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REGULATORY IMPACT ASSESSMENT (RIA)

National Insurance Contributions and Statutory Payments Bill

Introduction

1. The measures in the Bill build primarily on the improvements made through the transfer of responsibility for National Insurance Contributions (NICs) and the administration of Statutory Sick Pay (SSP) and Statutory Maternity Pay (SMP) from the then Department of Social Security (now Department for Work and Pensions) to the Inland Revenue in April 1999. This transfer of business was designed to modernise the administration of NICs, and to pave the way for further alignment in the operation of tax and NICs in order to reduce burdens on business.

Purpose and intended effect

2. The Social Security Contributions (Transfer of Functions, etc.) Act 1999 transferred existing functions of the Secretary of State, where they related to NICs and the operation of SSP/SMP, to the Board of the Inland Revenue. The aim was to effect that transfer quickly, and then to use a settling-in period to identify any anomalies or misalignments of powers or processes for later legislation.

3. Much has been achieved in the four years since the transfer, such as the introduction of joint employer compliance reviews and the joint handling of expatriates' tax and NICs affairs, but removal of some of the remaining misalignments requires primary legislation. This Bill is the first opportunity to address these. It covers areas where the NICs, Statutory Payments and equivalent tax regimes can be brought closer together, but it does not make fundamental changes to the nature of the National Insurance system or the contributory principle.

4. There are further measures which are not aimed at alignment, because they do not have tax equivalents, but which seek to make the administration of NICs less burdensome for employers.

Contents of Bill

5. The Bill contains a number of minor measures with an overriding theme of improving the administration of NICs and SSP/SMP. These have been put into five groups of descriptions. A detailed analysis of each cost impact is contained in the main body of the RIA. The annexes give descriptions of each

measure along with explanations of how we intend to consult, monitor and evaluate. The groups in summary are:

Non-alignment measures assisting employers' administration of NICs

(A) - Changes to the rules employers must follow to recover from their employees the primary NICs they pay to the Inland Revenue on securities based earnings.

(B) - Extending the current provisions for Joint Agreements and Elections, which allow the employee to pay the secondary NICs arising on gains from employment-related securities options. The new provisions will now also allow employers and employees to jointly elect or agree for the employee to pay the secondary NICs due on convertible and restricted securities (post-acquisition chargeable events only).

Alignment measures

(C) - Alignment of debt recovery procedures for a small proportion of NICs (primarily the flat rate Class 2 NICs paid by the self-employed) with those used to recover other NICs and tax debts. These include changing the 30 day notice period for taking action in England and Wales to distraint goods to 7 days; changing the 30 day time notice period for application for a summary warrant in Scotland to 14 days; introducing procedures in Northern Ireland in line with those which apply in England and Wales (currently action to distraint must be taken by the Enforcement of Judgments Office); and extending the normal arrangements for the recovery of tax and NICs to the recovery of NICs debts which have been transferred to an officer of a company by a personal liability notice.

(D) - Alignment of powers of employer compliance officers to inspect records and gather information for tax, NICs, and statutory sick and maternity pay purposes. This is the outcome of a review that was promised by the Minister (Baroness Hollis) during the passage of the Transfer of Functions Bill.

(E) - The introduction of a routine compliance regime, including civil penalties, for the operation of SSP and SMP, replacing the current criminal offences.

Overall Benefits, Risks, Transfers and Options

6. Further details of the measures, including discussion of options, are contained separately in the annexes. All benefits, costs and transfers are discussed in the main body of the RIA. Overall there are no significant risks associated with the measures in this Bill, though one measure addresses very small scale avoidance in SSP/SMP. The key aim of the package is to smooth existing misalignments in a way that, overall, does not impose any significant

new burdens, either administrative or in additional revenue to be paid to the Exchequer. The measures should reduce the time and money that contributors – in particular employers - have to spend in fulfilling their obligations to the Inland Revenue. There are no changes to the nature of the NICs, SSP and SMP systems and the implementation and on-going costs to both Inland Revenue and employers are negligible.

Policy Costs

7. There are no significant policy costs. (Please see the transfers and distributive impacts section). The basis of these conclusions for each measure is explained below.

Measure (A) - Employers will benefit from the certainty of knowing that their employees or ex-employees will bear their own NICs on security-based gains. There are no Exchequer costs as the employer pays over the primary National Insurance to the Inland Revenue at the time that the gain arises. Under these proposals employers will have a longer period to recover primary NICs than they have under current rules.

Measure (B) - For NICs Elections and Agreements, the Exchequer costs are considered to be negligible. The costs are for the provision of Income Tax relief to the employee for the secondary NICs they agree to pay in respect of restricted and convertible securities. However, this cost is partially offset by the loss of Corporation Tax relief for the employer in respect of the costs of secondary NICs to be borne by the employee. It is estimated the Inland Revenue will process on average 2 cases a day and therefore the additional work will be absorbed by current staff levels and there will be no additional public costs.

Measure (C) - Compliant businesses will not be impacted by the debt recovery measures. As the changes will enable existing debt recovery procedures to apply to all NICs the flow of money to the Exchequer will change very little, but there will be a very small transfer or re-distributive effect from a very small increase in the flow. This is because NICs that are currently collected separately on a 30 day notice will be subject to a 7 day notice. Class 2 NICs only represent 2.5% of the total amount collected for NICs by the current Tax provisions. It is estimated that there are less than 1,000 distraint actions for Class 2 NICs each year. Only a handful of actions per year (anecdotal evidence suggests that it is a tiny proportion) result in goods being distrained. Most distraint actions usually result in the debt being paid as it is in both the debtor's and the Revenue's interest to settle the debt before distraint takes place. Class 2 NICs are only £2.00 a week. Class 2 debts will therefore be small and distraint action is therefore rarely cost effective. Letters advising of possible distraint action always recommend that individuals contact the Inland Revenue in the first instance and network offices are free to enter into "time to pay" agreements with them.

