Summary: Intervention & Options

Department /Agency:	Title:	
HMRC	Improved Collection of National Insurance Contributions from the Self-Employed	
Stage: **Implementation**	Version: **Final**	Date: **19 February 2011**
Related Publications: Consultation Paper - Collection of National Insurance Contributions from the self-employed: Issued 29 February 2008		

Available to view or download at:

http://www.hmrc.gov.uk/consult

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What is the problem under consideration? Why is government intervention necessary?

The previous Government's report, 'Income tax and national insurance alignment: an evidence based assessment' committed HMRC to consult on ways of improving the processes for collecting contributions from the self-employed.

A new process has been planned for implementation from 6 April 2011 that will align the payment dates for Class 2 NICs with Income Tax Self Assessment on 31 January and 31 July each year. The new process will simplify the payment procedures of Class 2 NICs.

What are the policy objectives and the intended effects?

To reduce the administrative burdens on small business and simplify collection of Class 2 NICs by:

- aligning the payment dates for Class 2 NICs and ITSA liabilities;
- reducing the number of Class 2 NICs bills for those not paying by Direct Debit; and
- encouraging the take up of the direct debit option and expanding Direct Debit payment options.

What policy options have been considered? Please justify any preferred option.

We considered three options where improvements may be possible:

1. Advising contributors of Class 2 arrears through their Self Assessment statements;
2. Reducing the number of Class 2 payments and aligning payment dates with Self Assessment;
3. Aligning the consequences for late paid Class 2 with those for Class 4 contributions.

Having considered the range of options, some of which would have involved extensive and costly IT changes, the Government announced in November 2010 that option 2 would be taken forward.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The policy will be reviewed within 3 to 5 years from implementation. Evidence of the impact of the change will start to become available following the end of 2011/2012.

Ministerial Sign-off for implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.

Signed by the responsible Minister:

Date: 04 March 2011

Summary: Analysis & Evidence

Policy Option: 2 | **Description: Reducing**

COSTS			
ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups' The original transitional costs of £11.2m were predicated on the development of an IT link between the NIRS and SA systems that during project development was not a requirement under the preferred option. The recurring straight line cost has a nugatory impact reflected under the existing payment notice costs.	
One-off (Transition)	**Yrs**		
£ 1 million	1		
Average Annual Cost (excluding one-off)			
£ 400,000		**Total Cost** (PV)	**£ £3 million**

Other **key non-monetised costs** by 'main affected groups'
No non-monetised costs have been identified.

BENEFITS			
ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups' We estimate that that the administrative burden for business may reduce by up to £9m. This is on the basis of being able to make a single payment twice yearly for Class 2 NICs and tax. Commercial and opertational savings to HMRC are respectively £676k and £547k, totalling around £1.2m.	
One-off	**Yrs**		
£ n/a	1		
Average Annual Benefit (excluding one-off)			
£ 10 million		**Total Benefit** (PV)	**£47 million**

Other **key non-monetised benefits** by 'main affected groups' Improved messages on bills will generate a greater understanding of contributory benefits which will increase voluntary compliance amongst non-payers. We estimate that this option will reduce the level of irrecoverable class 2 debt by £3.5 million pa (see evidence base for more detailed explanation).

Key Assumptions/Sensitivities/Risks Existing customers will have a new 6 monthly payment option that will simplify paperwork and align payment dates with tax Self Assessment/Class 4 NICs.

Price Base Year 2010	Time Period Years 5	**Net Benefit Range** (NPV) **£ n/a**	**NET BENEFIT** (NPV Best estimate) **£ 44 million**

What is the geographic coverage of the policy/option?			UK	
On what date will the policy be implemented?			6 April 2011	
Which organisation(s) will enforce the policy?			HMRC	
What is the total annual cost of enforcement for these organisations?			£ Business as usual	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			N/A	
What is the value of the proposed offsetting measure per year?			£ N/A	
What is the value of changes in greenhouse gas emissions?			£ N/A	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro N/A	Small N/A	Medium N/A	Large N/A
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices) (Increase - Decrease)

Increase of £ no impact Decrease of £ 8 million **Net Impact** **£ 8 million Decrease**

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Rationale for intervention

Every person who is over the age of 16, but below pensionable age who is self-employed is liable to pay Class 2 NICs for each week of self employment (currently at a rate of £2.40 a week) unless they apply for and are granted Small Earnings Exception (SEE). Additionally Class 4 National Insurance Contributions are payable where annual profits are equal to or above the Lower Profits Limit, currently £5715.

