EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY (CONTRIBUTIONS) (AMENDMENT No.3) REGULATIONS 2009

2009 No. 600

1. This explanatory memorandum has been prepared by HM Revenue and Customs (HMRC) and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 The purpose of the instrument is threefold:

a) to mirror for Class 2 National Insurance contributions (NICs) the penalty regime which now applies for failures to notify a new taxable activity for other taxes and duties administered by HMRC;

b) to introduce a disregard for non-cash vouchers which can be used only to obtain a health screening or a medical check-up and which are exempt from income tax;

c) to remove from the existing regulations the powers of HMRC to require production or allow inspection of an employer's NICs records. Those powers are now provided in Schedule 36 to Finance Act 2008.

2.2 The powers provisions (c) above) will come into force on 1 April 2009, while the other provisions will come into force on 6 April 2009.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None

4. Legislative Context

Penalties

4.1 The new penalty regime which applies to failures to notify a new taxable activity to HMRC is contained in Schedule 41 to the Finance Act 2008 ("Schedule 41"). It applies to income tax, class 4 NICs, corporation tax, capital gains tax, VAT, excise duties, insurance premium tax and environmental taxes (landfill tax, climate change levy and aggregates levy).

4.2 The timing for the commencement of these provisions (6 April 2009) is such that the first new penalties for income tax, class 4 or class 2 NICs become chargeable for failures to notify which result in tax or contributions remaining unpaid after 31 January 2011.

Medicals

4.3 The instrument amends Part 5 of Schedule 3 to the regulations that are being amended ("the NICs Regulations") which provides for certain non-cash vouchers to be disregarded as payments in kind for the purposes of NICs. The effect is to remove the condition that requires an employer to make them available to their employees generally on similar terms. The existing tax relief in S.I. 2007/2091 is being revoked by a separate instrument and, if enacted as part of the Finance Bill 2009, a new provision in the Income Tax (Earnings and Pensions) Act 2003 will give tax relief without that condition.

Powers

4.4 The inspection powers in Schedule 36 apply to a person's "statutory records" which are records that a person is required to keep and preserve under the appropriate tax or NICs legislation. The revised regulations make it clear that the same records that could previously be inspected under those regulations must be kept and preserved, for the same lengths of time. This ensures that they are "statutory records" for the purposes of Schedule 36.

4.5 Paragraph 26 of Schedule 4 to the NICs regulations also contains provisions about an officer's power to issue certificates about an employer's liabilities. In order to improve clarity, those provisions are separately rewritten in a new paragraph 26A.

Other

4.6 The opportunity is taken to make an unrelated correction. Regulation 8(4) inserts sub-paragraph 29F(5) in Schedule 4 to define the term "reckonable date" in sub-paragraph 29F(3) by reference to the meaning given in paragraph 17(3)(b)(i) of Schedule 4. This definition should have been included in S.I. 2007/2068 (as the Committee has suggested).

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

Penalties

7.1 The HMRC Review of Powers, Deterrents and Safeguards began in 2005, following the merger of the Inland Revenue and HM Customs and Excise, to provide a framework of law and practice for HMRC that supports the Government's objectives of a tax system that is fair and better adapted to the needs of customers. One of the first legislative outputs was a new penalty regime for incorrect returns and other documents aligned across HMRC taxes, contained in Finance Act 2007.

7.2 The principles underlying these new penalties were carried forward into a new aligned penalty regime for failure to notify a new taxable activity. The aim is to support those who seek to comply while dealing firmly with those seeking an unfair advantage by not complying, supported by a behaviourally based penalty regime. Aligning penalties across taxes enables clearer deterrent messages and facilitates cross-tax compliance checks.

7.3 Schedule 41 to the Finance Act 2008 and this instrument together provide a single penalty framework for failure to notify a new taxable activity, for a number of different taxes, where there were previously different ones. A penalty only becomes chargeable once tax has become unpaid as a result of the failure, and the penalty is determined by the amount of tax involved, the nature of the behaviour giving rise to the failure and the extent of disclosure by the taxpayer. Rights of appeal will operate in a similar way across the taxes.