Measure (D) - The alignment of Officers' powers for both tax and NICs will enable the inspection of employers' records to continue in the same way as it has done before. As there will be no changes to the way a review is carried out or the amount of people required to inspect records, we do not anticipate that there will be any changes in the public sector costs to the Exchequer.

Measure (E) - The new compliance regime for SSP/SMP is aimed solely at those who are abusing the present system. Non-compliant employers will find that a new, efficient and more cost effective regime will mean that they will now have to meet their obligations. This should mean savings to the public sector; but these are not expected to be significant, as the SSP/SMP non compliance that we are combating in this measure is very small scale. Any additional work created will be accommodated in present staffing levels. We are currently aware of about 250 cases in which an employer has failed to pay SSP/SMP and the total amount involved is less than £50,000. This block of cases has accumulated over a two year period. The civil compliance regime may increase the number of cases being taken up for action by a handful but, as indicated, SSP/SMP failures are very rare and we do not expect many more to be picked up. Since the merger of the Inland Revenue and the Contributions Agency there have been no cases that have resulted in a criminal prosecution. For all other employers there will be no additional costs.

Implementation Costs

8. None of the measures involve significant implementation costs for employers. There are some implementation costs for the Inland Revenue in terms of changing guidance for staff and customers, but the amounts are negligible. The measures at Annex C, D and E will cause very small reductions in compliance and administrative costs resulting from the implementation. These will be offset by the small increases in compliance and administrative costs created by the measures at Annexes A and B. The implementation costs for each measure are summarised below:-

Measure (A) - The costs to employers will be very small and in most cases there will be no additional cost. In order for employers to recover the NICs they have paid on their employees' behalf, they will already have agreed to hold onto an amount of the security award equal to this figure, and put in place a mechanism to recover the amount from the employee. They can choose the most cost efficient way of doing this. Therefore, employers should have no significant additional costs if they decide to rely on the extended provisions.

Measure (B) - This measure provides two ways, Agreements and Elections, by which the employer can agree with the employee for the latter to pay the secondary NICs due on restricted and convertible securities (post-acquisition chargeable events). It is difficult to estimate the cost to the employer of

implementing joint agreements. Any costs will primarily be associated with drafting a suitable agreement, asking employees to enter into these agreements and ensuring the secondary NICs are recovered from the employee correctly. However, most employers are likely to incorporate suitable wording into their existing share scheme documents and any cost will become part of the overall cost of setting-up and operating employee share schemes. Agreements will not require Inland Revenue approval and therefore can be implemented immediately, saving on any costs associated with seeking approval.

For joint elections the employer must obtain prior Inland Revenue approval of the form of wording and arrangements to recover the transferred secondary NICs from the employee. An employer may incur initial costs for seeking professional advice on preparing a form of election and obtaining Inland Revenue approval and it is estimated this service may cost around £3,000. However, the Inland Revenue will provide a model form of election on its website, free of charge, that will help reduce these costs. Additionally, the benefits of a joint election to the employer will outweigh this initial one-off cost. The end of year P35 employer's return entries will remain unchanged. Computer payroll systems will not require major updates, except to allow for the fact that the taxable gain will be reduced to allow for tax relief on the amount of secondary NICs the employee pays. We anticipate a take up of the new joint elections of about 500 applications a year based on previous NICs elections.

Measure (C) - There will be no cost in implementing the new debt recovery policy because, other than having to deal with the new time limits, any contributor who gets into debt will find that the system is far more efficient. The whole debt can be recovered in one action rather than the two that it would take currently.

Measure (D) - By abolishing our inspection powers under Section 110ZA we are contributing towards the Government's deregulation agenda. At the current time we have one set of inspection powers for NICs and another for tax. All our inspections will be done under the information powers given at Section 20 of the Taxes Management Act. Employers will have certainty as to what powers we are acting under and the information that they are required to give us. The regime that remains will make no practical difference to the impact of an employer compliance review. With that in mind we believe that there will be no increase in employers' costs (and probably a small decrease) in dealing with such a review, because this measure does not increase the amount of records that the Inland Revenue can access, but rather gives the Inland Revenue the same access for both tax and NICs.

Measure (E) - Changes to the enforcement regime will have no implementation costs as there are no changes to the way that SSP/SMP works for compliant employers, and there should be no additional costs for

employers or employees who have taken reasonable care but have misunderstood what they were supposed to do.

Other costs/Impacts

9. The nature of the measures, which focus largely on reducing the regulatory burden on employers, means there should be no behavioural changes or adverse impact on the environment or on health status. The individual summaries are set out below. For all the measures there might be costs to the Inland Revenue in producing guidance for staff or external customers. The total cost of this would be well under the de minimis limit for producing an RIA.

Measure (A) - Any implementation costs relating to employers' recovery of primary NICs from employees would be small as there would be no need to introduce reporting requirements for Inland Revenue purposes. New guidance for staff would be included in the annual update of the Employer's Guide to PAYE & NICs and the National Insurance Manual.

Measure (B) - The Inland Revenue will issue publicity when the Bill is enacted to make employers aware of the change on joint elections, and how to access and use model forms of elections and approvals. This is a part of the normal process of introducing new legislation and no additional costs will be incurred.

Measure (C) - The measure is intended to simplify the process of dealing with debtors. There will need to be an update of internal and external guidance but this would be incorporated into the regular updates of guidance.

