



Department
for Business
Innovation & Skills

NATIONAL MINIMUM WAGE

**Review of the policy changes to the
National Minimum Wage by the
Employment Act 2008**

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Executive Summary

Background

The aim of this paper is to evaluate the changes that were made to the NMW regime by the Employment Act 2008 as part of the process set out in the document 'Post Legislative Scrutiny – The Government's Approach (Cm 7320).¹

Research aims and design

The aim of the review was to consider the effect of the changes, and how successful they have been in delivering the objectives they were expected to achieve (including what has been effective and the barriers to effectiveness).

The review of the changes were based on the five elements outlined below.

1. Fair arrears regime

This is specifically exploring a) the changes to the collection of the arrears and b) practicality of the fair arrears enforcement regime in relation to what works well and any impediments.

2. Changes to the civil penalty in April 2009

The civil penalty was introduced as an enabler to compliance (by issuing a discount on the penalty to employers who pay arrears within 14 days of the NoU being issued) as well as having a deterrent function. However, a fundamental step to securing compliance is the level of awareness of NMW and the penalty regime. All of these factors will be examined.

3. Power to remove records

This civil power was extended to remove records (beyond being able to examine records and copy them at the employer's premises). This is available to and exercised by the NMW Compliance officers in the course of their duties and is used consensually.

The objective of this was to make the information gathering process more effective by counteracting the following problems encountered in the previous regime:

- a) Obstruction by employers

¹ <http://www.official-documents.gov.uk/document/cm73/7320/7320.pdf>

- b) No equipment available to photocopy material
- c) Too much information for the officer to copy at the relevant premises in the time available).

4. Search and seize powers

Officers in HMRC Criminal Investigation are able to obtain records using the Police and Criminal Evidence Act 1984 search and seize powers. The objective of this is to provide HMRC with coercive powers to search and seize for evidence. This will enable them to investigate the most serious allegations with a view to the submission of a file with sufficient/admissible evidence for the Crown Prosecution Service to consider whether a prosecution is appropriate.

5. Value for money

As the objective of the changes was to act as a punitive measure rather than to generate revenue, value for money considerations will only focus on whether we can modify the effectiveness of the current process (rather than assessing the cost of enforcement against the revenue generated from penalties or the amount of arrears collected).

A number of sources of information were used to measure the objectives including:

- Management information from HMRC
- The Pay and Work Rights Helpline
- Interviews with a range of HMRC staff
- Research into employers' attitudes and behaviour towards compliance with UK National Minimum Wage (NMW) Legislation²
- Understanding workers' behaviour in complying with the NMW³.

A process review was also undertaken to examine any changes to the operational processes since the introduction of the new enforcement regime to identify any unforeseen consequences and understand any obstacles/ good practice as a result. Any wider issues that could affect compliance with the enforcement regime were also explored.

² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32180/11-1335-research-employers-attitude-national-minimum-wage.pdf

³ <https://www.gov.uk/government/publications/national-minimum-wage-understanding-worker-behaviour-in-complying-with-the-law>

As in the case of most policy changes, once an intervention has occurred the counterfactual can't be observed. Therefore, the counterfactual in this review was the difference between before and after the policy change. A major limitation with this approach is, because of other factors outside of the changes made, a simple difference may over or under state the true effect (for example the recession may have led to lower volumes of complaints from individuals who fear losing their jobs and believe it will be harder to find a new job in an economic downturn). These extraneous variables were also explored in the review.

Fair arrears regime

Evidence indicated that workers receive a higher amount of arrears than they would have done under the previous regime. This suggests that the policy objective of ensuring that arrears take account of the amount of time that has elapsed since the original underpayment has been achieved.

The overall number of appeals have increased since the changes to the regime (though this may not be directly attributable to the policy changes). However, the number is relatively low (average of 3.5%) indicating that most employers do not formally complain about the amount of arrears and penalty issued. This may be due to the simplicity in administering the penalty and the way the arrears are calculated.

The Pay and Work Rights Helpline and the opportunity to talk to Compliance Officers face to face was seen as a positive element of the enforcement regime by workers. Emphasis was given to the fact that the worker could remain anonymous as an enabler to report underpayment.

A concern in relation to issuing a NoU was the difficulty in calculating arrears when the employer did not keep sufficient records or where employers purposefully provided inadequate records, thus making evidence gathering difficult and delaying the issue of a NOU. Furthermore, there is no tangible penalty for employers who keep poor records as opposed to an employer who keeps good quality records.

There was consensus that there is more incentive for the employer to cooperate with the investigation (or to provide sufficient records) prior to the issue of a NoU or where the investigation is being finalised after the end of a rate year (October). The enhancement goes up on 1st October (but only if NMW is increased). After 1 October there is no incentive to comply as the employer will not benefit from paying a reduced amount of uplift⁴. This can delay the issue of the NOU and subsequently the payment of the arrears to the worker⁵.

⁴ The uplift is the difference in what would have been paid prior to the policy change and after the change.

⁵ However, the uplift process does introduce an imperative around rate change (October) for the employer to resolve outstanding matters.

Issuing the NOU was reported as a lengthy process due to the following factors:

- The number of administrative procedures prior to issuing a NoU.
- The onus on compliance officers to check the employer records in the organisation before issuing a NoU as part of a wider approach to checking non-compliance.

In cases where the employer has made a genuine error, there was a mixed opinion in relation to whether a penalty should be discretionary. Some felt that it would be difficult to define genuine error (especially if an employer kept poor records). However, in these cases, where the arrears owed were small amounts it was felt that the associated penalty was not proportionate for small businesses.

Wider issues (outside the changes) that affected enforcement included employers lack of understanding the NMW and consequently how arrears were calculated. Consequently, compliance officers had to dedicate extra resource time to explain to the calculations. Lack of co-operation from employers was also highlighted as a problem as it made the evidence gathering process more difficult and time consuming. Finally, limited companies being struck off and put into administration were reported as an issue. Especially, after officers had reached the stage to issue or have issued a NoU, only to find the employer has been or is about to be closed down.

