**RESEARCH PAPER 99/12**
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# *Social Security Contributions (Transfer of Functions, Etc.) Bill [HL]*

**Bill 38 of 1998-99**

In his March 1998 Budget the Chancellor, Gordon Brown, announced a series of changes to National Insurance, as part of the Government's aim "to create a modern tax system that will help create jobs and reward work." One of these measures was the "establishment of a single organisation to deal with both income tax and National Insurance" [HC Deb 17 March 1998 cc 1103-1104]. At present the Contributions Agency - an executive agency of the DSS - is responsible for collecting and recording National Insurance contributions (NICs). The *Social Security Contributions (Transfer of Functions, Etc.) Bill [HL]* transfers the Agency's operational functions to the Inland Revenue, as well as providing the Revenue with policy responsibility for NICs, and the control and management of the National Insurance Fund.

Normally transfers of functions between Government Departments would be achieved by an Order in Council under the *Ministers of the Crown Act 1975*. In this case a Bill is required to transfer functions, because the Inland Revenue does not fall within the definition of "Minister of the Crown" in that Act.

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# Summary of main points

The Inland Revenue administers and collects direct taxes - mainly income tax, corporation tax & capital gains tax - and advises the Chancellor of the Exchequer on policy questions involving them. It employs some 50,000 staff at present. The Contributions Agency (CA) is responsible for the operational functions of collecting and recording National Insurance contributions (NICs) which are paid into the National Insurance Fund (NIF). The CA also carries out the operational functions in relation to Statutory Sick Pay (SSP), Statutory Maternity Pay (SMP), and the contracting-out of the State Earnings Related Pensions Scheme (SERPS). The Agency employs 8,000 staff.

In announcing a series of measures in his March 1998 Budget to simplify NI the Chancellor, Gordon Brown, said, "Employers and employees will also benefit from a further institutional reform: the establishment of a single organisation to deal with both income tax and National Insurance. My right hon. Friend the Secretary of State for Social Security and I have agreed that the Contributions Agency will be transferred to the Inland Revenue with effect from April 1999."[1]

The *Social Security Contributions (Transfer of Functions, Etc.) Bill [HL]* was introduced on 25 November 1998, and completed its progress through the House of Lords on 1 February 1999. It is due to have its Second Reading in the Commons on 8 February 1999. The Bill has three main purposes:

- to transfer to the Inland Revenue the Contributions Agency and its operational functions, as well as policy responsibility for NICs, and the control and management of the NIF will also move to the Inland Revenue. (Policy responsibility for contracting-out of SERPS, and for SSP & SMP are to remain with the Secretary of State for Social Security.)

- To make a number of changes to social security and other legislation as it relates to functions transferred by the Bill, in particular by bringing appeals about NICs, SSP and SMP within the jurisdiction of the General and Special Commissioners for Income Tax, who hear tax appeals.

- To correct a defect in the legislation which governs the financing of National Insurance rebates for contracted-out occupational money purchase pension schemes.

Although these aims are quite clear, the wording of the Bill is quite complex, as Baroness Hollis of Heigham explained for the Government, during the Committee stage of the Bill in the Lords:

> It is complicated because there are many issues associated with contributions into the National Insurance Fund as well as payments out, which are handled by the DSS. The Bill fillets those responsibilities not two ways, but three ways. Some responsibilities will remain with the DSS, particularly those for statutory sick pay and maternity pay; some responsibilities will go to the Inland Revenue and some will go to the Treasury. Therefore there is a three-way split into other departments which use different terminologies and have different understandings. We are trying in this Bill not only to fillet the responsibilities but to standardise terminology throughout the system.[2]

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1 HC Deb 17 March 1998 c 1104

2 HL Deb 14 January 1999 c 288

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# I Introduction

As part of the Queen's Speech in November 1998, it was announced that "a Bill will be introduced to transfer the Contributions Agency to the Inland Revenue, paving the way for better and simpler collection of National Insurance contributions and tax." The purpose of the Bill was summarised in a press notice issued by the Department of Social Security:

> In his Budget on March 17, the Chancellor of the Exchequer announced proposals to pave the way for better and simpler collection of National Insurance contributions together with tax, by transferring the Contributions Agency and contributions policy to the Inland Revenue.
>
> This will be a technical Bill. From 1 April 1999, it would translate, into functions of the Inland Revenue or the Treasury, extensive and detailed statutory references to functions of the Secretary of State for Social Security.
>
> The Contributions Agency would be transferred to the Inland Revenue on 1 April 1999, and policy on National Insurance Contributions would be transferred on an appointed day.
>
> This would reduce the burden on businesses and individuals, enabling them to sort out taxes and contributions through a single organisation.[3]

The *Social Security Contributions (Transfer of Functions, Etc.) Bill [HL]* was introduced in the House of Lords on 25 November 1998, and received a Second Reading on 10 December.[4] Introducing the Bill for the Government, Baroness Hollis of Heigham said the following:

> There have already been moves to bring the Inland Revenue and the Contributions Agency closer together. Noble Lords may recall the joint working programme between the two departments that was launched in 1995. This programme has led to a number of benefits such as the joint annual pack for employers and a single leaflet and registration form for the newly self-employed.
>
> But joint working can take us only so far. Employers and individuals still need to deal with two separate departments. There is no single focus for employers to discuss improvements in process across tax and NICs. To bring out the real benefits for business and individuals we need to bring the two organisations together. Bringing the Contributions Agency and the Inland Revenue together is a good example of the way this Government are redesigning their services to deliver policies more effectively and to deliver a better service to taxpayers and contributors. That is what this Bill does.[5]

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3 Background Note to the Queen's Speech, Department of Social Security, 24 November 1998
4 HL Deb 10 December 1998 cc 1036-1077
5 HL Deb 10 December 1998 cc 1037-1038

The Bill's further stages in the Lords were as follows:

- Committee stage 14 January 1999 cc 281 - 340
- Report stage 25 January 1999 cc 801 - 838
- Third Reading 1 February 1999 cc 1289 - 1297

The *Social Security Contributions (Transfer of Functions, Etc.) Bill [HL]* (Bill 38) was introduced in the Commons on 1 February 1999, and the debate on Second Reading is scheduled for 8 February.

The scope of the Bill was set out in a press notice, from which the following is taken:

> The Government today published a Bill to transfer the Contributions Agency from the Department of Social Security to the Inland Revenue. The transfer, planned for April 1999, will be a key step in achieving the Government's long term aim of promoting greater alignment of tax and National Insurance contributions. The proposals in the Bill will mean that tax and National Insurance contributions can be processed through one organisation thus reducing the burdens on businesses and individuals.
>
> The Bill will transfer:-
>
> - operational responsibility for National Insurance contributions, statutory sick pay, statutory maternity pay and contracted-out rebates to the Inland Revenue
>
> - policy responsibility for National Insurance contributions to the Inland Revenue and to the Treasury
>
> The proposals in the Bill will allow the Tax Appeal Commissioners to hear appeals on both tax and national insurance contributions. The changes are in line with recommendations made by the Tax Law Review Committee. This will streamline the appeals process, and ensure more consistent decisions …
>
> The Contributions Agency, responsible for the operation of the National Insurance system, is currently an Executive Agency of the Department of Social Security. The Contributions Agency's 8,000 staff will join the Inland Revenue. Most Contributions Agency staff work at the DSS site at Longbenton near Newcastle, but around 3,500 of them work in field offices in 120 locations around Great Britain … The transfer of the Contributions Agency to Inland Revenue is aimed at achieving better service and better compliance. But as a result of combining the two organisations, we expect some efficiencies by removing duplication of effort. It is estimated that there could be a loss of around 200 jobs countrywide in the combined organisation as a direct result of the transfer. We will be able to manage these staff reductions mainly through natural wastage (for example through retirements and resignations).

> Newcastle will remain an important site for government employment. The recently announced project to redevelop the Longbenton site will go ahead as planned, as will the development of the new National Insurance Recording System. Inland Revenue see Longbenton as one of their strategic sites for the future in the new combined organisation. These arrangements secure its long term future.[6]

Speaking at the Bill's Third Reading, Baroness Hollis suggested that in amalgamating the two bodies, the Government sought significant improvements in three areas: customer service, taxpayer compliance, and the quality of tax legislation:

> This Bill will transfer the Contributions Agency to the Inland Revenue. This will enable businesses and individuals to sort out their tax and contributions questions through a single government department. The two organisations will be able to combine their expertise and resources on customer service and compliance.
>
> The Bill will also transfer responsibility for policy on national insurance contributions from the Department of Social Security to the Treasury and the Inland Revenue, along with control and management of the National Insurance Fund. It will also provide a single focus for discussion of improved legislation guidance and procedures. Over time, it will make it easier to achieve a gradual alignment of the tax and NIC rules.[7]

This paper discusses the background to this measure, before looking at the Bill in detail. Part II discusses the alignment of National Insurance and income tax, recent changes in the structure of NICs, and concerns about the impact of these changes on the contributory principle underpinning National Insurance.

Part III looks at the present structure for tax administration in this country, the debate as to whether there should be a single body collecting tax, and the recent developments in closer working between the Inland Revenue and the Contributions Agency in the light of the Government's decision to merge the two. Part IV examines the Bill itself, drawing on its progress through the Lords.

As with other Bills that have been presented this session, an Explanatory Note has been produced, which provides a detailed explanation of its clauses ("Bill 38 - EN").[8] The technical nature of the Bill makes this a particularly valuable supplement to the Bill, in addition to this paper.

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6 Department of Social Security press notice 98/287, 26 November 1998

7 HL Deb 1 February 1999 cc 1295-1296

8 This supersedes the explanatory note issued when the Bill was introduced in the Lords (HL Bill 1-EN).

# II Aligning National Insurance and income tax

## A. The Taylor Report & recent changes in NICs

In his March 1998 Budget the Chancellor, Gordon Brown, announced a series of changes to National Insurance, saying, "it is now time to create a modern tax system that will help create jobs and reward work. So I want to announce today a tax reform to cut the costs of hiring at the wage levels where most new jobs are created."[9] One part of the Chancellor's reform was the transfer of the Contributions Agency to the Inland Revenue. These proposals had been informed by a report on work incentives, commissioned by the Chancellor just after the General Election, by Martin Taylor, then chief executive of Barclays Bank.[10] This initiative had been mentioned in the Labour Party's Election Manifesto; in its discussion of 'fair taxes', the modernisation of the country's tax structure had been seen as a priority:

> To encourage work and reward effort, we are pledged not to raise the basic or top rates of income tax throughout the next Parliament. Our long term objective is a lower starting rate of income tax of ten pence in the pound … This goal will benefit the many, not the few. It is in sharp contrast to the Tory goal of abolishing capital gains and inheritance tax … We will cut VAT on fuel to five per cent, the lowest allowed. We renew our pledge not to extend VAT to food, children's clothes, books and newspapers and public transport fares. We will also examine the interaction of the tax and benefits systems so that they can be streamlined and modernised, so as to fulfil our objectives of promoting work incentives, reducing poverty and welfare dependency, and strengthening community and family life.[11]

Mr Taylor's task force was composed of officials drawn from four departments: HM Treasury, the Department of Social Security, Inland Revenue and the Department for Education and Employment. His final report was published on the same day as the March 1998 Budget statement, and, as the Chancellor said at the time, many of his recommendations have been accepted as part of the Government's welfare to work strategy.[12] In his discussion of National Insurance, Mr Taylor argued that the schedule of rates, and the basis of the tax, imposed a burden on the low paid and distorted the labour market. The report includes a short description of this tax, reproduced below:

> The current National Insurance system
>
> If an employee earns over the lower earnings limit (£64 a week in 1998-99), he or she pays NICs at a rate of 2 per cent on earnings up to the lower earnings limit

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9 HC Deb 18 March 1998 c 1103

10 HM Treasury press notice 47/97, 19 May 1997

11 *New Labour: because Britain deserves better*, April 1997 pp 12-13

12 For example, Mr Taylor's recommendation that Family Credit be replaced with a tax credit is being implemented by the introduction of the Working Families Tax Credit in October 1999. Details on this measure are given in Library Research paper 99/3, *Tax Credits Bill*, 18 January 1999.

> (LEL) and 10 per cent on earnings over the LEL subject to a cap at the upper earnings limit (UEL) of £485 a week. Employees contracted out of the state earnings related pension scheme (SERPS) receive a rebate of 1.6 per cent on earnings between the LEL and UEL, ie a reduction in the rate of national insurance they pay …
>
> Entitlement to some benefits is based on earnings on which employee NICs have been paid. These benefits include basic state Retirement Pension, SERPS, Jobseeker's Allowance, Incapacity Benefit and Statutory Maternity Pay. Typically they use "earnings factors", which relate benefit entitlement to the length of time when pay is above the LEL. For example, entitlement to Statutory Maternity Pay turns on average weekly earnings being at or above the LEL for eight weeks.
>
> Employers pay a uniform rate of NICs on all earnings for employees earning above the LEL. The rate paid depends on the earnings of the employee as set out below:
>
> - £64 - £110 3%
> - £110 - £155 5%
> - £155 - £210 7%
> - £210 and over 10%
> - For those contracted out of SERPS, employers receive a 3 per cent rebate on earnings between the LEL and UEL.
>
> With employer NICs, entry into each new band triggers the application of the higher rate to all earnings (unlike in income tax where the tax rate only applies to income in excess of any threshold). The result is that for employers there are steps not just at the LEL but at the three other thresholds.[13]

Martin Taylor argued that the 'entry fee' and 'steps' for both employee and employer NICs had significant deteriorative effects. For employee NICs, the step at the LEL had the greatest impact, resulting in high marginal tax rates for the individual and a serious administrative burden for the employer.[14] Mr Taylor argued that the entry fee for employee and employer NICs should be abolished, and that all three steps in employer NICs should be scrapped, recouping the cost of the changes to employer NICs by charging a headline employer rate of 12.2%. He also proposed that the LEL should be increased to the level of the income tax personal allowance for employer NICs, and - provided that the rules on contributory benefits were amended to prevent significant loss of employees' benefit entitlement - for employee NICs as well.

One of the guiding principles underlying national insurance - when it was introduced just after the Second World War - was that the benefits that someone received once they retired were to be directly related to the amounts they had contributed to the fund over their

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13 HM Treasury, *Work incentives: a report by Martin Taylor*, March 1998 pp 11-12

14 On earnings of £64 a week, an employee will become liable to NICs of £1.28 per week - an employer, a charge of £1.92 per week - for 1998-99.

working life. Since the principle of the system was that there should be this actuarial link between contributions paid in and benefits received - much as with any insurance scheme - there was some question whether NICs should be considered as a tax at all. However, in the fifty years of its existence, NICs have been changed to such a degree that they have lost any claim to be a genuinely insurance based system. Indeed critics of NICs have argued the erosion of the insurance principle means NICs represent simply an extra administrative burden for employers to deal with, and the tax should be integrated with income tax.[15] This is a fair criticism, though many taxpayers would feel that their contributions over the past fifty years were made under the contributory principle, and that to disregard this altogether in abolishing NICs would be a fundamental breach of faith on the government's part.[16]

The possibility of integrating NICs with income tax has been discussed for well over a decade, though - from a historical perspective - it was not surprising that Martin Taylor firmly ruled this out in his report.[17] Without going into too much detail, there are two fundamental problems with full integration, even if one ignores the fact that it would mean a complete redefinition of the contributory principle for short term benefits and for pensions. First, the revenue neutral abolition of NICs and their replacement with higher personal tax rates would have profound effects upon those for whom earnings form a relatively small or insignificant part of their taxable income: primarily pensioners, but also those who enjoy income from interest, rents or dividends. Second, the interaction of NICs and income tax results in an uneven pattern of marginal combined deduction rates across the income distribution, of considerable benefit to those on certain incomes.

