

Starting up in Business

Regulatory Impact Assessment

10 JANUARY 2001

INLAND REVENUE

Objectives

1. This measure forms part of the Government's response to Lord Grabiner's report on the Informal Economy that was published in March 2000. It contributes to the objective of moving economic activity away from illegitimate to legitimate businesses. By ensuring that new businesses register with the Inland Revenue soon after they start up they can gain access to help with their tax and National Insurance Contributions (NICs) affairs from the outset, and they can avoid drifting into the informal economy.

Details

2. The relevant recommendations in Lord Grabiner's report are:

3.34 I recommend increasing the assistance given to the newly self-employed. One idea tried in Australia and New Zealand is to offer new businesses an early visit from customer service staff, intended to educate and encourage, so that record-keeping is put on a sound basis from the outset.

4.7 I recommend that there should be an additional rule requiring a person to give notice immediately or within a very short period of having started a business of any kind. It would be a simple process, involving completion of a short form. This would not only improve enforcement, but would have a customer service benefit, allowing the Revenue to offer advice and guidance at an early stage. The rule could be harmonised with the equivalent requirement for NICs.

3. So we have put together a package with three key elements building on the existing requirement for the newly self-employed to notify the Inland Revenue immediately of their liability to pay Class 2 NICs. Two elements

involve better help and support and the third involves regulations. The package entails:

- Streamlining the notification/registration process through the use of a short, easy to complete form and providing telephone registration facilities. The registration for Class 2 NICs will also be treated as notification for tax and Class 4 NICs purposes.
- The registration will trigger the provision of a new Guide on tax/NICs liabilities; with options for direct support from Business Support teams and a dedicated helpline.
- Making the requirement more effective by introducing a £100 penalty if they fail to register by the end of the third complete calendar month after starting up.

Alternative options considered

4. Lord Grabiner had envisaged a new rule for registration of a business. He felt it was particularly unsatisfactory that no penalty is incurred for failing to notify the Inland Revenue that there is income to declare until six months after the end of their first financial year of trading. For a business starting in April this could mean there was no requirement to register for 18 months. We therefore considered introducing a new requirement for registration for tax purposes at the start of the trading year, rather than at the end. But we decided that this would introduce unnecessary new regulation.
5. As there is already legislation requiring notification of liability for Class 2 NICs, the majority of new businesses that would be required to register for the purposes of tax would also be required to register for NICs. We therefore looked for a solution which would make the existing requirement more effective, rather than introduce a new one.
6. There is clearly a need to make the existing requirement for NICs registration more effective. More than one third of people registering for

Class 2 NICs do so later than three months after commencing self-employment, although liability to pay starts from the first week. A recent data matching exercise and anecdotal evidence indicated that there was also some ignorance of the need to register for Class 2 NICs – with significant numbers assuming that notification of taxable income through the Self Assessment process was sufficient. Options to achieve better compliance included incentives to register, rather than sanctions. But we decided that introducing incentives for an existing requirement would be neither fair to current compliant businesses, who could not benefit, nor practical considering the scope for repeat registrations.

7. We therefore decided to introduce sanctions against non-compliance. Various options concerning the level of the sanctions were considered – including making the amount vary depending on the amount of NICs owing, the extent of the lateness and whether the self-employed person had voluntarily come forward or had been “discovered”. It was decided that a flat rate amount should be applied that was easy for the public to understand and straightforward to administer. The £100 penalty for failing to return the Self Assessment form on time is an effective tool in securing compliance. Continued non-compliance already attracts more severe sanctions in the shape of existing tax geared penalties for failing to notify taxable income, and these will continue to apply.

Risks

8. The measure addresses the risk identified in Lord Grabiner’s report that people in business can simply drift into the hidden economy. They then find it increasingly difficult to put their affairs in order which can result in:
 - Failure to be able to take advantage of the support, advice and opportunities for growth available in the formal economy.
 - Accruing unmet liabilities with the Revenue departments (and perhaps other regulatory bodies).

- Unfair competition for legitimate businesses who meet their obligations in full.
9. The risk of introducing a penalty for failing to notify the Inland Revenue is that it could act as a disincentive to those in the informal economy to “come clean” – knowing that they will face a penalty in addition to any tax/NICs arrears. To counter this we will publicise the introduction of the penalty well before it becomes payable. In the publicity we will remind people of the Tax and Benefits Confidential Helpline which was set up last June and enables people in the informal economy to find out where they stand on a no-names basis. We have also ensured that those in very low paid informal work will not be disproportionately penalised by specifying exemption from the penalty if net income has been below the level where they would qualify for exemption for paying Class 2 NICs (currently £3825 pa).
10. Alternatively there is a risk that the amount of £100 could be seen as insufficient to deter those deliberately evading their liabilities. The Inland Revenue’s Intelligence teams will continue their investigative work into the hidden economy. Existing, tax geared, penalties in respect of non-disclosure of taxable income will continue to apply.
11. The risks identified with the facility to register by telephone include the possibility that inaccurate or incomplete information could be given, thus resulting in incorrect registration; and disputes over whether registration had taken place could not be settled through production of written evidence. To safeguard customers the Call Centre of which the registration helpline will be part, has security measures in place which are published in their statement of practice. For registration they will record telephone calls and maintain a database of calls received and the information obtained from them.

