TAXREP 33/01

SIMPLIFYING NATIONAL INSURANCE CONTRIBUTIONS

Memorandum submitted in November 2001 to the Revenue by the Tax Faculty of the Institute of Chartered Accountants in England and Wales commenting on the summary of comments and response issued by the Revenue in July 2001

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SIMPLIFYING NATIONAL INSURANCE CONTRIBUTIONS

GENERAL COMMENTS

1. We responded in August 2000 (in TAXREP 28/00) to a technical discussion document (TDD) issued in June 2000 by the Revenue. Whilst we are pleased that, as noted in the Revenue's summary of comments and IR response, many of the initiatives in the TDD are being progressed, we are disappointed that there is no evidence to suggest that the overarching problems over and above the specific issues raised in the TDD that characterise the national insurance contributions (NIC) regime are being given due consideration. We reiterate our comments in the introduction of TAX 28/00, in which we said:

> 3. '…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.
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> 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 peoples' behaviour and result in endless changes which are no clearer and are probably more burdensome and expensive than what is replaced.
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> 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.
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> 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.
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> 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…'.

2. We are disappointed and concerned that the recent draft regulations for tax and Class 1 NICs on mileage allowances are contrary to the general aim of simplifying NICs for employers. We know of many employers who currently pay 'own car' allowances greater than the 40p limit that will apply from 6 April 2002. Many payroll administration systems are not integrated as far as expenses and salaries are concerned and the costs for employers of re-writing computer programs to this end, even if technically feasible, would be disproportionate. Since the taxable profit is to be reported on the P11D, it would seem logical and sensible that the charge should be to Class 1A NICs and not to Class 1 NICs.

3. As to current invitations by the Revenue to comment on mileage allowances, passenger payments, cyclists' breakfasts, lunchtime shopping trips in works buses and employer-subsidised public bus services (which we are/have responded to separately), we consider that such proposals, that involve additional record-keeping and increase divergences between tax and NIC, are evidence of there being no will to really simplify matters for employers.

4. Whilst not unwelcome, all these measures are relatively trivial and show an unwillingness to undertake a 'root and branch' type of reform. Ironically, owing to the complexity of the conditions that employers have to comply with, many have simply given up providing works buses and similar incentives for employees for fear that a Revenue PAYE/NIC inspector some years hence concludes that they have not applied the strict letter of the law and assesses back tax and NIC.

COMMENTS ON ISSUES IN SUMMARY OF COMMENTS AND IR RESPONSE

Chapter 3. Employer compliance powers

Item 4 – Employer compliance reviews

5. We agree that there should be a timeframe within which employer compliance reviews are to take place. This would place payroll enquiries on a similar footing to those for income tax and corporation tax self assessment, force Revenue staff on a case not to delay and better focus the minds of the policy makers to simplify matters properly. In our experience, a high proportion of non-compliance is a result of failure to understand the current complicated system rather than wilful neglect.

6. We suggest that payroll and benefit-in-kind enquiries for a tax year should have to be commenced by the same date as for income tax self assessment. Also, as employers are obliged to retain records for three years, earlier years should only be able to be opened in regard to the period for which records have to be retained. At present, the reviewing inspector can review one year and extrapolate liabilities over the preceding five years. As employers may not have kept earlier years' records because they have

disposed of them as allowed by law, it is difficult to prove the facts and many additional liabilities are paid because of this. So far as concerns the timeframe in which enquiries should be finalised, where the Revenue are causing delay, employers should have the right to ask the Commissioners to direct that enquiries should be closed where there the Revenue cannot justify otherwise (as for income tax and corporation tax self assessment).

7. We would suggest that the details should be set out in primary legislation, as they are for personal and corporate tax compliance. The Revenue should then produce practical guidelines for employers and their advisers, similar to that for personal and corporate tax self assessment.

Item 5 – Dealing with employer records

8. Paragraph 26(6) of Schedule 4 to the Social Security (Contributions) Regulations 2001 states that records are to be retained by employers for not less than three years following the end of the income tax year to which they relate and, effectively, for not less than four years in the case of records concerning Class 1A and Class 1B NICs. The two different time limits are confusing and we would suggest that they be aligned.