Changes to the civil penalty in April 2009

Enabler to compliance

The civil penalty worked fairly effectively as an enabler to compliance. Most employers (ranging from 59%-66%) paid back the arrears owed to workers within the 14 day window (thus taking advantage of a reduced penalty). However, the amount of time the workers wait for their arrears from when the case is reported has started to increase since 11/12. Reasons for this include cases becoming more complex, issues with HMRC resources, employer's lack of co-operation, a reflection of the economic climate and processes around preparing a NoU.

Deterrent to compliance

It may be concluded that the penalty regime did not seem to have a deterrent effect on non-compliance based on measures of non-compliance reported in this paper. Possible reasons for this could be employers' lack of awareness of the penalty regime and a lack of understanding about the NMW. Employers and workers reported difficulties in finding suitable guidance about the NMW. Broader issues outside the regime such as the recession were also reported to affect compliance. A fundamental step to securing compliance is the level of awareness of the NMW and the penalty regime.

Power to remove records

The introduction of the power to remove records had very little impact as this did not change the working practices of the COs. The process for removing records remained the same as prior to the changes. Employers were generally co-operative when asked to remove records therefore, this power did little to incentivise employers.

Search and seize powers

Search and seize powers have only been used once since their introduction as they are only used to investigate the most serious cases to support a prosecution⁶.

The criteria to meet when submitting cases for prosecution is high because of the need to prove the employer's guilt beyond reasonable doubt as in any criminal regime. Since the changes to the policy took place in 2009, there have been 3

Conclusions

Key points for consideration:

- The Government has recently introduced tougher civil sanctions by increasing the financial penalty and revising the naming scheme to target the more serious cases of non-compliance. Further to this, non-compliance at the other end of the spectrum could be reviewed taking into account proportionality, impact and the costs of these. Education and information for employers who are non-compliant *due to genuine error* may be a good way to address this (e.g. improve communication about the technical details of the NMW and how to apply the correct rate for different types of workers).
- Consider what more the government could do to help employers improve their record keeping and explore any incentives or sanctions for employers who refuse to co-operate with investigations.
- Continue to increase awareness of the enforcement regime for employers and workers.
- Explore how current enforcement processes could be improved to be less onerous for CO and employers.

⁶ This enabled HMRC criminal investigators to seize records which provided the offences for which an employer was convicted in March 2013.

1. Introduction

The aim of this paper is to evaluate the changes that were made to the NMW regime by the Employment Act 2008 as part of the process set out in the document 'Post Legislative Scrutiny – The Government's Approach (Cm 7320).⁷ The paragraphs below provide details of the Act.

1.1 Policy Background

The intention of the changes made to the NMW regime by the Employment Act 2008⁸, was to strengthen NMW enforcement in the following ways:

1. By changing the way arrears are calculated so that workers do not lose out in real terms as a result of underpayment ("fair arrears").

From 6 April 2009, workers who have been underpaid the NMW are entitled to have arrears repaid based on *current rates* where these are higher than the rate or rates that applied at the time of the underpayment⁹. This increase takes account of the length of time workers have had to wait for their arrears. Previously, arrears were calculated as the difference between the amount paid and the amount that should have been paid under the NMW rate at that time.

2. By introducing a new civil penalty for non-compliance to create a clearer deterrent than presently exists.

If HMRC find that there has been an underpayment of the NMW they will issue a notice of underpayment in line with Government policy. This requires an employer to repay arrears to the workers and to pay a financial penalty to the Secretary of State. Employers can appeal against the notice of underpayment to an Employment Tribunal¹⁰.

⁷ <http://www.official-documents.gov.uk/document/cm73/7320/7320.pdf>

⁸ As described in the Impact Assessment that was completed when the Bill was going through Parliament

⁹ The arrears must be calculated according to a formula which is set out in the Act and this change applies retrospectively (i.e. from 6 April 2009, workers will be entitled to have their arrears repaid at current rates for all periods that they have been underpaid, including periods prior to 6 April 2009). The formula only applies if the current rate is higher than the rate or rates that applied at the time the worker was underpaid.

¹⁰ The penalty will only be charged in respect of underpayments of the NMW occurring in pay reference periods starting on or after 6 April 2009. There will be no penalty in respect of underpayments occurring before this date. The penalty is set at 50 per cent of the total underpayment for periods starting on or after 6 April 2009. There is a minimum penalty of £100 and a maximum penalty of £5,000. Employers who comply fully with the notice of underpayment within 14 days of service will receive a discount of 50 per cent on the penalty.

3. Power to remove records

Compliance officers are now able to remove NMW records from an employer's premises for photocopying but must return them within a reasonable period (7 days).

4. Search and seize powers

The Act gave HMRC the power to use the search and seize powers in the Police and Criminal Evidence Act 1984 when investigating criminal offences under the National Minimum Wage Act 1998.

Search and seize powers provide HMRC with coercive powers to search and seize for evidence to enable them to investigate the most serious allegations with a view to the submission of a file with sufficient/admissible evidence for the Crown Prosecution Service to consider whether a prosecution is appropriate.

1.2 Research Aims

The aim of the review will be to consider the effect of the changes, and how successful they have been in delivering the objectives they were expected to achieve (including what has been effective and the barriers to effectiveness).

As well as the effect of the changes, the enforcement process will also be examined to review the system as a whole. The review of the changes will be based around the five elements outlined below.

1. Fair arrears regime

This is specifically exploring a) the changes to the collection of the arrears and b) practicality of the fair arrears enforcement regime in relation to what works well and any impediments.

2. Changes to the civil penalty in April 2009

The civil penalty was introduced as an enabler to compliance (by issuing a discount on the penalty to employers who pay arrears within 14 days of the NoU being issued) as well as having a deterrent function. However, a fundamental step to securing compliance is the level of awareness of NMW and the penalty regime. All of these factors will be examined.

3. Power to remove records

This civil power was extended to remove records (beyond being able to examine records and copy them at the employer's premises). This is available

to and exercised by the NMW Compliance officers in the course of their duties and is used consensually.