Measure (D) - There will be a very small increase in Inland Revenue costs as we expect the need to use the Section 20 route will increase slightly. This is because Section 20 allows third party scrutiny of our requests for information. Central statistics are not kept on the use of the Section 20 powers and we cannot say on how many occasions those powers were used in relation to an employer compliance review. The stronger powers of Section 110ZA were used in less than 0.3% of the 31,000 visits to employers that took place in 1999/2000 and in no cases was a failure to comply penalty issued. From anecdotal evidence, we believe that the Section 20 powers are very rarely used in these circumstances. There will also need to be some changes to internal guidance but this guidance is regularly updated so no additional cost would be created.

Measure (E) - There will be minimal costs in updating Inland Revenue internal and external guidance to take account of the new compliance regime as instructions for penalty cases will have to be updated in any case. There are no other impacts on other areas.

Transfers and Distributive Impacts

10. The measures at Annexes A and B involve transfers of money from the employee to the employer. The opportunity for this transfer to take place is created by allowing employers to recover fully primary NICs from employees and to pass the cost of secondary NICs to employees where those employees agree to enter into joint elections or agreements. Enabling recovery (at Annex B), will transfer around £1 million per annum in primary NICs from employees to employers. The NICs elections & agreements (at Annex B) could result in transfer of up to around £15 million in secondary NICs from employees to the employers per annum, where earnings are paid in the form of restricted or convertible securities. For example, if an employee agreed to enter into a NICs election and received restricted securities remuneration of £5,000, they would have to pay 12.8% (employers secondary NIC liability) to the Inland Revenue. This £640 secondary NIC cost, when paid by the employee rather than employer, will be deducted from the amount on which the employee's income tax liability is calculated. The debt recovery measure may speed up the flow of money to the Exchequer and hence have a re-distributive effect but this will be very small. None of the other measures involves transfers.

Small business impact

11. All sizes of business benefit from general deregulation. Only one measure is likely to impact more on small businesses than on other sectors. This is the debt recovery alignment package set out in Annex C. The procedure for recovering Class 2 debt paid by the self-employed is being brought into line with procedures for tax and other Classes of NICs. Debtors who are sole traders or in small unincorporated businesses will be most affected. The package will allow one action in place of two for the recovery of tax and NICs debt, which is less burdensome on the debtor and more efficient for the Inland Revenue. Any disproportionate effect on small business from this measure is therefore beneficial. As there are no significant impacts we have not carried out a more detailed Small Firms' Impact Test. The annexes set out in further detail why we believe that the other measures will not impact on small businesses.

Competition Effects

12. The competition effects of the five measures are considered together as one package. Three of the 5 measures (Annexes C to E) are aimed at general de-regulation. The two share schemes measures at Annex A and B are almost exclusively concerned with voluntary schemes within individual firms, whereby NICs liabilities are transferred between employer and employee. The overall package is very unlikely to have any competitive effects on any market. Any company, regardless of size or market sector, that operates and offers equity remuneration involving restricted or convertible securities will be

able to take advantage of the measure to extend the use of joint NIC Agreements and Elections. Certain employees whose remuneration contains a large share package will on balance find that their typical employment package is improved. Companies will generally be encouraged to offer equity incentives because they will have recourse to a mechanism that helps to remove the unpredictability of secondary NICs. Widespread employee share ownership has been linked to improved company performance and growth in productivity.

Equality Impacts

13. We are confident that there are no implications on Sections 75 and 76 of the Northern Ireland Act 1998 which guarantee equality of opportunity in the Province. We have screened all the measures for equality impacts and do not believe that any of them suggest adverse impacts that would require a full equality impact assessment. We are also confident that the measures do not impact on any of the equality based legislation such as the Human Rights Act or any of the Race Relations legislation (Race Relations Act 1976 & the Race Relations Amendment Act 2000 - RRA).

Consultation

14. The consultation paper *Simplifying NICs for Employers* (issued June 2000) contained proposals on measure (D) above. These were broadly welcomed by respondents and the Inland Revenue agreed to implement them at the first available opportunity. The measure at Annex E is based on the compliance regimes for Statutory Paternity Pay and Statutory Adoption Pay, which were widely consulted on before they were introduced in the Employment Act 2002. Annex A was not consulted on but is an employer friendly measure required to deal with the introduction of the uncapped Class 1 primary NICs liability. Informal representations have been received from employers and share schemes representatives in support of the measures now in Annex B which allow NICs elections for restricted securities. The debt recovery measures at Annex C change Inland Revenue administrative processes and mirror, in relation to England, Wales and Northern Ireland the period of notice of distraint action proposed in the then Lord Chancellor's Department's White Paper 'Effective Enforcement' Cm 5744 published in March 2003.

Monitoring and Evaluation

15. It is not proposed to introduce special monitoring or evaluation arrangements. The Inland Revenue's existing reporting systems are designed to provide comprehensive information about the operation of all its systems and procedures. In addition the Inland Revenue engages in regular forums with employers, their representatives and other tax and NICs experts. These provide a valuable source of feedback for issues arising – indeed measure B on extending joint elections is being introduced as a direct result of this feedback. The Revenue will continue to listen and respond appropriately to such representations.

Summary

16. The combined impact of the various measures in this Bill is deregulatory. On the few occasions where the changes impose a cost on employers/employees these will be offset by savings elsewhere when looked at in terms of an overall use of resources. For both employers and individual contributors the alignment of the rules for tax and NICs will help to provide clarity on rights and responsibilities. Taken separately 4 out of the 5 measures are so small that, individually, they would come well under the de minimis requirement for producing an RIA.

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REGULATORY IMPACT ASSESSMENT (RIA)

National Insurance Contributions and Statutory Payments Bill

Annex A - Enabling employers to recoup primary NICs liability from employees from security-based remuneration (Clauses 1 and 2).