The standard rate of employee contributions is 10% on earnings between £64 and £485 per week for 1998-99. At the lower scale someone will start to pay NICs before they pay income tax, so that their marginal rate of tax will be 10% initially. Once their income is large enough for them to be paying income tax at the basic rate of 23%, their combined marginal rate of tax jumps to 33%. Once earnings rise above £485 per week - the upper earnings limit - the marginal rate will fall back to 23%. An individual's earnings would have to be in excess of £602 per week at least for them to be paying income tax at the higher rate.[18] Of course, once this occurs, their marginal rate of tax rises to 40%. Eliminating this

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15 The issue was discussed during the Second Reading of the *Social Security Contributions (Transfer of Functions, Etc.) Bill* in the Lords on 10 December 1998; for details see Part II.B of this Paper.

16 In a recent qualitative study of perceptions of the National Insurance system, the author found that although the respondents lacked detailed knowledge of the benefits system, in their responses they were strongly committed to the contributory principle and the importance of work. Bruce Stafford, *National Insurance and the Contributory Principle*, DSS In House Report 39, 1998

17 For example, the arguments against integration were set out in impressive detail in the Conservative Government's 1986 Green Paper on personal taxation: *The Reform of Personal Taxation*, Cmnd 9756, March 1986 pp 37-39.

18 For 1998-99 the first £4,300 of an individual's taxable income is charged the lower rate of 20%. Tax is charged at the basic rate of 23% on income earned in excess of this threshold, up to £27,100, above which it is liable to tax at the higher rate of 40%. The basic personal allowance is £4,195. Taking just this allowance into account, someone would have to earn over £31,295 a year to start paying income tax at 40%. Further details of the income tax structure are given in Library Research paper 98/37, *Personal tax allowances & reliefs*, 18 March 1998.

"kink" by abolishing NICs would hit some taxpayers particularly hard. In his memoirs Nigel Lawson, called this dilemma the "elephant trap" and referred to it as the key reason why he left the upper earnings limit (UEL) unchanged when Chancellor in 1988.[19]

The Institute for Fiscal Studies has a long standing interest in the possibilities for reforming national insurance,[20] and in their *Green Budget* prepared for the November 1996 Budget, they made some prescient comments, looking not only at the relationship between tax rates, but also at the base of NICs and income tax:

> A further anomaly in the current system is the discrepancy that exists between the tax base for NICs and that for income tax, which provides an incentive for both employees and employers to adjust their financial arrangements in order to minimise their overall tax liability. Whilst there would inevitably be significant practical difficulties in the implementation of such a system, any government wishing to create a more integrated structure could find plenty of reasons to justify this course of action.[21]

In his report Martin Taylor also argued the lack of alignment between the two systems was a cause for concern, particularly as employers were faced with separately recording and accounting for two sorts of NICs as well as income tax:

> The main areas of difference are:
>
> - base of charge. Income tax is paid on total income including savings and investment income, state and occupational pensions and earnings replacement benefits. NICs are paid only on earnings from employment and self-employment and excludes many taxable benefits in kind;
>
> - reliefs and rebates. The income tax system has a wide range of allowances and reliefs, whereas no reliefs can be set against earnings for NICs. NICs are, however rebated for both employer and employee, where the employee is contracted out of SERPS;
>
> - period of assessment. PAYE may be deducted each time an employee is paid but the employee's final income tax is based on total taxable income from all sources for the tax year. NICs are calculated fully and finally for each pay period on the basis of earnings in that pay period;
>
> - structure of charge. Particularly with the 10p rate, income tax would be a progressive tax, charged at graduated rates above the personal allowance. NICs are charged as above.[22]

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19 Nigel Lawson, *The View From No 11*, 1992 pp 824-828

20 For example, "Income tax and National Insurance: Better Together?" in *Tax Reform for the Fourth Term*, October 1992 pp 103-124; and, Andrew Dilnot, Director of the IFS, "Integrating income tax and social security", in Cedric Sandford (ed.), *More Key Issues in Tax Reform*, 1995 pp 19-33

21 Institute for Fiscal Studies, *Options for 1997: the Green Budget*, October 1996 pp 120-121

22 HM Treasury, *Work incentives: a report by Martin Taylor*, March 1998 p 13

In particular, Mr Taylor focused on the treatment of benefits in kind:

> At present, benefits in kind are not subject to NICs, other than the employer-only Class 1A charge on company cars and car fuel. This gives employers an advantage in offering benefits in kind, so reducing the NICs yield and distorting competition. However, it does not look straightforward to value benefits in kind, at least on anything like the income tax rules, on the current NICs pay period basis. So a full employee and employer NICs charge may not be easy for employers to handle. The pragmatic solution may be to extend, perhaps at a higher NICs rate, the Class 1A employer-only charge.[23]

In discussions with employers, Mr Taylor found strong support for aligning NICs and income tax (*my emphasis*):

> Understandably, some employers and representative bodies argue for closer alignment of the detailed charging rules for tax and NICs, as well as for broader alignment. Bringing benefits in kind generally into a Class 1A NICs charge would be such an alignment, assuming it also followed income tax rules. There are strong arguments for looking for further alignment of NICs with the employment income charge and with the boundaries of the PAYE charge. *This could be started by bringing NICs operational and policy functions together with their tax equivalents in the Inland Revenue.* Such a move would send a strong signal that the Government was serious about reducing business costs by progressive alignment over the longer term.[24]

Mr Taylor's conclusions were echoed in a major study of employers' tax compliance costs, carried out by the Centre for Fiscal Studies at the University of Bath,[25] and published by the Inland Revenue in November 1998:

> **Amalgamation of PAYE and NI**
> When invited to comment, employers almost invariably (and sometimes in strong language) argue for an amalgamation of PAYE and NI. This is a matter of policy and outside of the remit of the present report. It was recently considered, and rejected, in the report … by Martin Taylor. There would almost certainly be compliance cost savings from amalgamating the two, though the extent of these is difficult to measure.[26] Employers have suggested that, short of this, the Lower Earnings Limit should coincide with the (most common) Tax Threshold, etc., and

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23 *op.cit.* p 14 Class 1 contributions are paid by both employees and employers on the employee's earnings. They are mostly collected with PAYE income tax. Class 1A contributions are paid by employers on the value of cars and fuel provided to their employees.

24 *op.cit.* p 15

25 *The Tax Compliance Costs for Employers of PAYE and National Insurance in 1995-96 : Inland Revenue Economic Papers No.3,* 1998. This report is discussed in more detail in Part III.B of this Paper.

26 The authors of the report had not asked employers in their main survey to provide estimates for the time they spent on accounting for each, because employers in their pilot study "had been reluctant to split the hours spent on PAYE and National Insurance as they are largely joint operations." *op.cit.* p 42

> that NI should be cumulative, like PAYE. But "free pay" differs across individuals for various reasons so the potential savings from this would be limited. And the unit of time for NI (except for directors) is the week or the month. Major savings could be made only by abandoning the insurance principle and/or differences in the relevant period. One aspect of additional costs associated with NI has been the necessity of dealing with two separate bodies. This should be eased by the joint operation of IT/CA.
>
> It is therefore recommended that: given that PAYE and NI are not to be amalgamated into a single system, the IR/CA should go as far as it possibly can in achieving consistency and uniformity across PAYE and NIC operations, so as to minimise compliance costs to employers.[27]

In his March 1998 Budget the Chancellor announced that he had accepted Mr Taylor's proposals for a "simpler, fairer and more employment-friendly national insurance system":

> From next year, the Government will abolish the distorting entry fee for employers' national insurance. We will also abolish the multiplicity of separate national insurance rates. We will therefore cut the cost of hiring lower-paid employees. Employers will pay no national insurance on any employee earning less than the starting point of the personal tax allowance--£81 a week. The right to benefit for all employees earning between £64 and £81 a week will be upheld in all the changes we make.
>
> With these changes, we are cutting the costs to business of employing 13 million of our lower and middle-income employees. We are taking up to 1 million of the lowest-paid employees out of employers' tax altogether and we are cutting the cost of hiring someone on half average earnings by more than £250 a year …
>
> Employers and employees will also benefit from a further institutional reform: the establishment of a single organisation to deal with both income tax and national insurance. My right hon. Friend the Secretary of State for Social Security and I have agreed that the Contributions Agency will be transferred to the Inland Revenue with effect from April 1999. We are a Government who do not simply talk about cutting the costs of red tape and bureaucracy, but take the decisive action necessary to achieve it.[28]

The Chancellor did not propose any immediate changes in the lower earnings limit for *employees*:

> The lower earnings limit for employees will remain unchanged (at £64 in 1998-99). But the Government is committed to aligning it with the personal allowance as soon as it has reformed the rules for contributory benefits to ensure that those

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27 *op.cit.* p 90

28 HC Deb 18 March 1998 c 1104

> who are taken out of national insurance contributions do not lose their right to accrue benefit entitlement.[29]

Baroness Hollis of Heigham - Minister of State at the Department of Social Security - mentioned this issue during the Second Reading of the *Social Security Contributions (Transfer of Functions, Etc.) Bill*:

> There are many approaches that [the Chancellor] could take [in protecting benefit entitlement, with increases in the LEL]. He could do it by crediting people in; by deeming that they have paid a contribution; or by modelling it on home responsibility payments. The undertaking has been given that people who move from the 65 to the 81-83 personal tax level will not thereby lose their entitlement to benefit. These discussions are ongoing and the Chancellor will make his determination in due course.[30]

The Government reaffirmed these changes to NICs in the *Pre-Budget Report*, published in November 1998. In line with the decision to align the threshold with employers NICs with the personal tax allowance, the Chancellor announced at this time that the personal allowance for 1999-2000, taking into account indexation, would be £4,335 a year, and the threshold for employers' NICs would be £83 a week.[31] Finally, on 30 November, Alastair Darling, Secretary of State for Social Security, announced his review of NICs for 1999-2000.[32] Details were given in a press release from which the following is taken:

> The NICs "entry fee" currently payable by employees once earnings reach the lower earnings limit (currently £64 a week) will be abolished, so that employees will not pay NICs on the portion of earnings at or below the lower earning limit.
>
> Employers will also no longer pay NICs on the portion of earnings at or below the lower earnings limit once earnings reach that level. The point at which employers start to pay NICs will be further increased to the level of the personal tax allowance. In practice, this will mean no employers' contributions will be payable on earnings up to and including £83 a week.
>
> The 3 per cent., 5 per cent., 7 per cent. and 10 per cent. rates of employers' NICs for different levels of employees' earnings will be abolished and replaced with a single 12.2 per cent. rate of employer NICs payable on earnings above the level of the personal tax allowance …
>
> In line with the Social Security Contributions and Benefits Act 1992, the lower earnings limits for Class 1 contributions is to be raised to £66 a week. It is set at the level of the basic Retirement Pension rate for a single person from April

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29 *Financial Statement & Budget Report* HC 620 1997-98 March 1998 p 45

30 HL Deb 10 December 1998 c 1075 Baroness Hollis is referring to the LEL for employees (£65) and employers (£83) for the *coming* year: 1999-2000.

31 HM Treasury, *Pre-Budget Report*, Cm 4076 November 1998 p 63

32 HC Deb 30 November 1998 cc 97-99W

> 1999, rounded down to the nearest pound. The upper earnings limit is to be raised to £500 a week which is slightly less than 7 1/2 times the new basic pension rate as provided by the Social Security Contributions and Benefits Act. These new earnings limits will replace the current ones of £64 and £485 respectively. Employees will pay a standard rate contribution of 10 per cent. on that portion of their earnings which exceeds the lower but not the upper earnings limit.
>
> As announced by my right hon. Friend the Chancellor of the Exchequer in his 3 November Pre-Budget Report, the Earnings Threshold from which employers will start to pay secondary Class 1 contributions will be £83 a week. The multiple contribution rates for employers will be replaced by a standard contribution rate of 12.2 per cent. on all earnings which exceed the earnings threshold.[33]

One further change has been made recently to modernise National Insurance, as a recent written answer noted (*my emphasis*):

> **Mr. Fabian Hamilton:** To ask the Secretary of State for Social Security what steps he has taken to harmonise the arrangements for tax and National Insurance contributions.
>
> **Mr. Timms:** The Government are committed to modernising the National Insurance contributions system so that it is simpler and easier for employers to understand and operate, and to promoting greater alignment with the tax system in the longer term.
>
> From April 1999, the point at which employers start to pay secondary Class 1 contributions will be raised to a new "earnings threshold" set at the level of the personal tax allowance. *The tax and contributions treatment of payments and benefits to employees included in PAYE settlement agreements will be aligned by the introduction of new Class 1B contributions for employers.* Also from that date, under the provisions of the Social Security Contributions (Transfer of Functions, etc.) Bill the Contributions Agency will transfer from the Department of Social Security to the Inland Revenue. This will reduce the burdens on businesses and individuals by enabling tax and National Insurance contributions to be processed through one organisation.[34]

Provision for the introduction of Class 1B contributions was made under section 53 of the *Social Security Act 1998.* The origin of this measure was a working group set up under the previous Government's deregulation initiative, to find changes to the definitions of income (for tax) and earnings (for NICs) which would cut employers' costs and made it easier for them to meet their obligations in the administration of both.[35] The Deregulation Task Force recommended the two systems should be replaced by a unified simple tax-

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33 Department of Social Security press notice 98/292, 30 November 1998

34 HC Deb 11 January 1999 c 65W

35 DSS, *Deregulation Review: Report of the Tax/NICs working group*, 1993

based system,[36] which unsurprisingly, the Conservative Government rejected.[37] Nonetheless it accepted the principle of closer alignment between the rules for income tax and NICs, part of which was the proposal that annual voluntary settlements for NICs would be introduced so that employers who volunteered to pay their employees' tax on some expense payments and benefits in kind could do so in a lump sum. This way they would not have to reach a separate settlement for each individual employee.

In 1996 the Inland Revenue introduced a statutory scheme - PAYE Settlement Agreements (PSAs) - to replace annual voluntary settlements from October of that year.[38] Under this framework employers can settle the income tax liability on certain benefits in kind and for expenses in a single payment. PSAs can include expenses payments and benefits which are minor, or irregular, or provided in circumstances where it is impracticable to apply PAYE or to apportion the value to particular employees.[39] Following a consultation exercise,[40] the Government introduced legislation as part of the *Social Security Act 1998* to introduce a new class of NI contribution - Class 1B - payable in circumstances where a PSA has been agreed, from April 1999.[41]

Finally, in this context, it is worth noting one point made by Baroness Hollis of Heigham for the Government, during the Report stage of the *Social Security Contributions (Transfer of Functions, etc) Bill* - that following the amalgamation of the CA, the Revenue would be carrying out a review about "desirable harmonisations of tax and NICs":

> This Bill is not the occasion for substantial change of powers since the aim of the Bill is to transfer the CA as a "going concern". We have been clear from the outset that professional advisers would be nervous that there might be a levelling up of powers. This we have very deliberately not done. Nevertheless, we accept that the statutory powers of enforcement under NICs legislation that the Inland Revenue will inherit will not be fully consistent with the existing powers in relation to tax. It is in no one's interests to have any lack of clarity or certainty about the state's powers to ask questions or ask to enter premises.
>
> We anticipate that, after this legislation takes effect, the Inland Revenue will be consulting with a range of opinion about desirable harmonisations of tax and NICs. Indeed, those discussions have already started. Some areas for discussion would be on the details of the charging rules. Others would be on the

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36 *Deregulation Task Forces Proposals for Reform,* January 1994 para 350

37 *Business Deregulation Task Forces Proposals for Reform: Update,* November 1995 para 350

38 Under section 206A of the *Income and Corporation Taxes Act (ICTA) 1988* (introduced by section 110 of the *Finance Act 1996*) The rules are set out in detail in the Inland Revenue's *Tax Bulletin*, December 1996 pp 365-369.