Different processes exist for the collection of Class 2 and 4 NICs. Class 2 contributions can be paid either by Direct Debit monthly or on receipt of a quarterly bill (issued soon after the end of March, June, September and December). The quarterly bill includes the current quarter's liability and any arrears.

Class 4 contributions are paid through the Self Assessment (SA) process and a payment is due as part of the SA liability due on 31st July and 31st January.

Policy objective

The Government aims to identify and consider changes to current processes that will simplify and improve the collection of NICs from the self-employed. Such change also links to HMRC's Customer Centric Strategy.

Policy Options Considered

Feedback from the self-employed and their representatives identified concerns with the current processes, so we have not considered a 'no change' option as clearly this would not achieve the improvements sought.

We considered three options that can be viewed as independent measures which could be implemented alone. From this perspective we regarded option 1 as a way to address arrears, option 2 as a way to simplify future payments, and option 3 as a new framework for the consequences of late payment.

The original IA costs incorporated one-off costs of £11.2m against all three options on the assumption that it would be necessary to develop a link between IT systems (NPS/NIRS and CESA). If all options were adopted the total costs would be estimated as £14.2m (£11.2m for option 1, plus £3m for options 2 and 3), with total ongoing costs estimated as £540k (£360,000 for option 1, plus a further £180,000 for options 2 and 3).

Option 2 was the preferred option pursued for project implementation as it was realised during the early stage of development that that the policy objectives could be achieved without developing the assumed IT link. This delivered a saving around £10m.

Policy Option 1: Including Class 2 arrears within Self Assessment statements

We have identified that there is a proportion of the self-employed who are compliant with respect to their SA liabilities but get into arrears with their Class 2 liabilities. Given the fact that Class 2 liabilities are usually relatively small sums compared to SA liabilities, and that benefit entitlements (including State Pension) result from the payment of Class 2 contributions, we believe that, for some at least, arrears of Class 2 are likely to arise from a mistaken belief that all their liabilities are met through their Self Assessment payments.

We believe that the timing of the Class 2 quarterly bills, particularly those for the quarters ending June and December, may get confused with the SA statements, which include Class 4 liabilities. Indeed, information from our contact centres suggests that this is the case. Therefore, we have considered including within the SA statement an additional line of information showing any Class 2 arrears at the time the statement is produced.

In the case of a statement ahead of a payment due on 31 January, it would include any arrears of Class 2 up until the end of the preceding September. It would not include arrears for the quarter to December as at the time of the issue of the statement the December quarter would not yet be in arrears. For example, a statement requiring payment by 31 January could be issued in early January, but the December's quarterly bill should be issued within 14 days of the end of the quarter and the contributor has 28 days in which to pay. Therefore the December quarter's contributions would not be overdue until mid February.

Business Costs and Benefits

We have not identified any significant costs to business. There may be some costs for taxpayers and their representatives in familiarising themselves with the new arrangements, but this is expected to be negligible. We believe that there would be benefits to business through a better understanding of whether their Class 2 liabilities have been met.

HMRC Costs and Benefits

As this option would require the creation of links between the computer system that records Class 2 liabilities and payments (NPS/NIRS2) and that which records liabilities and payments for Class 4 (CESA), there would be significant IT and consultancy development costs estimated at £11.2 million plus on-going costs estimated at £360,000 a year. For this reason the costs were regarded as prohibitive compared to option 2. There would however also be savings under option 1 to HMRC accruing from the automation of what is currently a manual process of drawing together information on Class 2 and wider SA debts, saving about £600,000 per annum.

Exchequer Yield/Costs

We believe that the changes outlined in these three options could together lead to a reduction in the irrecoverable Class 2 debt (our latest available estimate for which is 5%), to a level closer to the SA irrecoverable level of 1%. We believe that almost all of the additional irrecoverable debt for Class 2 arises from those receiving Quarterly Bills (this will include some people who take out a direct debit which subsequently fails and is not promptly re-instated – following which they are issued with Quarterly Bills).

