

REGULATORY IMPACT ASSESSMENT (RIA)

NATIONAL INSURANCE CONTRIBUTIONS BILL

Background

1. The Government is determined to ensure that all employers and employees pay the proper amount of tax and National Insurance Contributions (NICs) on the rewards of employment, however those rewards are delivered to the employee. Despite the efforts of successive Governments, there have been increasingly complex and contrived attempts to avoid paying tax and NICs on rewards from employment, particularly in relation to bonuses in the City.
2. In the most recent year for which figures are available, well-rewarded individuals have received bonuses of at least £1.5 billion in an attempt to avoid paying their fair share of tax and NICs. The disclosure rules contained in Finance Act 2004 revealed that this kind of avoidance is still rife. Without prompt and decisive action, up to £2 billion could have been paid in 2004-05 in bonuses on which the amount of tax and NICs properly due was at risk, as a result of increasing ingenuity and inventiveness of tax avoidance planning.
3. The Government has decided that avoidance on this scale cannot be allowed to continue. It is only right that everyone who should pay tax and NICs does pay, and that they pay their fair share when it is due. The overwhelming majority of employers and employees do pay their fair share. But some employers and employees with the benefit of sophisticated tax advice have sought to avoid their responsibilities and to pass more of a burden onto others.
4. Early attempts at avoidance in this area took the form of paying bonuses and salaries in gold bullion, diamonds and fine wines. When these routes were closed, employers started to pay bonuses through shares and share options to reduce the amount of NICs they had to pay, avoid their obligation to operate PAYE, and reduce employees' tax bills. When, in 1998, assets readily convertible into cash were brought within PAYE, and NICs, avoidance schemes moved on to more complex arrangements.
5. Despite extensive reforms to the tax legislation dealing with employment related shares and securities in 2003, employers and their advisers are continuing to devise and operate ever more contrived avoidance schemes. The objective of this Bill is to deter employers from using schemes to avoid paying NICs on the rewards from employment. And where employers have not been deterred to have the power to close down avoidance schemes and introducing NICs

liability effective, if necessary, back to 2 December 2004 when the Paymaster General made her statement.

6. To this end, legislation in Finance (No.2) Act 2005 closed down avoidance schemes that used employment related securities, effective from 2 December 2004 that HMRC have identified. This Bill ensures that NICs can be charged on these schemes with effect from the same day.
7. However, it is not always possible to anticipate the ingenuity and inventiveness of tax avoidance. The Government's objective is clear in that it wishes to close this activity down permanently. This Bill will ensure that the Government can deal with any arrangements that emerge in future designed to frustrate its intention that employers and employees should pay the proper amount of tax and NICs on the rewards of employment.
8. Where the Government becomes aware of arrangements that attempt to frustrate this intention, it will introduce legislation to close them down, where necessary from 2 December 2004. This action will not affect employers and employees who organise their affairs in a straightforward and transparent way - the vast majority. In particular, genuine employee share schemes and share option plans will not be affected.

The do nothing and non-regulatory option

9. Doing nothing will indicate to those devising avoidance that the Government is not serious in its attempts to tackle NICs avoidance. It will also leave unchecked the contrived schemes identified through the tax avoidance disclosure rules, so that payments made in 2004-05 would continue to avoid NICs. The Government's view is that this option presents a significant risk to Government finances and is therefore not viable.

What the Bill does

10. In Pre Budget Report (PBR) 2004 the Paymaster General (PMG) announced a new approach to tackling attempts to avoid tax and National Insurance Contributions (NICs) where that avoidance used schemes to disguise remuneration from employment. The new approach builds on income tax disclosure provisions and includes a commitment to introduce legislation to close down existing and any new avoidance routes, if necessary, from the date of the PBR - 2 December 2004.

11. The National Insurance Contributions Bill (hereafter referred to as the NICs Bill) has the following provisions: -
- A power to introduce NICs regulations, that may have effect from 2 December 2004, on payments treated as remuneration and earnings to mirror so far as possible anti-avoidance measures introduced into tax legislation. The Bill will also include powers to allow amendments to the scope of NICs exemptions to mirror so far as possible anti-avoidance tax measures with effect from 2 December 2004 and for the making of consequential regulations for the purposes of contributions, contributory benefits and statutory payments. **(Measure A)**.
 - Deem NICs agreements & elections null and void if applied to securities income that is affected as a result of the above NICs anti-avoidance regulations **(Measure B)**.
 - Introduce NICs disclosure rules **(Measure C)**.