39 Examples include, the cost of an office Christmas party; Christmas hampers provided for employees; provision of a works' bus; and reimbursement of late night taxi fares.

40 *Proposed Changes to Align NICs with Inland Revenue Treatment of Tax under PAYE*, 1996 DEP 3/2743

41 Further details are given in Library Research paper 97/93, *Social Security Bill 1997/98*, 17 July 1997

> administration powers and administrative processes to the extent that they impinge on employers and others.
>
> So we see considerable merit in conducting a review of inspectors' powers, taking into account the rights of individual contributors as well as the interests of employers and the need to block fraud.
>
> Such a review needs to be done properly, running well beyond the timescale of this Bill. Moreover, the review needs to look at the wider context. The Inland Revenue is being given other tasks such as policing the national minimum wage and student loan recovery, and handling the working families tax credit. All three involve employers, although we hope to burden them as little as possible.[42]

## B. The contributory principle & the Bill

It is worth emphasising that the *Social Security Contributions (Transfer of Functions, Etc.) Bill [HL]* does *not* make any fundamental changes to the structure of National Insurance. During the Second Reading of the Bill in the Lords, Baroness Hollis of Heigham - Minister of State at the Department of Social Security - admitted that, "some noble Lords will be looking to this Bill for signals as to the future direction of tax and benefits policy", though the Baroness was keen to make clear "what the Bill does not do": "It makes no changes to the structure of NICs. It does not affect the tax or NICs yield, nor benefit expenditure. It has no effect on individuals' entitlement to contributory benefits. And it makes no changes in pensions policy."[43] In concluding, the Minister referred to the transfer of the Contributions Agency as the first stage in a wider reform of NICs:

> In conclusion, transferring the Contributions Agency to the Inland Revenue is good news for employers. The Bill allows that to take place. But I hope I have explained that the Bill and the transfer from April are only the start of the process. This Bill is not the vehicle for major alignment of tax and National Insurance contributions. We want to work through that in consultation with representative bodies. Instead, this Bill is about a safe landing of the Contributions Agency within the Inland Revenue and about making sure that the Contributions Agency can operate within the Inland Revenue from next April. That will provide a platform on which we can build service improvements and gradual alignment of tax and NICs over the forthcoming years.[44]

A number of speakers during the Second Reading saw the Bill as part of a wider change in National Insurance - the erosion of the contributory principle. Lord Skelmersdale suggested that the Bill might be "the thin end of the wedge":

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42 HL Deb 25 January 1999 c 819
43 HL Deb 10 December 1998 c 1038
44 HL Deb 10 December 1998 c 1043

> Government Ministers of all persuasions have defended the separation of national insurance contributions and tax from 1948 onwards as being for two entirely different purposes. One of the lines of defence used was that they were administered by two entirely separate government departments. This defence disappears once this Bill becomes operative … Shall we soon see a Bill which seeks to do away with the National Insurance Fund altogether? If so, there is nothing to stop all benefits being means tested rather than only some non-contributory benefits, as is the case at the moment.[45]

Speaking for the Conservative Party, Lord Higgins argued that the Bill was part of a wider trend, "the general thrust of the Government towards more and more means testing":

> The Minister was at pains to say that this is a mechanical measure not related to other policy changes. That is difficult to accept. The whole thrust of the Government's social security policy over the past year or 18 months has been to undermine the contributory principle in a number of respects. That in turn undermines universal benefits. The effect of moving the Contributions Agency from the DSS to the Inland Revenue is to make the contributions more and more like a tax … It will become … easier to argue that a contribution to a specific National Insurance scheme does not have the same force of entitlement to benefits as was previously the case.[46]

Lord Goodhart, on behalf of the Liberal Democrats, agreed with this analysis, and very much *welcomed* the Bill on those grounds: though the Bill was "extremely technical and, to a large extent, non-uncontroversial", the fact that the Revenue was to assume responsibility for the administration and collection of NICs was only appropriate, "because NICs are not insurance contributions at all, but a hypothecated tax on earned income in the case of employees or a payroll tax as regards employers":

> The National Insurance system has not for many years, if ever, been a genuine system of insurance. For example, retirement pensions make up more or less three-quarters of the total spending under the contributory system. In a proper insurance system retirement pensions would be paid for by retaining and investing the contributions in order to provide pensions for the contributors when they retire. But right from the start of the non-means-tested state pension system, under the Pensions Act 1925 pensions have been paid on a pay-as-you-go basis. Therefore, today's contributors are not saving for their own retirement pensions, but paying for the pensions of today's pensioners …
>
> It is true, of course, that people must have made contributions in the past in order to qualify for the right to a pension now. But, frankly, that is not so very different from saying that one has to pay vehicle excise duty before one is entitled to drive one's car on the public highway. Further, of course, there is no link between the

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45 HL Deb 10 December 1998 c 1071

46 HL Deb 10 December 1998 cc 1044-1045

> amount of benefit payable and the amount paid in contributions. Contributors pay a percentage of their income between the lower and upper earnings limits or, in the case of employers, NICs without limit. But the benefits, with the only serious exception being the state earnings-related pension supplement (SERPS), are flat rate. The fact that the amount paid in contributions has no link to the amount paid in benefits is again a characteristic of tax rather than insurance ...
>
> It is clear that further alignment between NICs and income tax is both possible and desirable. It is absurd that some forms of remuneration have been treated as income for income tax, but not for national insurance contributions. For example, that leads to many ridiculous schemes to avoid national insurance contributions by payment in gold bars or hay or various other tradeable commodities. It is quite clear that the test of income should be the same for both income tax and national insurance contributions. All this emphasises both the logic and convenience of treating NICs as a tax.[47]

Winding up the Second Reading, Baroness Hollis was keen to make a strong distinction between the Government's intention to further align NICs and income tax, and its attitude to the contributory principle:

> We accept, and always have, that there must be limitations on the contributory principle, simply because it privileges people who have the luxury, as it were, of a 35 or 40-hour a week job extending over 40 years. That means that women, part-time workers, those who are in and out of employment and those who have a disability tend to have a less adequate income under the contributory principle than would otherwise be the case and it must be supplemented regularly by a means-tested benefit. Therefore there is no single answer as to the right nature of benefit support. The contributory principle is one answer, particularly for pensions; the means testing of benefit is another, also for particular groups who may be in and out of the labour market who have special needs, family needs and so on which cannot be covered by a contributory benefit; but there are also category benefits such as child benefit.
>
> A main reason why contributory benefits have fallen as a proportion of social security expenditure has been partly the growth of means-tested benefits, but means-tested benefits of a particular sort. Since the late 1960s and early 1970s the three major benefits that we have seen growing, all of which are necessarily income-related, have been housing benefit, in-work benefits, and the "citizen's right" benefits of disabled people. The first two are by definition income-related and the third is a category benefit. That is one of the main reasons that the amount of expenditure in the social security system, which is contribution-linked, has fallen. It is not just about the increase in means-tested benefits, although that has also been true. It is that different types of benefit have grown up for which either an income test or alternatively a category test is relevant. I do not believe that anyone in this House thinks that that is an inappropriate way forward. It is

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[47] HL Deb 10 December 1998 cc 1047-1048

> clearly not right to have a benefit such as housing benefit on a contributory basis which takes no account of housing cost and housing need.
>
> I therefore hope that noble Lords do not continue to insist that the Government are getting rid of a contributory principle and that as a result we might just as well accept that national insurance is a hypothecated tax. The picture of social security is much wider and more complicated than that. We should accept that different contingencies are rightly entitled to different responses. Some benefits that are attached to the labour market should be on a contributory basis; others associated with special needs may be category or income-related. What is important is that we match the right benefit with the right sort of situation. Those are some of the discussions and debates that we shall have over the next year or two.[48]

During the Committee stage of the Bill, Baroness Hollis took a second opportunity to summarise the Government's position on the contributory principle:

> The welfare benefits system is based on three different structures of benefit: means-tested or income-related benefits, contributory benefits based on the national insurance principle and also what I call universal category or contingency benefits which are by virtue of the group of people to whom you belong - for example, an entitlement to disability living allowance or an entitlement to child benefit … It is precisely because of the problems of means-testing that the Chancellor announced, and will bring to the House reasonably shortly, a Bill to replace the main in-work benefit, family credit, with a working family tax credit system … Nothing in the Bill will affect the contributory principle … We recognise that there is no single structure of benefit which will fit all forms of need. I am sure we shall continue to have a mixed economy, with that effect.[49]

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48 HL Deb 10 December 1998 cc 1074-1075

49 HL Deb 14 January 1998 c 284

# III Tax administration: closer co-operation or integration

## A. The Inland Revenue and HM Customs & Excise

In this country there are two national tax authorities: the Inland Revenue, responsible for administering direct taxes such as income tax and corporation tax; and HM Customs & Excise, responsible for administering indirect taxes such as VAT and excise duties. Of late there has been considerable interest shown in the idea that the two should be merged into one department;[50] the following paragraphs provide a short introduction to the issue.

The idea of amalgamating the Revenue and Customs is not new; indeed, during the 19th Century it was considered very seriously. A history of these plans was given in the report of the Keith Committee, set up in 1980 to investigate the enforcement powers of both authorities.[51] The Committee observed that "during the last 120 years there have been several proposals for the amalgamation of the two Departments. Indeed at one time the management of the excise duties was undertaken by the Commissioners of Inland Revenue and it was transferred to the Commissioners of Customs in 1909. However, none of the proposals for amalgamation came to fruition and the continued existence of two separate Revenue Departments with their particular divisions of functions was therefore largely a matter of historical accident."[52]

The Keith Committee did not itself examine the possibilities for amalgamation, but it did discuss the advantages of closer co-operation between the Revenue and Customs. Though the exchange of information between the two bodies was provided for under law (specifically, section 127 of the *Finance Act 1972*), the concerns raised about this provision when it was introduced had meant that in practice this was only done at a Head Office level. The Committee noted that exchanges done at a local level had been carried out in Leeds from 1977 to 1981 with great success and recommended that this should be extended on a nationwide scale,[53] which indeed was done in 1988.[54]

The Committee also discussed possible co-operation in making joint visits to trading taxpayers. This represented potential savings both in official manpower, and for businesses, who could deal with their VAT and PAYE responsibilities at one time. The Committee recommended that a pilot scheme be set up to explore the feasibility of this proposal, which was done in 1986, though the Committee's separate suggestion, for joint investigations, seems not to have been taken up. In October 1988, the Government announced that the feasibility study had found that joint visits had not cut either department's costs, nor

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50 For example, "Revenue and Customs & Excise may merge", *Financial Times*, 6 October 1997

51 *Committee on Enforcement Powers of the Revenue Departments* Cmnd 8822 March 1983. A short history of the two departments, and their possible amalgamation, was given in a separate note to the Committee's Report (pp 786-787).

52 *op.cit.* p 463

53 *op.cit.* p 581

54 HC Deb 8 March 1988 c 128W

substantially reduced the numbers of visits the authorities had had to make.[55] As a consequence, the proposal was dropped:

> **Mr. Robert Banks:** To ask the Chancellor of the Exchequer what has been the outcome of the pilot study of joint pay-as-you-earn and value added tax visits which the Inland Revenue and Customs and Excise undertook in the Nottingham area.
>
> **Mr. Norman Lamont:** The pilot study, which took place in the last quarter of 1986, was designed to test the Keith committee's suggestion that joint visits, rather than separate visits for PAYE and VAT purposes, could be mutually beneficial to traders and to the Inland Revenue and Customs and Excise. The findings are that, while joint visits are feasible and acceptable to most of the traders who received them, in only 2 per cent. of cases would a joint visit replace two separate visits. So, in most instances, a joint visit would add to, rather than reduce, the inspections of a business's records. Furthermore, a system of joint visits would add substantially to the departments' costs. In the light of these results, it is not proposed to implement a programme of joint visits at this stage. But both departments will continue to improve the information and other services they provide, especially to small businesses.[56]

Subsequently in the early 1990s, the possible integration of certain activities carried out by the Revenue and Customs was raised in the context of the Conservative Government's Fundamental Expenditure Review. It was announced in November 1993 that both departments would be part of the coming batch of Reviews.[57] In March 1994 it was reported in the press that one option being discussed was merging those sections responsible for collecting tax from small businesses.[58] At the time both the Revenue and Customs simply reiterated that the purpose of the survey was to examine all potential cost savings.

When completed in November 1994, the Government announced that one outcome of each body's Review "was not to merge the departments but for them to work together more closely." A number of projects were to be examined, including "the introduction of shared telephone helplines, joint educational seminars, and jointly-run Mobile Advice Centres."[59] In September 1995 it was announced that a pilot scheme for a helpline - shared between the Revenue, Customs, and the Contributions Agency - covering employers' enquiries on PAYE, National Insurance contributions, VAT, excise and customs duties, was to be set up in Scotland.[60] Following this successful pilot, the helpline was made available nationally on 7 October 1996.[61] At the time it was reported that "evaluation of the pilot by an independent

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55 HM Customs & Excise press notice, 21 October 1988

56 HC Deb 20 October 1988 c 990W

57 *Financial Statement and Budget Report*, HC 31 30 November 1993 p 95

58 "Review of tax departments threatens thousands of jobs", *Financial Times*, 11 March 1994

59 HM Customs & Excise press notice, *Closer Working*, 29 November 1994

60 Inland Revenue press notice, *Tax and national insurance red tape cut for business*, 19 September 1995

61 The number is : 0345 143 143.

company showed that 97% of all callers were satisfied or very satisfied with the service."[62] A deposited paper laid in November 1996 gave further details of the emerging joint working programme between these three organisations:

1. A joint leaflet, (CWLl "Starting your own business?"), for people starting up in business on their own which explains tax, national insurance issues and VAT and guides them through the notification procedures, was published in November 1995 and updated in April 1996.

2. A single notification form for people starting up in business was introduced in April 1996. Linked to the joint leaflet this joint notification form allows new businesses to simultaneously notify all three departments that they have started up in business.

3. The Employers Telephone Helpline (0345 143 143). Following the successful pilot in Scotland this service was made available nationally from 7th October 1996. The helpline gives general advice, at local call rates, on Pay as You Earn (PAYE) and National Insurance issues, along with advice on VAT registration.

4. Review of leaflets and forms. A review of all leaflets and major forms published by IR, CA and C&E and develop common versions where appropriate.