On the assumption that we can reduce the level of irrecoverable Class 2 debt to 2.5%, an annual additional reduction in NICs Class 2 debt of £8 million a year will be achieved. We believe such an assumption is reasonable based upon our view that there is an element of those non-compliant for Class 2 who are willing to comply but are confused as to their position. We believe that most of the improvement in yield will arise from Options 1 & 2. We have therefore attributed the bulk of this improvement (£7 million) to Options 1 & 2 and split it evenly as £3.5 million attributable to each of these options. The remaining £1 million has been attributed to Option 3.

(Preferred) Policy Option 2: Reducing the number of payment dates and aligning Class 2 payment dates with Income Tax/Class 4 under Self Assessment

This is the option selected for project implementation.

HMRC encourages the newly registered self-employed to opt to pay their Class 2 liabilities by Direct Debit. This is beneficial for both HMRC and the individual, as once the Direct Debit is set up there are much lower compliance costs than for quarterly bills. Those who do not opt to pay by Direct Debit are notified of their liability by quarterly bills. We have mentioned above the possibility of confusion between the quarterly bills and the SA statements potentially leading to increased Class 2 debt.

Where the contributor understands their liabilities and pays their Class 2 and SA liabilities on time they will make a total of five or six payments (depending upon whether they need to make payments on account). This consists of four quarterly Class 2 payments and one or two SA payments.

Each of these payment 'events' carries a cost to the taxpayer, therefore a reduction in the number of separate payments required, or alignment of when liabilities are due would reduce the admin burdens to the business.

Under this proposal, bills that are issued quarterly would be replaced with bills issued twice yearly with payment dates aligned to Income Tax/Class 4 payment dates of 31 January and 31 July. Existing customers who pay by Direct Debit would have their contributions aligned to the same dates and be provided with a new improved payment option to pay twice yearly by Direct Debit instead of monthly.

Business costs and benefits
There may be some costs for taxpayers and their representatives in familiarising themselves with the new arrangements, but this is expected to be insignificant. We believe that there would be benefits to business through a better understanding of whether their Class 2 liabilities have been met.

We also expect there would be savings in the admin burdens for business by any reductions in the need for separate payments. We estimate that the current number of Class 2 quarterly payments is 3.7 million each year. 90% of these are paid by cheque that are sent in the post or by cheque/cash over a bank of Post Office counter and (on the basis of the standard cost model) have admin costs of £2.35 per transaction. The remainder are paid online with an estimated cost of £1 per transaction. Therefore by combining Class 2 payments with SA payments (by making Class 2 liability six monthly rather than quarterly), we would expect an admin burden reduction of £9 million (in current prices).

HMRC costs and benefits
Original costings assumed that there would be a requirement to make changes to the NPS/NIRS2/CESA systems with respect to the timing and issue of bills plus development of links between IT systems required in Option 1. We estimated that further IT development costs, for Options 2 & 3, to be in the region of £3 million, additional to those core costs identified for Option 1.

Actual implementation costs were restricted to NPS/NIRS at a cost of £1million representing a saving of £10 million over the original estimate. Ongoing annual costs of £386,000 are nugatory as the HMRC process is largely the same with 4 quarterly bill issues being replaced by twice yearly issue.

The reduction in the number of quarterly bills issued will produce savings in printing and postage of £686,000 annually which will be augmented by a further estimated saving of £35,000 representing a reduced requirement in issuing amended bills. We also estimate that there will be a saving in HMRC staff costs related to reduced output of bills of 24 Full Time Equivalent (£546,984 per annum).

Total savings are estimated to be up to a maximum of £1.2 million a year.

Exchequer Yield/Cost
As noted in option 1, we believe that the rationalisation of payment dates for Class 2 would support the aim of getting irrecoverable Class 2 debt closer to that for Class 4, resulting in a reduction in irrecoverable Class 2 NICs debt across all three options of £8 million per annum. The reduction attributable to this option has been calculated at £3.5 million for the reasons set out in the corresponding section for Option 1.

Depending upon any changes that might be made, there is a potential for a loss of interest within the tax year. We do not anticipate that large numbers of contributors would stop paying by direct debit (though some may switch to the 6 monthly payment option). For those currently paying by Direct Debit we believe it works efficiently, and any benefit they could derive from delaying payment would be very minor. Assuming no change to the numbers paying by direct debit, we can examine the impact of quarterly payments being paid less frequently having established a six month due date. This provides us with a maximum potential interest loss of £1.7 million per annum to the Exchequer.