Purpose and intended effect of measures in the Bill

The Regulation making power

12. Overall, the purpose and intended effect of the measures and powers contained in the NICs Bill is to deter employers from engaging in NICs avoidance and stop the activity permanently.
13. Measures closing down loopholes in legislation exploited by avoidance schemes have become a regular feature in annual Finance Bills and NICs legislation. Current primary NICs legislation is limited in that it only allows NICs to be imposed by regulation from a date in the future (or in very limited instances back to the beginning of the tax year in which the regulations are made). A change to the NICs primary legislation is therefore needed to bring into an existing definition certain items that would otherwise fall outside of NICs liability in order to give effect to the announcement in PBR 2004. The changes will also ensure successful collection of that liability.
14. The general power to make regulations in future to counter avoidance will be restricted to responding to tax legislation which relates to the charge to income tax under the employment income Parts of the Income Tax Earnings and Pensions Act 2003.
15. This general power will be used in the first instance to introduce regulations to ensure that NICs liability will mirror so far as possible anti-avoidance tax measures in the Finance (No.2) Act 2005 relating to employment related securities that close a number of loopholes. These tax measures introduce purpose tests in various Chapters in Part 7 of the Income Tax (Earnings & Pensions) Act 2003 (ITEPA) to frustrate avoidance schemes which use employment related securities to deliver

cash bonuses. They also bring new benefits from these securities into a tax charge or accelerate the occasion of the charge.

16. This RIA also covers the impact of the specific regulations that will be introduced to mirror the Finance Act measures concerning employment-related securities. The general regulation making power has no impact on business unless it is used again to reflect a tax provision introduced as a result of tax avoidance.

NICs Elections

17. The second measure concerns NICs Elections and Agreements that enable recovery of secondary or employers' NICs liability due on certain share based employment income. A provision will be introduced to ensure that the application of NICs elections and agreements does not extend to income, which arises as a result of regulations made under the Bill. As those regulations will be targeted at avoidance schemes this measure will effectively mean that the application of NICs elections and agreements is limited to non-avoidance schemes only. It will void elections and agreements that have been put in place by employers for avoidance schemes where they consider no NICs liability arises but may be imposed in the future.

NICs Disclosure Rule

18. The third measure is introduced to redress the information gap on the use of avoidance schemes. In Budget 2004, the Government announced the introduction of new rules that would require either those who design or market potential tax avoidance schemes, or those who use them, to provide information about the schemes to the Inland Revenue. The Government announced that the initial scope would be restricted to two high-risk areas; employment and financial products.
19. The rules are restricted to new and innovative schemes and arrangements that:
 - Concern income tax, corporation tax or capital gains tax; and
 - Involve employment or the use of certain financial products.
20. The NICs Bill provides that the Treasury may make regulations providing that the rules in Part 7 of Finance Act 2004 and the corresponding regulations, which require the disclosure to HMRC of information about certain tax schemes, will also apply to NICs schemes. The tax rules apply to schemes that might be expected to give income tax, corporation tax or capital gains tax advantage as a main benefit and which concern either employment or certain financial products.

21. As there was no suitable vehicle at that time for the primary legislation needed for NICs, this Bill provides for regulations to align NICs with these disclosure rules in respect of employment related products that have the objective of NICs only avoidance.

Benefits

Economic

22. The most obvious economic benefit from effectively deterring much of NICs avoidance is that for given NICs rates, earnings limits, thresholds and employee earnings, the Exchequer raises more revenue to allocate to contributory benefits and improving the National Health Service in a less distortive way. For employers and employees who are unwilling or unable to engage in NICs avoidance, the main benefit of effective deterrence is that the total NICs burden on the economy is borne more fairly by all employers and employees.
23. Avoidance allows some employers and employees to reduce their effective NICs rates, which can generate unfair competitive advantages in product and labour markets through attainment of lower employment costs than more compliant competitors. Employers deterred from NICs avoidance should benefit from the resultant redirection of time and resources away from avoidance into activities that are more productive. There will be a direct saving to the employer in terms of not having to seek professional advice on, setting up and managing a complex avoidance transaction. In addition, employers will also save on costs associated with litigation by HMRC on doubtful cases.

Social

24. These measures will help to prevent the undermining of the Government's public spending objectives. Avoidance reduces revenues that go towards the payment of contributory benefits and the funding of improvements to the NHS. These measures are also aimed at tackling the unfairness generated where more of the tax/NICs burden is borne by taxpayers unwilling or unable to engage in avoidance.

Environmental

25. No environmental benefits are anticipated.

Policy and implementation costs

26. The powers in this Bill will first be used to introduce NICs changes through regulations to mirror tax measures contained in Finance Act 2005 (No.2) that tackle avoidance through employment related securities. This measure is aimed at relatively small number of

employers, perhaps as few as around 500, that are engaged in the use of contrived schemes using employment related securities, to avoid income tax and NICs. We estimate that around 10,000 employees may fall within the scope of this measure and that around £2 billion in bonuses could have been paid in 2004-05, with the aim of avoiding income tax and NICs.