5. Piloting Touch Screen Information Kiosks. The touch screen pilot is an initiative designed to help ordinary people understand the complexities of dealing with government. It uses new technology to make things simpler, and brings together information from three government departments in one place. The system was demonstrated at the launch of the Government Green Paper on Information Technology on the 6th November 1996.

6. Linking the departments via the Internet and exploiting and developing opportunities for communicating joint working on the Internet.

7. Development of staff interchanges and loans between departments. Closer working links between departments, with greater use of staff interchanges.

8. Maximise compatibility of Information Technology between departments.

9. Exchange of information and common access to stored data subject to taxpayer confidentiality, and within the terms of the legislation governing the use of information.

10. Co-ordinating cross departmental training opportunities.

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[62] An evaluation of the national helpline began in January 1997 [HC Deb 4 December 1996 c 657W]

11. Phoenix Companies. Exchange of information about "phoenix" directors between IR, CA, C&E and DTI. (Phoenix Companies are those which go out of business and are immediately replaced by another company with the same directors).

12. Piloting a Combined Enquiry Office. A Combined Enquiry Office has been running in Cardiff since March 1996. The potential for further combined offices is to be evaluated.[63]

Following the General Election, there was some speculation that the Labour Government might consider amalgamating the two departments. Edward Troup argued the case in the *Financial Times* in June 1997; part of his article is reproduced below:

> Britain is destined to enter the 21st century unenviably unique among the developed world in having two national tax collecting departments - the Inland Revenue and Customs & Excise. This peculiarly British anomaly has, in recent years, quietly contributed to bad policy-making, poor tax collection and the continued frustration of businesses …
>
> The origins of this curiously British system lie in the perception that the excise and similar levies involve trade with foreigners, while the direct taxes, by and large, relate only to domestic transactions. The separation was encouraged by the touchingly naive hope of the early 19th century tax raisers that no single officer of the Crown should ever be in possession of all the information relating to one of its citizens. The most recent opportunity to address this division was hopelessly ducked in 1972 when responsibility for the new value added tax, adopted as part of the terms of Britain's accession to the then European Economic Community, was given to Customs to administer. This was largely based on the argument that, as purchase tax had been collected by Customs, giving its replacement to the Inland Revenue would have left Customs with time on its hands. The consequence has been that the overwhelming majority of businesses in the land now deal with two separate tax authorities.
>
> Such an oddity might be justifiable if it produced some gain for the government, but the reverse is the case. The government finds itself framing tax policy for business through two entirely separate organisations … The Revenue is meticulous to the point of obsessiveness, while Customs relies as much on gut feeling as on the analysis of detail. Yet both organisations deal with the same businesses - financial conglomerate or fish and chip shop. From tax collection to the broadest application of policy, those businesses find themselves subjected to wildly differing approaches.[64]

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[63] Dep 3/4210 25 November 1996. This was deposited in answer to a PQ [HC Deb 21 November 1996 c 648W].

[64] "Double trouble over tax: Personal View: Edward Troup: Two national collection departments are one too many in Britain", *Financial Times*, 2 June 1997. Mr Troup is head of tax strategy at City law firm Simmons & Simmons and was tax adviser to former chancellor Kenneth Clarke.

An excellent response to Mr Troup's argument was made by Richard Watson, head of indirect taxation at Price Waterhouse, published in the *FT* some days later, part of which is reproduced below:

> What matters in terms of the approach of the two departments is not so much where they have come from as what they are now being expected to do ... The Inland Revenue is collecting taxes which are intended to fall on business profits, which in turn are determined by accounting concepts used in the preparation of a business's annual accounts. The taxes are annual and what matters is the profit rather than how it has been achieved. VAT, in contrast, is a tax on consumption …
>
> [VAT] is a tax on transactions at the time they take place. Unlike income tax and corporation tax it cannot be left until the end of the year, until the annual accounts have been submitted and until after the ritual arguments with the inspector of taxes. These two factors mean Customs has a very different job from the Inland Revenue in terms of policing the collection of its tax. It also has a very different body of legislation, which impacts on just about any area of business operation ... All this means that Customs is a far more legalistic department than the Inland Revenue. It knows perfectly well that it is comparatively easy to go to law over its interpretation of legislation, and that the arguments that will be put there will be extremely detailed and based on real circumstances rather than conceptual accounting principles …
>
> There is one element of income tax which is an indirect tax. The collection of income tax on individuals through PAYE is very similar to the collection of VAT. In both the final taxpayer is the individual and businesses are being used as unpaid tax collectors. The tax collection involves visits to business premises and an audit of the appropriate systems. There would be considerable benefit to both business and to the Revenue departments if these processes were combined ... How much easier it would be to deal with a combined team which would audit PAYE (and of course the associated National Insurance contributions) at the same time as VAT. Similarly, Customs would gain a greater insight into the workings of a business if it was looking at employment records at the same time as purchase and sales records. It would then possess full knowledge of a business's operations.[65]

In a later piece the *FT* quoted Richard Baron, taxation executive at the Institute of Directors, as saying, "in principle [a merger] looks a good idea. But we would be concerned about a culture clash." Mr Baron went on to suggest that taxpayers would gain more if the Revenue was merged with the Contributions Agency.[66]

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65 "A tale of two taxes: The tasks of Customs and the Inland Revenue need different skills, says Richard Watson", *Financial Times*, 19 June 1997

66 "A marriage that could tax two minds", *Financial Times*, 9 October 1997

Around this time Dawn Primarolo, now Paymaster General, mentioned the issue during an interview with the *FT*:

> For almost 200 hundred years, sales duties and income taxes have been collected by two different departments, which have reported to different ministers. Prompted originally by the belief that no single government official should know everything about a taxpayer, the division has become entrenched through tradition rather than logic. Mr Brown has little time for such traditions and at the end of last year Ms Primarolo was given both responsibilities in opposition. With no fanfare, the same structure has been adopted in government.
>
> In her first interview since the election, Ms Primarolo is quick to play down the obvious conclusion that Mr Brown would like to merge the Inland Revenue with Customs & Excise. 'There are no plans at the moment,' she says carefully. Such a merger has long been advocated by business ... But Ms Primarolo insists there are important differences between the two departments and dismisses the argument that no other leading country separates the two. 'Just because nowhere else in the world does it, doesn't make it wrong,' she says.[67]

In answer to a PQ, Ms Primarolo was similarly circumspect - though, as two other PQs underline, the joint working programme has continued:

> **Mr Quentin Davies:** To ask the Chancellor of the Exchequer what assessment he has made of the advantages of merging the Inland Revenue, the Customs and Excise and the Contributions Agency; and if he will make a statement.
>
> **Dawn Primarolo:** A programme of closer working between Customs and Excise, Inland Revenue and the Contributions Agency has been developed since 1994. We intend to develop further this programme in support of Government objectives. [68]
>
> **Mr. Jack:** To ask the Chancellor of the Exchequer when he expects to publish the findings of his review on the feasibility of merging Customs and Excise and the Inland Revenue.
>
> **Dawn Primarolo:** A programme of closer working (but not merger) between Customs and Excise and Inland Revenue resulted from a review under their Fundamental Expenditure Reviews in 1994 of the boundary between the two departments. We intend to develop further this programme in support of Government objectives.[69]
>
> **Mr. Jack:** To ask the Chancellor of the Exchequer, pursuant to his answer of 3 June, Official Report, column 146, if he will make a statement setting out how closer working between Customs and Excise and the Inland Revenue will be

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67 "Doubly taxed at the Treasury," *Financial Times*, 9 June 1997
68 HC Deb 1 July 1997 c 113W
69 HC Deb 3 June 1997 c 146W

> developed; and what are the manpower and financial implications of each of these proposals.
>
> **Dawn Primarolo:** The closer working programme has been continually developed since its introduction. Where initiatives have manpower or financial implications these are being contained within existing spending plans.[70]

Since then, the joint working programme has seen the creation of an Internet site,[71] and, for the Revenue, two important pilot programmes. First, in July 1998 the Revenue set up a Call Centre in East Kilbride, to conduct services for employees and pensioners over the telephone.[72] If this experiment proves successful, it is the Revenue's aim to extend these Centres across the rest of the UK, with a roll out of 50% of Call Centres by 31 March 2002. Second, over the past three years the Revenue has been running a scheme in Leicester with the Contributions Agency to provide one-to-one help for new employers getting to grips with tax, National Insurance and benefits.[73] At the time of the March Budget it was announced that this service would be offered in more areas during the coming year and go nationwide from April 1999.[74]

In his Pre-Budget statement to the House in November 1998, the Chancellor mentioned that this service could be extended to cover not only income tax and NICs, but VAT as well:

> I have in mind a bigger reform to cut the burdens of tax and red tape. Small businesses getting started and growing lack not only the resources to pay tax, but the back-up to administer national insurance, income tax and VAT payments and their payroll systems. From April 1999, the Inland Revenue and the Contributions Agency will be merged. We propose to roll out on a nationwide basis a new, comprehensive service for all businesses, helping them to replace time-consuming book-keeping by offering a one-stop advice service, administered by local offices and a national helpline. So, from now on, every Government Department will have an obligation to encourage enterprise and entrepreneurs.[75]

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70 HC Deb 1 July 1997 c 114W. Joint working between the Revenue and Customs is discussed further in Part III.B of this Paper, in light of the Public Accounts Committee's views of the Revenue/Contributions Agency merger.

71 http://www.open.gov.uk/jw/jw.htm This now carries two more joint publications: CWL2 *National Insurance Contributions for Self-Employed People*; and, CWL3 *Thinking of Taking Someone On*. In January 1997 a new annual Tax and National Insurance information pack was developed, and following a positive response from recipients, 1.2 million were issued over a two week period from the end of January 1998: Inland Revenue/Contributions Agency press notice, 26 January 1998.

72 Legislation was introduced recently - section 118 of the *Finance Act 1998* - to allow the Revenue to carry out certain types of business by telephone as well as in writing, as specified in directions. To date it has issued two sets of directions to this end. Inland Revenue press notice 165/98, 18 December 1998.

73 The service includes rapid response tailor-made help with the employer's first pay-day, and one-to-one assistance with a wide range of other subjects such as Statutory Sick Pay, Statutory Maternity Pay, and expenses and benefits in kind provided to employees.

74 Inland Revenue Budget press notice IR 43, 17 March 1998

75 HC Deb 3 November 1998 c 685

The *Financial Times* reported some support for the initiative, quoting Ian Barlow, head of tax at the accountancy firm KPMG, as saying, "this is certainly a very sensible move as the hassle factor for a new business is very high."[76]

## B. Merging the Inland Revenue and the Contributions Agency

The Contributions Agency was set up in its present form in April 1991. In their 1991 report on NICs, the National Audit Office described the reasons behind the Agency's launch:

> The Department recognised in the late 1980s that it was no longer appropriate for responsibility for collecting and recording National Insurance contributions to be fragmented within the Department. They also recognised that they were failing to ensure that contributors paid all that was due. To address the problems, the Secretary of State announced plans in May 1989 for a new management structure for collecting and recording individuals' contributions. A separate unit, operating within the Department and known as the Contributions Unit, was set up on 2 April 1990 and became an executive agency in April 1991.[77]

The Agency performs three basic tasks:

- ensuring compliance with NI related legislation for the collection of NI contributions, and the administration of the contracting-out system
- maintenance of accurate NI accounts
- provision of NI related information.

It is responsible for maintaining the NI accounts of over 65 million customers, and its other customer databases cover 1.4 million employers, over 3 million self employed people and a personal pension population in excess of 5.7 million. Of its 8,000 staff, about 60% are located in Newcastle upon Tyne and the surrounding area; their work includes maintenance of individual contributors' NI records, the administration of contracting out arrangements for occupational and personal pensions and support functions. The remaining 40% work in field offices located throughout the country and deal directly with employers, businesses and contributors.[78]

The Agency's work has come in for some criticism in recent years. In 1997 it published a survey on customer satisfaction, which - although it reported a customer satisfaction rating of 81% - highlighted some problems in the responsiveness to customer enquiries:

> Those customers who were not very satisfied with the CA's service were asked to identify the single biggest problem they had in dealing with the CA. The most

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76 "Brown promises national advice service on tax via helplines", *Financial Times*, 4 November 1998
77 NAO, *National Insurance contributions*, 18 October 1991 HC 665 1991-92 p 8
78 "Agency overview" in *Contributions Agency Annual Report 1997/98*

> frequently mentioned problem was the length of time taken to get a reply, or resolution to a query. Finding the right person to help, and getting full answers to all questions, were the next most frequently mentioned. Dissatisfied customers were especially likely to mention speed, and were also more likely than quite satisfied customers to mention not getting a reply to their queries or all the information they needed, and a lack of communication between CA departments.
>
> All customers were invited to suggest improvements, and these to some extent reflect the problems identified. Faster service was the most sought after improvement, with simpler forms and explanations, better internal communications, and more information also in some demand …
>
> Taking an overview of the survey results, as in 1995, three key themes for improvement emerge. One is responsiveness, combining speed with realistic estimates of when results will be available, effective explanations for delays, and progress reports. Efficiency is also crucially important, handling enquiries in a well organised way, with easy access to appropriately knowledgeable staff who are attentive to customer needs and handle their problems sensitively. The third theme relates to providing information, an area on which the CA already performs very strongly, but where some groups such as the self-employed still express a need for access to simpler or fuller information.
>
> The telephone helplines (Employer Helpline and COEG Helpdesk) received especially favourable ratings from their customers, and as the CA considers handling greater volumes of telephone contact, ideally they could build on the experience of these operational areas.[79] Certainly the radical improvement in satisfaction achieved among the Debt Collection Unit customers, following a number of initiatives (including helplines) and the shift to contacting customers by telephone, provides an encouraging example of how effective such measures can be.[80]

In June 1995 the Adjudicator's Office[81] - the independent body set up in 1993 to deal with complaints about maladministration by the tax authorities - extended its brief to cover the Contributions Agency, as well as the Inland Revenue and HM Customs & Excise.[82] In its annual report the following year, the Adjudicator acknowledged the impressive conclusions of the *CA Customer Satisfaction Survey*, but found that the Agency's handling of customer complaints was very poor:

> I am alarmed at the standard of work – including complaints handling – I have seen this year from the Contributions Agency. They were the poorest organisation

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79 The success of this initiative is striking, in light of the Inland Revenue's recent pilot programmes for Call Centres and 'one-stop' advice shops, discussed in Part III.A of this Paper.

80 Rachel Craig, *CA Customer satisfaction survey 1996 - Social Security Research*, 1997 pp 8-9

81 The Adjudicator's Office, Haymarket House, 28 Haymarket, London SW1Y 4SP 0171 930 2292

82 Elizabeth Filkin has held the post since it was first set up in June 1993. She is become Parliamentary Commissioner for Standards - in succession to Sir Gordon Downey - in February 1999. Inland Revenue press notice, 22 January 1999.

