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|--|---|--|---------------------------|--|
| Title: Increased NMW financial penalty calculation – 2016 IA No: BISLM011 Lead department or agency: Department for Business Innovation and Skills (BIS) Other departments or agencies: | EANCB Validation IA | | | |
| | Date: 30/10/2015 | | | |
| | Stage: Final | | | |
| | Source of intervention: Domestic | | | |
| | Type of measure: Secondary legislation | | | |
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| Summary: Intervention and Options | | | RPC Opinion: GREEN | |

| Cost of Preferred (or more likely) Option | | | | |
|---|----------------------------|--|---|----------------------|
| Total Net Present Value | Business Net Present Value | Net cost to business per year (EANCB on 2014 prices) | In scope of the Business Impact Target? | Measure qualifies as |
| £0.0m | £0.0m | £0.0m | No | NA |

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

The Government believes that the consequences for employers that break the National Minimum Wage (NMW) law are insufficient. We intend to raise the penalty amount that employers face for underpaying workers the NMW.

Evidence from the Annual Survey of Hours and Earnings (2014) estimates that there are 236,000 employee jobs paid below the NMW. The introduction of the National Living Wage in April 2016 will further increase the coverage of jobs at or below the NMW therefore strong enforcement will be essential.

What are the policy objectives and the intended effects?

Alongside a package of measures announced by the Government, this policy aims to improve non-compliance with National Minimum Wage legislation. The change we are proposing will mean an employer who breaks NMW law will receive a greater fine than before. This should deter other employers that would otherwise be tempted to underpay to comply with the law and ensure that workers receive the money they are legally due.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The penalty is currently calculated as 100% (reduced by half for prompt payment) of the total underpayment for all the workers specified on a Notice of Underpayment issued to employers. We propose doubling this calculation to 200% (while retaining the incentive for prompt payment). The currently penalty maximum of £20,000 per worker will remain.

An increase to 200%, falling to 100% for prompt payment, ensures that employers pay a penalty at least equivalent to the arrears owed. A penalty above 200% is considered to be too punitive.

Therefore the 200% penalty calculation is the only option considered in this EANCB Validation. In particular, non-regulatory options were not considered because the percentage and maximum penalty in the National Minimum Wage Act 1998 can only be increased through legislation. However, as mentioned above this is part of a wider package of options (including non-legislative) such as awareness-raising.

| | | | | | |
|--|--|---------------------|-----------------------|-----------------------|---------------------------|
| Will the policy be reviewed? It will not be reviewed. If applicable, set review date: | | | | | |
| Does implementation go beyond minimum EU requirements? | | | N/A | | |
| Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base. | | Micro Yes | < 20 Yes | Small Yes | Medium Yes |
| What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent) | | | | Traded: N/A | Non-traded: N/A |

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: _____ **Nick Boles** _____ Date: 7 January 2016

Summary: Analysis & Evidence

Policy Option 1

Description: Option 1) Increase NMW non-payment penalty to 200% of total NMW underpayment

FULL ECONOMIC ASSESSMENT

| Price Base Year | PV Base Year | Time Period Years | Net Benefit (Present Value (PV)) (£m) | | |
|-----------------|--------------|-------------------|---------------------------------------|-----------|--------------------|
| | | | Low: N/A | High: N/A | Best Estimate: £0m |

| COSTS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Cost (Present Value) |
|---------------|---|--|----------------------------|
| Low | N/A | N/A | N/A |
| High | N/A | N/A | N/A |
| Best Estimate | | | £0m |

Description and scale of key monetised costs by 'main affected groups'

The majority of businesses are compliant with National Minimum Wage law and most workers get paid more than the national minimum wage rate that applies to them. There will be zero cost on compliant (as per criteria 2.3.42 of the Better Regulation framework) businesses as they will be complying with National Minimum Wage law and will not be issued with a penalty i.e. the Equivalent Annual Net Cost to Business (EANCB) will be zero.

Other key non-monetised costs by 'main affected groups'

We do not expect any familiarisation costs as we currently have a NMW penalty for underpayment and these policy proposals will only change the calculation and maximum of the penalty. Also, we do not expect businesses to change their record keeping practices.

| BENEFITS (£m) | Total Transition (Constant Price) Years | Average Annual (excl. Transition) (Constant Price) | Total Benefit (Present Value) |
|---------------|---|--|-------------------------------|
| Low | N/A | N/A | N/A |
| High | N/A | N/A | N/A |
| Best Estimate | | | £0m |

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

As a result of the package of measures designed to strengthen enforcement of the NMW, which includes increasing penalties, we aim to see improved compliance with NMW law this will protect workers from NMW abuse.

Increasing the penalty calculation may mean the amount of money received (in penalties) by the Exchequer increases, however this depends on the impact of the deterrent effect on the level of non-compliance.

| | | |
|-------------------------------------|-------------------|-----|
| Key assumptions/sensitivities/risks | Discount rate (%) | N/A |
|-------------------------------------|-------------------|-----|

BUSINESS ASSESSMENT (Option 1)

| | | |
|---|-------------------|-------------------|
| Direct impact on business (Equivalent Annual) £m: | In scope of OITO? | Measure qualifies |
| Costs: | No | NA |
| Benefits: | | |
| Net: | | |

Evidence Base

Fast Track system

In line with new guidance, this measure has been deemed eligible for the Better Regulation Fast Track system for low cost or deregulatory measures. As discussed above, compliant businesses will not incur any additional costs and is therefore low cost. Previous similar legislative changes to the calculation of the penalty for underpayment of the NMW were confirmed to be a low-cost regulatory proposal by the RPC under the old system of Regulatory Triage Assessments¹. This submission is to validate our zero-cost EANCB estimate.

