

TAXREP 36/00

STARTING UP IN BUSINESS

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

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STARTING UP IN BUSINESS

GENERAL COMMENTS

1. We welcome the opportunity to comment on the discussion paper issued in October 2000.

Executive summary

2. We have a number of concerns about the proposals in the discussion document which are likely to have the opposite effect of what is the stated intention:
 - difficulties in determining when a business starts means that the date of commencement is not something that in many cases can be pinpointed without the benefit of hindsight;
 - imposing penalties on those who notify commencement of business late is likely to discourage people from registering at all;
 - Class 2 National Insurance Contributions ('NIC') should be abolished and the contributory element absorbed into Class 4;
 - notification for NIC should be the same as for income tax ie by 6 October following the year of assessment in which the source exists;
 - new businesses should be encouraged to complete a single form when they initially approach any part of the revenue departments so that guidance on PAYE or VAT can be provided if necessary: the form should therefore be general in content.

The issues

3. The stated aim appears to be to stop people drifting into the hidden economy and to provide more help to the newly self employed early on to avoid trouble later. We are in favour of making the procedure simpler and we are also in favour of encouraging people to notify where they have a tax liability, but what is now proposed is over-regulatory, burdensome and intrusive.
4. One of the main difficulties in regulating start-ups is determining when a business actually starts. Is it when an individual starts marketing, opens his business premises, completes his first contract/supplies his first goods, renders his first bill, or collects the first payment?
5. We do not think that this is a question that can be readily answered. It very much depends on the facts of an individual business. We think that it is wholly unrealistic to expect an individual setting up in business to be capable of answering this question which even experienced professionals often have difficulty with.
6. Many business start-ups are presently in the service sector and people often continue their full time employment concurrently whilst they assess whether they can 'make a go' of being in business. It may take three months or more to reach a conclusion on this. The activity may be initially no more than a hobby, for example reflexology or painting, and it is only later that the interest expressed by others makes the individual consider that money rather than an unsolicited gift may be a better reward. It is at that point that he may seek advice from an accountant

7. As Class 2 NICs are so small we suggest that it would be better to abolish them and absorb the contributory charge into Class 4 rather than create a new bureaucracy to enforce Class 2 properly. The rule in section 7, TMA 1970 about advising chargeability by 5 October following the tax year in which the source arose could be extended to national insurance contributions, which subject to complying with VAT and PAYE requirements, would mean that businesses can commence without having broken the law relating to taxes on day one.
8. Another aspect which needs to be clarified is whether the individual is in fact self employed. It is also extremely difficult to be sure in many cases whether someone is self employed or is actually an employee of his major client. We recommend that leaflet IR56 be attached to or sent with the initial start-up form CWG1.
9. As to the means of notification, we welcome the proposal to have one form for a new business. However, whilst it should ask questions designed to ascertain whether there is likely to be a VAT or PAYE liability, it needs to be borne in mind that most people who set up in business are unlikely to know the answers to such questions and so the responses will need to be interpreted with care.
10. Where the concept in the discussion paper of assisting the newly-self employed to avoid trouble with the revenue departments falls down is linking the penalties with registering for Class 2 NICs. Whilst this may be logically the first step from the Revenue's point of view, it is probably the last thing on the mind of the new businessman and the last thing that he can reasonably be expected to be aware of as it is one of the more obscure levies. It is more likely that the businessman's first contact with the revenue departments will concern PAYE, VAT or the self assessment tax return. The form should therefore be more general in content.
11. To impose a penalty on a new business for failing to notify within three months of starting in business is calculated to help drive people on the borderline into the black economy. The issue of notifying existence and the penalties for those who do not notify are already far better covered by the rules governing self assessment, PAYE and VAT.
12. In the many cases where the individual continues his employment until his business reaches a critical mass, he is entitled to apply for exception from Class 2 NIC, so a penalty where no NIC is at risk is likely to be perceived as unfair.
13. In any event, we doubt that a penalty will discourage people from moving into the black economy: all thought of a penalty should be abandoned as it will not encourage compliance. It will be more effective to use the form as a general data collection medium issued automatically by all departments when they are first approached by an individual or his advisor, with a request to along the lines of 'please complete this if you have not already done so'.

Consultation

14. We are very concerned that the time allowed for this consultation is short, far shorter than that suggested in the Code of Practice referred to in the Cabinet Office news release dated 27 November 2000. In addition, it is proposed to charge penalties from 1 January 2001. This will require a Statutory Instrument (SI). Statutory instruments usually have to be laid in Parliament 21 days before they take effect. Some responses to the discussion document may be made within the time scale permitted and yet

arrive after the time by which the SI has had to be laid to take effect by 1 January 2001. We are, therefore, unsure as to what opportunity the relevant authorities will have to consider responses received. We believe proper consultation requires adequate time to consider the responses before action is taken.

DETAILED COMMENTS

Who must notify the Inland Revenue?

Para 1

15. We question the suggestion that burdens are not being increased if an existing requirement is strengthened rather than a new rule being imposed. Plainly, regulation is being increased.