The objective of this was to make the information gathering process more effective by counteracting the following problems encountered in the previous regime:

- a) Obstruction by employers
 - b) No equipment available to photocopy material
 - c) Too much information for the officer to copy at the relevant premises in the time available).
4. Search and seize powers

Officers in HMRC Criminal Investigation are able to obtain records using the Police and Criminal Evidence Act 1984 search and seize powers.

The objective of this is to provide HMRC with coercive powers to search and seize for evidence. This will enable them to investigate the most serious allegations with a view to the submission of a file with sufficient/admissible evidence for the Crown Prosecution Service to consider whether a prosecution is appropriate.

To determine the effectiveness of objectives 3 and 4 the following criteria will be examined:

- How often are the powers used?
- What type of cases are the powers used for?
- Barriers to using the new powers

5. Value for money

As the objective of the changes was to act as a punitive measure rather than to generate revenue, value for money considerations will only focus on whether we can modify the effectiveness of the current process (rather than assessing the cost of enforcement against the revenue generated from penalties or the amount of arrears collected).

1.3 Methodology

1.3.1 Output and outcome measures

The outcome (the changes or benefits that result from the intervention) and output measures (what is produced through those activities) are outlined in table 1 along with the sources used to obtain these.

The following data sources were used to inform the review:

- Management information from HMRC (HMRC MI)
- Management Information from Pay and Work Rights Helpline (PWRH MI)
- Annual Survey of Household Earnings 2005-2012 (ASHE)
- Interviews with a range of HMRC staff
- Research into 'Employers' attitudes and behaviour towards compliance with UK National Minimum Wage (NMW) Legislation'¹¹
- Research into 'Understanding workers' behaviour in complying with the NMW'¹².

¹¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32180/11-1335-research-employers-attitude-national-minimum-wage.pdf

¹² <https://www.gov.uk/government/publications/national-minimum-wage-understanding-worker-behaviour-in-complying-with-the-law>

Table 1. Output and outcome measures

Outcome measures	Output measures (and information sources)
1 Fair arrears regime	(HMRC MI) <ul style="list-style-type: none"> ○ Amount of arrears ○ Number of appeals
2 Changes to the civil penalty in April 2009	<p><u>Level of compliance</u></p> <ul style="list-style-type: none"> ○ Complaints to the Pay and Work Right Helpline (PWRH MI) ○ Strike rate (HMRC MI) ○ Annual Survey of Household Earnings (ASHE) <p><u>Incentives reimburse quickly and deterrent to compliance (HMRC MI):</u></p> <ul style="list-style-type: none"> ○ Amount of reduced penalty paid ○ Customer waiting time ○ Total amount of penalty charges ○ Number of penalties raised
3 Power to remove records	<ul style="list-style-type: none"> ○ The use and effectiveness of the power to remove records (Interviews with HMRC)
4 Search and seize powers	<p><u>Effective deterrent</u></p> <ul style="list-style-type: none"> ○ No of prosecutions (HMRC MI) ○ The use and effectiveness of the power to search and seize and prosecutions (Interviews with HMRC)
5 Value for money	<ul style="list-style-type: none"> ○ Good practice and barriers to current enforcement (Interviews with HMRC)

1.3.2 Process evaluation

The goal of this exercise was to examine any changes to the operational processes since the introduction of the new enforcement regime to identify any unforeseen consequences and understand any obstacles/ good practice

as a result. Any wider issues that could affect compliance with the enforcement regime were also explored.

The main areas explored were:

1. Fair arrears regime

- The changes to the collection of NMW regime arrears and the fair arrears regime.
- The practicality of the new regime in relation to; a) evidence gathering b) initial contact with the employer c) the inspection d) post inspection e.g. case for non-compliance and whether the arrears were paid.
- The advantages and disadvantages of the way arrears are calculated in relation to ease of understanding/application to various types of workers.
- Wider issues that affect enforcement of the fair arrears regime

2. Changes to the civil penalty in April 2009

- Whether the regime has effective incentives in place to encourage employers/workers to comply with it
- Examine the enforcement regime to ascertain whether it is an effective deterrent.
- Wider effect on incentives and deterrence to compliance will also be examined.

3. Power to remove records

- The use and effectiveness of the power to remove records.

4. Search and seize powers

- The use and effectiveness of the power to search and seize

5. Value for money

- To explore if the current enforcement regime can be improved to be more efficient.

This part of the review was based on a series of 13 semi structured interviews with relevant HMRC staff for which written responses were provided (see annex 1 for list of questions and annex 2 for a breakdown of the role of the participants). The interviewees were selected on the basis of having experience of the former enforcement regime (pre April 2009) and the current enforcement process.

Interviewees were selected from the following regions:

- Eastern Counties (2)
- Northern Ireland (2)
- Scotland (3)
- Yorkshire (1)
- Teesside (1)
- South East (1)
- Midlands (1)
- Wales and South West (2)

The interviews were carried out in between March and May 2013 and were analysed by grouping responses according to the themes that emerged from the data.

1.3.3 Limitation of the review

In order to measure the effect of the changes to NMW legislation, it is important to measure what would have happened in the absence of the intervention (i.e. establishing a counterfactual) to determine whether any changes were caused by the intervention (in this case, the intervention being the changes that were introduced).

As in the case of most policy changes, once an intervention has occurred the counterfactual can't be observed. Therefore, the counterfactual in this review will be the difference between before and after the policy change. A major limitation with this approach is, because of other factors outside of the changes made, a simple difference may over or under state the true effect (for example the recession may have led to lower volumes of complaints from individuals who fear losing their jobs and believe it will be harder to find a new job in an economic downturn). These extraneous variables will also be explored in the review.

1.4 Structure of the Report

The report is broken down into 6 sections. Section 2 and 3 discuss the findings in relation to the fair arrears and the changes to the penalty in April 2009 respectively. Section 4 examines the power to remove records, section 5 the power to search and seize, and section 6 outlines the conclusions.