7.4 The aim of this part of this instrument is for a person to become liable to a penalty for failure to notify liability to pay class 2 NICs at the same time as tax first becomes unpaid as a result of a failure to notify chargeability to income tax, and to pay associated class 4 NICs.

Medicals

7.5 It had long been the stated practice of HMRC that where an employer provides their employees with health screening or a medical check up it should not be considered a taxable benefit. However this view was called into question and HMRC now thought that a tax charge might arise on such provision.

7.6 For the avoidance of doubt, and to ensure fairness across the workforce, it was decided to introduce regulations to formally exempt from tax the provision of health screening and medical check ups that are made available by employers to their employees.

7.7 Generally speaking if tax is due on an employer provided benefit, there will also be a liability for Class 1A NICs from the employer. Introducing legislation to remove the tax charge on medical check ups and health screening will mean that no Class 1A NICs is due.

7.8 The position is not so straight forward if an employer chooses to use a non-cash voucher to provide their employees with health screening and medical check ups. This is because non-cash vouchers, if derived from the employment, are regarded as earnings for Class 1 NICs purposes. However, Part 5 of Schedule 3 of the NICs regulations provides that certain non-cash vouchers can be disregarded for the purpose of calculating Class 1 liability.

7.9 In order to maintain alignment between the tax and NICs legislation we need to make consequential changes to the contributions regulations. Without such changes the NICs position of vouchers for health screening and medical check ups would be out of step with the tax position and add to the complexity of the tax/NICs system and compliance burden for employers.

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7.10 One of the main outputs of the HMRC Review of Powers, Deterrents and Safeguards mentioned in paragraph 7.1 is a harmonised set of powers with which HMRC may carry out checks into a person's tax position. That is contained in Schedule 36 to Finance Act 2008 which will take effect on 1 April 2009. It applies to checks of income tax (including PAYE), corporation tax, capital gains tax, VAT and NICs and includes checks into an employer's obligations. Schedule 36 repeals a number of powers in primary legislation that will not be required after 1 April. This instrument does the same for the existing powers in NICs regulations.

7.11 HMRC wish to avoid leaving overlapping powers in place as this will cause uncertainty as to which set of powers is being used. The powers in Schedule 36 contain greater safeguards for employers than those in the NICs regulations, especially in relation to where checks may be carried out and the arrangements for giving notice of a visit. Accordingly, the powers in regulations are being revoked so that officers must use Schedule 36.

- ***Consolidation***

7.12 This instrument makes relatively small amendments to the NICs regulations which are very large and complex. HMRC has no current plans to consolidate these Regulations. On the last occasion on which the NICs regulations were consolidated it was a task involving 18 months work and contributions from four different Government departments.

8. Consultation outcome

Penalties

8.1 A consultation document: Modernising Powers, Deterrents and Safeguards: Penalties Reform: The Next Stage was published on 10 January 2008. The consultation ran until 6 March 2008 and a Summary of Responses was published in March 2008. Both documents are available on the HMRC website. HMRC received 24 written responses to their January 2008 consultation and held eighteen meetings with representative bodies and professional firms during the consultation period.

8.2 Following the consultation, Ministers decided to include the draft legislation in the 2008 Finance Bill, and it was subsequently legislated as section 123 of, and Schedule 41 to, the Finance Act 2008.

8.3 The suggestions for penalties for failure to notify a taxable activity were broadly welcomed, particularly the idea of tying the penalty to the tax or contributions lost as a result of the failure and the removal of the £100 fixed penalty for Class 2 NICs.

8.4 Some concerns were expressed about whether the balance was right between penalising those who did not notify, which provides a deterrent and may be seen as fair to those who had complied with their obligations, and encouraging those operating in the hidden economy to come forward. All respondents felt that there should be a greater reduction for disclosure where it is within a short period of the date required for notification, and that this would act as an important incentive to encourage people to come forward to HMRC.

8.5 Respondents suggested that publicity for the proposed changes to penalties for failing to notify should emphasise the positive benefits of joining the formal economy and the help available from HMRC. The Public Accounts Committee made a recommendation along similar lines in their report into "HMRC – Tackling the hidden economy" published on 9 December 2008.

