REGULATORY IMPACT ASSESSMENT (RIA)

NATIONAL INSURANCE CONTRIBUTIONS BILL

Purpose and intended effect

1. In the 2002 Budget the Chancellor announced a package of reforms to the structure of National Insurance Contributions (NICs) and the Income Tax system to take effect in the year 2003-04. These reforms are aimed at providing extra funds for the Government's spending plans.

2. There are two parts to the package of reforms which take effect in 2003-04:

   i) An additional 1% National Insurance Contribution by employers, employees and the self-employed, including on earnings above the Upper Earnings and Profits Limits.
   ii) A freeze of the personal tax allowance for those aged under 65, the NICs primary and secondary threshold and the lower profits limit for the self-employed for the year 2003-04.

3. The first part of these measures, the 1% increase on employers, employees and self-employed NICs rates, including on all earnings above the Upper Earnings and Profits Limits, is implemented in this Bill.

Risks

4. The need to ensure that the burden on employers in collecting the additional revenue to support the Government's spending plans is kept to a minimum.

5. The need to ensure adequate funds are provided for the Government's spending plans.

Options

6. Additional revenue could have been raised from other sources instead of NICs. However, NICs are different from tax in that they are paid by all earners below pension age and their employers, and reflect the Beveridge principle that people in work contribute towards the benefit

and health services they will need when they are unable to work. A proportion of NIC revenues has been allocated to the National Health Service since the National Insurance system was first established in the 1940s.

7. Given the Government's decision to ensure that employees, employers and the self-employed should contribute on an equal basis, according to their or their employee's income, it would have been possible to treat the additional contributions as a separate Class of contribution, separate from the existing Classes (Class 1 paid by employers and employees, Classes 1A and 1B paid by employers, Class 2 and 4 paid by the self employed, and Class 3 voluntary payments). But this would have involved additional recording and accounting obligations for employers and the Inland Revenue.

Benefits

8. The major benefit of these reforms is to provide £8.6 billion in 2003-04 to fund the Chancellor of the Exchequer's spending plans with the maximum efficiency and the minimum disruption to business, the individual and the Inland Revenue.

Policy Costs

9. For 2003-04 the total increase in employee's NICs will be £3.55 bn, the total increase in employer's NICs will be £3.9 bn and the total increase in self-employed NICs will be £0.45 bn. The additional £0.7 bn comes from freezing the NICs threshold for 2003-04 (£0.25 bn) and freezing the Income Tax Personal Allowance for the under 65's (£0.45 bn).

Implementation costs

10. For the vast majority of individuals and companies the implementation costs of the NICs increases will be marginal to nil. There will be no additional entries on payslips and no extra recording necessary on employers' end-year returns.

11. The calculation for secondary NICs (the employer contribution) is structurally identical to current years and as such there will be no additional impact in its implementation and running or its error rates.

12. The calculation for primary NICs (the employee contribution) and self-employed NICs involves an extra calculation due to the 1% increase above the Upper Earnings and Profits Limit where there is currently no contribution. Whether this creates implementation/ running costs depends on whether the company/ self-employed individual uses payroll software/ I.T. or performs the calculation manually.

Impact on the Employee

13. There will be no implementation or running costs for employees as the increase in NICs will be dealt with through PAYE for them by their employers.

Impact on the Employer

14. For employers using payroll software the administration impact will be minimal as it will simply involve a change in the figures the software uses to calculate both the employer and employee contributions. Where the employer uses a commercial payroll package this will simply involve installing the upgrade from the provider. Otherwise this would involve changing the rates himself. Either way the employer would need to make similar changes after each rates change anyway and the ability to change these figures readily is an essential feature of these software packages in order that they can cope with any periodic changes in contribution rates hence for these employers the change is not considered a significant burden.

15. For employers who perform their payroll manually there will be no extra cost resulting from the change to the employer NICs contribution.

16. There may, however, be an extra level of calculation to be added to interpreting the tax tables when working out employee NICs. This will involve calculating 1% of any earnings above the Upper Earnings Limit. However, no extra forms/ boxes need to be filled in and obviously this only applies to employers whose employee earns above the Upper Earnings Limit. We estimate the amount of additional time it takes to perform this calculation at around 2 minutes initially although over time this will drop significantly. Therefore the initial start-up impact on the employer would be around 2 minutes per payday per employee earning over the UEL and calculated manually. Assuming an average hourly rate of £20 for an owner/proprietor using manual methods this equates to 66p per employee earning above the UEL per payday.