2. Fair arrears regime

The key issues that were explored were:

- The changes to the collection of NMW regime arrears and the fair arrears regime.
- The practicality of the new regime in relation to; a) evidence gathering b) initial contact with the employer c) the inspection d) post inspection e.g. case for non-compliance and whether the arrears were paid.
- The advantages and disadvantages of the way arrears are calculated in relation to ease of understanding/application to various types of workers.
- Wider issues that affect enforcement of the fair arrears regime

2.1 Key points

- Evidence indicates that workers receive a higher amount of arrears than they would have done under the previous regime. This suggests that the policy objective of ensuring that arrears take account of the amount of time that has elapsed since the original underpayment has been achieved.
- The overall number of appeals have increased since the changes to the regime (though this may not be directly attributable to the policy changes). However, the number is relatively low (average of 3.5%) indicating that most employers do not formally complain about the amount of arrears and penalty issued. This may be due to the simplicity in administering the penalty and the way the arrears are calculated.
- The Pay and Work Rights Helpline and the opportunity to talk to Compliance Officers face to face was seen as a positive element of the enforcement regime by workers. Emphasis was given to the fact that the worker could remain anonymous as an enabler to report underpayment.
- Employers were seen to be more accepting of paying arrears than paying penalties. It was reported that advising the employers of the penalty and method of calculating arrears could at times make for a contentious meeting. Furthermore, being informed of the penalty had a negative influence on their attitudes and levels of co-operation which could lengthen the time of the enquiry and consequently delay the workers receiving their arrears. However this may be due to the COs investigation skills rather than being directly attributable to the changes to the regime.
- It was reported that a number of employers delayed the investigation in order to allow them to raise funds by withholding information and being generally un-cooperative.

- A concern in relation to issuing a NoU was the difficulty in calculating arrears when the employer did not keep sufficient records or where employers purposefully provided inadequate records, thus making evidence gathering difficult and delaying the issue of a NOU. Furthermore, there is no tangible penalty for employers who keep poor records as opposed to an employer who keeps good quality records.
- For cases with poor records, COs were also of the opinion that preparing a NOU for only a very small amount of arrears (e.g. £10-£20) was too time consuming.
- There was consensus that there is more incentive for the employer to co-operate with the investigation (or to provide sufficient records) prior to the issue of a NoU or where the investigation is being finalised after the end of a rate year (October). The enhancement goes up on 1st October (but only if NMW is increased). After 1 October there is no incentive to comply as the employer will not benefit from paying a reduced amount of uplift¹³. This can delay the issue of the NOU and subsequently the payment of the arrears to the worker¹⁴.
- Issuing the NOU was reported as a lengthy process due to the following factors:
 - The number of administrative procedures prior to issuing a NoU.
 - The onus on compliance officers to check the employer records in the organisation before issuing a NoU as part of a wider approach to checking non-compliance.
- In cases where the employer has made a genuine error, there was a mixed opinion in relation to whether a penalty should be discretionary. Some felt that it would be difficult to define genuine error (especially if an employer kept poor records). However, in these cases, where the arrears owed were small amounts it was felt that the associated penalty was not proportionate for small businesses.

Wider issues that affect enforcement.

- Employers who didn't understand the NMW and thus made errors in payment found it difficult to understand how the arrears were calculated (particularly in relation to the different types of workers) and COs had to dedicate extra resource time to explain the calculations. However, this

¹³ The uplift is the difference in what would have been paid prior to the policy change and after the change.

¹⁴ However, the uplift process does introduce an imperative around rate change (October) for the employer to resolve outstanding matters.

issue is more pertinent to the employer's understanding of calculating the NMW rather than the changes made in April 2009.

- COs felt that it was more difficult to gather evidence due to the increasing lack of co-operation from employers during the evidence gathering phase which was perceived to be a consequence of the recession.
- Limited Companies being struck off and put into administration/receivership or liquidation were seen as a real problem. Especially, after officers had reached the stage to issue or have issued a NoU, only to find the employer has been or is about to be closed down.

2.2 Arrears received

Following the changes to the regime, workers received a higher amount of arrears than they would have received under the previous regime (See table 2).

This is in line with the policy objectives i.e. workers who are owed arrears for pay reference periods starting on or after 6 April 2009 are entitled to have their arrears repaid at current rates where these are higher than the rate or rates that applied when the arrears arose. The increase to current NMW rates takes account of the length of time that the arrears have been outstanding.

It is difficult to predict trends in relation to the amount of arrears as there are a number of factors that affect this; a) a worker's level of underpayment b) previous rate increases and c) the length of time of underpayment.

Table 2 Arrears identified prior to the new regime				
Year	Complaints	Risk assessed	Total	
Arrears identified following the new regime				Amount that would have been claimed prior to new regime ¹⁵
Year	Complaints	Risk assessed	Total	Total
2009/10	£2,803,154	£1,586,869	£4,390,023	£4,357,746
2010/11	£3,056,666	£761,730	£3,818,396	£3,521,954
2011/12	£2,429,601	£1,153,084	£3,582,685	£3,262,426

¹⁵ Calculated as the difference between the amount paid and the amount that should have been paid under the NMW rate at that time.

Table 2 Arrears identified prior to the new regime				
Year	Complaints	Risk assessed	Total	
Arrears identified following the new regime				Amount that would have been claimed prior to new regime ¹⁵
Year	Complaints	Risk assessed	Total	Total
2012/13	£2,600,719	£1,192,099	£3,792,818	£3,588,331