9. Taking this a stage further, there is a certain logic to harmonising the PAYE and NIC time limits with those for VAT, given that when a person commences in business, these are the three main 'taxes' for which he has to register, keep records and account for. For VAT, there is a three-year limit for refunds and for underpayments, with this limit being modified by section 77(4), VATA 1994 in fraud and other circumstances.

Chapter 4 – Helping employers get it right - allocation of arrears

Item 1 – General

10. The Revenue states that it recognises that the PAYE/NIC system is less well suited to modern remuneration packages and invites suggestions to be put forward for future reforms. To some extent, suggestions have already been put forward in respondents' original comments in August 2000. In summary, what is required is a simpler system which employers are able to comply with easily, and acceptance by the Revenue that where employers do get NICs wrong, the impact on a contributor's benefits entitlement is generally negligible.

Chapter 5 – 'Pay'

Item 1 – General

11. All misalignments of tax and NIC should be eliminated, including pension contributions. Charging Class 1 NIC where there is no income tax charge at the time of payment through the PAYE system does not constitute alignment. Therefore, what is required is that what is subject to income tax generally (as employment income) is also subject to NIC generally. Within that general parameter, what is subject to PAYE by the employer on a pay period basis should be subject to Class 1 NIC on a pay period basis. That which is subject to PAYE income tax should not be subject to

any other Class of NIC, that which is not subject to PAYE income tax should not be subject to Class 1 NIC and that which is not subject to Class 1 NIC should not be subject to PAYE income tax.

Chapter 6 – Employees seconded abroad: An additional collection mechanism for NICs

Item 2 – Interaction with self-assessment

12. We agree with the proposal for an additional P35 procedure; the proposed time limit is sensible. We would welcome clarification of whether the Revenue in arriving at the response 'There is no read-across to self-assessment' in the context of the additional P35 proposal have thought through the integration with self assessment. Is there an assumption that the employee will always be not-resident and not-ordinarily resident and consequentially will not be 0completing a self assessment (SA) return? What if a secondment terminates prematurely, so that the employee remains UK resident? What if the employee has UK rental income or other reasons for completing an SA return?

13. A secondment could commence in, say, May 2001 and be terminated early in, say, January 2003. The employee has not been absent from the UK for a complete tax year and thus remains resident and ordinarily resident throughout the period, with a requirement to file a tax return for 2001/02 by 31 January 2003. But the employer will hitherto have proceeded on the basis of additional P35 reporting by 31 January 2003 too. An employee in the final year of a secondment will have tax return filing obligations anyway for that year since for part of it he will be UK resident. It could be that the employer may leave the additional P35 filing to the last minute giving practically no time for the employee to comply with the SA time limit. We suggest that consideration needs to be given towards granting self assessment interest and penalty concessions in such circumstances.

14. The Revenue appears to dismiss any imminent alignment of the residence rules for NIC with references to international agreements. In our experience most bilateral NIC agreements contain terms such as 'ordinary residence' but without any definition within the agreement. It seems to us that the definition is therefore a matter for domestic law and no impediment to harmonisation. It should be noted that the domestic treatment of ordinary residence for NIC has shifted in recent years from, broadly, a five-year rule to one based on intention and that change does not seem to have been inhibited by treaty considerations.

Chapter 7 – Earnings of employees seconded abroad

Item 2 – Content of guidance material

15. We would suggest that the following items should also be included:

- host country language training for employee/partner/family;
- home and host country tax compliance advice;
- tax equalisation payments; and

- host country accommodation (for both unaccompanied and accompanied employees).

16. We recommend that comments are invited on the guidance, once initially drafted, particularly for some of the more difficult areas such as shares and share options. The tax (and consequently the NIC) treatment of share-related benefits is particularly difficult where the employee is not within Schedule E Case I at the grant of a share option or at the award of conditional shares (and the employee is thus outside the scope of sections 135 and 140A, ICTA 1988). Advice should include detailed guidance on how section 162, ICTA 1988 operates (on which the Class 1A NIC charge is based), apportionment for non-UK workdays and factors affecting whether a share-related benefit is to be attributed to a UK employment or not.

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