27. The Regulations made under this power will require employers to incur marginally higher professional advice costs in learning of their liability and the remedy, and then re-calculate NICs for closed years by taking into account earnings already received with payments brought into liability by this measure. Employers affected will have to submit supplementary end of year returns to HMRC detailing the revised amounts of NICs paid. We refer in paragraph 29, that 500 employers and 10,000 employees may be affected by the measures in the Bill. Businesses that have chosen to take up these schemes will have factored into their cost benefit analysis for the schemes with their advisers, the risk of an HMRC response to close down the loopholes they aim to take advantage of.
28. The combined impact of the measures in this Bill will impose an additional burden or cost on those employers that continue to engage in contrived schemes to avoid NICs on remuneration paid to employees. Employers that do not engage in such activity will be unaffected. Where employers are affected, we estimate that the combined cost of complying with the measures per employer will not exceed around £3,000 on average. This takes into account the administrative costs of revising and paying the NICs liability and allows for only those additional professional advice costs directly involved in establishing the employer is affected by any new regulations.

Measure (A) – Using the general power to make regulations and regulations that mirror tax measures related to employment based securities that take effect from 2 December 2004.

29. For employers who are deterred from trying to avoid NICs the cost will be that they operate PAYE and pay the NICs in full on the remuneration they would otherwise have channelled through an avoidance scheme. The true extent of the actual avoidance is always difficult to accurately assess. From the information we have, we conservatively estimate that around 500 employers and 10,000 employees are likely to be affected. This is a relatively small fraction of the total number employers and employees in the UK.
30. The additional administration costs for business will be small. Most employers deterred from avoidance will simply be paying a larger amount via PAYE than they would otherwise have done in the normal way. This generates zero additional cost because they operate PAYE already and remuneration avoidance schemes used of late have commonly involved paying over some tax through PAYE anyhow.

31. If employers are caught by the measures they may incur a small additional cost, where they have to submit a further end of year returns to account for the NICs. It is estimated that this element will involve HMRC in £20,000 additional manpower costs, but could rise depending on the number of cases. We estimate that there will be negligible additional HMRC IT costs associated with this measure.
32. The Bill also includes powers to make amendments to the scope of NICs exemptions to reflect similar changes to reliefs or exemptions for income tax that are exploited beyond their original intent and used for NIC avoidance. This is being introduced as a precautionary measure in case tax avoidance moved into tax reliefs and deductions where there was a parallel NICs disregard. Government will be able to act quickly and introduce NICs changes to mirror tax changes so far as possible. Similarly there are no additional costs to businesses that do not attempt to avoid paying NICs on remuneration using tax reliefs.

Measure (B) – Voiding NICs Elections and Agreements

33. Voiding of NICs elections and agreements to stop recovery of secondary NICs from the employee. This measure is not considered to have any significant implementation costs for HMRC. It only applies where employers wish to put in place a scheme to avoid NICs with the added benefit of the NICs transfer mechanisms in case a liability does arise. Employers will have a clear and unambiguous choice. That on implementing a NICs avoidance scheme now they will face an employers' NICs liability charged on any employment income arising from it once the scheme or transaction is discovered and legislated against. The cost to them of this measure is that they will not be able to recover that liability from the employee.

Measure (C) - NICs Disclosure Rules

Business Costs

34. Promoters of NICs schemes (or in some cases users) who are required to disclose information to HMRC may incur the following:
 - one-off learning and professional education costs associated with understanding the new rules;
 - set up costs in putting systems in place to identify schemes required to be notified; and
 - compliance costs in having to provide information to HMRC.
35. Where a scheme affects tax and NICs, a single disclosure covering tax and NICs is all that will be required. The information contained will be substantially the same, as that presently required for tax disclosures.

36. In practice, since schemes normally cover tax and NICs, persons required to disclose will incur additional compliance costs at a result of this proposal only insofar as they are involved with NICs only schemes. We expect such cases to be very few and the additional costs to be marginal.

HMRC Costs

37. Anti-Avoidance Group (Intelligence) will handle disclosures received in HMRC. The amount of additional work generated will not be significant and the additional cost to the AAG will be marginal. There will be negligible costs associated with additional guidance and publicity.

Transfers and Distributive Impacts

38. As discussed above, the distributional impact of effective deterrence of NICs avoidance will be a more equitable sharing of the NICs burden and higher NICs revenues for a given distribution of employee earnings. Historically, NICs avoidance has been most acute around annual bonuses paid to a relatively small number of highly paid employees and directors, particularly in financial services. A fairer distribution of the NICs burden will be more equitable to the majority of employees who are further down the income distribution.
39. We estimate that this measure will secure an additional £95 million in NICs in 2004-05 and £240 million per annum thereafter. We have evidence that that some employers may have abandoned plans to channel bonuses through these schemes and instead paid cash bonuses following the Paymaster General's announcement of 2 December 2004.

Small business impact

40. The impact of the NICs Disclosure rules on small business mirror the tax disclosure provisions introduced in Finance Act 2004. Any small business affected in terms of administrative burdens by the need to disclose NICs avoidance arrangements will need to consider the tax avoidance rules as well. However, the marginal cost (in terms of learning and familiarisation with the rules) to these businesses will be negligible as the vast majority of employment schemes are intended to gain a tax and NICs advantage and so are already reportable.
41. Approximately 21,000 small accountancy and tax consultancy firms and a further 90,000 self-employed individuals in related professions, may need to familiarise themselves with the new legislation that is capable of creating a NICs charge that may take effect from 2 December 2004. The marginal cost (in terms of learning and

familiarisation with the rules) to these businesses and individuals will be negligible as the vast majority of employment schemes are intended to gain a tax and NICs advantage and they will already have familiarised themselves with the equivalent tax legislation.