2009/10-2011/12 – figures are 1st April – 3rd March

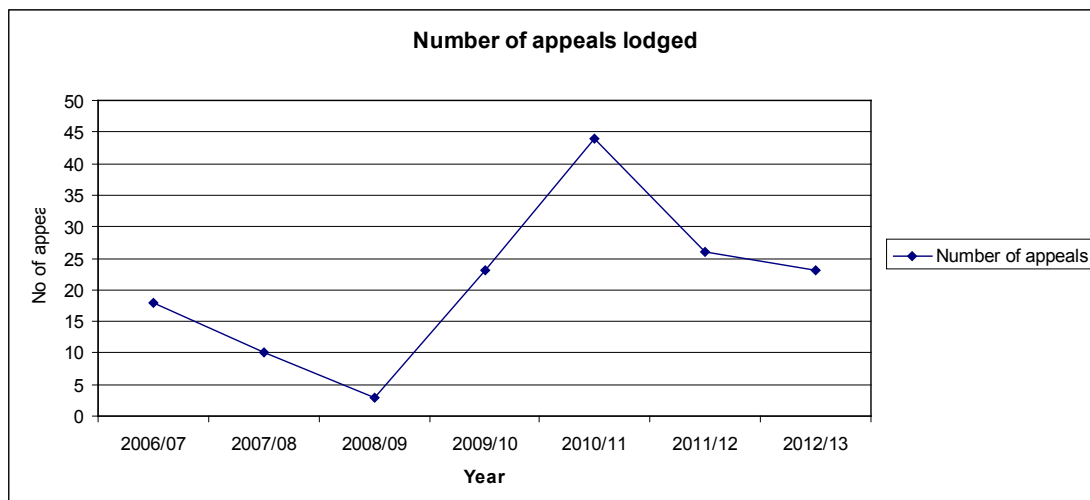
2012/13 – figures are 1st April – 31st March

2.3 Appeals

Figure 1 below shows that although the overall number of appeals have increased since the implementation of the fair arrears regime (which is consistent with the fact that there is a bigger pool of employers who will receive a penalty under the new regime), the numbers are relatively small (3.5%). Therefore, it appears that most employers do not formally contest the amount of arrears/penalty owed. There was a peak in the number of appeals on 2010/11 which may be explained by the increase in the number of NOUs issued that year.

The reasons for appeal were recorded by HMRC for years 2009/10 and 2010/11. The reason for a majority of appeals was recorded as ‘No arrears owed to any worker on NoU’, followed by ‘Amount owed to worker(s) was incorrect’.

Figure 1 Number of appeals lodged



2.4 Process review

COs provided information on the perceived benefits and obstacles of the changes to their working practices as a result of the implementation of the fair arrears regime. Figure 2 shows the overview of the current enforcement process. Wider impact on working practices were also considered outside of the changes made.

Complaints from the worker

Compliance Officers reported that workers were positive about having the Pay and Work Rights Helpline as a means of reporting underpayment. Furthermore, workers emphasised being able to remain anonymous as an enabler to encourage them to come forward¹⁶. However, anonymity was seen to diminish relative to the size of the workforce¹⁷.

Being able to provide face to face witness statements were also seen to give workers confidence to be open and honest with Compliance Officers which in effect are crucial to the correct outcome regarding any complaints made.

Evidence gathering to calculate arrears

HMRC operational staff reported that working with the employer but remaining impartial from the outset assisted in the evidence gathering process. Particularity as they were more mindful that should an employer appeal the NOU, their approach to evidence gathering will be questioned in tribunal. Furthermore, it was perceived that as a consequence of more cases requiring court action (note however, that these are a very small number), HMRC have better systems in place to record the evidence gathered and this improvement may have been driven by employers reacting to penalties by refusing to settle.

Initial contact with the employer

It was generally agreed that the appointment letter, information sheet and instructions are helpful when it comes to explaining the regime at the introduction stage of an initial meeting. It was reported that contacting the employer, arranging the appointment and explaining the 2009 changes allows the employer to feel involved from the outset and gets their buy in. Employers know from the beginning of the enquiry that if they are found to be non-compliant they will receive a fine in addition to paying the arrears.

¹⁶ This can hinder the investigation however, if for example the worker is not included in any employer records

¹⁷ Retaining anonymity when reporting underpayment of the NMW was also raised as an issue in the qualitative research with workers.

However, it was felt that some employers saw the initial contact as a heads up for them to either hide or change information, especially if they know they are repaying the arrears at a higher rate than before and they are also going to receive a financial penalty. Discussing the penalty regime before establishing whether an employer is compliant can be seen by an employer as being provocative, and can set the review back.

The inspection - co-operation from employers and workers

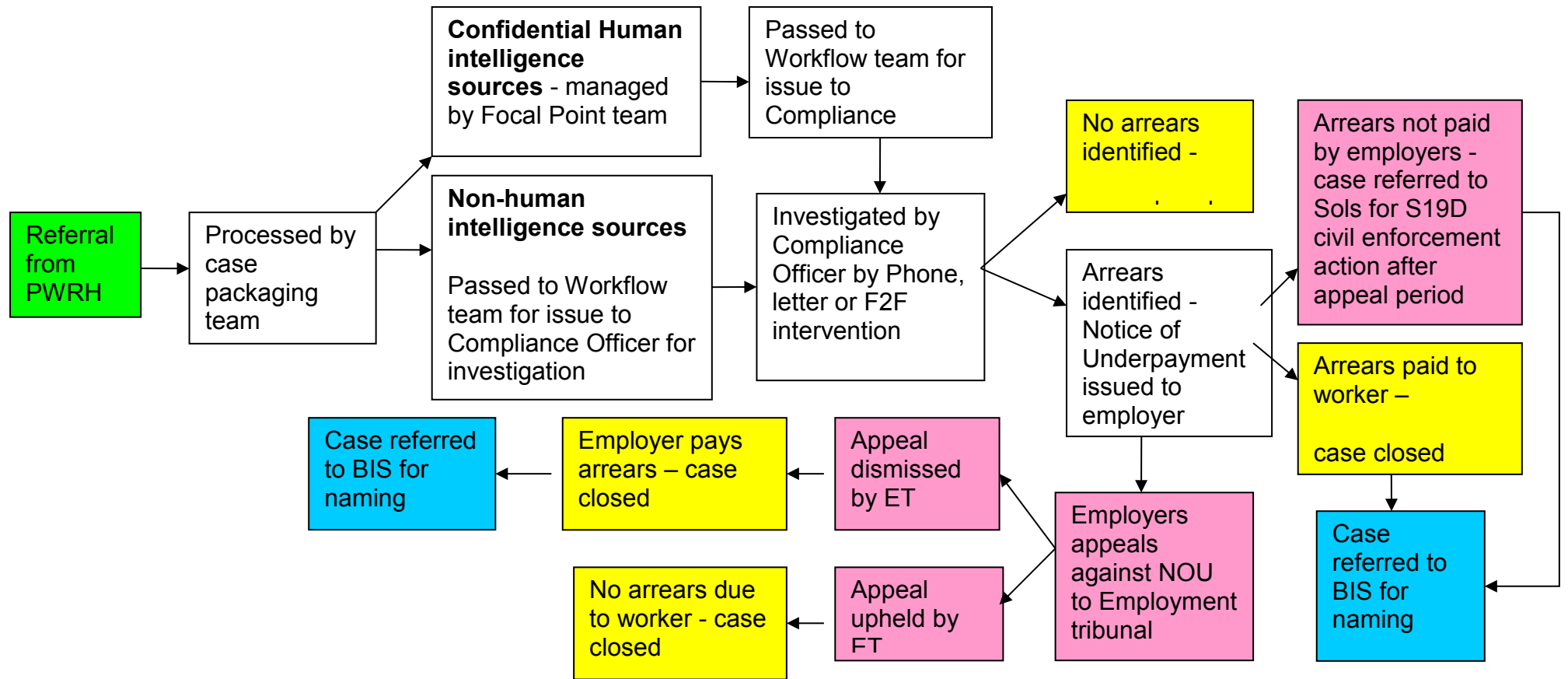
It was felt that, genuinely good employers will always go out of their way to assist with supplying relevant information so an officer can make an informed decision.