Introduction

1. The measure described in this section concerns the NICs that arise on share-based remuneration, now called securities-based remuneration following Finance Act 2003. The proposed measure will extend the period which employers have to recover from employees the primary (employees') NICs liability arising on securities-based remuneration.

Purpose and intended effect

2. The Government is keen to encourage increased employee share ownership. The introduction of the 1% additional NICs charge on employees' primary NICs liability above the Upper Earnings Limit (UEL) could have an unintended impact on employers' ability to recover from an employee the primary NICs arising on non-cash payments of earnings such as securities. When an employer makes a security-based payment of earnings NICs liability does not arise until, for example, options are exercised to acquire shares (or other securities), or restrictions attached to shares are lifted. At that point the employer is liable to account for and pay to the Inland Revenue both the primary and secondary NICs due on the employee's gain. Until 5th April 2003 it was unlikely that primary NICs would be due on share based earnings as, typically, employees would have paid up to the UEL on their regular cash earnings. But, from 6th April 2003 there has been a further 1% due on earnings that exceed the UEL. The two measures in this clause are intended to remove some of the restrictions placed on the employer's ability to recover the primary NICs payable with respect to security-based payments of earnings.

3. With the employee's agreement, the employer may currently retain some of the shares or securities so as to cover the primary Class 1 NICs, but this only applies to security-based earnings paid to former employees in the same year that they cease to work for that employer. And it only applies where there are insufficient monetary earnings from which to recover. The existing provision is required because an employee may be able to exercise an option to acquire securities for a period after they leave the employment of the

awarding company. The proposals here seek to widen the choices available to employees and employers for meeting the primary NICs in these circumstances by:

- enabling the retention of securities by employers to pay primary NIC liabilities arising on security-based payments of earnings to existing employees (ie so that existing employees who do not want to pay NICs on these gains out of their other cash earnings may have a choice); and
- enabling the retention of securities by employers to pay primary NIC liabilities arising on security-based payments of earnings to former employees in the year after they ceased to work for that employer.

Risks

4. Employees may not give their agreement to enable employers to retain sufficient shares or securities to cover the primary NICs liability. However, it is not in the employee's interests to do this since the employer is under no obligation to reward them with security-based payments of earnings and is unlikely to do so if they have to meet an additional cost in the form of employee NIC liability.

Options

Option 1 - Do Nothing

5. If we do not extend the right of recovery to employers in certain situations there will be more cases where the employer has to meet the employee's liability. At the current time primary legislation prevents the employer from recovering the employee's primary NICs by holding onto a proportion of the securities equal in value to the employees liability. The employer is also only able to recover the NICs liability from an ex-employee in the year of cessation even though there are some situations where a gain could arise in the year following. If we do not remove these restrictions an extra burden will fall on the employer, increasing their costs and acting as a disincentive to granting securities to their employees.

Option 2 – Extend the right to recovery of the employee's NICs

6. The second option would allow the employer to recover the primary NICs due on the exercise of employment related security options in the year after ex-employees cease working for them and, also, ensure current employees' NICs are recoverable by allowing the employer to hold onto some of the shares. These measures will help employers because they will be able to recover the primary NICs they have paid to the Inland Revenue. It is in line with the Government's objective of promoting employee share ownership to help boost productivity.

7. The current restrictions which are designed to avoid employee hardship through over-deduction from cash earnings will not be disturbed because employees would be simply required to pay the 1% NICs liability to their ex-employer at the time that the gain arises. Also an employer cannot hold back securities to cover the primary liability without prior agreement from the employee.

Decision

8. **Option 2** is our favoured option as it limits the cost to employers of rewarding their employees with employment related security options. This supports the Government's policy of promoting increased employee share ownership. There are no real disadvantages, as the employee will only be paying back to the employer what is their liability in the first place.

Costs

9. All costs are discussed in the main RIA.

Securing Compliance

10. There are no specific compliance measures required as this change gives the employer and the employee the option to enter into agreements of this sort but it is not mandatory.

Competition Assessment

11. We have undertaken a competition assessment and the competition filter indicated that the measure should not have any adverse effects on the competitive process in markets because it is open to all employers equally.

Impact on Small Business

12. This measure is aimed at all employers who reward their employees with security-based earnings. Employers who take up the option to recover the primary NICs that they have paid from their employees should be able to reduce their costs. The impact of the measure will not vary according to the size of the employer and therefore there will be no adverse impact on small business.

Consultation

13. No formal consultation has been carried out. The measure widens the current choices open to employers and employees and does not impose any new requirements.

Monitoring and Evaluation

14. The Inland Revenue will still be receiving the same amount of NICs at the correct time. Both our Business Support and Employer Compliance teams regularly visit employers who operate employee share schemes and will report back to our technical experts any problems experienced by employers in recovering primary NIC liability on share and security-based payments of earnings. Further feedback will be received directly from employers and share scheme practitioners. We do not anticipate a need to evaluate the measure beyond this routine information gathering.

Summary

15. This is an enabling measure that removes restrictions on the ability of employers to recover the primary NICs that they have paid on their employees' behalf.

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REGULATORY IMPACT ASSESSMENT (RIA)

National Insurance Contributions and Statutory Payments Bill

Annex B - Joint elections for secondary NICs on security-based earnings (Clauses 3 and 4).

Introduction

1. This measure will increase the areas where an employer can ask the employee to fund the employer's (secondary) National Insurance Contributions (NICs) liability on security-based earnings.