42. Additionally, tax professionals undertake Continuing Professional Development in order to keep up to date and refresh relevant skills and knowledge. This includes reading of general and specialist journals and this would be sufficient in terms of awareness unless the business is actively engaged in such schemes. Information will also be readily accessible on the HMRC website.
43. The avoidance targeted by the proposed Bill and FA (No. 2) 2005 measures is conducted mainly by firms in the City of London and some other large companies. Such taxpayers are invariably advised by larger or specialist accountancy firms. Any businesses specialising in devising these schemes will have factored into their risk analysis for the schemes, the likely response of HMRC in closing down the loopholes that they aim to take advantage. It is most likely to be the large accountancy firms that have the technical and legal resources to research and produce elaborate avoidance schemes.

Competition Assessment

44. We have applied the competition filter to each of the NICs Bill measures and found that they are unlikely to harm the competitive process in markets. If anything, deterring NICs avoidance will be a spur to effective competition because the lower employment costs enjoyed by employers and employees who avoid NICs can distort to both product and labour markets. Employers and employees who engage in avoidance are able to gain a cost competitive advantage, which is unfair on those unwilling or unable to follow suit. By increasing the risks and curtailing the benefits of moving on to a new scheme once a current scheme has been closed down, the NICs Bill should have a pro-competitive effect. In fact, to the extent that the Bill deters avoidance, companies are likely to focus more effort on their primary business activities, rather than avoiding NICs, which will be beneficial for the economy.

Equality Impacts

45. 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). 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.

Securing compliance

46. Employers will be required to pay any NICs due under this measure by a specified date. Where NICs remain unpaid or are late paid after this date, penalties and interest will also be payable. This will be in line with the existing rules for unpaid or late paid NICs.
47. The existing guidance on disclosures will be revised with targeted publicity. The existing penalty regime for non-compliance with the tax disclosure rules will be extended to the NICs disclosure rules.

Consultation

48. The draft clauses for the Finance Bill were published on 24 March 2005. This Bill also extends to NICs the tax disclosure rules, which were discussed with interested parties, and amended as a result of those discussions, before implementation. Draft regulations under powers in the Bill will be published a minimum of 12 weeks before they take effect for technical comment.

Monitoring and Evaluation

49. In accordance with Government policy there will be a Post Implementation Review within two years of the measure coming into force and full evaluation of the measure within three years.
50. The aim of the Bill is to deter future NICs avoidance. There is already evidence that following the announcement of the Paymaster General on 2 December 2004, employers that were intending to use NICs avoidance schemes, did not in fact do so.
51. HMRC engages in regular forums with employers, their representatives and other tax and NICs experts. These provide a valuable source of feedback for issues arising. HMRC will continue to listen and respond appropriately to such representations. In addition, there will be a post implementation evaluation of the measures in the Bill as follows: -
52. **Measure (A)** - The measures are primarily a deterrent to employers and their representatives who use such arrangements to avoid paying their fair share of NICs on disguised remuneration. But for those that are willing to take the risk, we want to be able to act decisively and recoup any NICs that has been avoided. The effectiveness of this policy can be monitored by the number of avoidance schemes disclosed relating to employee remuneration following the 2 December 2004 announcement and how often legislation is introduced in the future to counter avoidance using the power in the Bill.

53. **Measure (B)** - Whenever a NIC liability is imposed affecting an NIC avoidance arrangement we plan to check the appropriate records to ensure the employers' NIC liability was not recovered from the employee. We do not anticipate a need to evaluate the measure beyond this routine information checking.
54. **Measure (C)** - Both our Business Support and Employer Compliance teams regularly visit employers who use NICs avoidance schemes and will be able to report back to our technical experts should there be problems in operating the rules, or if there is evidence of significant non-compliance. Further feedback will be received from promoters and employers. We do not anticipate a need to evaluate the measure beyond this routine information gathering.

Summary

55. There has recently been repeated evidence of significant NICs avoidance through use of tax/ NICs avoidance schemes. The Paymaster General has indicated that where avoidance schemes are closed down, liability should also be applied to the date of her announcement. This Bill seeks a power to be able to introduce NICs liability through regulations to counter avoidance. The power will be used, in the first instance, to close down avoidance involving the use of employment-related securities.
56. The Bill also includes powers to make amendments to the scope of NICs exemptions to reflect so far as possible similar changes to reliefs or exemptions for income tax that are exploited beyond their original intent and used for NIC avoidance.
57. In addition the government has decided to extend the scope of the disclosure rules to NICs avoidance schemes to close a gap in the existing rules and to ensure that the HMRC has the information to counter NICs only avoidance. The overall costs to Government and employers of this Bill and the related regulations will be minimal.
58. The combined impact of the measures in this Bill will not impose significant additional burdens or costs on employers unless they engage in contrived schemes to avoid income tax and NICs on remuneration paid to their employees. Employers that do not engage in such activity will be unaffected.
59. To summarise, costs/benefits identified are: -
- Employers that have engaged in avoidance will have to submit supplementary end of year returns of NICs now payable and that we estimate 500 employers and 10,000 employees may be affected, incurring additional costs estimated not to exceed around £3,000 per employer.
 - The cost of processing these additional returns for HMRC is estimated to be £20,000 in additional manpower costs.