Employers were seen to be more accepting of paying arrears than paying penalties (as found in the research with employers) and it was reported that being informed of the penalty had a negative influence on their attitudes and levels of co-operation which could lengthen the time of the enquiry and consequently delay the workers receiving their arrears. However this may be due to the COs investigation skills rather than being directly attributable to the changes.

It was reported that employers did not always co-operate when asked to show their records for evidence. A reported barrier was employers who felt it was entirely the officer's job to prove that they are not paying NMW. It was felt that the mind-set of some employers had changed to only giving the inspectors records or documents if they are specifically requested, thus making the job more difficult. However, this may have also been the case, prior to the regime change.

It was felt that a number of employers often delayed the investigation in order to put off the date of the NOU being issued to allow the employer more time to raise funds to pay in full within the 14 days of the issue of the notice, by withholding information. Also, some employers didn't comply in attending meetings, responding to queries, providing records etc, therefore, the entire burden of putting together an NoU (even if it's possible given the lack of records) fell on the compliance officer.

Figure 2 Overview of NMW Compliance process



Calculation of arrears and issuing the NOU

There was widespread agreement amongst HMRC staff that the current method of calculating arrears enables workers to be compensated for the delay in the correct rate of the NMW being paid. It was felt that prior to 2009, an employer suffered no additional cost and in fact might make a saving by not paying the NMW until inspected and then simply paying the outstanding figure.

The arrears were judged to be more accurate, fair and defensible. It was maintained that worker types are generally easy to distinguish and the arrears for these workers are generally easy to identify and explain to an employer. Furthermore, employers will more readily accept calculations when they have a good understanding of the types of workers and how the legislation applies to those workers. This avoids unnecessary tribunal cases due to non-acceptance of liability as a result of lack of understanding.

However, officers reported their concerns around making precise calculations for the NoU when the employer did not keep sufficient records¹⁸. Three main issues were identified by COs that needed to be resolved in order to issue a NOU; precise pay reference periods, disputed hours and worker status. The difficulty arose when the employer did not keep sufficient records as it made evidence gathering more difficult and delayed issuing a NOU¹⁹. Sufficient evidence is required to issue a NOU (if an appeal is submitted this evidence is looked at by a technical team to ensure that it can stand up in a tribunal).

It was also reported that in cases where the employer possessed poor records, preparing a NOU for only a very small amount of arrears per worker (e.g. £10-£20) was too time consuming, especially if it was for a large organisation.²⁰

It was argued that few NOUs are ever appealed and the majority of employers voluntarily paid back the arrears once they were told they had underpaid their workers²¹. Consequently, Officers felt they were spending a lot of resources on collecting evidence for precise calculations for the arrears, especially where employers keep poor records.

¹⁸ Poor record keeping by employers has been highlighted as a problem by the research with employers and workers. The research stated that poor record keeping resulted in errors in applying the NMW and deductions made from wages. Workers also reported that they were unaware of deductions made and if they were paid correctly if employers did not provide adequate records (e.g., contracts, payslips etc).

¹⁹ In these circumstances, the CO will send them a letter explaining that they will be issuing a NoU basing the amount of arrears on the evidence they have. This is to ensure that the employer understands the process, is co-operative and to give the employer the opportunity to challenge or supply further evidence if he disagrees.

²⁰ Every worker would have to be named, every pay reference would have to be checked and the CO would have to go back many years depending on records and when the business started.

²¹ In 2006/7 95% of employers (n= 1,452) who were found not to be paying the NMW settled informally by repaying the arrears to the workers (information from the Impact Assessment published at the time of the policy change).

As most employers voluntarily comply with the schedule, COs felt that in the case of low value non-compliance, they were only issuing a NoU to support the payment of the penalty and strongly felt that they needed to find a solution to this problem as it was deflecting resources from serious non-compliance²².

There was mixed opinion in relation to the issue of whether a penalty should be discretionary depending on if the employer made a genuine error (this was also reported in the research with employers)²³. It was reported that there can be a lack of understanding with some employers, accountants and solicitors as to the reason for raising a penalty and the fact it is set and not negotiable.

Opinions against a discretionary element argued that the present system is easier to administer. If arrears are due then a penalty is due, without exception; this is easy for an employer to understand and for a compliance officer to explain. Furthermore, it carries no process costs associated with appeals against a decision to impose a penalty.

Some felt that it would be difficult to define genuine error (especially if an employer kept poor records) and problems would arise if an employer used the 'genuine error' argument as a line of defence at a tribunal. There could be a danger of hostility if discretion was used in one case and not another. The current system was seen as fair, providing little room for subjectivity thus ensuring that everyone was treated fairly. Furthermore, this method forced an employer to be more proactive in ensuring that workers are paid, especially if they have to pay a penalty.