Purpose and intended effect

2. Currently, employers can ask their employees to fund the employer's NICs liability arising when an employee exercises an employment-related option to acquire securities, either through a NICs "election" or an "agreement". This enables the employer to remove the need to provide for the unpredictable secondary liability for NICs in their accounts, when the amount of the employer's NIC liability is contingent on the gain from options on exercise. Employers who award restricted and convertible securities have told us that they also face the same problem in respect of these awards. We therefore also want to allow employers to ask employees to bear the secondary NICs liability arising on payments of earnings in the form of this type of award of securities. Consequential changes will also be made to Income Tax (Earnings and Pensions) Act 2003 so that the employee can obtain income tax relief for the amount of employer's NIC liability payable by them.

Risks

3. The risks are that security-based remuneration may not provide a sufficient incentive for employees if the amount of the total income tax and NICs burden they face is increased to include the secondary NIC liability as well.

Alternatively there are risks that some employees will fail to meet their obligations to pay the secondary NICs due and the Inland Revenue will be unable to enforce compliance, because the employee is no longer in the UK.

4. Our experience with the joint NIC elections already in existence for NICs due on share options indicates that these risks are not significant. Without the ability to pass secondary NICs liability on to the employee, employers may be reluctant to offer incentives in this form, and consequently employees will not be able to enjoy the benefits of employment-related securities. Employers

may be reluctant to use an incentive that could help them boost productivity and employees would therefore lose opportunities to participate financially in the success of the company they work for. We have set up compliance mechanisms to ensure the employer has a vested interest in the employee meeting the liabilities (the employer is not able to make joint elections again if an employee defaults) and there has not been any difficulty in this area to date.

Options

Option 1 – Do Nothing

5. If we do not allow employers the opportunity to enter into a joint NIC election or agreement so that their employees bear the secondary NICs, then employers will not be able to remove an otherwise unpredictable liability.

Option 2 – Extend NICs Election and Agreements to Restricted and Convertible Securities

6. By allowing NICs elections and agreements between employers and employees, we would reduce the costs and uncertainty to employers of rewarding their staff using convertible and restricted securities awards. Employees although having a greater overall NICs liability, will still gain financially from the advantages of share ownership. An employee will also have the ability to decide whether they want to enter into these agreements and joint elections.

Decision

7. **Option 2** is our favoured option as there does not seem to be any reason for not extending the ability of employers to transfer their secondary NIC liability costs associated with rewarding employees with restricted or convertible securities. The measure would increase the tax and NIC costs associated with the award to the employees but they are still better off than if they had not been given the securities in the first place. The employees also benefit from the tax relief available when the secondary NIC is transferred to them. The compliance systems already in place should prevent any difficulties arising if the employee attempted to avoid their liability.

Costs

8. All costs are discussed in the main annex.

Securing Compliance

9. If an employee chooses not to enter into an agreement or joint election then the employer can still decide to award the securities with or without the authority to transfer employers NIC or they can decide not to reward the employee by this method. All three options are perfectly acceptable to the Inland Revenue and it is up to the employer and the employee to agree on one of these outcomes. We already have compliance mechanisms in place that ensure that the employer cannot enter into the elections again if an employee defaults. This has proved more than adequate in this area to date.

Competition Assessment

10. We have undertaken a competition assessment and the competition filter indicated that extending NIC elections and agreements should not have any adverse effects on the competitive process in markets because they are open for any employer to utilise, subject to the agreement of employees receiving securities.

Impact on Small Business

11. There is no specific impact on small businesses. Those businesses that do award restricted and convertible securities will be able to choose to enter into a NICs election or agreement and if they do they should be able to gain from no longer having to meet the employer NIC costs.

Consultation

12. We have received informal representations from employer and share scheme representatives who were particularly concerned that businesses awarding restricted securities were unable to take advantage of transferring the employers secondary NIC liabilities. Like the grant of share options the award of restricted securities can create an unknown NICs liability for the employer.

Monitoring and Evaluation

13. The Inland Revenue will still be receiving the same amount of NICs at the same time. The only change will be that it will be coming indirectly from the employee rather than the employer. Both our Business Support and Employer Compliance teams regularly visit employers who run such schemes and will be able to report back to our technical experts should there be problems in operating them or if there are a substantial number of employees defaulting. Further feedback will be received from employers and share scheme practitioners together with data on the number of joint elections submitted for

approval. We do not anticipate a need to evaluate the measure beyond this routine information gathering.

Summary

14. NICs elections have proved popular with employers in the areas where they are presently permitted. By extending them to awards of restricted and convertible securities we are giving employers the ability to reduce or remove a future unpredictable and unquantifiable NICs liability and employees will be able to benefit from advantages of share ownership.

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REGULATORY IMPACT ASSESSMENT (RIA)

National Insurance Contributions and Statutory Payments Bill

Annex C - Recovery of NICs debt (Clauses 5 and 6)

Introduction

1. Even before the transfer of the responsibility for NICs to the Inland Revenue, some 96% of NICs were collected with income tax, and the legislation enabling recovery of debt to take place applied to these NICs in exactly the same way as the tax they were collected with. Thus an employer would account for the tax due from employees' wages under PAYE and the NICs due in respect of the same wages on one form, and the Inland Revenue would take one action to recover non or under payment. Similarly self-employed people making a return of their taxable income have the tax and Class 4 (profit related) NICs due on that income assessed and collected at the same time.

2. But the classes of NICs that hitherto were not collected with tax have, historically, different legal structures and procedures attached to them. This is now highlighted in the Inland Revenue where for reasons both of customer service and administrative efficiency, all the taxpayers'/contributors' liabilities should be dealt with in the same way and at the same time. This part of the Bill addresses the misalignments for the recovery of debt in that small proportion (4%) of NICs which were previously handled separately from tax.

