TAXREP 28/00

SIMPLIFYING NATIONAL INSURANCE CONTRIBUTIONS FOR EMPLOYERS

Memorandum submitted in August 2000 to the Revenue by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a technical discussion document issued in June 2000

CONTENTS

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INTRODUCTION

1. We are pleased to have the opportunity to comment on the proposals in the technical discussion document issued by the Revenue in June 2000. However, we would point out that although the length of the consultation period is about right, timing it to coincide with the summer holiday season is not within the spirit of Open Government.

GENERAL COMMENTS

2. We welcome the proposals in the technical discussion document. They go some way towards simplification and harmonisation, but still leave differences. Thus as far as they go, the proposals will help employers.

3. The statement in Chapter 2 in the first paragraph under 'Next Steps' that employers are interested only in technical detail is only half the story. Whilst the busy businessman is indeed concerned about whether he has understood sufficiently the inconsistent and labyrinthine rules that he has to master in order to ensure that he pays his employees and the Collector of Taxes the correct amounts and will not be caught out at a later date by a PAYE/national insurance contributions ('NIC') auditor, this is simply because when he is computing the payroll or completing forms P11D this is his immediate and pressing objective.

4. In the longer term he would rather the Government provided him with a simple system, so that he does not need to do two different sets of calculations for each item of pay and complete up to eight columns in the NIC section of each employee's deductions workings sheet, rather than initiatives which tinker at the edges such as this exercise or, worse, which use the tax/NIC system to try to influence people's behaviour and result in endless changes which are no clearer and are probably more burdensome and expensive than what is replaced.

5. Real simplification and harmonisation of tax and NICs would involve aligning the inconsistent rules not only for those items which are not only the most common but which employers find the most complex, namely cash payments, credit cards, vouchers and pecuniary liability, but also 'sacred cows' such as charitable giving and pension contributions. As to the latter two items, we agree with the Government that charitable giving and self-provision of pensions should be encouraged, which suggests that both should be deductible for NIC.

6. In short, if an item is subject to/deductible for PAYE income tax, then it should be subject to/deductible for Class 1 NIC and vice versa, and (given that Government policy is that benefits-in-kind are subject to Class 1A NIC) if an item is a taxable benefit-in-kind which goes on the P11D, then it is subject to Class 1A NIC. Whilst common rules might result in a loss to the Exchequer, overall a revenue-neutral outcome could be achieved by adjusting tax or NIC rates.

7. In the longer term, although NIC is not officially acknowledged to be a tax, the underlying structure of NIC (and social security generally) needs to be critically examined in the light of our ten tenets towards a better tax system. In addition, section 198, Income and Corporation Taxes Act 1988 and the NIC equivalent should be amended so that the criterion is commercial need. Whilst we note that acknowledgement is given to important policy

questions which are listed under 'Tax/NICs alignment', we are disappointed that the technical discussion document does not include a commitment to any long-term strategic review of the contributory principle, the unquestioning acceptance of which has over the years hampered any meaningful discussion which might otherwise have resulted in progress. We consider that the collection of taxes to fund social security should be by way of a more straightforward and streamlined system to which the contributory system is then applied, rather than, as at present, the contributory principle tying the authorities' hands and preventing helpful change.

8. Only if such radical proposals are addressed and implemented can meaningful simplification ever be achieved.

DETAILED COMMENTS

CHAPTER 2: CONTEXT

Recent developments in simplifying NICs

9. We welcome the cross-skills training being given to employer compliance officers. We have for many years expressed the view that PAYE/NIC officers who visit employers should have the same range of knowledge as is expected of those whose work they are reviewing. We consider that they should, like employers, be expected to know about both the tax and NIC implications of all items that pass through the payroll and benefits-in-kind. We suggest that as well as improving ex post facto compliance assurance, the Government should improve its support for small businesses so that employers can obtain advice from competent people about tax and NIC and therefore get their payroll and P11Ds right first time, rather than await an audit visit. We understand that this was an intended function of the Small Business Service but given that small employers frequently do their paperwork outside normal business hours, we suggest that a 24/7 (ie a 24 hour 7 days a week) telephone helpline would be the most economical and efficient method.

10. We question the implication in the final paragraph under this section that NICs are now simpler because there is no charge between the lower earnings limit and the earnings threshold, given the intricate analysis of earnings that is required, even in some case where there is neither a PAYE nor a NIC liability, and recording of petty NIC rebates on tiny slices of earnings.

CHAPTER 3: REVENUE POWERS TO CHECK EMPLOYERS' RECORDS

Key principles (para 6)

Are these attributes sufficient? Are there others that we should consider?