- We estimate 21,000 small businesses, and potentially a further 90,000 self-employed persons, specialising in accountancy and tax will incur learning and familiarisation costs but these costs will be negligible.
- We estimate that this measure will secure an additional £95 million in NICs in 2004-05 and £240 million per annum thereafter.
- We have evidence that that some employers may have abandoned plans to channel bonuses through these schemes and instead paid cash bonuses following the Paymaster General's announcement of 2 December 2004.

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**REGULATORY IMPACT ASSESSMENT (RIA)
NATIONAL INSURANCE CONTRIBUTIONS BILL**

Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

Dawn Primarolo

Paymaster General

Date: 04/10/2005

REGULATORY IMPACT ASSESSMENT (RIA)

National Insurance Contributions Bill

Annex A. Mirroring so far as possible tax measures dealing with employment related securities in the Finance (No. 2) Act 2005 and providing a power to make regulations to counter NICs avoidance

It also includes a pre-emptive power aimed at avoidance covering reliefs or exemptions for income tax that are exploited beyond their original intent and used for NIC avoidance. It allows HMRC to make amendments to the scope of NICs exemptions.

Introduction

In Pre Budget Report (PBR) 2004 the Government announced that it would tackle attempts to avoid tax and NICs by making legislative changes to close down avoidance schemes and any changes would go back to 2 December 2004, if necessary.

Purpose and intended effect

The policy objective

A change to the NICs primary legislation is needed to impose NICs liability in order to give effect to the announcement at PBR 2004. The changes will also ensure collection of that liability.

In the first instance, regulations will need to be made to ensure that NICs liability is applied to employment related securities from 2 December 2004. It will mirror Finance (No.2) Act 2005 anti-avoidance tax measures that relate to employment related securities used to deliver cash bonuses. It should not have a material impact on those employers who do not seek to avoid paying their fair share of NICs on remuneration that they pay their employees.

Background and Introduction

The NICs powers as currently framed do not allow for NICs liability (except in very limited circumstances but, then only back to the beginning of the tax year in which the regulations are made). We need to have a capability to enable us to introduce liability (back to 2 December 2004 if necessary) in order to reflect tax measures on avoidance.

For tax purposes, **specific** tax avoidance schemes will be closed down with effect where appropriate. So it is not necessary to have a **general** measure for tax because the annual Finance Bill allows scheme specific avoidance legislation to be introduced.

Without a general power for imposing a NICs charge we would need a Programme Bill every time we wanted to introduce a NICs charge and this would lead to a long delay in collecting the additional NICs and undermine the credibility of the PBR announcement. A general NICs power, back to 2 December 2004, that is used to counter avoidance schemes is justified as it will only apply in limited circumstances where there is use of an avoidance scheme.

Risks

It is important that the legislative framework in respect of NICs is in place to establish the credibility of the PBR announcement on avoidance and ensure that measures for tax can be replicated for NICs promptly.

The measures will increase fairness by providing a level playing field for employers who do not attempt to reduce tax and NIC liabilities by using complex avoidance schemes.

Options

Option 1 – Do Nothing

To do nothing to collect NICs where an avoidance scheme has been used risks giving a message that using such schemes can still be worthwhile. This would reduce fairness across business by disadvantaging companies who do not use such schemes. It would allow employers to avoid NICs for past periods and the deterrent effect of the PBR announcement would be diluted.

Option 2 – The Legislative Option

This option reinforces the strong, clear commitment from the Government that everyone should pay the proper amount of tax and NICs. It will provide tax certainty to employers and a level playing field for employment costs.

Decision

The Government will pursue the legislative option because of the benefits of ensuring fairness in NICs liability across business.

Costs

All costs are discussed in the main annex.

Securing Compliance

A Technical Note and the draft Finance Bill clauses dealing with employment related securities tax avoidance arrangements have already been published. The HMRC website will be updated to ensure those affected are able to apply the revised rules for tax and NIC purposes. The HMRC network offices that

deal with employer compliance activity will ensure that any employment income caught by the change in the legislation is subjected to income tax and NICs. The existing interest and penalty regime on failure to pay tax and NICs will apply as necessary in relation to prospective liabilities and in relation to liabilities that are not paid according to their due date.

Competition Assessment

The competition filter has been applied and no likely adverse impacts on the competitive process were found.