> I dealt with and I saw problems at all levels of the organisation. There are offices, teams and individuals doing very good work … but I see many muddles and serious mistakes which are not sorted out even when they are brought to their attention by complaints from the public ...
>
> During the year, 192 people contacted my office with complaints or queries about the Contributions Agency, almost 80 per cent more than last year. In 127 of these cases, we provided assistance and we took on 65 complaints for full investigation, more than three times the number last year. We completed 51 investigations compared with 13 last year. We had more complaints about the Agency to investigate this year and more, and better experienced, staff dealing with them. But although we received more complaints about the Contributions Agency this year, the number is much lower than for the other organisations I look at. This concerns me ... I feel that the Agency have not done enough to publicise their own complaints procedures or the services of my office …I have also been told by some customer bodies, such as accountancy associations, that the way the Contributions Agency have dealt with complaints they have made on their clients' behalf has led them to believe that complaining to the Agency is not worthwhile ...
>
> This year I upheld a staggering 80 per cent – 41 complaints – against the Agency. They showed much poor work by the Contributions Agency, for example: breaching customers' confidentiality; resistance to paying compensation; excessive delays and failing to understand things from the customer's point of view … The few improvements the Contributions Agency have made have been undertaken on a piecemeal basis and they still fall far short of the efforts made by Customs and Excise, the Inland Revenue and the Valuation Office Agency. They have told me of the efforts they are making to improve things now. I shall report on what I see next year.[83]

The following year, the Adjudicator found little improvement in the Agency's record in dealing with complaints, though the Agency's response to the comments made in the 1997 report had been impressive:

> Disappointingly we have seen little improvement in the way that the Contributions Agency handle complaints. This year we upheld 74% of the complaints we investigated about the Contributions Agency. This compares with 80% in 1996/97 and 77% in 1995/96.
>
> We continue to be concerned about the small number of complaints we receive about the Contributions Agency. In 1997/98 we received only 158 complaints about the Contributions Agency, and of these we took up 46 for investigation. In December 1997 the Contributions Agency produced a revised complaints leaflet. They have made this leaflet available in public places such as libraries and Citizen's Advice Bureaux, Employment Services and Benefits Agency offices.

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[83] *The Adjudicator's Office Annual Report 1997* pp 4-5

> And they have told their staff to offer the leaflet to customers who appear to be dissatisfied. But we still feel that the Contributions Agency have not done nearly enough to publicise, and give people confidence in, their complaints procedure or to make their customers aware of the opportunity for independent review by the Adjudicator.
>
> On the other hand we have been impressed by the Contributions Agency's response to the serious criticisms we made in our 1997 annual report. They relaunched their Complaints Taskforce, reviewed their complaints handling instructions, provided new training to their staff, and made Directors personally responsible for complaints in their areas. But, sadly, we have not yet seen the effect of these efforts on the service provided to their customers ... From the cases we investigated during 1997/98, it appears that the Contributions Agency still have a lot of work to do to bring their service to the public up to an acceptable standard.[84]

As important as the Agency's work is, it is important to note that it is the Inland Revenue which collects 94% of all NICs, alongside income tax under PAYE. Notably, during the Second Reading of the *Social Security (Transfer of Functions Bill) [HL]*, Lord Skelmersdale noted that given the Revenue's present responsibilities in collecting NICs, transferring responsibility for the National Insurance Fund "obviously makes logistical sense":

> I believe it would have been reasonable for the noble Baroness to have opened by saying that this is a very complicated Bill with two very simple purposes; namely, to pass the operational functions of collecting and recording National Insurance contributions from the Contributions Agency to the Inland Revenue, and to allow the Inland Revenue to deal with SERPS, statutory sick pay, statutory maternity pay and, of course, their appeals, rather than the Secretary of State …
>
> This change results in the Inland Revenue holding the National Insurance Fund, from which contributory benefits are paid. In a nutshell, we no longer have NICS but NICIRS. This obviously makes logistical sense. For many years, the Inland Revenue has had the responsibility of being agent for the Department of Social Security for collecting the vast proportion of money going into the fund, both from employers on a monthly basis and employees on a weekly or monthly basis, and the self-employed on an annual basis. These three amount to well over 90 per cent. - I think that the notes say 94 per cent., if memory serves me right - of the total sums going into the fund. The rest is made up of Treasury top-ups, as in most years the Treasury has to subsidise the fund because incomings and outgoings do not match, and of voluntary contributions, which are collected by the Secretary of State.[85]

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84 *The Adjudicator's Office Annual Report 1998* p 90

85 HL Deb 10 December 1998 c 1070

The possible merger of the Inland Revenue and the Contributions Agency had been examined earlier in the 1990s, as part of the Conservative Government's Deregulation initiative. Among the many proposals made in the White Paper, *Competitiveness: helping business to win* published in May 1994 was a "review of how the work of the Inland Revenue, Customs & Excise, and the Contributions Agency can best be co-ordinated to minimise cost on business arising from tax collection and compliance."[86] The Contributions Agency's 1994-95 *Annual Report* noted that during 1994 "the Secretary of State asked the Chief Executive to look at ways of working closer with the Inland Revenue to reduce the administrative burdens on business."[87] Though amalgamation was ruled out, the exercise provided the impetus for closer co-operation generally:

> **Mr. French:** To ask the Chancellor of the Exchequer what assessment he has made of the administrative savings to be made from amalgamating the Inland Revenue and the Contributions Agency.
>
> **Sir George Young:** The relationship between the Contributions Agency and the Inland Revenue was examined last year. It was concluded that the overlap between the Revenue and the agency did not warrant an amalgamation of the two businesses. In addition, any efficiency gains would be outweighed by transitional costs and disruption to both departments. Work is in hand, as part of their respective deregulatory plans, to achieve closer working between the two organisations which should offer worthwhile savings to business.[88]

Lord Higgins, spokesman for the Conservative Party, mentioned Mr Young's review when discussing the financial impact of merging the Agency with the Revenue, during the Second Reading of the Bill:

> I am a little puzzled about the motivation of the Bill. The costs involved are not inconsiderable - £16 million one year, £17 million the next, £4.8 million the next, and so on - and savings are slow to come through. In terms of government efficiency, that does not seem a very good deal … The previous government's Ministers turned the proposals [for merger] down ... In terms of efficiency, it is uncertain whether the Bill is as justified as the Minister seeks to argue.[89]

In responding for the Government, Baroness Hollis said the following:

> We accept that, at least to start with, there are primarily more costs than savings … because much of the expenditure is investment in staff training which … is crucial to the activity. Therefore we may spend £16 million or £17 million for the first couple of years and then subsequent savings may be of the order of £3

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86 Dept of Trade and Industry, *Competitiveness: helping business to win*, Cm 2563 May 1994 para 13.61
87 HC 503 18 July 1995 p 21
88 HC Deb 14 June 1995 c 516W
89 HL Deb 10 December 1998 c 1044

> million or £4 million. There is a high front end loaded cost in staff training. We think that is right.
>
> The purpose of the Bill, as I have tried to make clear, is to ensure that we produce an integrated service for employers and employees. I do not know why Sir George Young rejected the measure other than on cost grounds … It is the quality of service that we seek to drive forward in this Bill rather than immediate savings. Had Sir George Young perhaps had a wider remit at the appropriate time, he too might have decided that it was worth proceeding with this measure.[90]

As mentioned, the present Government announced the amalgamation of the Contributions Agency with the Revenue at the time of the March 1998 Budget:

> Helping businesses to comply with rules by providing them with advice and assistance is an important way in which government can ease the burdens of compliance. The Government is committed to looking for new ways to do this by providing better, more co-ordinated advice and adapting government services to new technologies and working methods.
>
> Many businesses say they want to deal with one organisation about the tax and National Insurance contributions (NICs) they collect from their employees. The Contributions Agency will therefore be transferred to the Inland Revenue in April 1999. Separately the Government is also committed to transferring the related NICs policy functions to the Inland Revenue once agreement on a new entitlement test for benefits has been reached (the Department of Social Security would retain responsibility for benefit entitlement). These transfers will further improve customer service through unified delivery of guidance and assistance, and speed the pace of tax and NICs alignment.[91]

In a brief published in August on their Internet site, the Contributions Agency gave some details of the initial benefits they anticipated from amalgamation:

> **Benefits to customers**
> Detailed work is being carried out to determine exactly how the Transfer can bring about early improvements to the services we provide, building on the successful Joint Working Programme that already exists between CA and IR. Examples of the areas under review are: Specific help for new employers; enhancing leaflets and guidance; provision of combined NICs/tax assistance for customers.[92]

The proposed merger have been widely welcomed, as the *Financial Times* reported at the time of the 1998 Budget:

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90 HL Deb 10 December 1998 c 1073
91 *Financial Statement & Budget Report* 18 March 1998 HC 620 1997-98 p 64
92 http://www.dss.gov.uk/ca/transfer.htm

> Peter Wyman, a leading tax expert with Coopers & Lybrand, who is a member of the government's deregulation task force, said: "This will deliver considerable efficiencies and better customer service. There are real and quiet long-term benefits - although costs are immediate and not insubstantial." He doubted whether the merger spelt the end for NICs. "There is a lot of evidence that the contributory principle is appreciated and that you get much better levels of voluntary compliance. It would be rash to throw that away." …
>
> But not everyone is sure NICs are safe. Jim Yuill, of Ernst & Young, while welcoming the merger added: "What I wonder is whether the tax itself will follow the tax gatherers and be swallowed by the Inland Revenue. I don't think New Labour is quite brave enough to do away with the contributory principle - yet." … The best news will be that from April next year taxpayers and employers will begin to see real progress in cutting red tape in dealing with the two tax gatherers. The logic of the merger seems unassailable. Cultural problems may persist but not critical problems. The only uncertainty is the long-term future of NICs.[93]

In their Budget response, a spokesman for the Institute for Chartered Accountants said, "We very much welcome the merger of the Contributions Agency into the Inland Revenue which should reduce red tape for employers … This appears to be in keeping with changes that the Institute has been requesting for some time and makes it a good budget for small business."[94]

In addition the Public Accounts Committee has welcomed the proposed merger, in their report on the Inland Revenue's practice of employer compliance reviews,[95] from which the following is taken:

> The Department told the Committee that they were acutely conscious of the perceived burden by employers of separate efforts by the Contributions Agency and the Inland Revenue. They had an extremely active programme of joint working, with 37 separate projects, some tripartite with Customs and Excise. By December 1997, each of their Regional Executive Offices would have framework documents with the Contributions Agency setting out the ground rules for liaison and planning of visits. As part of their joint working initiative they would also be sharing their computer systems with the Agency on a pilot basis with a view to wider roll-out if it proved effective. The Chancellor of the Exchequer has, however, subsequently announced that the Contributions Agency will be transferred to the Inland Revenue from April 1999 to establish a single organisation to deal with both income tax and National Insurance, which would benefit both employers and employees …
>
> The Government's decision to establish a single organisation to deal with both income tax and national insurance contributions offers the opportunity to secure a

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93 "Jobs fears follow plan to merge agency with Revenue", *Financial Times*, 19 March 1998

94 Institute for Chartered Accountants press notice, *A good budget for small business*, 18 March 1998

95 These are to check employers are properly calculating income tax and National Insurance contributions in respect of their employees and are paying over to the Department the amounts due.

> significant reduction in the administrative burden on employers. We look to the Department to continue also to explore the scope for further co-operation with Customs and Excise.[96]

In its response to this conclusion, the Government noted the following:

> The Department notes the Committee's comments and will continue to seek to reduce the burdens on employers. The Department and Customs and Excise are already working very closely together on a wide range of issues. The Department will be developing pilots with Customs and Excise to explore how data sharing could assist in identifying and tackling risk, for example "phoenixism" amongst employers. The two Departments have already issued a joint Debt Management Guide.[97]

In the technical journal, *Taxation*, one commentator argued that one result of the merger would be an increase in tax receipts from improved voluntary compliance:

> The work of the Contributions Agency's former Special Compliance Unit and Divisional survey teams (who previously dealt with large employers) was absorbed into a new unit called the 'Large Employers Unit' during late 1996. Now a separate business unit of the Contributions Agency, it comprises about 140 staff who are responsible for compliance visits to large employers and groups of companies and also co-ordinates National Insurance contributions avoidance work for the Agency.
>
> It deals with the same employer client base as the Revenue's National Audit Group, which is responsible for the largest 3,000 or so employers and groups, covering nearly 20,000 pay-as-you-earn schemes. A programme of selected joint visits between the National Audit Group and the Large Employers Unit is already under way, and the conclusion must be that the Contributions Agency's Large Employers Unit will merge with the National Audit Group providing increased coverage at the top end of the employer market …
>
> There was a time when employer compliance was regarded by many as the Cinderella compliance activity - but not any more. 75 per cent of the Revenue's and gross income tax receipts in 1996-97 came from pay-as-you-earn, Employer Compliance reviews produced an extra £240 million with a cost yield return of 1:5 (National Audit Group achieved 1:12) in the same year, a better result than either corporation tax or income tax full investigations.
>
> Consequently there is now wide-spread recognition within the Revenue that checks on employers to ensure compliance with their obligations to operate the pay-as-you-earn/NICs/sub-contractor systems and make correct returns of

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96 Committee of Public Accounts, *Inland Revenue: employer compliance reviews*, 27 April 1998 HC 357 1997-98 paras 50-54

97 *Treasury Minute on the Thirty-first to Thirty-seventh Reports from the Committee of Public Accounts 1997-98*, Cm 4004 July 1998 para 16

> benefits and expenses can generate substantial amounts of extra cash for the Exchequer. In resource terms, the current Revenue Employer Compliance workforce will double when the integration with the Contributions Agency takes place next April which could result in the same employers being reviewed on a more regular basis. That will place a bigger administrative burden on some employers, but from the Revenue's perspective it could improve voluntary compliance whilst inevitably reducing yield.[98]

Employers' tax compliance costs were the subject of a major study commissioned by the Inland Revenue and the DSS in 1995, and published in November 1998.[99] On the size and the structure of these costs, the authors concluded:

> **Total compliance costs:** It was found that the total relevant compliance cost for 1995-6 was of the order of £1.32bn. This amounted to 1.3% of relevant tax receipts or 0.2% of GDP. Comparing 1981-2 and 1995-6, compliance costs increased by 42% in real terms, much the same as the increase in GDP over the period so their share of GDP was approximately the same.
>
> **Regressivity of compliance costs:** The pattern of compliance costs is highly regressive against smaller employers in that the "bottom" 30% (by PAYE and NI collected) pay 75% of the compliance costs. Compliance costs per employee were £288 per annum for employers in the 1-4 employee size band but only a little over £5 per annum for those in the 5000+ band. Real gross compliance costs per employee have hardly changed over the 1981-2 to 1995-6 period for the 10-49 size band but have almost doubled for the smallest employers and have fallen by nearly a quarter for employers with over 100 employees. Compliance costs are found to be very high in the 1-9 size band across all sectors but are particularly high in financial and professional services.
>
> **Cash-flow benefits:** Employers receive "cash-flow" benefits from PAYE and NICs in the interval between collection and payment. At 1995-6 tax and interest rates these benefits amounted to about £10 per annum per employee for small employers and more than offset gross payroll costs for employers with more than 1000 employees.[100]

In welcoming the report, the then Financial Secretary Dawn Primarolo and Social Security Minister Stephen Timms, gave a joint statement, from which the following is taken:

> We collect annually well over £100 billion of revenue from PAYE and National Insurance contributions (NICs). Complying with PAYE and NICs inevitably has a cost to business, which is estimated in total at 1.3% of the revenue raised. When

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98 "First the good news!", *Taxation*, 7 May 1998

99 *The Tax Compliance Costs for Employers of PAYE and National Insurance in 1995-96 : Inland Revenue Economic Papers No.3*, 1998