Purpose and intended effect

3. The main group impacted by these misalignments are the self-employed where, as stated above, their profit related tax and NICs (Class 4) are handled together, but the flat rate Class 2 NICs (which is the element that earns state pension entitlement) are dealt with entirely separately. The specific elements to be aligned are:

- the statutory periods of notice following the issue of a written notice before authorised officers can take action to distrain goods in England and Wales or apply for a summary warrant and attachment in Scotland;
- the distraint procedures in Northern Ireland

Risks

4. There is a risk that the move to distraint action for recovery of Class 2 NICs debt in Northern Ireland could be viewed as less fair than the current action through the Enforcement of Judgment Office (EJO). Or that the reduction from a 30 day to a 7 day period of notice before action is taken reduces debtors' rights. However these proposals simply put this small proportion of NICs on a par with the way other tax and NICs debts are recovered. The Inland Revenue procedures are well regulated, with published information on the process and how to make complaints if debtors have a grievance.

5. The new system will create a system for debtors that is much easier to understand. The time limits for recovery of tax and NICs will be the same. The different classes of NICs will all be able to be collected at the same time along with tax by the same officers. Distraint procedures will go through the same procedures in Northern Ireland as they do in England and Wales and in one less stage than they do presently. When dealing with the Revenue the debtor will find that the system should save them both time and money.

Option 1 – Do Nothing

6. The “do nothing” option has little merit because the result of having to take two actions is both burdensome for the debtor who incurs costs arising from the separate recovery actions and an inefficient use of public money. Moreover, in Northern Ireland as well as the costs arising from the EJO's enforcement action, the debtor would also have to meet the Inland Revenue's additional costs arising from first obtaining a court judgement. These additional costs will be higher if the case is dealt with in the High Court.

7. Parliament's intention in transferring the function of the Contributions Agency to the Inland Revenue was clearly to enable the citizen to have their tax and NICs affairs dealt with by one body and in one action where it was appropriate to do so. The present misalignments in the legislation governing recovery thwart that intention.

Option 2 – Alignment of the tax provisions with NICs procedures

8. The advantage of aligning tax provisions with NICs procedures would be that we introduce a universal 30 day notice period for debt collection. Employers would have certainty about what the time limits were for all types of tax and NICs. There would also be only one action for them to face rather than the typical two actions that occur now under the present system.

9. There are disadvantages with moving to the NICs procedures. The first is that it would entail making changes to existing and well established tax recovery powers in section 61 and 63 of the Taxes Management Act 1970

(TMA). The amount of money collected by the tax provisions is around £144 billion. £336 million was collected in Class 2 NICs under the NICs provisions. It would seem perverse, given the amounts, to align tax with the NICs provisions. By extending the period of notice to 30 days from 7 day (14 days in Scotland) it is likely that some employers would delay payment for longer creating a loss of interest to the public purse.

10. Aligning tax with the NICs provisions would also bring Corporation Tax into this system. This would introduce significant delays to the current recovery process and could jeopardise tax flows to the Exchequer.

11. Professor John Beatson QC published in 2000 his *Independent Review of Bailiff Law* in which he considered the period of notice for distraint action generally. In his report Professor Beatson recommended that for distraint action on private premises a period of 7 days' notice should be given, and for distraint action on commercial premises the recommended period of notice was 72 hours. This recommendation was supported in both the Lord Chancellor's Department's Green Paper *Towards Effective Enforcement* on the structure and regulation of civil enforcement action which was published in 2001 and the subsequent White Paper *Effective Enforcement Cm 5744* published in March 2003. A move to a 30 day period will put us out of step with the recommendations for periods of notice generally in debt collection work. It would also put us out of step with the 14 day period for attachment that exists in Scotland.

Option 3 – Align the NICs Provisions with those that exist for Tax

12. This option would increase the efficiency of debt collection and reduce costs for both the Revenue and the employer. It would mean that all debts could be collected under one action, by the same officer and with only one time limit. For the Revenue this would mean that we would protect the flow of money to the Exchequer and also reduce the costs to the public purse in collecting these debts. For the employer, there is certainty in what their requirements are and they would now only have one action to collect the debt rather than two or more.

13. Adopting the tax provisions would also bring the NICs procedures closer to the regime for debt recovery in general proposed by the then Lord Chancellor's Department in the White Paper *Effective Enforcement Cm 5744* published in March 2003 and to the Scottish system of recovery. A longer period of notice would be at odds with the period of notice generally required.

14. For Northern Ireland moving to the tax provisions rather than the Judgments Enforcement (Northern Ireland) Order (JEO) is preferable because the JEO takes longer and is much more expensive than direct action by the Revenue's own staff, particularly if judgement is obtained in the High Court. There are also restrictions as to when cases can be handled by Revenue

staff. The tax provisions will ensure that debt recovery is reduced to a one step process rather than the two or three steps it currently takes.

15. The only disadvantage is that NICs debts which previously had a 30 day notice now only have a 7 day notice. This is far outweighed by the advantages that the change will make.

Decision

16. **Option 3** is our favoured option as it will produce the best system of debt recovery. *Option 1* would perpetuate a disjointed system whilst *Option 2* could jeopardise the flow of money to the Exchequer.

Benefits

17. These Bill measures will:

- Clarify the system and simplify the system of debt recovery.
- Ensure that employers/businesses who pay their tax and NICs over to the Revenue at the correct time will not suffer a cash flow disadvantage to those who do not.
- Simplify the system in Northern Ireland as direct action by the Inland Revenue will mean that there will be fewer stages of judgements needed to recover the debts and the procedure will therefore be less expensive.
- Ensure where there is associated tax debt the Inland Revenue can recover small amounts of Class 2 NICs where recovery is at present uneconomical, in the long term this could be of benefit to the debtor as such contributions count towards entitlement to the basic state retirement pension.

