

REGULATORY IMPACT ASSESSMENT

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

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

Purpose and intended effect

Objective

These Regulations define the circumstances in which shipping operators with a place of business in the UK who engage UK resident mariners through offshore manning companies will have to pay employers' National Insurance Contributions (NICs) from 13 October 2003. The changes will **only** apply in respect of mariners employed by persons outside the UK ("offshore manning companies").

Where the mariners provide their services wholly or mainly outside Category A B, C or D waters as provided for under the Merchant Shipping (Categorisation of Waters) Regulations 1992 and identified in the Merchant Shipping Notice 1776 (M) published by the Maritime Coastguard Agency, the shipping companies will not be liable for employers' NICs. This change will not affect UK shipping companies that do not use offshore manning companies to crew their vessels.

Background and introduction

Risks

Most UK companies who use the services of UK resident workers employed by a foreign employer are liable to pay employers' National Insurance Contributions on the earnings of those workers. Until now this rule has not been applied to employers of mariners. This has led to the growth of the practice of offshore manning, where the crews of ships operated by UK based companies have been transferred to the employment of companies based abroad. This has caused concern for some of the employees involved about their employment rights and entitlement to some UK benefits. It has also led to unfairness of treatment between these employers and other UK employers who cannot, or choose not to, benefit from offshore manning arrangements. At the same time, there has been some uncertainty about the legal basis for the special treatment of mariners in this respect, and in particular whether it should apply to mariners employed within UK territorial waters.

The purpose of the current measure is to resolve a lack of clarity in the existing law relating to companies using these workers, and ensure that those companies operating in UK category waters A, B, C or D as described in the

Merchant Shipping notice 1776 (M) pay National Insurance Contributions on the same basis as other UK employers. As a result shipping companies with a place of business in the UK, who engage mariners to work wholly or mainly in relevant UK waters through offshore manning companies, will have to pay employers' National Insurance Contributions from 13 October 2003 on the same basis as other UK employers. The employers' contribution rate is currently 12.8% on earnings above £89 per week. We estimate that number of UK mariners for whom an employer's liability will arise is 2500-3000 out of a total of some 25,000.

The change excludes international shipping, most ferries, coastal cargo trade and aggregate carriers who operate wholly or mainly outside these waters. In these cases UK operators using workers employed by offshore companies will not be required to pay employers' contributions.

Policy Options

The policy objective was to ensure fairness between employers by ensuring that all UK employers paid National Insurance contributions on the same basis. Two alternative policy options were considered:

- to extend the liability to pay employer's contributions to shipping operators using the services of UK resident mariners regardless of where the duties of the employment are carried out. This extended liability would have been the case in the absence of these Regulations, following legal advice that the previous practice of not collecting employer's contributions from UK shipping operators using offshore manning arrangements was not consistent with the legislation.
- to extend the liability to pay employers contributions to shipping operators using the services of UK resident mariners operating wholly or mainly in UK territorial waters i.e. within 12 miles of the coast of the UK.

However, the Government's policy of support for the UK shipping industry and the competition that shipping operators face from foreign companies which may be subsidised or have lower wage costs has led to the proposed restriction to those mariners who are employed wholly or mainly within UK waters as defined by the Merchant Shipping Notice 1776 (M).

There are possible unintended consequences of making this change but these are very limited. One is that international competitiveness of some shipping operators operating vessels wholly or mainly in UK category waters may be affected. Another is that employers may take steps to reduce wage costs by using cheaper foreign labour. Set against these are the benefits of ensuring fairness in treatment of UK employers and workers who work in such close proximity to the UK mainland.

The options that were considered for administering the new Regulations are covered below.

Benefits

By limiting the scope of the change, shipping operators will not have to pay NICs in respect of UK resident mariners employed outside relevant UK waters by offshore manning companies. The value of this benefit is estimated at £40–50 million per annum.

Costs

Policy costs: The Inland Revenue has received legal advice that shipping operators using offshore manning arrangements were liable for employers' NICs under the previous legislation. Because advice given in the past had not made this clear, they will not seek to collect arrears of contributions in respect of periods before 13 October 2003. This means that the current Regulations do not impose a new NIC liability on shipping operators using offshore manning arrangements within relevant UK waters. The effect of the change of practice in relation to those mariners employed wholly or mainly within relevant UK waters under offshore arrangements, will be to increase their employment costs. This impact will vary between operators depending on wage costs but is expected to be £6-7m a year in total.

Implementation costs: The impact of the changes on shipping companies will depend on whether they have vessels which operate inside relevant UK waters, and whether they use offshore manning companies to crew their vessels.

In the simplest scenario a UK shipping company that does not use an offshore manning company and engages its crew directly will not be affected and the company will not face any additional administrative costs because of the changes.

Where an offshore manning company is being used by a UK shipping company to crew its vessels it will be the responsibility of the shipping company to determine whether it is liable for employers' NICs in respect of mariners providing services through an offshore manning company. In the majority of cases it will be relatively straightforward for the company to decide whether liability for employers' NICs arises for a particular mariner.

For companies who become liable for employer NICs, they may choose to end the offshore manning arrangement and transfer the worker to a UK based payroll. If so they will face a one-off transitional cost of transferring staff to their payroll and normal payroll administrative costs thereafter. The precise cost will depend on the number of mariners that are transferred to the company payroll and may have a disproportionate impact on those operators with relatively high payroll costs. However, this may be offset to a large extent by not having to pay the offshore manning company fees which are likely to include an element to cover its payroll administrative costs.