100 *op.cit.* p 7

> the cash flow advantage to business is taken into account, the total net compliance cost is reduced to about 1% of revenue raised.
>
> The Report shows that compliance costs over the period between 1981/82, the date of the last comprehensive study, and 1995/96 have risen broadly in line with gross domestic product. Keeping the compliance costs of taxation to the minimum necessary is a key element of our policy objectives for tax and National Insurance. We are particularly concerned for small businesses …
>
> We are pleased to see that the team report that "the level of service employers received from the Inland Revenue and Contributions Agency staff is thought to have improved considerably in recent years"; and that the majority of employers felt that staff in both Inland Revenue and Contributions Agency were either helpful or very helpful. This provides a good platform on which to build improvements in service.[101]

Notably one of the report's recommendations to the Government was the amalgamation of the Contributions Agency with the Revenue:

> **Collaboration.** Closer collaboration between the IR and the CA is one of the main themes arising from discussions with employers. Indeed this report was jointly sponsored by them and they already have a joint Working Programme. The Team therefore welcomes the Budget announcement (March 17 1998) that the IR is to take responsibility for the work of the CA. On the assumption that the whole of the work relating to PAYE, NI, SSP and SMP will now come under the same umbrella this should greatly facilitate the carrying out of some of the recommendations that follow.[102]

Finally, in November 1998 the Treasury Sub-Committee announced that it was to carry out a short inquiry into the Inland Revenue, which, among other things, would assess the impact on resources of the proposed transfer of the Contributions Agency to the Inland Revenue. Details were given in a press notice:

> The Sub-committee intends to carry out a short inquiry into the Inland Revenue. It will begin with a hearing on the Inland Revenue's Annual Report in January.[103] The hearing aims to address three issues in particular:
>
> A To review progress in the implementation of self-assessment (for both corporates and individuals);
>
> B To assess the Inland Revenue's progress in encouraging compliance, with particular regard to the burdens imposed on small businesses and

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[101] Inland Revenue press notice 138/98, 11 November 1998

[102] *Inland Revenue Economic Papers No.3,* 1998 p 85

[103] This was scheduled for Thursday 28 January; to date, the minutes have yet to be published. The Sub-committee expects to hold further hearings early in 1999

including relevant joint working initiatives with Customs and Excise and the Contributions Agency;

C To assess the impact on resources (including staff and IT) of the proposed transfer from the DSS of the Contributions Agency and the Family Credit unit in the Benefits Agency to the Inland Revenue in April 1999.[104]

[104] Treasury Committee Press Notice No. 3 of Session 1998-99, 26 November 1998

# IV The Bill

## A. Part I : General

Part I of the Bill provides for the transfer of both operational and policy functions from the Secretary of State for Social Security to the Inland Revenue and the Treasury on one or more appointed days. It also deals with the exercise of those operational functions by the Revenue post-transfer.

**Clause 1 introduces Schedules 1 and 2.** Schedule 1 transfers to the Inland Revenue the day-to-day operational functions currently discharged by the Contributions Agency (CA) on behalf of the Secretary of State. These functions, in relation to contributions, SSP, SMP and contracting-out matters, will be exercised by the Inland Revenue from the day appointed for the operational transfer. The Government intends that operational transfer will occur in **April 1999**.

**Schedule 1** amends the provisions of Acts which confer such functions on the Secretary of State, and also other provisions which make consequential references to his exercise of those functions. Functions conferred on the Secretary of State by the subordinate legislation listed in **Schedule 2** are also transferred to the Inland Revenue. In most cases, Schedule 1 substitutes "Inland Revenue" for "Secretary of State" in the relevant provisions, and makes related amendments. Lord Skelmersdale questioned the wording used in Schedule 2 during Committee, noting that the Bill refers to individual provisions, not to each set of regulations. So, for example, all the regulations set out in the *Social Security (Contributions) Regulations* 1979/591 are transferred to the Revenue, "except regulations 37 to 39, 41 to 42 and 44". As the noble Lord said, "I find it very difficult to work out how something can be both policy and yet transferred." In answering his question, Baroness Hollis shed light on the legislative approach which underpins the Bill:

> Our strategic intention behind the Bill is to transfer the operational functions of the Contributions Agency to the Inland Revenue, together with policy responsibility for national insurance contributions. The way we have done this is, to go through the relevant primary and secondary legislation to identify those provisions which confer specific functions on the Secretary of State for Social Security and to decide whether those specific functions should be transferred to the Inland Revenue or the Treasury as necessary. The functions conferred in primary legislation are amended as necessary in Schedules 1 and 3. Clause 1(2) transfers to the Inland Revenue functions conferred on the Secretary of State by provisions of subordinate legislation specified in Schedule 2. …
>
> We need to specify only provisions which actually confer a function on the Secretary of State … Where a provision of regulations simply deals with how a function conferred elsewhere is to be exercised, there is no need to specify it in Schedule 2. So, in order to ensure the regulations work when they have been transferred, there is no need to transfer regulations which deal with how a function is to be exercised if the regulations do not themselves identify the

> function holder. Any stray references to the Secretary of State which do not themselves confer functions are converted into references to the Inland Revenue or Treasury, as necessary--as a sweep-up, if you like--by paragraph 1(4) of Schedule 7.[105]

**Clause 2** introduces Schedule 3 which transfers contributions policy - such as the level and scope of the contributions charge - to the Treasury or the Inland Revenue as appropriate. These functions consist mainly of the exercise of powers to make subordinate legislation in relation to contributions, and the control and management of the NIF. They will be transferred from a date appointed by a commencement order under clause 28.

Existing social security law contains extensive powers to make regulations. Where these powers relate wholly to contributions they will be transferred to the Treasury or to the Inland Revenue. However, in a number of cases a regulation-making power affects the operation of the contributory benefits system, which will remain the responsibility of the Secretary of State. Also, in the case of matters such as SSP and SMP and contracted-out pension schemes, policy responsibility (and therefore the prime powers to make subordinate legislation) will remain with the Secretary of State. In these cases the Bill makes provision for the regulations to be made by the Inland Revenue or the Treasury with the concurrence of the Secretary of State or vice versa. This is designed to provide a safeguard against unintended operational consequences, or effects on benefit entitlements, of regulations.

During Committee Lord Renton questioned the wording to Schedule 3, in so far as in certain cases, regulations are to be made by the Treasury, but with "the concurrence of the Secretary of State." For example, liability to a certain class of NICs will depend on whether an individual is an "employed earner" or a "self employed earner." Under section 2 (categories of earners) of the *Social Security Contributions and Benefits Act 1992*, regulations may prescribe certain types of employment as falling within either of these categories. Schedule 3 (para 2) of the Bill [Bill 38 page 30 line 40] transfers the power to make these regulations to the Treasury "with the concurrence of the Secretary of State." Lord Renton asked what the difference might be, adding "in any event, is not the Chancellor of the Exchequer the Minister responsible when the Treasury makes regulations?" Baroness Hollis responded by saying, "existing social security legislation already requires some powers of the Secretary of State to make regulations to be exercised with Treasury consent; for example, Section 189(8) of the *Social Security Administration Act 1992*. I do not think that this is a constitutional novelty. It seems to us to be a sensible way to proceed."[106]

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[105] HL Deb 14 January 1999 cc 290-292 Schedule 7 in HL Bill 1, to which Baroness Hollis refers, is Schedule 8 in Bill 38.

[106] HL Deb 14 January 1999 c 298, c 300 This provision provides that any power of the Secretary of State to make regulations under the 1992 Act except under s 80, 154, 174 & 178 "where the power is not

For his part Lord Higgins raised the wider question why the operation of National Insurance is to be transferred to the Inland Revenue: "one would have thought it was more appropriate to transfer it to the Chancellor of the Exchequer."[107] In response, Baroness Hollis said the following:

> Perhaps I can offer the noble Lord a short [answer]. Parliamentary accountability will not be diluted. The person responsible to Parliament for this activity is the Paymaster General. That will continue. However, the operational day-to-day functions will be exercised by the Board of Commissioners of the Inland Revenue. Of course, all high-level policy issues will be determined by the Chancellor, as the noble Lord, Lord Higgins, will know … Nothing else is happening here that does not already exist; for example the Child Support Agency, the Next Steps Agency and so forth …
>
> [Parliamentary responsibility for] the day-to-day running of the Contributions Agency as an operation … would [rest with] the Paymaster General and, if it raised high level issues, the Chancellor. As and when policy for NICs is handed over, it would be the responsibility of the Paymaster General through to the Chancellor. That is on the collections side. The disbursement of those revenues in terms of social security spend will remain the responsibility of the Secretary of State for Social Security.[108]

**Clause 3** brings contributions under the care and management of the Inland Revenue and places the Inland Revenue under a duty to collect contributions. It amends legislation which governs the role and functions of the Inland Revenue and the powers and duties of its officers.

For critics of the Bill - concerned that NICs are to be treated just like a tax in future - the Lords' discussion of clause 3 may go some way to allay their fears. The Inland Revenue's statutory responsibilities are established under the *Inland Revenue Regulation Act 1890*; section 1 provides for the Revenue's Commissioners to be appointed, "for the collection and management of inland revenue." Section 39 of the 1890 Act defines the term: "Inland Revenue means the revenue of the United Kingdom collected or imposed as stamp duties, taxes, … and placed under the care and management of the Commissioners." Clause 3(1) of the Bill states that "contributions shall be under the care and management of the Board". Clause 3(2) goes on to state that the definition of inland revenue provided by the 1890 Act "shall be taken to include contributions."[109]

In opposing an amendment to delete clause 3(2) from the Bill, Baroness Hollis pointed out that both subsections are necessary, because of the nature of NICs:

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expressed to be exercisable with the consent of the Treasury, shall if the Treasury so direct be exercisable only in conjunction with them."

107 HL Deb 14 January 1999 c 287

108 HL Deb 14 January 1999 cc 296 - 297

109 Clause 3(3) provides a list of sections of the 1890 Act which are excluded from applying to contributions. In some cases comparable legislation already exists in relation to contributions, while in other cases the section no longer applies to income tax and would not be suitable in relation to contributions. *op.cit.* c 306

> If NICs were a tax, subsection (1) on its own would be sufficient to complete the transfer of functions to the Inland Revenue that is effected by the Bill. But NICs are not a tax, which is precisely why subsection (2) is needed. It adds NICs to the statutory provisions covering the exercise by the Inland Revenue of its tax functions. Without it, some other means would be needed to fulfil a key purpose of the Bill, to enable the Inland Revenue further to integrate the arrangements for the collection of NICs into those for the collection of tax.
>
> I can assure the Committee that subsection (2) does not merge tax and NICs but merely brings their administration together in one body. In deleting subsection (2), this amendment would omit a key step in the transfer of functions to the Inland Revenue that is to be effected by this Bill, and, incidentally, could put at risk the collection of some £2 billion of NICs money, which I am sure the noble Lord would not wish to be a party to.[110]

**Clause 4** introduces Schedule 4 which is concerned with methods of enforcing the recovery of unpaid contributions. It enables summary proceedings to be taken in magistrates' courts in the same way as for tax debts. Schedule 4 also permits authorised officers of the Board who are not lawyers to appear in proceedings in the county courts (in England, Wales and Northern Ireland) and in the sheriff court in Scotland. These provisions were added to the Bill at the Report stage in the Lords. Baroness Hollis gave the following summary of their effect:

> The amendments give the Inland Revenue, from next April, access to exactly the same methods of enforcing the recovery of unpaid NICs as it currently has for tax. The amendments permit summary proceedings for the recovery of smaller NIC debts in magistrates' courts. They also give authorised officials who are not lawyers the right to take county court proceedings.
>
> I shall set out the current position. Tax enforcement provisions currently apply for the recovery of unpaid contributions that are already collected by the Revenue--that is, 94 per cent. of total NICs. But the procedures available to the Contributions Agency to gather in the other 6 per cent. are currently not as comprehensive as they are for tax. We are talking principally here of flat-rate Class 2 NICs paid by the self-employed and that part of Class 1A NICs paid directly to the Contributions Agency.
>
> Apart from the use of proceedings in the High Court for very large NIC debts, the only method the Contributions Agency has to enforce the recovery of unpaid NICs is having DSS lawyers take county court proceedings, or sheriff court proceedings in Scotland. In the Social Security Act 1988 those powers were supplemented to allow officials to recover contributions by distraining on the goods of debtors and by the equivalent process under Scottish law, thereby

[110] HL Deb 14 January 1999 c 304

> bringing recovery procedures for NICs a step closer to those which have long been available for tax.
>
> We propose now to complete the alignment process begun last year in time for the transfer by extending NICs recovery powers in two ways. The first is to allow summary proceedings for the recovery of NIC debts under £2,000 to be taken in magistrates' courts in England, Wales and Northern Ireland. Again, that mirrors existing tax law. The Revenue's experience is that summary proceedings are an effective way of collecting small debts. They are likely to be the most effective way of collecting unpaid Class 2 NICs from the self-employed. Your Lordships will recall that the recently published report of the Comptroller and Auditor-General on the National Insurance Fund expresses concern about the high level of Class 2 arrears. This proposal directly addresses that concern, as well as being fully justified in its own right. No Scottish equivalent of the proposal is needed, as last year's Social Security Act has already made provision for equivalent recovery action to be taken there.
>
> The other proposal is to give officials who are not lawyers the right to conduct proceedings in the county court, and in the sheriff's court in Scotland, to recover NICs. Collectors of Taxes already have that power for tax and indeed for the NICs that are recovered through the tax system.
>
> That change will avoid the need for Revenue lawyers to scurry around the country at public expense to conduct proceedings that are normally of a quite routine character. That would be a waste of scarce and expensive resources and will be a greater waste when recovery proceedings, which currently have to be taken in the High Court, are devolved to county courts.[111]

**Clause 5** introduces Schedule 5. This amends certain powers of enforcement relating to contributions, SSP and SMP for Inland Revenue officers to exercise alongside their existing powers of enforcement in relation to tax.

During Committee particular concern was expressed that Inland Revenue officers would have greater powers than their counterparts in the CA to enter premises for DSS purposes, because the wording of the Bill referred to Revenue officers' existing powers to enter premises - as well as those transferred to them. As Baroness Hollis explained, in accepting an appropriate amendment to the Bill, this was not the Government's intention:

> Section 110 of the Social Security Administration Act permits the Secretary of State to enter into arrangements with any other government department. Under those arrangements the officers of the latter may act on behalf of the DSS, using DSS powers to enter premises, inspect them and obtain information there for DSS purposes. The only condition is that the premises in question must either be subject to inspection by officers of the other department under their own powers, or be under the control of that other department.