Benefits

12. The benefits of the proposal are:
- Quicker and easier means of registering. The experience of our own staff in the Inland Revenue Enquiry Centres and informal feedback from

customers and taxpayers' advisers all led us to the conclusion that the previous form "CWF1" was difficult to complete accurately. The newly self-employed person frequently had to seek advice from local Inland Revenue officers or independent tax advisers / accountants.

Independent advice comes at a cost to the business - although we have been unable to establish the costs attributable to this type of advice.

- Better guidance and help from the Inland Revenue. A new "Starting up in Business Guide" containing integrated step-by-step guidance for the newly self-employed on tax and NICs liabilities, record keeping and signposting help available from other agencies and (from April 2001) the Business Support Teams' visiting service. This should result in more accurate assessment of tax and NICs liabilities by the individual. However it will not reduce costs of independent financial advice for those with more complex affairs.
- Compliance with the requirement to notify Class 2 liability means that the self-employed person can maintain their National Insurance contributions record and build up entitlement to contributory benefits and basic state retirement pension.

13. Tackling the informal or hidden economy has a general benefit for society as a whole. It is harder for hidden economy businesses to expand and get support; and tax/NICs evasion and benefit fraud places a burden on law-abiding tax-payers.

Costs

14. The introduction of a penalty for failing to register will place **no additional costs on compliant businesses** as the requirement to notify Class 2 NICs liability is not new.

15. There will be savings in time taken to complete the form because of the reduction in the amount of information requested. And there will be an instant acknowledgement that the registration process has been successful. These "softer" savings are difficult to quantify, but we estimate an average

of 12 minutes per new registration will be saved simply in the completion of the registration process, which amounts to 24,000 hours over a year for all new registrations – equivalent to between £300,000 to £400,000.

16. The cost difference between telephone and postal registration is likely to be marginal. Assumptions are that the registration element of a telephone call will last around 3 minutes – charged at local rates. Phone lines will be available 7 days a week from 8am to 8pm. However the choice to use the telephone registration service is unlikely to be made by businesses purely on cost grounds – there will be benefits in obtaining general information too.

Impact on Small Business

17. This measure is specifically targeted at the newly self-employed. In the vast majority of cases these will be small/micro businesses. Exceptions could be in new partners in large accountancy or law practices.

Compliance

18. There will be a publicity campaign launched when the new telephone registration line opens to let the public know about the facilities that are available, the availability of the starting up in business guide, and to advise them of the requirement to register. In the run up to 30 April 2001, the last day for registering before a notification penalty becomes payable by those who started self employment in January 2001 or earlier, further publicity will remind people of the requirement.

19. Thereafter the requirement and consequent penalty will feature prominently in Inland Revenue's literature. Registration levels will be monitored and consideration given to renewed publicity if non-compliance persists or increases.

20. The Inland Revenue's investigation teams will continue to identify those working in the informal economy and self-employment notification failure penalties will be imposed where it is appropriate, in addition to any penalties for non declaration of taxable income.

Consultation

21. The consultation paper "Starting up in Business" was issued on 17 October 2000 with consultation closing on 11 December 2000. There were a total of 63 responses to the proposals of which 13 were from national organisations and representative bodies, 11 were made by local organisations working with small businesses, mainly enterprise organisations and chambers of commerce, and 31 from accountants with localised practices. A further 8 were received from individuals or small businesses on their own account.
22. The consultation revealed that there was broad support for the introduction of easier registration and advice, and recognition of the need to stop people drifting into the informal economy. No additional costs were identified to business, but around half of those responding disagreed in principle with the introduction of a penalty. The proposals were modified to provide for a three month period of grace for registration and a flexible starting point - ie. the clock to start ticking only from the end of the month in which self employment starts.
23. The report on the consultation was published on the Inland Revenue website on 20 December 2001, and copies sent to those who responded.

Monitoring and evaluation

24. The policy will be monitored by comparing the baseline of late notifications (currently around 33% of voluntary registrations are received more than three months after self-employment started.) with the numbers who are late after the introduction of the measures described above. Qualitative evaluation of the improvement in knowledge following the advertising campaign and people's experience of the usefulness of the new registration arrangements will also be undertaken.

Regulations covered by this assessment

25. The Social Security (Contributions) (Amendment) Regulations 2001, SI 2001 No.45 and the Social Security (Contributions) (Amendment) (Northern Ireland) Regulations 2001, SI 2001 No.46.

Contacts

26. For more information, or further copies of this report, it may be found on the consultation register of the Inland Revenue website at www.inlandrevenue.gov.uk, or by contacting

Jenny Fox

Inland Revenue Cross Cutting Policy

Room 432, 22 Kingsway

London WC2B 6NR

Telephone: 020 438 7544

Or E Mail: starting.business@ir.gsi.gov.uk