Medicals

8.6 HMRC consulted with employers and their representatives on the tax and NICs treatment of employer funded medical check ups. As a result HMRC accepts that the current regulations clearly had an impact wider than had previously been anticipated and could affect adversely the tax-free status of check-ups provided by some employers to only a small number of employees for good business reasons.

8.7 Ministers agreed that HMRC introduce legislation in Finance Bill 2009 to exempt from tax the provision of one health screening and one medical check up a year by employers to their employees without the proviso that they have to be available generally on similar terms. These regulations follow the principals of that tax provision and ensure that NICs will not be due where a medical is exempt from tax.

Powers

8.8 The provisions that became Schedule 36 to FA 2008 were fully consulted on. The fact that having a single set of powers would enable existing information powers to be repealed or revoked was made clear in the consultation and welcomed by respondents.

9. Guidance

Penalties

9.1 There will be a period of over 20 months between the making of this instrument and the first new class 2 NICs penalty becoming chargeable. This ensures that people know the consequences of failure to notify in good time to allow them to take appropriate remedial action to escape any penalty liability. It also allows for the first penalties to apply across the taxes at broadly the same time, enabling a programme of work to be undertaken to prepare HMRC staff, taxpayers and agents for the new penalty regime. This includes the publication of detailed technical guidance, communication and training.

9.2 HMRC are focusing their efforts on publicising the benefits of joining the formal economy and how a taxpayer should do this. Their forthcoming initiatives will include help and guidance on keeping proper tax records, updated education through outbound telephone centres and greater use of publicity and compliance marketing. A range of interventions and initiatives are being planned for 2009-10, which will focus on improving overall rates of tax compliance in both the hidden economy and formal economy. This will include more prominent guidance to better enable the Department's customers to register for tax at the right time.

Medicals

9.3 HMRC have already contacted those that had been identified as affected by the original legislation and also announced its intention to introduce this legislation on their Website.

9.4 HMRC will update their published guidance in the National Insurance Manual which is available to the public on the HMRC website.

Powers

9.5 These instruments remove powers that are no longer necessary. Guidance on the new powers in Schedule 36 has been published and consulted on.

10. Impact

10.1 There will be negligible impact on business, charities and voluntary bodies.

10.2 There will be negligible impact on the public sector.

10.3 An Impact Assessment has not been prepared for this instrument.

10.4 However, an Impact Assessment on the wider penalties reform was published by HM Revenue and Customs on 27 March 2008 and is attached to this memorandum, and can be found at http://www.hmrc.gov.uk/ria/penalties.pdf. The figures in the Impact Assessment are still up to date.

11. Regulating small business

11.1 The legislation applies to small business.

Penalties

11.2 Under the new penalty regime, a person will no longer be charged a penalty where they are just three months late notifying HMRC that they have commenced self-employment. Instead they will only become liable to a penalty if their failure persists beyond the 31 January on which their first tax return should be filed. For twelve months after this date, a business can also have any penalty reduced to nil if they come forward unprompted to HMRC.

11.3 The structure of the new penalty regime took into account consultation responses and meetings with a range of bodies including Community Links, the Federation of Small Businesses, the Low Income Tax Reform Group and Tax Aid.

Medicals

11.4 A Small Firms Impact Test has not been undertaken because the legislation does not alter the operation of existing procedures.

Powers

11.5 Businesses will have to keep the same PAYE and NICs records in respect of employees as they do at present. The main effect of the instruments is to remove an unnecessary set of powers under which those records could be inspected. Small businesses, as with all employers, will gain from having only one set of powers to refer to.

12. Monitoring & review

Penalties

12.1 HMRC is introducing systems which will allow it to track the number and value of penalties charged across taxes under the new penalty regime compared to the amount of tax involved. There will be guidance and governance procedures in place to ensure that the new penalty regime is applied in a consistent manner.

12.2 There will be an Implementation Oversight Forum made up from external stakeholders and relevant HMRC directors which will report to ministers. A Post Implementation Review will take place within three years of implementation.

Medicals

12.3 The intended outcome of this legislation is to maintain the tax position that existed prior to August 2007 and HMRC will undertake an internal review after 24 months to ensure that this outcome has been achieved.

Powers

12.4 As the effect of these instruments is to get rid of redundant legislation, no review is proposed.

13. Contacts

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can answer any queries regarding this instrument.