11. We are content with the attributes in para 6, subject to the safeguards referred to in the final bullet being enshrined in the law so that the Courts can ensure that the safeguards, preferably constituting the agreed product of public consultation, are effective in practice.

Routine powers (paras 7-14)

We would be grateful for comment on the detail of this proposal.

12. We are content with the proposals as described to tidy up the reg 55 and similar powers.

Non-routine powers (paras 15-18)

Comments are invited on this conclusion.

13. We agree that in principle it is unsatisfactory to have divergent powers for effectively the same purpose.

Proposals (paras 19-26)

We would welcome comment on this approach in light of the attributes in paragraph 6

14. Replacing section 110ZA with section 20 would meet the attributes in para 6.

15. However we are concerned about the proposal in para 23 that officers would be able to require employees to provide written statements. The paragraph refers to 'safeguards' but in the absence of any detail in the technical discussion paper, we trust that detailed proposals once formulated will be exposed for public consultation, that is to say, issued under cover of a press release rather than merely posted on the Revenue's or another Government department's website to be found by those who have time to look.

By getting rid of section 110ZA are we left with a sufficiently robust regime with which to deal with serious non-compliance?

16. The provisions in section 20, Taxes Management Act 1970 have been over the years the subject of much discussion between the Revenue and the Tax Faculty (amongst others). This has resulted in a robust yet balanced package which broadly meets its objectives. Section 110ZA, Social Security Administration Act 1992 contains few safeguards for the employer and is disproportionate.

17. In connection with the impact of visits to employers by government representatives generally, we are concerned that whilst the powers of one department, namely the Revenue, are proposed to be changed, the equivalent power for other purposes in section 110, SSAA 1992 will, so far as we aware, remain.

Regulatory impact (para 27)

We welcome comment on this view. In particular we would welcome information on specific ways in which compliance costs will either increase or decrease if this approach is adopted.

18. Providing the safeguards are sufficient (and, as noted above, we trust that there will be public consultation on these), we do not anticipate that the proposals will have a detrimental effect on compliance costs.

CHAPTER 4: HELPING EMPLOYERS GET IT RIGHT

Earnings periods and arrears

19. Despite its heading, this Chapter considers the effect on benefit entitlement of contributors of misallocated or omitted NIC and suggests two administrative easements. In principle we consider that both proposals, subject to our specific comments below, will assist employers.

20. We welcome the recognition in the technical discussion paper of the generally negligible impact on a contributor's benefit entitlement of a misallocation, or even an omission, of NIC. In the past this was not publicly acknowledged, even though clients' pension estimates seen by members suggested that even where an employer had provided sufficient details to allocate arrears to a contributor's record, the arrears had not been allocated. Looking to the longer term, this points to the desirability of considering the need to retain earnings periods of less than one year.

Can employers recognise the problems described [in paras 1-14]? What other sorts of payments do employers have problems with ? Are there other problems ?

21. The issues described in paras 1-14 are instantly recognisable and the main problem area can indeed be encapsulated under the generic heading of expenses. Under this head it is necessary to consider cash payments, credit card payments, vouchers (whether or not pecuniary) and pecuniary liability questions generally (for example, fuel and home telephone bills). Difficulties arise for small employers because although they are in general terms accustomed to charging NIC on payroll items and know that many benefits-in-kind have to be entered on form P11D because they are subject to income tax, it is not intuitively obvious to many of them that certain non-payroll expenses are also subject to NIC.

22. A number of payments that would be covered by this Chapter could be covered by a PAYE Settlement Agreement ('PSA') and we recommend that Revenue officers encourage employers to enter into PSAs, although officers need to appreciate that a PSA entails employers incurring a tax cost which is not legally theirs. Officers must recognise that this will not be acceptable to all employers. In addition, a way will need to be found to dispel the perception that a request for a PSA is a request for a PAYE audit.

Proposal (1): earnings period flexibility (paras 20-21)

Would employers find more time to process these payments helpful? If so, would a statement along the lines of annex 6 be helpful? How might the statement be improved ? What other payments might be covered?

Are the safeguards on benefit entitlement reasonable ?

What might be the effect of this additional flexibility on compliance costs ?

Proposal (2): estimation and non-allocation of some arrears (paras 22-27)

Comments are invited on:

the use of global estimation where normal earnings fall between the LEL and the UEL but the amount of under-recorded NIC-able pay is below a set amount – set according to our estimation of minimal benefit impact.

From recent experience roughly what proportion of under recorded earnings for NICs would fall below the one off cut off point of £100 per employee.