Impact on Small Business

The NICs avoidance measures are not aimed at businesses of any particular size and will not affect small businesses disproportionately.

Consultation

To the extent NICs regulations will be introduced to provide for NICs liability on employment income charged to income tax by the provisions in Schedule 2 of Finance (No.2) Act 2005. A Technical Note giving full details of the anti-avoidance tax measures in Schedule 2 was published on 2 December 2004 and the draft clauses for the Finance Bill were published on 3 February 2005. The corresponding NIC regulations complete the anti-avoidance provisions.

Monitoring and Evaluation

This is essentially a deterrent to using a scheme or arrangement to avoid tax or NICs and will only be employed if such a scheme results in action to recover tax. We will monitor the effectiveness of legislation by how often we have to introduce legislation to counter avoidance using these powers.

Summary

There is evidence of significant NICs avoidance through the use of employment-related securities. The Government will counter this avoidance using the measures in this Bill. Further use of these powers is entirely dependent on whether employers continue to use avoidance schemes instead of paying their fair share of NICs on employment rewards.

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REGULATORY IMPACT ASSESSMENT (RIA)

National Insurance Contributions Bill

Annex B. Voiding Joint NIC Elections & Agreements used in NIC Avoidance Arrangements

Introduction

This measure will prevent the use of National Insurance contributions (NICs) agreements and joint elections that allows employers to ask the employee to fund the employer's (secondary) liability on employment income from certain employment related securities, where that income is brought into NICs liability as a result of regulations made under Measure A.

Purpose and intended effect

Currently, employers can ask their employees to fund the employer's NICs liability arising on earnings from certain types of shares and securities. The ability is limited to gains from employment-related securities options, restricted securities and convertible securities, in all cases where there is a future unpredictable NICs liability. This enables the employer to remove the need to provide for the unpredictable secondary NICs liability in their accounts, when the amount of the employer's NIC liability is contingent on the future value of the securities.

This measure will ensure an employer is unable to apply the benefit of the NICs agreements and joint elections to securities that are part of a NICs avoidance arrangement. These are arrangements or transactions that may in future have a NICs liability imposed by legislation that is effective for earlier periods. If this were to happen, the voiding of any agreement or joint election in respect of that transaction will ensure the employer remains liable for the employer's NICs.

Risks

We do not consider there are risks associated with this measure. If the measure is not implemented then it gives the employer an unfair advantage where they have chosen to implement a NICs avoidance scheme because they would be able to recover the employer's NICs charge on income from these schemes from the employee. There would also be human rights law concerns from the employee's point of view if the employee's agreement or joint election was capable of covering income which was not subject to NICs when they made the agreement or election, but which was made subject to NICs.

Without the ability to pass secondary NICs liability on to the employee, employers will be further deterred from offering cash bonuses disguised as employment-related securities by way of an avoidance scheme.

Options

Option 1 – Do Nothing

Employers who consider that a NICs avoidance arrangement is likely to result in the imposition of a NICs charge, may have entered into a joint NICs election or agreement so that their employees bear the secondary NICs. If such election or agreement were capable of applying to the NICs liability, this would weaken the deterrent effect of the NICs charge. Doing nothing would also mean that employers are using these mechanisms beyond the original policy principle, which is to help the employer deal with a future unpredictable size of the employers' NICs liability on earnings that will crystallise in the future. There would also be human rights law concerns from the employee's point of view if the employee's agreement or joint election was capable of covering income which was not subject to NICs when they made the agreement or election, but which was then made subject to NICs.

Option 2 - Void NICs Election and Agreements in respect of NICs liabilities for earlier periods

This option will ensure the employer is not able to pass on their employers' NICs liability that may be imposed on employment income derived from avoidance arrangements and transactions. It has the effect of treating the income, in terms of NICs liabilities, as if the payment was a cash bonus. Additionally, it maintains the policy principal behind the NICs agreements and legislation of allowing employers to deal with future unpredictable NICs liabilities on certain types of share incentives.

Decision

NICs election and agreements will be voided in respect of NICs liabilities arising from avoidance which has been targeted by the regulations made under Measure A.

Costs

[All costs are discussed in the main annex.]

Securing Compliance

We already have compliance mechanisms in place to ensure that the employer is applying NICs agreements and elections correctly. This has proved more than adequate in this area to date. Where on inspection of the employer's records it is discovered that either of the mechanisms has been operated outside the scope of the legislation, then the employer would have any further future use of the joint election withdrawn. In some circumstances, usually in cases where the agreement or election has been voided, the employer will be asked to pay the secondary NICs as appropriate.

Competition Assessment

We have undertaken a competition assessment and the competition filter indicated that voiding NICs elections and agreements in prescribed circumstances should not have any adverse effects on the competitive process in markets because the measure will stop any employer from using these to support NICs avoidance arrangements.

Impact on Small Business

There is no specific impact on small businesses. The measure is only relevant to those businesses big or small that do award employment related shares and securities and options over these where the award is part of an avoidance scheme.