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[111] HL Deb 25 January 1999 cc 815-816

> Currently officers in the Contributions Agency may be asked by their colleagues in the Benefits Agency to visit employers to check on the earnings of employees who have made income-related benefits claims. No special power is needed to permit co-operation of this nature as both agencies are part of the same department.
>
> After the staff of the Contributions Agency move to the Revenue, co-operation of this kind remains as desirable as ever to counter potential fraud. But once the staff involved belong to different departments, special provisions are needed to enable those of one department to gather information for the purposes of the other. The purpose of this measure (paragraph 2 of Schedule 4) is to enable that co-operation to continue.
>
> However, I can see why some Members of the Committee, particularly the noble Lord, Lord Higgins, might be concerned that paragraph 2 goes beyond what is needed for the purposes I have just described. For example, officers of the Inland Revenue expert in the valuation of property have for many years had the power to inspect premises for the limited purpose of making valuations needed in connection with those taxes for which the Revenue is responsible, for business rates or for council tax.
>
> I accept that an argument could be constructed whereby all such premises could be regarded as liable to inspection by any Revenue official on behalf of the DSS. This is not our intention. I am therefore happy to accept Amendment No. 20, as Inland Revenue officers will still be able to inspect premises on behalf of the DSS where the Inland Revenue controls those premises, or where its officers have reason to inspect them for the purposes of NICs or other transferred functions, which fulfils our intentions.[112]

The Government introduced a second amendment at the Report stage, in line with these concerns, to subsection 3 of this schedule, which details the premises liable to be inspected. Originally this had prohibited an inspection of "any private dwelling house not used by, or by permission of, the occupier for the purposes of a trade or business." As Baroness Hollis explained, "we have decided to substitute the wording in Section 110B(5) of the Social Security Administration Act 1992 … with the necessary addition of a line to include premises from which a personal or occupational pensions scheme is being administered. The revised wording … makes clear that if business records are kept both at home and in the office, the inspector's visit must be to the office."[113]

**Clause 6** introduces Schedule 6 which amends existing social security and tax legislation, setting out the powers to exchange contributions information following the transfer.

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[112] HL Deb 14 January 1999 c 307 Baroness Hollis is referring to the provisions that now appear in paragraph 2 of Schedule 5 to Bill 38.

[113] HL Deb 25 January 1998 cc 833-834

Existing flows of information will be protected without creating new, additional exchanges of information.

**Clause 7** allows the Inland Revenue to pool, internally, information obtained in connection with functions transferred by this Bill with the information from its tax functions.

Concerns about the pooling of information were raised by Lord Higgins on the Second Reading,[114] and in more detail on Committee. In particular, Lord Higgins was concerned that the clause allowed information held by the Board "to be supplied to any person *providing services to the Board*", for the functions of the Board in relation to tax, and those other functions transferred to it by the Bill. Might not the provision "lead to some leakage of otherwise confidential information to people who might misuse it?" Baroness Hollis gave the following response:

> The overall intention of Clause 6 is to enable the Board to make appropriate use of the information which is available to it for carrying out its various functions ... It includes being able to pass information freely to the contractors who provide the board with services, with the proviso always, of course, that the information can be used by those contractors only for the purpose of providing services to the board. Those service providers are contractually bound to keep data confidential. I absolutely understand the noble Lord's concern; he was worried about leakage and therefore whether there would be a risk of or temptation to impropriety.
>
> The provision mirrors and in fact is based on that in Section 3 of the Social Security Act 1998. That section allows the pooling of information held by the Secretary of State for Social Security in respect of social security, child support and war pensions. It also specifically allows the Secretary of State to supply any such information to a person providing services for use in connection with the exercise of functions for social security, child support or war pensions …
>
> I should stress that, as with the existing Section 3 of the Social Security Act 1998, there is no question or should be no question of confidential information being passed to contractors for indiscriminate use. The sole use which can be made of such information is in relation to the services provided to the Inland Revenue by the contractor. The contractor in those circumstances is doing no more than acting on behalf of the Inland Revenue.[115]

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[114] HL Deb 10 December 1999 c 1046

[115] HL Deb 14 January 1999 cc 317-318 Baroness Hollis made clear in a later exchange that "contractors" were primarily the providers of computer services to the Revenue [*op.cit*. c 318]

## 1. Information Technology & the Contributions Agency

During the Second Reading of the Bill, Baroness Anelay of St. John's raised the issue of the timing of this transfer, and whether it might be too rushed, given the recent technical problems that the DSS has had with its new National Insurance Recording computer system.

> Can this transfer be carried out effectively? I am something of an IT anorak, but even I can appreciate the potential in the Bill for bureaucratic and IT meltdown … Public confidence in the use of IT in complex DSS operations has been shaken by the current fiasco of the computer glitches at the DSS which has left millions of personal pension holders being owed well over £1 billion by the Government. New computers, which were set up to deal with the NI records of the entire nation, are sadly in a shambles after a summer of turmoil … How confident are the Government that that will be a one-off problem with large computer systems, and how will they ensure that similar problems cannot plague the transfer of functions which will follow the passage of the Bill?[116]

The issue was also raised by Lord Higgins at the Committee stage, during the debate on Schedule 1 of the Bill:

> I thought that it would be helpful at this stage to ask whether or not this is an appropriate moment to transfer the operation from the Department of Social Security to the Inland Revenue … would that be a sensible move when the computer, which I gather is a massive computer, is not operating effectively? It may well be that the department which has been operating it so far is in a better position to sort out the problem and then to transfer at a later date.[117]

The background to this issue was given in a long written answer in November 1998, reproduced below:

> **Mr. Rendel:** To ask the Secretary of State for Social Security what has been the cause of the problems with the NIRS2 computer system.
>
> **Mr. Darling:** The Contributions Agency (CA) has recently introduced a new National Insurance Recording computer system (NIRS2). The old NIRS1 system had to be replaced because it was ageing and could not support future business and legislative changes, in particular those associated with the 1995 Pensions Act. The new system is designed to collect contributions, hold 65 million individual contribution records, calculate contributory benefits, provide data to many other Government Agencies, and pay age-related contribution rebates to Private Pension Providers. It is one of the biggest systems in Europe, with over fourteen million lines of computer software.

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[116] HL Deb 10 December 1998 cc 1067-1068
[117] HL Deb 14 January 1999 c 287

In April 1995 Andersen Consulting was awarded a contract, under Private Finance Initiative (PFI), to replace NIRS1. The replacement system is the first major IT contract to be delivered under PFI. Under the terms of the PFI contract Andersen Consulting has borne all of its own costs in getting the system accepted and has not been paid for operating the new system until it was accepted. Payments for providing the new system did not commence until 13 July. The original plan was to replace NIRS1 completely in February 1997. However, in March 1998 Andersen Consulting made a supplementary proposal to phase implementation, in order to reduce the technical and business risks. Therefore, the contract was varied, including financial compensation arrangements, to reflect this phased implementation between February 1997 and April 1999. This variation was documented in the National Audit Office report of May 1997. The contract letting and the phasing variation are fully covered in the 46th report of the Public Accounts Committee published on 17 September 1998.

Because of the scale, complexity and sensitivity of the NIRS2 system it has been thoroughly tested prior to acceptance by CA. During the first year of operation the system is being introduced through a series of pilots leading to national implementation. Contingency plans were developed by both CA and Benefits Agency (BA) in order to accommodate the phased implementation and the attendant difficulties. These plans have been systematically updated to ensure minimum impact on contributors and benefit claimants. In June 1998 data were transferred from the NIRS1 system to NIRS2. Andersen Consulting estimate that over four billion data items were successfully transferred before NIRS2 went live. Since then there have been some implementation problems; however, as I said in my letter of 11 September to Members of the House, no data have been lost and no records have been destroyed. On 13 July 1998 the majority of the new system was switched on. After three weeks pilot several major business processes were implemented nationally. For example NIRS2 has read over 40 million items from end of year returns supplied by employers, posted over 14 million national insurance contributions for 1997-98, paid out over £630 million in age related rebates to holders of personal pensions and billed and/or collected over £230 million in National Insurance contributions from the self employed. The CA is still piloting some key business processes.

On 14 September 1998 further parts of the system were switched on. Since then there has been a focus on piloting the links into the benefits systems. It is expected that the links to Jobseekers Allowance and Incapacity Benefit will start nationally in November. Andersen Consulting has submitted a plan that, subject to a satisfactory outcome from the current pilot exercise, enables the links to pensions and long term benefits to be available from December for implementation in early 1999. To reach this milestone problems identified during the pilot running of these functions critical to benefits must be cleared. These include the calculation of benefit entitlement for some cases, these are currently under investigation by Andersen Consulting.

As a result of the extended transition and pilot period there have been problems for some people making claims to Jobseekers Allowance, Incapacity Benefit, Retirement Pension and Widows Benefit. Ninety five per cent. of new and repeat

claims for JSA are being cleared using information from other DSS systems, from the claimant or by the award of an interim payment. An interim payment is made where the actual contribution position cannot be confirmed and an amount equal to the benefit rate is paid. The remaining 5 per cent. are currently being processed. Ninety five per cent. of new claims for Incapacity Benefit are being cleared using information from other DSS systems, and the claimant. The 5 per cent. claims remaining are being processed or have been referred to Income Support. All interim payments and cases referred to Income Support will be reviewed when the NIRS2 system is fully implemented.

Most new Retirement Pension claims, an estimated 97 per cent. are being cleared using NIRS1 information. Because 1997-98 contributions are not being taken into account most claimants will be receiving initial awards. An initial award is a pension assessment based on the contribution information available at the time, in most cases the initial award of basic pension is likely to be correct or an underpayment of £1.25 a week. All initial awards will be reviewed as soon as the NIRS2 system is fully implemented and their 1997-98 contributions are posted. It is usual practice to make initial awards of benefit while waiting for additional contribution information. However, more cases than usual are being affected and claimants will have to wait longer before their retirement pension is finalised. In the remaining 3 per cent. of claims, where the Benefits Agency has no record of a claimant's contribution history, emergency payments equal to the basic pension rates can be made. All emergency payments will be reviewed when the contribution information is available.

Where there are unresolved issues relating to contracting out of State Earnings Related Pension Scheme (SERPS) some pensioners will be underpaid between a penny and a maximum of £100 a week. The Benefits Agency is undertaking clerical calculations in cases of hardship. For Widows Benefit it is estimated about 10 per cent. of new claims are being cleared using information available to the Benefits Agency and the remaining 90 per cent. of new claims are being cleared by initial awards or emergency payments. All initial awards and emergency payments will be reviewed when NIRS2 information is available. Where benefit payments are delayed as a result of the problems with NIRS2 payment of compensation will be automatically considered within the normal rules of the Department Special Payments Scheme. Where there has been an adverse effect as a result of the NIRS implementation on CA customers, compensation payments are being considered in line with normal procedures.

Considerable effort has been jointly made by DSS Agencies, private sector, pensions industry and Andersen Consulting to maintain service levels. All the work involved is being taken forward through a co-ordinated plan agreed between the DSS Agencies involved and Andersen Consulting. The key priority is to ensure that full normal operations can resume as soon as possible. It is expected that this will take until the end of this financial year. It will take longer to catch up on all backlogs. Within the plan, priority is being given to those

> aspects of the NIRS2 system, which most directly affect benefit claims. I shall keep the House informed of progress.[118]

In responding for the Government to Baroness Anelay's concern, Baroness Hollis suggested that the transfer of the CA to the Revenue would have a minimal impact on the IT systems of both organisations, a matter that she underlined during Committee:

> Like the noble Baroness, I am an anorak or a windcheater nerd when it comes to IT systems. We are transferring the existing CA business, and with it the existing IT system, over to the Inland Revenue. I am told that the only main change will be the heading on the stationery--it will no longer read "CA" or "DSS", but "IR". In other words, the systems go over as they currently stand … I agree with the noble Baroness that if we were to see a repetition of the NIRS experience, it would be extremely worrying. I am assured that NIRS is not relevant to this consideration. As I said, there will be a limited impact; we have well-developed programmes within IR and the amount of IT change that is required is trivial because the system will be taken over as a package in its existing form.[119]
>
> *
>
> The problems that we have experienced with the late running of the NIRS 2 contract are undeniable. Although stabilisation plans are under way, I understand that as at 1st January, while a total of £1.4 billion of age-related rebates had been paid, it equates to about 60 per cent. of the figure paid this time last year. I do not seek in any way to diminish the problem associated with NIRS 2, but it does not affect this Bill. The responsibility for its administration--ring-fenced so to speak--simply transfers from one section of the Civil Service to another and has no necessary implications (whatever one wishes) for the better or more efficient, or worse or less efficient, running of the computer. The project and its operation and co-ordination with Andersens simply transfers across. Although we hope that those problems will be addressed quickly, they will be addressed neither more nor less rapidly by virtue of this switch than they would have been if it had remained within the responsibility of DSS.[120]

As Baroness Hollis points out, the contract for the NIRS 2 system is to be managed by the Inland Revenue. Provision for this is made under **clause 21** of the Bill, which covers the transfer of contracts made with the CA, which provide for the supply of goods and services to both the CA *and* to other parts of the DSS (for example, office accommodation and office services are often supplied to both the CA and the Benefits Agency under the terms of the same contract). The clause provides two options for treating these contracts, dependent on whether the Inland Revenue is to gain wholesale

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[118] HC Deb 4 November 1998 cc 603-606W For those who are interested, Baroness Hollis provided a detailed explanation at the Report stage of the Bill of those who have been affected by the delays of NIRS 2 [HL Deb 25 January 1999 cc 804 - 811].

[119] HL Deb 10 December 1998 c 1075

[120] HL Deb 14 January 1999 c 289

access to the contract (as it is in the case of NIRS 2), or not. Baroness Hollis described the operation of the clause during Committee:

> Subsection (3) provides that in these cases the contract will continue to be with the Department of Social Security but that the Contributions Agency can continue to receive goods and services under that contract once it is part of the Inland Revenue. It does not allow the Inland Revenue to gain wholesale access to DSS contracts.
>
> However, we accept that in some cases the contract may relate sufficiently largely to transferred functions, as opposed to retained functions, that it would be appropriate for the Inland Revenue to take over management of that contract. So subsections (4) and (5) provide an alternative option. Certain contracts, specified by order, can be treated as exceptions to the rule and transferred to the Inland Revenue, while allowing the Department of Social Security to continue to receive benefits under that contract.
>
> There are two main contracts we intend to specify in such an order. The first is the contract for the new National Insurance Recording System - NIRS2. Noble Lords will be aware of the difficulties that there have been. The Contributions Agency has been managing the contract with Andersen Consulting to develop and run the NIRS2 system on behalf of the department. We have concluded that NIRS2 is so integral to the work of the Contributions Agency that, while it provides information to the other DSS agencies, it would be most appropriate to transfer the contract for its development and maintenance to the Inland Revenue with the Contributions Agency.
>
> The other main contract is that with the Newcastle Estates Partnership for the redevelopment of the Longbenton estate in Newcastle. Although the other DSS agencies occupy parts of the Longbenton estate, the Contributions Agency is the principal occupier and has been managing the contract on behalf of the other agencies. So we intend that this contract will also transfer to the Inland Revenue.[121]

At the Report stage of the Bill, Lord Higgins put down an amendment to delay the transfer of the NIRS 2 contract to the Revenue, until the system was fully operational, with all NICs records installed, and no benefit payment based on NIC records to "be outstanding for more than one month." In introducing this measure, he said:

> The amendment seeks to impose conditions so that the transfer should not take place from one department to another until the department from which the computer is being transferred has sorted out the substantial problems which it now emerges exist in the department. It seems clearly inappropriate to switch it from one department to another and from one Minister to another without the

[121] HL Deb 14 January 1999 c 336

> situation having been rectified … it is important that the matter should be put right rather than put right fast or not put right because of the hurry.[122]

In responding, Baroness Hollis explained when NIRS 2 was expected to be fully operational, and why, in the Government's view, delaying the transfer of the contract would not significantly improve on this deadline:

> Our current plans and those of Andersen Consulting are that the whole system will be available by the end of the financial year; that is, by the end of March. So … NIRS will be operational in any case by the time the Contributions Agency transfers to the Inland Revenue …
>
> I do not see anything to suggest that [deferring the transfer would significantly improve the chances of getting NIRS2 fully operational much more quickly] … The first reason … is simply that the transfer does not impose any significant additional burden on the system. The changes needed are relatively minor, largely to ensure that forms are correctly labelled and written; for example, changing an address at the top of a piece of paper. The second reason is that we have decided that those responsible for managing the system and managing the negotiations with Andersen Consulting will transfer to the Inland Revenue … The recovery plans will continue across the Benefits and Contributions agencies and will be overseen by senior officials from both the Department of Social Security and the Inland Revenue, as now.
>
> The third point is that it is not as if problems with the NIRS2 system have been identified only at this late stage. They were first identified last summer and we have therefore been able to plan the stabilisation and recovery arrangements for NIRS2 alongside the plans for the transfer … The final point is that plans for the March changes to the system are well in hand. These involve changes other than those relating to the transfer but which need to be made at the same time. There could be additional risk and additional cost if some of the changes go ahead in March but not those relating to the transfer.[123]

The issue was also raised on the Third Reading, when Lord Higgins moved a similar amendment. Baroness Hollis took the opportunity of giving further details on the compensation package for those retirement pensions and widow's benefits have been affected by the delays in fully installing NIRS 2:

> At Report stage we discussed compensation for those suffering delay through the problems with the NIRS2 system. Last week in another place the Public Accounts Committee also pressed the issue of compensation[124] … As I said on Report, we shall be paying arrears and, in that sense, there will be no loss. But we intend to go further. We intend to relax the current departmental guidelines, which require

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[122] HL Deb 25 January 1999 cc 801-804

[123] HL Deb 25 January 1999 cc 811-812

[124] PAC, *National Insurance Recording System: Minutes of Evidence*, 1998-99 HC 182-i 25 January 1999, HC 182-ii 27 January 1999

> a lengthy period of delay in payment and provide no compensation where the amount due is less than £10. Because of the one-off nature of the NIRS2 problem we propose a one-off solution. In any payment system there are inevitable delays, such as where details need checking or where an address has changed. But where people have suffered unreasonable delay they will receive a minimum £10 payment on top of the arrears. Those due larger amounts within the normal departmental guidelines will of course receive them. The compensation will be paid automatically where cases are reviewed. That will necessarily take time.[125]

## B. Part II : Decisions and Appeals

Part II of the Bill introduces new arrangements for decisions and appeals relating to National Insurance contributions, statutory sick pay (SSP), statutory maternity pay (SMP) and contracting-out matters. Decisions about these matters are to be made by the Inland Revenue, with a right of appeal to the tax appeal Commissioners, except in relation to contracting-out, where claimants may make an appeal to the unified appeal tribunals to be set up under the Chapter I of Part I of the Social Security Act 1998 (SSA).

**Clause 8** specifies the decisions to be made by an officer of the Inland Revenue.

**Clauses 9 and 10** enable the Inland Revenue to make regulations in connection with the decision-making process and to provide for decisions to be varied or superseded in certain circumstances.

**Clause 11** provides for rights of appeal to the tax appeal Commissioners against decisions made under clause 8 or by virtue of clause 10.

**Clause 12** provides for the manner in which an appeal is to be brought, and for the circumstances in which an appeal is to be dealt with by the Special Commissioners rather than the General Commissioners.

**Clause 13** provides for regulations to be made by the Inland Revenue in relation to appeals to the tax appeal Commissioners, and for the application, with appropriate modifications, of provisions of the Taxes Management Act 1970 (TMA) and regulations under it, relating to such appeals.

**Clause 14** enables the Inland Revenue to make provision in regulations about a person's right to SSP or SMP or his/her liability for contributions pending, or in consequence of, a decision made by one of its officers, or the determination of an appeal.

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[125] HL Deb 1 February 1999 c 1290 Further details were given in a press notice issued at the time (Department of Social Security press notice 99/022, 1 February 1999).

**Clause 15** enables the Secretary of State to make transitional provisions in connection with decisions, and appeals, for the period between the day appointed for the coming into force of clause 8 and the coming into force - possibly less than a year later - of Part I of SSA (which provides for new arrangements for decision-making and appeals about social security matters).

**Clause 16** makes provision for the Inland Revenue, instead of the Secretary of State, to make decisions about matters arising in connection with the contracting-out arrangements under the Pension Schemes Act 1993 (PSA), and related matters. However, Part I of the SSA (once it is in force) is in all other respects to apply to such decisions in the same way as if they had been made by the Secretary of State under that Act.

**Clause 17** allows the Inland Revenue to make decisions as agents of the Secretary of State in relation to "home responsibilities protection" and "credits", both of which affect a person's contributory record and hence benefit entitlement.

**Clause 18** introduces Schedule 7 which contains amendments - principally of the TMA, the Social Security Contributions and Benefits Act 1992 (CBA), the Social Security Administration Act 1992 (SSAA 1992) and the SSA - in connection with the new arrangements for decisions and appeals provided for in Part II of this Bill. Some of these amendments will be brought into force after the day appointed for the operational transfer, so as to fit with the progressive entry into force of the SSA provisions.

**Clause 19** contains definitions in connection with the tax appeal Commissioners.

## C. Part III : Miscellaneous & Supplemental

Part III of the Bill deals with miscellaneous and supplemental issues.

**Clause 20** provides for National Insurance rebates for contracted-out occupational money purchase pension schemes to be funded from the NIF, and for any rebate-associated recoveries to be paid into that Fund. It also provides for the NIF to reimburse the Consolidated Fund for the monies it has paid out in respect of such rebates in the current financial year. Corresponding changes are also made to the Northern Ireland legislation.

The background to this measure was set out in a written answer in November 1998, when the Government set out its intention to deal with an error in the *Pensions Act 1995*:

> **Mr. Derek Twigg:** To ask the Secretary of State for Social Security if he will make a statement about the funding of age-related rebates in respect of members of contracted-out money purchase schemes.
>
> **Mr. Denham:** Employers who operate contracted-out occupational pension schemes provide their employees with a pension to replace the pension they would have got had they remained in the State Earnings Related Pension Scheme

(SERPS). In contracted-out occupational schemes, both employer and employee pay lower rate National Insurance Contributions in recognition that full SERPS will not be paid. In a Contracted-Out Money Purchase Scheme (COMPS) part of the rebate is deducted from the national insurance contributions due by the employer. The remainder, known as the age-related rebate, is paid by the Contributions Agency to the pension scheme in the tax year following that in which it is due. Section 42A of the Pension Schemes Act 1993 (PSA) provides the legislative authority for the age related rebate to be paid by the Secretary of State for Social Security to the pension scheme.

This section was inserted into the PSA by the Pensions Act 1995. The intention is that these payments should be funded directly from the National Insurance Fund and classed as revenue forgone. However, the necessary provision to facilitate funding in this manner was erroneously omitted from the Pensions Act. So while there is a legislative duty to make the payments, there is no authority to fund them from the National Insurance Fund. As result a number of ultra vires payments have been made from the National Insurance Fund totalling around £490,000 which will have to be refunded from money voted by Parliament.

An amendment to the PSA to correct this defect will be put before Parliament. This will allow the payments to be funded properly from the National Insurance Fund in accordance with the original intention. Until the provisions are enacted temporary arrangements are necessary to ensure that the payments can continue to be made. Provision will also be made to ensure that the National Insurance Fund reimburses those accounts responsible for funding the payments up to the time when the legislation was brought into force. Legislation under s177(1) of the PSA does, by default, allow the payments to be paid from money provided by Parliament. Since Parliament did not envisage using provision in this way the ambits of the DSS Votes do not cover age related rebates. A Supplementary Estimate is therefore needed to extend the ambit of Class XII, Vote 2. A token Supplementary Estimate of £1,000 has been sought on Vote 2 to amend the ambit to enable payments, totalling £82 million, to be made to Contracted-Out Money Purchase Schemes in respect of age related rebates.

As the Contributions Agency computer system, NIRS2, does not have the functionality to separate the payments in respect of age related rebates, which are paid in conjunction with personal pensions, Vote 2 will, therefore, also be responsible for paying personal pensions. The National Insurance Fund which does have the legislative power to pay personal pensions will refund Vote 2 for the payments made on its behalf. These arrangements will continue until the defective legislation is corrected. An advance of £77 million has been sought from the Contingencies Fund to finance urgent expenditure. The advance will be repaid from Vote 2 when Parliament has approved the necessary token Supplementary Estimate.[126]

[126] HC Deb 5 November 1998 cc 649-650W

**Clause 21** provides for property, rights and liabilities associated with functions being transferred by the Bill to be transferred from the Secretary of State to the recipient of the functions in question.

In Committee Lord Higgins questioned the wording of subsection 3 to this clause, which provides that in cases where property has been transferred, the recipient, be that the Revenue, or the Treasury, may issue a certificate to this effect, which will be "conclusive evidence of the transfer." "If assets are to be transferred, it appears to be the recipient rather than the donor who is going to certify that the transaction has been completed. It seems more appropriate, if a certificate is to be issued, that it should be issued by the Department of Social Security rather than by the Inland Revenue or the Treasury which are coming into the assets."[127] Baroness Hollis provided the following explanation:

> Like any organisation, the Contributions Agency owns property, receives goods and services under contracts and has liabilities. As an agency of my department it does so on behalf of the Secretary of State for Social Security. Our underlying objective is to ensure that the Contributions Agency can take these property rights and liabilities over to the Inland Revenue so that it has all the necessary goods and services to enable it to continue its work …
>
> Let us say that in five years' time a company wishes to buy a piece of land from the Inland Revenue which was formerly Contributions Agency property. The company would wish to satisfy itself that the Inland Revenue was the legal owner of that land. In order to do so, its solicitors would need to check through the provisions of the Bill to link the land with functions transferred to the Inland Revenue. That would be a complex and expensive task. The certification procedure cuts through that and provides a simpler mechanism for verifying the ownership of the land; the Inland Revenue would simply supply the company with such a certificate and that would make clear that the new owner had good title to the land. This is based on a standard wording used in provisions transferring functions. Members of the Committee may be familiar with the National Health Service and Community Care Act 1990. This permitted transfers of functions to set up new health authorities and Section 8(8) of that Act included a similar certification procedure.[128]

**Clause 22** makes provision for the transfer of rights and liabilities under contracts which relate partly to functions transferred to the Inland Revenue and partly to functions retained by the Secretary of State.

**Clause 23** enables any future transfers of functions relating to certain contributions, the NIF, SSP, SMP and contracted out pension matters between the Secretary of State and the Inland Revenue to be made by Order in Council. Concerns were expressed that this

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[127] HL Deb 14 January 1999 c 334
[128] HL Deb 14 January 1999 cc 334-335

power was, in the words of Lord Higgins, "extraordinarily wide". Baroness Hollis responded as follows:

> Identifying and stripping out the NICs functions of the Secretary of State for Social Security is no easy task. Although in some cases the function is clearly related to NICs and therefore should be transferred, in other cases, particularly around the periphery of NICs, the distinction is much more difficult to draw. Further, whether a particular job is done in the Contributions Agency rather than the Benefits Agency is sometimes as much a matter of history as of current preferences. We have had to make a judgement about whether the function should stay with DSS or be transferred to the Inland Revenue. I hope that we have made the right judgement on these issues. But there is no right and wrong answer and, weighing the probabilities, it is possible that, in the light of operational experience, we may conclude that we have drawn the boundary in a slightly awkward place and that further adjustments are desirable to ensure the better operation of the legislation and delivery of services by the Government …
>
> One example, which the noble Lord, Lord Goodhart, has already raised, is the appropriate tribunal for hearing appeals on contracted-out matters.[129] We have made a judgement on that. If the fears of the noble Lord, Lord Goodhart, are realised, this provision allows us to rectify the position.
>
> Clause 22 provides a mechanism for making these adjustments. It does so by providing a power similar to that in the Ministers of the Crown Act 1975, but tightly limited to the subject of this Bill. As with the Ministers of the Crown Act 1975, this power is to be exercised by way of an Order in Council. That will mean that the adjustments can be made without needing to return to Parliament with a whole Bill.
>
> An order under this clause can transfer functions between the Secretary of State and the Inland Revenue and vice versa. It can set up new requirements for concurrence in the exercise of those functions; it can transfer responsibility for making decisions on various matters between the Secretary of State and the board and vice versa, and switch the route for appealing against such decisions between the unified appeal tribunals under the Social Security Act 1998 and the tax appeal commissioners. The three amendments remove in turn the first three of these powers.
>
> I should point out that Clause 22 does not allow orders to transfer functions between the Secretary of State and the Treasury - only the Secretary of State, or

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[129] Lord Goodhart had argued that appeals against decisions concerning contracting out should be made to the Revenue, and not to a DSS unified appeal tribunal (UAT), as provided for in the Bill [clause 16(6) of Bill 38]. Baroness Hollis had resisted the suggestion, arguing, "we need a decision and appeal-making system which ensures that when appeals arise they are deal with by the body which can best respond to the needs of the appellant. UATs will handle SERPS appeals; and experience has shown that questions about the contracted out pension … often arise as subsidiary points to the main SERPS appeal … We do not think it would be right to send those appeals to tax commissioners who have not expertise in that area and do not deal with benefits." HL Deb 14 January 1999 c 329

> the DHSS(NI), and the Inland Revenue. As I explained earlier, functions can already be transferred between the Secretary of State for Social Security and the Treasury by order under the Ministers of the Crown Act 1975. Only the Inland Revenue does not have such a power. So we need no separate provision here to permit that.
>
> I can well understand that noble Lords would seek constraints on what can be achieved by an order under this clause. These are set out in subsection (2) as functions relating to contributions and the National Insurance Fund, other than core activities such as the receipt of contributions and the control and management of the National Insurance Fund, together with functions relating to statutory sick pay, statutory maternity pay and contracting-out. So I hope noble Lords will recognise that Clause 22 does not provide a general power to transfer functions between the Secretary of State and the Inland Revenue. Indeed, we would anticipate that any exercise of this power would be very much at the edges of those functions. I am therefore pleased that the Select Committee on Delegated Powers and Deregulation was content that the negative resolution procedure provided by the Bill is appropriate.[130]

**Clause 24** allows the transfer by Order in Council to the Treasury or, as the case may be, the Inland Revenue of any functions relating to Northern Ireland which correspond to the functions in relation to Great Britain transferred by virtue of clauses 1 and 2 of this Bill. There is also provision for the transfer to the Secretary of State of certain functions relating to Northern Ireland and for the onward transfer of some of these functions to the Treasury or the Inland Revenue. These provisions are drafted to accommodate any restructuring and renaming of Northern Ireland Departments that may happen before an Order is made under this clause. An Order may also make appropriate consequential or contractual modifications.

**Clause 25** provides that Orders and regulations under the Bill are to be made by statutory instruments. These may make different provision for different circumstances. It also provides that Orders in Council and regulations under the Bill are to be subject to the negative resolution procedure.

**Clause 26** introduces Schedule 8 (which provides for savings and transitional arrangements) and Schedules 9 and 10 (which provide respectively for consequential amendments and repeals).

**Clause 27** defines "the Board" and "contributions".

**Clause 28** sets out the short title of the Bill, provides for the commencement of its provisions and specifies which provisions of the Bill extend to Northern Ireland.

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[130] HL Deb 14 January 1999 cc 337-339