Policy Option 3: Changing the consequences for late payment of Class 2 contributions
This option is reliant on the integration of Class 2 and tax/Class 4 liabilities into a combined payment request. On the same basis as option 1, this option is regarded as prohibitive at this time based on implementation costs.

The consequences of late payment of Class 2 NICs occur one year after the end of the tax year in which the contributions were due. The contributions are payable at the highest rate between the year when the contributions were due, and the one in which they are paid. As rates typically increase, this will tend to be the rate in force at the time of payment. By way of example, contributions paid in tax year 2007/08 for the tax year 2005/06 would be payable at the current rate of £2.20 a week, rather than the 2005/06 rate of £2.10 a week.

Class 4 contributions paid late are charged with interest, along with other SA liabilities. For example, the interest rate charged from 8 January 2008 became 7.5% per annum. Interest is charged at an annual rate on a daily basis from the date when it was due until the date payment is made.

In addition, a surcharge of 5% is applied when the balancing payment for the SA return has not been paid within 28 days of the due date and a further 5% surcharge on any balance still unpaid six months after the due date. We have only considered the application of interest to outstanding Class 2 balances in our work so far. As part of the review of Powers, Deterrents and Safeguards, penalties for late payment are also being reviewed across the range of HMRC's responsibilities including NICs. Any changes will be subject to consultation.

Clearly both the Class 2 contribution rate and interest rates change over time. We have not made any assumptions about the future rates of either Class 2 contributions or interest charges. The driver here is an attempt to help contributors understand the basis for the extra they have to pay as a consequence of late payment. This may particularly be a factor where a contributor is in arrears in respect of both Class 2 contributions and their wider SA liabilities. They will not have to carry out two separate forms of calculation if they wish to check the accuracy of the charges.

Business costs and benefits

We anticipate that those contributors in arrears for both Class 2 and SA liabilities will find a single form of interest calculation easier to understand and verify than two separate forms of calculation. There are likely to be minor costs associated with becoming familiar with the changes.

HMRC costs and benefits

This option would require changes to allow the calculation of interest charges for Class 2 arrears. It would also depend upon the links required in Option 1. We estimate that additional IT development costs, for Options 2 & 3, to be in the region of £3 million, additional to those core costs identified for Option 1. Additional on-going costs for Options 2 and 3 are estimated at £180,000. These have been divided evenly for Options 2 and 3. As the consultation progresses, and once the final shape of any changes are clear, we expect to be able to refine the costs and benefits further.

There would be savings for HMRC in staff costs since it currently costs £600,000 to manually update cases where debt management action has started when the rate of Class 2 contributions changes.

Exchequer Yield/Cost

We believe that clearer consequences for late paid Class 2 contributions would support the aim of getting irrecoverable Class 2 debt closer to that for Class 4. For the reasons set out in the corresponding section for Option 1, we expect the reduction in irrecoverable class 2 NICs debt attributable to this Option to be £1m, i.e. if all options were adopted the total debt reduction would be £8m with £7m attributable to options 1 and 2 and a further £1m under option 3 .

Other Considerations:

Combining Options 1, 2 and 3

We believe that while the options complement one another, it is possible to deliver the policy objectives under option 2 as an incremental step to fully aligning Class 2 with tax/ Class 4 under option 1, but without incurring high IT based system linking costs at this time on which options 1 and 3 depend.

Specific Impacts Tests

Competition
We have considered the impact and conclude that there are unlikely to be any effects.

Small Firms
These measures will impact most significantly on small and medium sized enterprises, though we anticipate the effects will be positive based on reduced administrative costs.

Human Rights
We have not identified any issues that impact on Human Rights.

Race & Gender& Disability Equality
As the impact of the changes will not affect the self-employed customer base we do not consider that there will be any negative impacts on different communities or groups or gender and race. It is possible customers with disabilities may benefit from the reduced payment requirements. A full equality impact assessment is not required.

Other Impacts
The following issues were considered and regarded as being unaffected by the proposed measures:

- Legal Aid
- Sustainable Development
- Carbon Assessment
- Other Environment
- Health Impact Assessment
- Rural Proofing

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

Annexes

There are no Annexes to this assessment.