Monitoring and Evaluation

As long as employers have the legal ability to pass on the employer's NICs liability on certain types of share remuneration the need for limiting the use of that facility will exist. Whenever a NICs liability is imposed affecting a NICs avoidance arrangement we would check the appropriate records to ensure the employers' NICs liability was not recovered from the employee. We do not anticipate a need to evaluate the measure beyond this routine information checking.

Summary

NICs agreements and joint elections have proved popular with employers in the areas where they are presently permitted. However, the facility has a defined purpose where employers wish to remunerate their employees by certain types of share or securities awards. It provides employers the ability to reduce or remove a future unpredictable and non-quantifiable NICs liability and employees will be able to benefit from advantages of share ownership. This measure will ensure that purpose is not abused. Those employers who seek to participate in NICs avoidance, the purpose or one of the main purposes of which is to escape an employer NICs liability, will not have the opportunity to transfer this liability to the employee following the imposition of a NICs liability.

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REGULATORY IMPACT ASSESSMENT (RIA)

National Insurance Contributions Bill

Annex C. NICs disclosure rules

Introduction

This measure provides for the current provisions requiring disclosure of information about certain tax planning schemes to be extended by regulations to NICs planning schemes.

Purpose and intended effect

The policy objectives

The objective is to counter the avoidance of NICs by requiring information about certain NICs schemes and arrangements to be disclosed to HMRC. This will enable HMRC to tackle avoidance in a more targeted way and for the Government to more quickly counteract schemes, which seek to defeat its NICs policy objectives.

The new rules are not intended to have any material impact upon the very large numbers of accountants and lawyers across the UK who merely assist their clients to understand the NICS system and plan their transactions appropriately.

Background and introduction

Tax and NICs avoidance costs the Exchequer lost revenues each year. It also undermines the government's public spending objectives and brings unfairness into the tax and NICs systems themselves. Measures closing down loopholes in legislation exploited by tax avoidance schemes have become a regular feature in annual Finance Bills. But these measures can only be introduced when the schemes have been discovered, often after they have been exploited for some time.

In order to redress this information gap, in Budget 2004 the Government announced the introduction of new rules that would require those who design or market potential tax avoidance schemes, or those who use them, to provide information about the schemes to the Inland Revenue. The Government announced that the initial scope would be restricted to two high-risk areas: employment and financial products.

The basic rules are at Part 7 of Finance Act 2004 ("the Act"). In principle, the Act requires disclosure of schemes or arrangements where:

- Use of the scheme or arrangements might be expected to confer a tax advantage; and

- That tax advantage might be expected to be the main benefit, or a main benefit, of using the scheme or arrangements.

The Act applies to income tax, corporation tax, capital gains tax, stamp duty land tax, stamp duty reserve tax, inheritance tax and petroleum revenue tax.

However, much of the detail of the rules was contained in regulations laid before Parliament later in the year and, as announced at Budget 2004, these restricted the initial scope of the rules to new and innovative schemes and arrangements that:

- Concern income tax, corporation tax or capital gains tax; and
- Involve employment or the use of certain financial products.

The Inland Revenue published the regulations in draft on 17 May 2004 and invited comments by 30 June. The regulations were eventually made and laid before Parliament on 22 July 2004, coming into force on 1 August 2004. They incorporated significant changes to the published drafts as a result of comments received in response to the consultation, in particular the use of 'filters' to ensure that the rules were finely targeted on avoidance as opposed to legitimate tax planning.

The regulations, as they apply to income tax, have been amended twice. The first, coming into force on 30 September 2004, added an additional filter to employment schemes in line with further suggestions made by businesses. The second, coming into force on 14 October 2004, ensured that in circumstances where legal professional privilege prevents a lawyer from making a full disclosure, the obligation falls upon the client to make the disclosure (the client may, however, choose to waive privilege in which case the lawyer must disclose).

Disclosures are risk assessed by the Anti Avoidance Group (Intelligence) Unit (AAG)] within HMRC. The AAG maintains guidance about the rules on the HMRC website. It also maintains a dialogue with tax advisers in which it has explained the rules and assisted promoters to comply.

To date, both the number and quality of disclosures provide strong indication that the rules are working as intended, targeting tax avoidance without affecting legitimate tax planning. HMRC has not received significant numbers of unnecessary "safety-first" disclosures, which some commentators had predicted.

Moreover, although the first disclosures were not due before 30 September 2004, the system has already begun to deliver its policy objectives. Disclosures have informed a number of anti-avoidance measures since the rules were introduced. A number of the disclosed tax avoidance schemes were concerned with the rewards from employment, but they were also aimed at the avoidance of NICs. Information gathered from the tax scheme

disclosure rules enabled Ministers to announce measures in PBR 2004 to close down, with effect from 2 December 2004, schemes intended to avoid payment of tax and NICs on employment income in the form of annual bonuses. The tax measures were contained in Finance (No. 2) Act 2005. The NICs measures are provided for in this Bill.