What if the profits from self-employment are too low to be taxable or the self employment is only part time?

16. As a general comment, the complications and exceptions in paragraphs 4-7 of the consultation document over such trivial monetary amounts lead us to conclude that Class 2 NIC should be abolished as a separate charge and the contributory element subsumed into Class 4. This would mean that for the purposes of the income tax and national insurance liability of the trader it would be sufficient to notify chargeability under section 7, TMA 1970.
17. Even if Class 2 NIC is not abolished, we consider that at £2 per week any arrears by the time the section 7 notification date is reached will be so modest that there is no significant loss of tax.

Para 4

18. Regarding the panel above para 4, the public will be confused by the fact that a person in full-time education undertaking self-employment in his spare time is not required to register (even though profits might exceed the small earnings exception limit thus producing a Class 2 liability if over age 16). However, others not in full time education but doing the same thing to the same extent must register, even if profits may be way below the small earnings exception limit.

Para 5

19. To require someone with an income below the small income limit to register simply so that they can be told about tax credits is again burdensome. Many such people will have other sources of income and both Class 2 NICs and tax credits will be irrelevant.

Para 6

20. Having derogations that are so complicated that an individual has to get in touch with the contact centre to find out whether he comes within them is not helpful. It ought to be apparent whether somebody does or does not have to register, and the simplest way of achieving this is by putting in an income limit.

Para 7

21. We would welcome clarification of why married women should be required to notify the Contributions Agency if they are exempt. It may be that this paragraph is offering a derogation but it is not clear.

What will make the Starting in Business Guide different from the current leaflets available such as “Starting your own Business”?

Para 9

22. A CD-Rom is likely to be too sophisticated for the sort of person that Lord Grabiner’s report was considering; however, that is probably true of almost any form of leaflet or other guidance.
23. In any event, we cannot see that the information is sufficiently voluminous to merit a CD-Rom or that it will be of much practical value to those actually being targeted. We suggest that this is an unnecessary gimmick, the cost of which could be put to better use either in the Revenue or Government generally.
24. For those who are web-enabled, a clear link on relevant Government websites might be of some assistance.

What will happen to people who don’t notify the Inland Revenue when they start a new business?

Para 10

25. It is plainly untrue that a penalty of this kind is going to have any real effect on the black economy. All it will do is alarm those who drift in and out of casual work and may discourage them from reporting that they are working, or even from working at all. When self assessment was introduced, the government promised to operate the compliance regime with a ‘soft touch’ and precisely the same should apply to NICs.
26. The sentiment expressed in the first two lines is laudable, but it is unclear in the discussion document by what means it is to be achieved. Just rewriting an existing leaflet and putting it into buildings which black economy workers do not visit will not do the trick. Similarly, just changing the law so that penalties can be levied does not inform the public of what their obligations are.

When will penalties be applied?

Para 13

27. Out of the options given, three months should be the absolute minimum for notifying starting in business in order to avoid a penalty. As mentioned elsewhere, complying with PAYE, VAT and income tax requirements extended to cover NIC should be sufficient.

28. The concern in para 13(ii) about debts building up is far less relevant now that the debt accrues at only £2 per week. We wonder whether the discussion document was written when Class 2 NIC cost well over £6 per week and has not been reviewed since.
29. We suggest that regard be taken of the disproportionate costs of collecting this small amount of money. It would be better to abolish Class 2 NIC so that low self-employed earners can earn contributory benefits without having to go out of their way to physically pay national insurance contributions, as happens for those subject to Class 1 NIC. This would be best achieved by consolidating the charge into Class 4 NIC, and would enable the income tax reporting time limit in section 7, TMA 1970 to apply for NIC as well as tax.
30. We would also draw to your attention the fact that our members' experience indicates that Class 2 NIC debts, albeit now small, accrue not just because people do not notify, but because, having notified, applications to pay by direct debit and the like are not acted upon by the National Insurance Contributions Office. A similar position can also arise where individuals or businesses change their bankers.

Para 14

31. A penalty of £100 is nearly equal to Class 2 NIC contributions for a year and is wholly disproportionate.

Para 16

32. With regard to the text box in para 16, we would appreciate confirmation that those with earnings below the small earnings exception limit will not have the penalty imposed, even if they choose to pay Class 2 voluntarily. The Revenue might think this would not happen. But it is when being approached by the authorities that an individual may use an accountant for the first time. An informed advisor may well, in the appropriate circumstances, advise that payment of Class 2 NIC would be beneficial and recommend payment nonetheless.

Will late notifiers be penalised?

Para 17

33. If it is intended that those not paying Class 2 NIC are to be encouraged to come forward, this will not be achieved if the first thing the Revenue is going to do is to charge a £100 fine.

Annex C, item 2: notification

34. For telephone (or, in the future, internet) registration, callers should be given a unique code which they are advised to keep until at least they have received their first quarterly bill or suffered their first direct debit, similar to the order number callers are given by the Employer's Orderline, whether by phone or Internet. This will protect the public from the authorities' failure to record and act on information, of which

there are disproportionate numbers in relation to Class 2 NIC.

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