From recent experience roughly what proportion of under recorded earnings for NICs would fall below the on going cut off point of £5 per week earnings per employee.

The safeguard for those on lower wages requires identification of those earning between the LEL and the primary threshold (current year) – or a sample if the numbers are large. Are there any particular circumstances where this would not be feasible ?

The compliance cost of savings of the revised approach

23. Both of the Proposals and the guidance will be of potential assistance to employers, although we have to say that in practice our members are aware of few cases where arrears of National Insurance contributions recovered by PAYE auditors are ever posted to the employee's National Insurance Accounts. It might therefore be the case that this new guidance will create a greater level of burdens for employers than already exists.

24. The guidance discussed in para 20 and as drafted in Annex 6 recognises that employers may experience difficulties in processing some items of pay through the payroll in the correct pay period and puts this into practical application by stating that employers will be treated as having complied provided they put such items through the payroll generally before the end of the year. This is welcome, but where the payment arises in March, or even in February, there may be insufficient time for the employer to be able to comply.

25. Although hard cases make bad law, the same difficulties in getting the information onto the payroll arise at any time of the year and we consider therefore that the employer should be treated as having complied if the information for February or March is included on the April or May payroll provided the same criteria as proposed in Annex 6, namely whether it appears that the employer is deferring the calculation to avoid or reduce NICs and the effect on benefit entitlement, are satisfied.

26. So far as concerns the wording in the guidance in Annex 6, we suggest substituting 'reasonably practical' for 'possible' in the third paragraph.

27. We would welcome clarification in the guidance of 'material' in 'material effect on an individual's benefit entitlement'.

28. In para 23(vi) and the flow chart in Annex 7, we consider that where an item of pay could have been included in a PSA, this should be treated as having been so included, that is to say, the same tests should be applied retrospectively. We suggest therefore that this exception be added to the list in para 23.

CHAPTER 5: PAY

Generally (paras 1-9)

29. When doing their payrolls and returns of benefits-in-kind, the main items that employers, especially small employers who do not have computerised payrolls, find difficult are the inconsistent rules for tax and NIC. The items that cause most difficulty are those that are common to the majority of employers, namely cash payments, credit cards, vouchers and pecuniary liability. As noted above the rule should be 'if it is subject to/deductible for PAYE, then it is subject to/deductible for Class 1 NIC, and if harmonisation means that

benefits-in-kind are subject to NIC, if it goes on the P11D, then it is subject to Class 1A'. This will entail, inter alia, a thorough review of section 198 ICTA 1988 and the national insurance expenses rules with a view to a more practical, commercial and harmonised approach. We consider that the current proposals should be adopted on the basis that they are only a temporary measure.

Would employers be interested in moving the NICs charge on employer contributions to FURBS from class 1 to 1A in the longer term ? If so, in what specific ways might it be helpful ? What would the effect on compliance costs be ?

30. We would acquiesce to the suggestion that the NICs charge on employer contributions to FURBS be moved from Class 1 to 1A in the longer term but for the fact that, despite assertions to the contrary from the authorities, the law does not presently provide for a Class 1 liability on such payments.

Common understanding of 'pay' (para 10)

Would a statement along the lines of the above be helpful to employers and their advisers? If so, how?

Is the specific wording above helpful ? How could it be improved ?

31. A statement such as in the box at para 10 is tangible evidence of intent and a desire for progress towards a harmonising of the tax/NIC rules. However, as drafted, the second sentence in the final paragraph in the box does not make sense. We accordingly suggest that the words: 'or is deemed to be an emolument (or under a specific charge in the Taxes Acts)' be deleted. We suggest also deleting the final words 'or case law' as we are unaware of any relevant cases.

Would the table at Annex 8 be helpful ? Have we covered the principal types of payments where you understand there to be different treatment? If not, what else should be included?

32. A table such as that in Annex 8 would be helpful. It would not replace the table in CWG 2 showing the tax/NIC treatment of all items but it would provide a useful summary of those items of pay whose tax/NIC treatment diverges. It would be even more helpful to employers if all these items were aligned, as on the assumption that any exemptions from tax are to further Government policy, any unintended loss to the exchequer could be compensated for by altering the tax or NIC rates.

CHAPTER 6: EMPLOYEES SECONDED ABROAD: AN ADDITIONAL COLLECTION MECHANISM FOR NATIONAL INSURANCE CONTRIBUTIONS

Current problem

Have we understood the NICs problems associated with employees seconded abroad?

33. Paras 2-7 correctly summarise the problems in this area. One of the main difficulties that employers face are the divergent definitions for tax and NIC of 'ordinarily resident'. We consider that these should be aligned and clarified.