There will be a cost to the Inland Revenue of administering a clearance procedure for unpredictable cases (see below) but this will be minimal, as existing Network compliance teams will do this work.

Clearance procedure for unpredictable cases

Representatives of shipping companies have indicated that they may find it difficult to comply with the new rules because it may be difficult for them to determine whether they are liable for employers' NICs in respect of mariners engaged through an offshore manning company. This is because the pattern of duties is genuinely unpredictable and it is difficult to decide whether the mariner's duties are to be performed wholly or mainly inside relevant UK waters or not. In order to make it as easy as possible to comply with the changes, we have looked at two options for dealing with difficult cases.

Option 1 – Detailed Record Keeping – Earnings period liability

Shipping companies could keep detailed records of the mariners' time spent inside and outside relevant UK waters. NICs could then be paid in each earnings period (monthly/ weekly) based on whether more time was spent inside or outside relevant UK waters in that earnings period.

Advantages

- Detailed records will allow shipping companies to determine whether employers' NICs are due.
- The Inland Revenue will be able to check detailed records to ensure compliance and request payment of arrears from shipping companies.

Disadvantages

- Increased administrative cost and burden on shipping companies.

Option 2 – Liability depends on nature of duties

Rather than require the employer to judge in each pay period whether the mariner has been working wholly or mainly within relevant UK waters, the Regulations could relate the liability to the nature of the individual's duties, rather than his location at any point in time. So a mariner whose duties are carried out wholly or mainly outside relevant UK waters would not attract an employer NIC charge if he happens to be within relevant UK waters in a particular pay period.

The Inland Revenue could provide a clearance procedure to help shipping companies where there is doubt about employers' NICs liability because of the genuine unpredictability of the mariners' duties. This will be on the basis of previous patterns of activity of the vessel, and any evidence of expected future activity. In cases where the mariner is new the operator might compare his duties with other mariners already engaged on the same vessel.

Once the Inland Revenue have given a ruling that the mariner falls outside the scope of the amended regulations, it will not collect arrears, if on review or on compliance visit it appears that the mariner has been engaged wholly or

mainly in relevant UK waters (unless the evidence supplied to support clearance was clearly misleading).

Advantages

- Provides certainty in application of rules where companies are genuinely uncertain about liability.
- Shipping companies do not need to keep unnecessary and detailed records adding to administrative burden.
- Shipping companies will not have to pay arrears of employers' NICs when covered by IR clearance, even if it later transpires that the mariner's duties fell wholly or mainly within relevant UK waters.

Disadvantages

Relies on shipping companies providing sufficient evidence that nature of mariners duties are wholly or mainly outside relevant UK waters.

Recommended Option

The shipping industry have indicated that to record the time that mariners spend inside and outside category waters would require the establishment of new systems and procedures at considerable cost in terms of equipment and labour. **In view of this Option 2 provides the best approach to dealing with borderline cases as it is less administratively burdensome on shipping companies and is the one being developed.**

The impact of using option 2 is that some shipping companies may apply and be given clearance not to pay employers' NICs when it later transpires on an employer compliance visit or on review that the mariner concerned was working wholly or mainly within relevant UK waters. But the potential loss of revenue has to be balanced against imposing a further burden of detailed record keeping on the whole of the shipping industry, to ensure employers' NICs are properly paid on all borderline cases as well.

For those companies that are uncertain about liability there will be initial costs of obtaining clearance for borderline cases. This will involve: -

- 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.

We estimate the likely number of shipping companies that could potentially require clearance is small. We have consulted with the industry on the clearance procedure to make it as easy as possible to operate using existing

records and the additional costs to those companies that need clearance will be minimal.

Securing Compliance

Routine employer compliance reviews will include checks to ensure that shipping companies that use offshore manning companies are complying with the new rules. It is not necessary to have special arrangements to secure compliance as general rules relating to non-payment of NICs will apply.

The IR will provide clearance for shipping companies who have borderline cases using the existing Network compliance teams responsible for the issue of Dispensations and PAYE Settlement Agreements. Using existing Area-based teams maintains the link between the employer and office responsible for the PAYE scheme.

Competition Assessment

The measure will create a level playing field for companies operating vessels in relevant UK waters with a place of business in the UK who employ UK resident mariners. This will be irrespective of whether they use offshore manning contracts. They will also be paying NICs on the same basis as other UK employers. Limiting the application of the change to those employees operating in relevant UK waters also limits the extent to which it will disadvantage operators competing with foreign companies who may receive subsidies or may have lower wage costs.

Impact on Small Businesses

The effect on small shipping companies of operating the clearance procedure for unpredictable cases will be the same as for large companies. To the extent that small businesses are less likely to have used offshore manning arrangements, they will benefit from the removal of a cost advantage from competitors who do.

Monitoring

We will monitor the operation of the new rules with a view to ensuring that the administrative burden of the arrangements is kept to the minimum.

Consultation

Representatives of the shipping industry, and trade unions have been consulted on the proposed administrative arrangements.

Summary

This regulatory impact assessment looks at the implementation of the new arrangements for employers' NICs for shipping companies in respect of

certain mariners and the steps that the Inland Revenue has taken to ensure that the administrative burdens of the change are kept to a minimum, especially in cases where shipping companies are uncertain about liability.

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