In cases where a small amount of arrears were identified, charging the current penalty in these circumstances was not deemed fair to smaller businesses as the penalty amount was seen as disproportionate to the amount of arrears owed. This was also supported by the research with employers.

The employer may have to pay more arrears due to the change in rates from October which affects the uplift due to the amount of time HMRC take to issue a NOU based on the new procedures. The October increase presents a problem for live NMW cases, as the increase may affect the calculation of the uplift - by increasing it. COs are obliged to inform employers who may be caught by the change and may try to complete and issue the NoU prior to 1st October. However,

²² It is BIS policy to issue a NoU in all cases of underpayment and not a requirement of the legislation (which does not compel HMRC to issue NoUs and therefore penalties, in such cases).

²³ The study showed that employers accepted that a mechanism was needed to ensure workers were not out of pocket. However, whilst a number of employers felt that this 'fine' was necessary to act as a disincentive for those who seek to purposefully break the law, others felt that it was unfair to financially penalise employers who had made genuine mistakes. And in the several cases of very small arrears being paid by employers (£100 or less), the penalty was felt to be excessive in relation to the arrears.

this can be problematical and was seen to aggravate employers who saw it as a ploy to get greater numbers of arrears. Or they feel coerced into settling on the amount of arrears earlier than they may otherwise have done.

As part of HMRC's risk assessment strategy, COs are required to check the payroll system to ascertain whether other workers apart from the complainant are being paid the NMW before issuing a NOU. This was reported as a time consuming exercise, particularly for large organisations or for employers who kept poor records.

Finally, a number of administrative procedures were also seen to delay the issue of a NoU. These include; peer checking of the NOU, authorisation by the People Leader, confirmation of TNT (post office service), and contact with workers to establish if penalty reduction applies etc. Delays were also reported due to the administrative burdens associated with record keeping (having to upload documents²⁴ and requirement to record all interaction with employers and workers).

Self-correction

An impediment reported by the COs was the time required to explain the penalty system and why the penalty is still payable if the employer has self-corrected between initial contact and date of visit.

Monitoring payment of arrears to workers

There was a perception that employers tended to pay arrears much more quickly than before 2009 to avail themselves of the 50% reduction in penalties. This is consistent with the data on customer waiting time in section 3.1.1²⁵).

However, checking whether the worker had been paid their arrears was seen as time consuming as workers often did not get in touch with HMRC once they had been paid. Prior to the changes, it was assumed that the workers had been paid if they did not get in touch. Currently, COs have to spend time checking a sample of workers from every NoU issued. In these situations, they also ask the employer to present them with bank statements to provide them with evidence that the worker has been paid (however, with this, there is danger that the employer can deduct the money from the next payslip).

Generally however, HMRC did not report non-payment of arrears after a NoU was issued as a problem. In fact, arrears were paid alongside the penalty for most of the cases. **Advice post inspection**

The advice HMRC give to employers post inspection was seen to have improved since 2009. It was reported that officers in general do not enjoy penalising a good employer for genuine mistakes so officers will reinforce their recommendations not only verbally at the face to face inspection but in the closure letter also. This was to

²⁴ There can be a high number of pay records.
²⁵ Note; this is for the time period 09/10-12/13

encourage an employer to check and comply in the future²⁶. The research with employers demonstrated that employers were positive about the visits from compliance officers. Most non-compliant employers felt that they learnt how to rectify the errors they had made and the compliant employers welcomed the external check of their record keeping.

Workers were also generally appreciative of the advice and support the officers afford them throughout the enforcement process. They usually only approach HMRC as a last resort and if they do receive their arrears of pay then they are satisfied with the service they have received.

Wider effects on enforcement.

As mentioned above, one of the key things that was noted to work well for employers in relation to resolving complaints in their favour was keeping high quality pay records and time sheets. It was also reported that employers said that HMRC's information sheets and letters were well written and easy to understand.

It was agreed that there is a better system in place to check that workers had been paid as the CO now contacts a percentage of workers to confirm that they have been paid. Previously, HMRC wrote to a sample of workers and asked whether they had been paid and it was assumed that a nil response would mean that they had received payment.

It was stated that all workers are now sent an explanation of their arrears and are given an opportunity to comment. COs are encouraged to undertake second inspections under the validation system to check whether arrears have been paid and whether the employer is now compliant. However, this is only done for a sample of workers (a minimum of five).

In terms of obstacles, COs outlined a number of wider issues that affected employers complying with the enforcement regime.

Employers who had a poor understanding of the NMW found it difficult to understand how the arrears are calculated (even though this information is supplied to the employer in writing prior to the issue of the NoU). In addition compliance officers also reported the intricacy in relation to calculating the arrears for the type of work being performed and sought technical advice in these circumstances. For example, the treatment of time spent sick differs depending upon the type of work being performed - time off sick is not counted for time worker/salaried worker doing more hours than

²⁶ The study showed that a general principle expressed by employers in the non-compliant sample was that the outcome of an inspection should differ depending on its findings. Those who made inadvertent errors said the inspection should be used to correct behaviour, for example, it should be used to educate employers rather than penalise them. In contrast, for employers who were seeking to intentionally avoid the rules, the result of an inspection should be punitive. Many of the employers taking part in this research found the inspection beneficial as it outlined errors they were making which they could then correct. Similarly, many of the employers in the compliant sample were happy to have their systems "validated" by an external, official source.

they should. However, this issue is more pertinent to the employer's understanding of calculating the NMW rather than the changes made in April 2009.

Problems were reported when support officers tried to make contact with the person responsible to make an appointment. Delays were reported due to the need to speak to an authorised person who is often not available to establish a formal date of contact. However, this is more likely to be a general problem related to enforcement rather than related specifically to the changes in the regime.