17. There are around 1.2 million employees whose NICs contributions are worked out manually. Of the working population 15% earn above the UEL therefore we can calculate the number of employees above the UEL who have their NICs calculated manually by taking 15% of 1.2 million to get 180,000 employees. This number is highly conservative as an individual that earns above the UEL is far more likely to work for a company that calculates its payroll automatically than an individual that earns below the UEL. However using the figure of 180,000 employees and 66 pence per payday per employee (see 15) we can calculate that it costs around £118,800 per payday and thus assuming 12 paydays in the year the cost of performing manual payroll for the relevant employee's earning above the UEL is around £1.5 million in 2003/04.

18. This cost will obviously decrease over time as the recommendations in the Carter Report are implemented and more companies become IT literate and able to calculate their payroll using computers.

19. In addition to the increase in time there may be a small initial increase in the error rate as individuals get to grips with the new calculation. This initial error increase would, of course, only apply to employers performing the calculation of employee NICs manually for employees earning over the Upper Earning Limit and would also only apply for the first few calculations. For employers who have implemented adequate payroll software there will be no related increase in the error rate.

Impact on the Self-Employed

20. We do not believe the impact of the increase on the self-employed will be significant. The vast majority of the self-employed use agents and we do not believe that the marginal amount of extra work involved in completing the tax return will lead to agents increasing their fees. Of the remainder of the self-employed who do not use agents these changes will mainly affect those earning above the Profit Limit. For these people there will be the extra impact of a 2 minutes calculation when they fill in their tax return once a year. We do not consider this significant.

Other costs/impacts

21. There will be a one off cost to the Inland Revenue of approximately £270,000 to brief Inland Revenue staff of the reforms and to put front line staff eg in business support teams and employer helplines in a position to provide members of the public with the help they need.

Securing Compliance

22. Through its established programme of compliance work the Inland Revenue will monitor employers', employee's and the self-employed's compliance with the new NICs rates.

Impact on Small Business

23. The impact on small business is the same as the impact for employers generally. There is no impact with respect to the changes to employer contributions. Where the small business calculates its payroll manually there will be an extra two minutes calculation per employee earning above the Upper Earnings Limit per payday. Initially there will also be an error increase although this will be neither large or prolonged. Where the small business has taken on board the suggestions of the

Carter report and uses IT effectively to calculate its payroll there will be no increase in administrative burden nor in the number of errors.

24. Small employers are permitted to recover a higher percentage of any Statutory Maternity Benefit /Statutory Adoption Pay or Statutory Paternity Pay that they pay out to their employees (Small Employers Relief). The small employer is defined as an employer whose National Insurance Contributions payments are £40,000 or less in the relevant year. The increase in both primary and secondary NICs could mean that a small number of employers who were previously able to claim Small Employers Relief will no longer be able to do so from 2004/05. Similarly some small employers could also be affected if the increase takes them above the threshold for accounting on a quarterly basis, rather than monthly, for their PAYE/NICs/Student loan Recovery liability. We will monitor the impact on small employers and the appropriate level of the thresholds.

Competition Assessment

25. We do not envision this policy having any significant effect on competition.

Equality and Fairness

26. The use of a 1% rise in NICs to raise these funds ensures the burden is spread as widely and fairly as possible across those of working age– matching cost to ability to pay.

Monitoring and Evaluation

27. The effectiveness of the policy will be closely monitored by the Inland Revenue. Support for businesses and individuals will be provided by the usual channels supplied by the Inland Revenue.

Summary

28. The goal of this policy is to provide extra-funds for the Government's spending plans with the minimum disruption to employers, employees and the self-employed. This has been achieved with a number of reforms the most significant of which is an increase of 1% to NICs rates for employers, employees and the self-employed including all earnings above the Upper Earnings and Profit Limit. There is no impact on employees other than the increased NICs. There is an impact for

employers where employee's primary class 1 NICs is concerned if the payroll is still calculated manually and must be calculated for someone earning above the Upper Earnings Limit. Initially this will constitute an extra 2 minutes calculation for every employee who earns above the UEL and whose PAYE is calculated manually. Where payroll software is used the impact is marginal.

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REGULATORY IMPACT ASSESSMENT

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 29 April 2002