the return are not made under a contract of employment.

5.11 The new construction industry scheme will apply to around 200,000 contractors and 900,000 sub-contractors. Because it will require much more frequent status checks, it is important that HMRC can provide a consistent, easy to use means of making these checks. (It is estimated that the annual volume of enquiries could increase by 250,000 – 500,000.) The ESI tool fulfils this requirement for the vast majority of cases, allowing specialists in HMRC and elsewhere to concentrate on the minority of very complex cases.

Consultation

Within Government

5.12 Early discussions were held with DTI and the Home Office on the need to develop the ESI tool and the possible implications for their work. Both departments were consulted as the earlier versions of the tool were developed.

Public Consultation

5.13 There has been extensive consultation with relevant representative and professional bodies throughout – in particular with construction industry organisations. In addition the ESI tool has been tested by external users on three separate occasions – in July/August 2004, August 2005 and September 2005. One important benefit of this external testing was that we received various suggestions for its improvement, and most of these have been implemented while others may be incorporated in future enhancements.

Options

5.14 Three main options were considered:

Option 1

5.15 Do nothing and continue to rely on Employer Compliance and Status staff to determine status on a case-by-case basis.

5.16 Even without the forthcoming introduction of the new construction industry scheme next year, this was not an attractive option, in view of HMRC's PSA targets and other key business objectives for customer service improvement. The considerable increase in the number of status checks which the new construction industry scheme will necessitate, and the likely inability of HMRC to cope with the increased volume of enquiries, meant that do nothing was not an option.

Option 2

5.17 Extend the deployment of the first version of the ESI tool to contact centre staff. This version was a computer-based interactive guidance tool, but used the less sophisticated 'case based reasoning' approach. It was made available to specialist status and compliance staff in HMRC from 2004, and proved successful, determining status in around 75% of cases. While this first version of the ESI demonstrated the benefits of such a tool it was not considered suitable for non-specialist HMRC staff in contact centres or for deployment on the Internet. It therefore seemed a much less attractive option than...

Option 3

5.18 Develop and deploy an enhanced version of the online ESI tool, using rule base technology, both for HMRC customer advisers and (via the Internet) for external customers and their agents. This was the preferred option because:

- user testing suggests that it will successfully determine status in around 90% of cases;

- it does not require users to have any prior knowledge of employment status rules; and
- when fully developed, it will enable external customers to obtain binding status decisions (provided the information supplied is accurate and complete) without contacting the department.

5.19 This option therefore increases the chances of HMRC meeting its PSA targets and key business objectives for customer service improvement. It also helps HMRC to manage the increase in external contacts which the new construction industry scheme is likely to generate. And it provides an excellent opportunity for HMRC to evaluate the potential application of rule base technology in a 'live' environment, in order to consider the scope for extending it to other areas of the department's business.

Costs and Benefits

Sectors and Groups Affected

5.20 Although the ESI tool can be applied to any contractual relationship, it is likely to be of most relevance to those industry sectors which typically have a high proportion of both employed and self-employed workers – in particular, the construction industry. The tool will make it easier for the majority of people in those sectors to obtain status rulings. The minority of people whose status cannot be determined by the tool will need to be judged by specialist HMRC staff, as before. So no-one will be adversely affected by this change.

5.21 There is no disproportionate effect on any sector or group, and no race, Northern Ireland or other equality impacts.

Benefits

5.22 Employment status determines how much tax and NICs are paid by businesses and individuals. It is important that status decisions are correctly established so that workers pay the right amount of tax and NICs and have access, where necessary, to the appropriate employment rights and benefits. The ESI tool will provide the necessary reassurance to individuals, to employers and to HMRC that status decisions are correct.

Benefits for Customers

- In the vast majority of cases, a reduction in the overall time taken to establish an individual's status;
- Greater consistency and certainty in status determinations where the circumstances are broadly similar;
- Contractors and sub-contractors better able to cope with the reporting requirements of the new construction industry scheme;
- Quicker resolution of disputes about employment status (resulting in some cases in prompter payment of Statutory Payments to employees); and
- Ability to self-serve (for customers who want this) by accessing the ESI tool via the HMRC web site.

Benefits for HMRC

- HMRC faces a substantial increase in the number of status enquiries when the new construction industry scheme comes into effect in April 2007. The ESI tool provides a cost-effective way of handling those enquiries;
- In the vast majority of cases, users (whether HMRC frontline staff or external customers) will be able to answer status enquiries without the need to involve status specialists – freeing up resources for more complex cases and other compliance work;
- Timely and accurate determination of status will help ensure prompt payment to the Exchequer of tax and NICs lawfully due; and
- The ESI tool will improve the management information available to HMRC.

Costs

5.23 The estimated overall costs to HMRC of developing and deploying the ESI tool are in the region of £7 million. This total includes the cost of IT software licences which HMRC will be able to use to develop other interactive guidance materials using rulebase technology. This represents good value for money for the taxpayer.

5.24 But in any event the costs are felt to be justified by the long term savings which the department will realise because:

- it would otherwise have to cope with a substantial increase in the volume of status enquiries, requiring substantial additional resources for contact and enquiry centres and for compliance work;
- the status of taxpayers will be correctly determined at the earliest possible stage; and
- taxpayers will pay the correct amount of tax and NICs from the outset.

5.25 External customers are not obliged to use the ESI tool but those who do are likely to achieve some saving in their compliance costs.

Small Firms Impact Test

5.26 No disproportionate adverse impact on small businesses was identified during the external consultations referred to in options above.

Competition Assessment

5.27 The introduction of ESI is not expected to have any competition effects. This assessment has been derived using the Cabinet Office Filter Test.

Enforcement, Sanctions and Monitoring

5.28 Should HMRC carry out an investigation into anyone's tax affairs and discover in doing so that their employment status has been incorrect, legal sanctions may apply: it may impose interest charges and penalties, in addition to enforcing collection of tax and NICs arrears. Moreover, the new construction industry scheme will require contractors to make monthly returns containing a declaration that no payments

included in the returns have been made under contracts of employment. Incorrect declarations may result in penalties.

5.29 Any penalties imposed will be subject to the usual right of appeal.

5.30 We are able through the management information system which supports the tool to monitor the results from its use.

Implementation and Delivery Plan

ESI was released to HMRC frontline staff on 12 December 2005 and externally on the HMRC Internet site on 19 December 2005. As noted in section 2 above, the version available to external customers only gives a provisional view of status at present. We hope to release an enhanced version of the tool during 2006/07, which will give external customers binding status decisions (provided that the information supplied is accurate and complete).

Post-implementation Review

5.31 HMRC has a programme in place to ensure that the compliance cost assessments made for all Regulatory Impact Assessments are reviewed within two years from when a policy is first implemented. This process may well be rolled out to consider the impact on Operational Impact Assessments in due course. The New CIS Regulatory Impact Assessment will be subject to the normal review after it has been implemented in April 2007.

Summary and Recommendation

5.32 It is essential that individuals, and businesses for which they work, can correctly determine their employment status where this may be unclear – and can do so in the most efficient, consistent and cost-effective manner. HMRC considered various possibilities before deciding that the best option is the interactive online guidance tool – the Employment Status Indicator. This tool has been successfully deployed to HMRC staff and external customers from December 2005.

Contact Point

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OPERATIONAL IMPACT ASSESSMENT

Employment Status Indicator

Statement of Ministerial Approval

I have read the Operational Impact Assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

Dawn Primarolo
Paymaster General

Dated: 14 March 2006