Costs

18. All costs are discussed in the main RIA.

Securing Compliance

19. As a compliance measure it will enable us to deal with both tax and NICs recovery at the same time. There will be no need for any additional compliance measures as, other than the time limits, the method of debt recovery remains the same in England, Wales and Scotland. In Northern Ireland the compliance measures currently applied to tax and NICs collected with tax will be applied to NICs which are not collected with tax.

Impact on Small Business

20. These changes will impact primarily on the self-employed liable for Class 2 NICs who are likely to be sole traders or small businesses. As stated above the changes will enable one action to be taken for tax, Class 4 and Class 2 NICs debt which is less burdensome on the small business.

Consultation

21. No formal consultation has taken place, but, as outlined at paragraph 11, the proposals mirror the changes proposed in March 2003 by the then Lord Chancellor's Department in relation to recovery of debt generally.

Monitoring and Evaluation

22. Feedback from staff involved in debt collection will be monitored as at present.

Summary

23. These measures will enable the debtor to be dealt with in one process rather than two, which relieves the burden on them and is a more efficient use of public money. Compliant businesses will not suffer cashflow disadvantages and aligning the Northern Ireland distraint provisions will create a quicker and simpler system of debt recovery in the province.

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REGULATORY IMPACT ASSESSMENT (RIA)

National Insurance Contributions and Statutory Payments Bill

Annex D - Alignment of Inland Revenue officers' powers to seek information to ensure compliance with National Insurance Contributions (NICs), and Statutory Payments (SSP/SMP) legislation (Clauses 7 and 8).

Introduction

1. At the time of the transfer of responsibility for NICs to the Inland Revenue it was recognised that the powers under which officers inspected employers' and businesses' NICs affairs were significantly different from those used in relation to the inspection of their tax affairs. The Minister in charge of the transfer legislation, Baroness Hollis, promised that there would be a review following the transfer. In our consultation document *Simplifying National Insurance Contributions for Employers* published in 2000 we asked for views on the powers of inspection that the Revenue should have. The measures in this Bill implement the alignment of the powers that were agreed to be necessary as a result of that review.

Purpose and intended effect

2. The transfer of business has left a situation in which our inspection powers for NICs are greater than those for tax. In cases where we are dealing with both tax and NICs at the same time it is difficult for employers to understand why, in the same inspection of both NICs and tax, there are different powers for each. The clauses here achieve alignment through a series of changes to the legislation.

3. First, clause 7 dispenses with the package of powers transferred to the Inland Revenue in Section 110ZA of the Social Security Administration Act 1992. This includes the ability to:

- enter premises;
- question anybody found on the premises; and
- compel them to provide information and documents (without first subjecting that request to third party scrutiny)

4. Routine inspection powers already exist for both tax and NICs which allow our officers to examine employers records (these are in regulations).

5. But there are cases where we need additional information for NICs purposes. So, second, in these cases we intend to apply the Inland Revenue's information powers contained in Section 20 of the Taxes Management Act, to NICs. This will allow the Tax Appeal Commissioners to ensure that we are acting fairly and properly.

6. In addition, minor changes to the Social Security (Contributions) Regulations 2001 were needed as the review identified a need to provide a specific right of access to computer records (in common with the power that currently exists for PAYE). These changes have been made through the Social Security (Contributions)(Amendment) Regulations 2003 (S.I. 2003 No. 183) which came into force on 6 April 2003 and therefore do not form part of the measures for this Bill.

Risks

7. There are no significant risks associated with aligning investigation powers on the NICs side with those that exist for tax because the use of the Section 20 powers will give the same result for inspections in a more balanced way. The disadvantage is that officers will not find it as easy to gain access to information that they need to see; but this is more than outweighed by the need for proper control on these powers.

Options

Option 1 – Do Nothing

8. We considered whether we should make no changes to the inspection powers at all. This would have left a situation in which our inspection powers for NICs would be greater than those for tax. We decided that this was undesirable because employers would be confused as to which powers we were acting under when we were inspecting records that had both tax and NICs implications.

Option 2 – Align the Tax Investigation Powers with those that existed for NICs

9. We also considered whether we should align the tax inspection powers to those that existed for NICs. This would have had the advantage of providing one comprehensive set of powers for all purposes. However the NICs powers are greater than the tax powers. Alignment with those powers would have meant an increase in our powers than would not have been welcomed by business. In addition the NICs powers were seen as being disproportionate to their purpose and uncontrolled in that there was not third party scrutiny of their more contentious applications (e. g. the ability to force persons to provide answers to questions and to provide documents).

Option 3 – Align the NICs investigation powers with those that exist for Tax.

10. Following a review of our powers and consultation we reached the conclusion that we should align the powers to inspect records and gather information for NICs to those that exist for tax. This will provide clarity for employers who will know that there is no difference in our tax and NICs powers, their obligations for each will be the same.

11. By using the Section 20 approach, where we need to go beyond what regulations currently allow us to examine, there will be third party scrutiny of our need to do so before we can compel the provision of documents or particulars. Responses to consultation have supported this approach. A client survey carried out by one respondent indicated that 93% of clients either agreed or strongly agreed that the proposed changes were broadly sensible.

Decision

12. We decided that **Option 3** was the most sensible and balanced as it allowed controlled access to information with third party scrutiny in the event of any disagreements.

Benefits

13. This measure gives clarity for employers about our powers to inspect records and the knowledge that we can only compel the provision of documents following third party approval. It does not give us the rights of access that we had under Section 110ZA but this was an unrestricted power which was viewed as being out of proportion to what was needed.