34. Para 3 cites the existence of reciprocal agreements as preventing harmonisation. We do not accept that this is a valid reason. 'Ordinary residence' is not defined in the law for either tax or NIC purposes. Case law must therefore be equally applicable to each and it is untenable that a single organisation can apply different meanings for different purposes when there is no statute to displace common law. The guidance in leaflets NI 38 and NI 132 is different now to that of five years ago, yet reciprocal agreements have not been re-negotiated to cater for that.

Proposed collection system

Would the proposed mechanism be helpful? If not, what might be done to improve it?

Are the timescales for sending the separate return reasonable?

Are we right to build on existing processes for agreeing a separate P35 scheme? If not, what alternative arrangements would you like to see?

What might be the effect on the compliance costs of dealing with employees seconded abroad ?

35. We very strongly favour adapting the current modified PAYE scheme as suggested in para 10(I). We question the assertion in para 11 that absence of a P11D means that the reconciliation process could not be adapted for NIC and would welcome a meeting to ascertain and assist in overcoming any perceived problems.

36. As to the options in paras 10 (II) and (III), we consider that the PSA route is inappropriate as the issue here is neither minor nor irregular and that the potential for duplication and omission that would arise if a separate PAYE scheme were used makes this solution utterly impractical. In addition, using a separate payroll would mean that employers may be operating three payrolls, given the measures that many will have adopted already for PAYE purposes.

CHAPTER 7: EARNINGS OF EMPLOYEES SECONDED ABROAD

Guidance

Would more detailed guidance on the tax and NICs treatment on payments made to employees seconded abroad be helpful?

We would welcome your views on other items in secondment packages that are causing difficulty, which could benefit from inclusion in the table above.

37. It would be helpful to have more detailed guidance about the tax/NIC treatment of payments made to employees seconded abroad. However a table as simplistic as that proposed in para 2 would fulfil no function save to mislead. For example, the table does not say what figure tax and NIC are chargeable on, define 'tax equalisation packages' or distinguish between (or in some cases even mention) share schemes, share incentives, pension schemes and tax equalisation accounts and, indeed, as drafted, states that tax relief is allowed even for non-approved pension schemes.

38. Owing to the varied circumstances of each case, we consider that the Revenue should have specialists on its head (not local) office staff to give rulings to employers based on particular facts and circumstances. This would be an efficient use of resources as it should ensure consistent application of the rules and obviate the need for employers to commission research. Also, a centralised clearance office could issue anonymised case studies to guide others.

39. This whole area is extremely complex and in terms of helping employers get it right we would have thought that the skills, knowledge and experience of staff such as those at International Services, National Insurance Contributions Office would be a valuable resource. We very much regret the recent move of some work away from Newcastle to local offices where, in our experience, the staff are not of sufficiently high technical grade and are ill-equipped to deal with such complex areas.

Foreign Travel Expenses

40. We welcome the Revenue's undertaking, in respect of seconded workers, to amend the legislation to exclude from NICs all travel expenses that are allowable for tax.

CHAPTER 8: BENEFITS PROVIDED BY THIRD PARTIES

Longer term solution

Are employers, third parties and their advisors interested in this as a longer term solution? What would the benefits be?

What would be the effect on compliance costs ?

In what circumstances might it be useful?

Would the PSA mechanism need to be adapted in any way to extend it to third parties, or is it solely necessary to extend the definition of who can use a PSA to include a third party?

41. Benefits supplied by third parties create enormous difficulties insofar as concerns the collecting of NIC. Section 7, Social Security Contributions and Benefits Act 1992 places the liability for secondary contributions onto the employer. However, where a benefit such as a voucher is provided by a third party, it is unlikely that the employer will be aware of its existence, let alone its value, or, most importantly, its cost to the provider.

42. This was acknowledged in the 1998 version of booklet CWG 2 which instructed employers not to include third-party benefits in gross pay. However, this instruction is reversed in the 2000 version of CWG 2, and we are concerned that this change has not been highlighted/black-lined to draw it to the attention of the employer or adviser.

43. The employer has no right to the information that would enable him to compute the NIC. We would welcome a public statement from the Government that the Revenue will not take penalty action against employers where the third party does not provide the information to enable him to compute the NIC.

44. A third party who provides benefits should be liable for any NIC. If the mechanism for this charge is the PSA regime, then changes will be needed to the scheme and we therefore recommend the Taxed Award Scheme as being more appropriate.

45. We would draw attention to cash payments to employees by third parties and we suggest that there is a need for legislation enabling liability for Class 1 as well as Classes 1A and 1B to be transferred to third parties.

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