Risks

There is considerable evidence of avoidance of NICs on employee income. To counter that avoidance HMRC currently relies heavily upon information that is received for income tax purposes. In practice, most NICs avoidance schemes also involve tax avoidance (a deferral of liability as PAYE is not applied). However, there are situations where NICs liability does not mirror employment income tax provisions. These include:

- Some expenses are excluded from NICs but not tax;
- Employee contributions to an approved pension scheme are not taxable but are subject to NICs; and
- Income from pensions is taxable but not subject to NICs.

Consequently, there is potential scope for NICs-only avoidance, where HMRC will not gather information from tax disclosures. There is limited evidence of the existence of NICs-only avoidance schemes.

Options

Option 1 – Do Nothing

If we do nothing, information about NICs-only avoidance schemes will not be obtained. For information about significant NICs avoidance schemes, we will continue to be dependent on disclosures of income tax avoidance schemes.

Option 2 – A non-regulatory option: e.g. seeking voluntary co-operation from NICs planners

We could identify no non-regulatory option that was likely to improve the flow of information to HMRC about avoidance schemes. As noted above, it is in the nature of avoidance that promoters and users go to considerable lengths to maintain secrecy. There is no evidence to suggest that they would be prepared to provide information in the absence of a statutory obligation to do so.

Option 3 - A pre-transaction ruling system

Option 4 – Require more detailed information on, or with, existing forms, e.g. Form P35 – Employers End of Year Return

Both Options 3 and 4 would place a considerable additional burden on taxpayers and would operate in addition to the existing disclosure requirements for tax schemes.

Option 5 - Rely upon a wider power to introduce legislation with effect for an earlier period.

The Bill proposes introducing a power to allow NICs anti-avoidance to have effect for an earlier period, to reflect equivalent tax provisions already enacted. This power will not extend to instances where only NICs is avoided. So, if an avoidance scheme is designed only to avoid NICs, the legislation can only be amended prospectively.

We considered the possibility of introducing a power that would allow NICs only avoidance schemes also to be closed down. However, we considered that such a power would be disproportionate to the risk, based upon the current evidence. Instead, we considered the proportionate response was to limit the power as described above, and use extended disclosure rules to gather evidence about NICs-only avoidance. This evidence will be used to inform future NICs legislation.

Decision

Doing nothing is not considered acceptable. Of the options for change, we concluded that extending the existing disclosure rules to NICs was the simplest and most proportionate solution.

Costs

All costs are discussed in the main annex.

Securing Compliance

There will be a targeted campaign to advise likely promoters and users of notifiable schemes about the rules. We will also update the published guidance on disclosures to describe who will be affected and how the rules will work in practice. The disclosure itself will be made through the already existing system, operated in HMRC by the AAG.

Sanctions will be needed to ensure compliance and the existing disclosure penalty regime will apply to promoters and taxpayers who fail to disclose full details of a notifiable scheme by the due date. The maximum initial default penalty will be £5000 with continuing penalties of up to £600 per day for continued non-compliance.

Initial penalties will be decided by a Special Commissioner, continuing penalties by an officer of Revenue & Customs. There is an appeals process against a penalty using an established appeals procedure.

Competition Assessment

The competition filter test has been applied. There is considered to be a low risk of a significant detrimental effect on competition.

Impact on Small Business

In our assessment there should be little impact on small business. Some small businesses may adopt NICs schemes. However:

- Most NICs schemes are also tax schemes that are already required to be disclosed; and
- In most cases there will be a promoter who has to make the initial disclosure.

Some small businesses may be promoters of NICs schemes. However, this is a specialised area and we would not expect scheme promoters to fall generally within the small business size.

The impact of the NICs Disclosure rules on small business mirror the tax disclosure provisions introduced in Finance Act 2004. Any small business affected in terms of administrative burdens by the need to disclose NICs avoidance arrangements will need to consider the tax avoidance rules as well. However, the marginal cost (in terms of learning and familiarisation with the rules) to these businesses will be negligible as the vast majority of employment schemes are intended to gain a tax and NICs advantage and so are already reportable.

Consultation

As this is a measure directed at tax avoidance, consultation was not appropriate before the publication of the Bill. The proposal is to apply to NICs the existing rules for disclosure of tax schemes. These rules were the subject of detailed discussions with the accountancy and legal professions, and other businesses during 2004 as described in paragraph 8 above.

Monitoring and Evaluation

Both our Business Support and Employer Compliance teams regularly visit employers who use NICs schemes and will be able to report back to our technical experts should there be problems in operating the rules, or if there is evidence of significant non-compliance. Further feedback will be received from promoters and employers. We do not anticipate a need to evaluate the measure beyond this routine information gathering.

Summary

The rules requiring disclosure of information about tax schemes are a key component in countering avoidance, which reduces tax revenues and leads to

unfairness in the tax system. Extending the rules to NICs will help counter NICs avoidance in a way that is proportionate and minimises the additional burden on promoters and employers.

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