Costs

14. All costs are discussed in the main RIA.

Securing Compliance

15. Using Section 20 powers gives a proper control on our ability to obtain access to records and information and will clear up confusion amongst employers as to what powers we are using as well as the knowledge that there is third party scrutiny of the more contentious applications.

Impact on Small Business

16. There will be no particular effects on small businesses given that the cost of reviews is not expected to rise for small employers.

Consultation

17. Detailed views were sought on the proposals in a consultation exercise on the paper *Simplifying National Insurance Contributions for Employers* between June and the end of August 2000. 93% of the respondents strongly or broadly agreed with the proposals we now plan to implement. The respondents were primarily employers' and practitioners' representatives such as the CBI and the Institute of Chartered Accountants (England and Wales).

Monitoring and Evaluation

18. The system will be monitored through our Employer Compliance sections. Any problems in accessing records are reported to our technical section who have regular meetings with staff who perform the inspections.

Summary

19. These proposals will introduce a common and balanced set of powers for both tax and NICs purposes. They will not increase business compliance costs. They will not increase the number of employer compliance reviews nor will they change the nature of reviews.

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REGULATORY IMPACT ASSESSMENT (RIA)

National Insurance Contributions and Statutory Payments Bill

Annex E - SSP/SMP civil procedures (Clauses 9 and 10).

Introduction

1. This part of the RIA deals with the introduction of a routine compliance regime for Statutory Sick Pay and Statutory Maternity Pay (SSP/SMP).

Purpose and intended effect

2. Our compliance regime for SSP/SMP is presently completely out of step with that for tax, NICs and tax credits and, indeed with the regime for the new schemes Statutory Paternity Pay and Statutory Adoption Pay (SPP/SAP). This is because employers' failures to meet their obligations under the SSP/SMP schemes are dealt with by a series of minor criminal offences. For SPP/SAP a system of civil penalties exists to deal with entirely similar failures by employers. We believe that this series of criminal offences is wholly disproportionate to the compliance risk for SSP/SMP schemes. A civil penalty system is a more proportionate system for dealing with employer failures.

Risks

3. The introduction of too severe civil penalties for SSP and SMP offences could lead to unintended disincentives for employers to meet their obligations. For example they could try to avoid employing people they thought likely to become entitled to such payments, or they could attempt to dismiss potential recipients.

4. Alternatively the removal of a criminal sanction or too low civil penalties could be seen as an attack on employees' rights to receive their statutory payments. The proposals attempt to counter these risks by introducing fair and proportionate responses to non-compliance.

Options

Option 1 – Do Nothing

5. The current system of criminal sanctions is disproportionate to the offence and therefore generally ineffective. The biggest compliance risk with SSP/SMP is where an employer fails to pay. Even in the most serious cases the amounts involved rarely reach four figures and the majority involve no more than a few hundred pounds. The cost of criminal proceedings is

disproportionate to this type of offence, and the length of time needed to complete proceedings means that the immediate need of the employee is not dealt with. If we continue to do nothing then a minority of employers will continue not to fulfil their obligations, and will gain an advantage on the majority of employers who do comply; and those employees who are sick or pregnant will lose out on payments that they are entitled to. Option 1 fails to stop some employers from exploiting the system.

Option 2 – Align SSP/SMP with SAP/SPP Compliance Regime

6. In common with our other regimes we would seek to impose financial penalties for certain failures and dispense with the entirely disproportionate criminal offences that currently exist. The new system would give us the right to inspect and check the accuracy of employers' records. Individuals claiming entitlement to SSP/SMP would be required to meet reasonable requests to provide documents or information relating to their entitlement.

7. Penalties could be imposed where an employer has refused to allow us access to records, they have failed to keep the required records, the employer has failed to pay SSP/SMP or the employer or an employee has failed to supply information. We would also want the ability to impose penalties where the system has been abused either through fraud or negligence. Employers and employees will be able to appeal against the imposition of penalties. Penalties would not be due where the employer had taken reasonable care but had misunderstood what they were supposed to do. We would reserve penalties for serious situations such as where there has been deliberate manipulation of the schemes, where a failure has continued after we have put the employer right and where the employer has failed to pay after the appeal period against a formal decision on liability.

8. The advantages of this policy are that the penalties introduced would be proportionate to the fraud or negligence committed by the Employer. This would mean that our compliance regime could be more responsive to failures by employers and would reduce the number who try and avoid their obligations. The only disadvantage is that we would lose the strongest sanctions in cases of serious abuse. As this failed to stop the small minority who abused the system then it is far outweighed by the advantages of the new approach.

Decision

9. It was decided that failure to meet SSP/SMP obligations would move from being a criminal offence to a civil penalty system and therefore **option 2** was the only one to follow. *Option 1*, because of its disproportionality, had failed to get non-compliant employers to meet their obligations.

Costs

10. All costs are discussed in the main RIA.

Securing Compliance

11. This is a compliance regime and sets out what will happen should employers or employees not meet their requirements.

Impact on Small Business

12. The measure is aimed at the small minority of employers who are non-compliant. The impact on non-compliant employers will be evenly spread and there will be no additional impact on a small business by virtue of its size.

Consultation

13. Our proposals mirror similar measures which were introduced for Statutory Adoption and Paternity Pay. Those measures were broadly supported during consultation and in the passage of the 2002 Employment Act.

Monitoring and Evaluation

14. We currently monitor all SSP/SMP dispute cases so that we can tell where the problems lie. This is done by regionally based dispute teams. Under the new system this monitoring for problems will continue.

Summary

15. We are seeking to dispense with a series of minor criminal offences and replace them with a civil penalty regime that is also in line with the penalty regime that is in place for other areas of our business. We are also seeking to introduce routine inspection powers that are in line with those used in other areas of our business. Again these measures are broadly de-regulatory.

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