Problem under consideration

Evidence from the Annual Survey of Hours and Earnings (ASHE) estimates that 236,000 employee jobs were paid below the NMW in April 2014 - this represents 0.9% of all 16+ employee jobs in the UK. However, this is still too high and the Government believes that the consequences for employers that break the National Minimum Wage (NMW) law are insufficient. The Prime Minister announced on September 1st 2015 that employers who underpay the NMW will face a higher penalty.

Section 19A of the National Minimum Wage Act 1998 provides that a notice of underpayment must require the employer to pay a financial penalty to the Secretary of State within 28 days of service of the notice unless the Secretary of State has, by directions, specified circumstances in which a penalty is not to be imposed. The notice of underpayment is a formal notice issued to an employer if a Her Majesty's Revenue and Customs (HMRC) officer finds that it is breaking National Minimum Wage law. The financial penalty is currently set at 100% of the total underpayment of the National Minimum Wage as specified in the notice of underpayment. The minimum penalty is £100 per worker and the maximum penalty is £20,000 per worker. Where arrears are paid within 14 days of service of the notice, the penalty is reduced by 50%.

By increasing the calculation of penalties we aim to secure greater compliance with the NMW. An increase to 200%, which is reduced by half if employers pay within 14 days, ensures that employers pay a penalty at least equivalent to the arrears owed while retaining the incentive for prompt payment. This specific measure is part of a wider package of enforcement actions outlined below (see 'Policy objective' section).

A similar change to the policy was made in early 2014, when the penalty calculation was increased from 50% to 100% of arrears owed. The Regulatory Triage Assessment and approval letter for this change has been attached separately.

This change will be delivered through secondary legislation and will be introduced as part of the regulations implementing the National Living Wage in April 2016.

Policy objective

Increasing the financial penalty for paying workers below the NMW is part of a package of measures designed to strengthen NMW enforcement, including;

- the setting up of a dedicated team in HMRC focused on tackling the most serious cases of wilful non-compliance.
- increasing the enforcement budget in preparation for the National Minimum and Living Wage from April 2016.
- the creation of a statutory Director of Labour Market Enforcement and Exploitation.

¹ Confirmation date: 01/01/2014, reference: RPC13-FT-BIS-1985

- improved guidance and support available to firms working with payroll providers to embed checks within payroll software.

The key objective of strengthening enforcement is to improve compliance with the NMW by deterring employers from breaking NMW law and ensuring that workers receive the pay to which they are legally entitled.

Policy option

Option 1: Raising the percentage element for calculating the penalty from 100% to 200%

The only option considered in this EANCB validation is to take forward option 1. This is because the Government believes that the consequences for employers that break the National Minimum Wage (NMW) law are insufficient.

The penalty is currently calculated as 100% of the total underpayment for all the workers specified on a Notice of Underpayment. We propose doubling this to 200%.

No non-regulatory options were considered because the percentage and maximum penalty in the National Minimum Wage Act 1998 can only be increased through legislation. A wider package of measures (in 'Policy Objective' section above) have also been taken forward during 2015 including non-regulatory approaches aimed at improving compliance.

Business impacts discussion

Compliant businesses will not incur any extra costs. These employers pay at least the NMW and will be unaffected by changes in the NMW penalty for underpayment of the NMW. The Equivalent Annual Net cost to Business (EANCB) will be zero (as per criteria 2.3.42 of the Better Regulation framework).

HMRC conduct investigations which sometimes end with no non-compliance being found. However, the policy under consideration here is about the penalty incurred after a finding by HMRC of non-compliance and after the employer has agreed and made good the underpayment to the employee. This process will remain unchanged.

We do not expect any familiarisation costs as we currently have a NMW penalty for underpayment and these policy proposals will only change the calculation of the penalty.

We do not expect businesses to change their record keeping practices. We are not modifying any regulations or guidance related to record keeping, so we anticipate that compliant employers will not change their practices to go beyond what is already legally required.

Potential impacts on non-compliant businesses

Any business impacts as a result of this proposal should be out of scope of One-in-two-out (OITO) as the policy options change the penalty issued to employers who break NMW law. Estimates from ASHE suggest that 236,000 16+ employee jobs (around 0.9% of all employee jobs) were paid below the NMW in April 2014.

In 2014/15, HMRC carried out 2,204 NMW investigations and recovered arrears in 735 cases (a strike rate of 33%). Of these cases where underpayment was found, the average arrears recovered was almost £4,500 per employer.

In the same year, HMRC issued 705 penalties (30 cases did not qualify for a penalty) totalling over £930,000, an average penalty per employer of over £1,300. This is in addition to arrears paid back to workers. This means that on average employers found to be non-compliant paid a penalty which was only 30% of the value of wages underpaid. These figures do not directly reflect the current penalty policy (of 100% and 50%) as arrears counted in 2014/15 may cover multiple years before the existing penalty regime was implemented. Furthermore, penalty figures are based on a slightly different reference period to arrears figures so the 30% figure is indicative only.

NMW penalties are collected by HMRC and go back to the exchequer. In 2014/15, HMRC charged just under £1 million in penalties but recovered £3.3 million in arrears for workers.

An increase in the penalty calculation will help to improve non-compliance rates. It will redress the imbalance between the penalty an employer faces for the scale of the underpayment they have made.

The increase in the penalty is also intended to deter employers who might otherwise be tempted to underpay, from breaking the law and ensure that workers are correctly paid. It is difficult to accurately estimate the deterrent effect, however due to the scale of the workers covered even a modest effect will see a large total annual wage that would otherwise be lost.