As mentioned above, officers expressed the increasing lack of co-operation from employers during the evidence gathering phase which was attributed to the recession. It was observed that employers were creating new ways of not paying NMW. In the past an employer would have shown a deduction for a uniform on the workers' payslip however they are now more likely to make the deduction or take the payment directly from the worker and not show it. This could be seen as a way of reducing any NMW liability thus reducing the penalty also.

In addition, it was reported that employers were starting to dictate the time scales for producing this information.

Officers stated that cases are not progressed as quickly as they could be as they have to rely on the employers to provide evidence in order to do the calculations.

Limited Companies being struck off and put into administration/receivership or liquidation were seen as a real problem. Especially, after officers had reached the stage to issue or have issued a NoU, only to find the employer has been or is about to be closed down with no assets.

3. Changes to the civil penalty in April 2009

The civil penalty will be reviewed in relation to its effectiveness as an enabler to compliance and whether it has a deterrent effect by examining the awareness of the NMW and the penalty. Wider issues affecting compliance outside of the introduction of the penalty will also be examined.

3.1 Enabler to compliance - key findings

- The number of employers paying back arrears within the 14 day window (thus taking advantage of a reduced penalty) is fairly high ranging from 59% to 66%. Therefore, it seems that the majority of employers pay back the arrears fairly quickly once a NoU is issued.
- Although the amount of time workers wait for their arrears from when the case is reported has decreased overall since the new regime, it has gradually started to increase since 2010/11. The upward trend is due to a mixture of issues; HMRC resources, cases becoming more complex, employers perhaps not responding as quickly to compliance officers – a reflection of the economic position and processes around preparing a formal notice of underpayment.

3.1.1 Reduced penalties

One of the incentives to comply once an NOU has been issued is the 50% reduction in the amount of penalty they have to pay if arrears are paid back within 14 days of the NoU being issued. Table 3 shows that the number of employers benefiting from the 14 day discount is fairly high ranging from 59% to 66%. Therefore, it seems that the majority of employers pay back the arrears fairly quickly once a NoU is issued.

Table 3 Penalties issued

Penalty information	2009*	2010	2011**	2012**
NOUs issued	77	1370		
Penalties Charged	190	896	868	808
Penalties paid within 14 days	112	589	547	528
% of penalties paid in 14 days	59	66	63	65
Amount of total Penalties Charged	£51,216	£417,112	£684,888	£842,241
Amount of Reduced Penalty	£15,791	£14,,2281	£211,684	£268,307
Number of Cases with Uplift	113	686	541	614
Total of Uplift	£219,49	£270,888	£237,779	£294,988
Penalty Amounts				
£100	96	318	238	201
£101 - £499	71	338	304	223
£500 - £999	16	135	127	134
£1000 - £4,999	6	96	177	199
£5,000	1	9	22	51

* The figures for 2009 only cover April- December

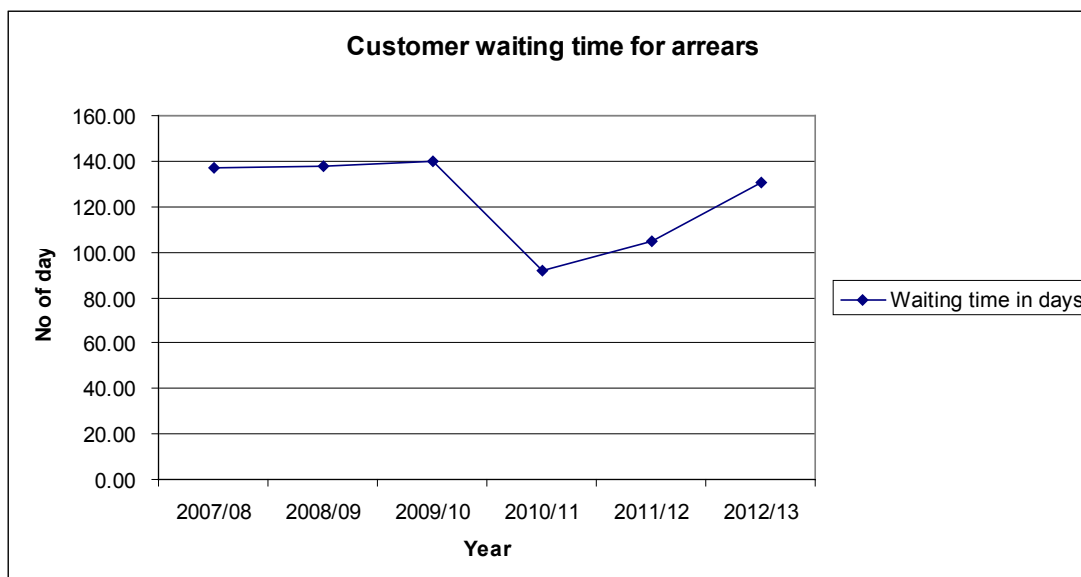
**The number of NOUs were not recorded however, it can be assumed that the number of penalties issued equates to the number of NOUs unless there are cases where the pay reference falls before 6/4/09 or due to technical reasons or if the employer goes into liquidation.

Customer waiting time

One of the aims of the fair arrears regime is to reimburse the worker quickly. HMRC calculate waiting time by calculating the number of working days between the date of first contact with the worker/employer and the date of closure of each case and then calculate an average waiting time overall. Figure 3 shows that although the waiting time decreased a year after implementation of the new regime, it gradually started to increase again.

The increase in waiting time is likely to reflect the issues outlined in the following process section.

Figure 3 Customer waiting time.



3.1.2 Process study

There was general consensus amongst HMRC staff that once an NOU is issued the employers will generally try to pay the arrears and 50% of the penalty within the 14 days. However, once the reduction is lost there is no incentive to comply.

It was felt that the worst employers who have chosen not to pay the NMW are not incentivised by the 14 day reduction as they invariably opt out of most HMRC responsibilities. The PAYE records may indicate low hours and NMW compliant wages but these will be topped up by off record unofficial payments. Overall, wages could be less than NMW for the (recorded and unrecorded) hours worked in these cases.

3.2 The deterrence effect of the penalty regime- key findings

- The various measures of non-compliance outlined in this paper suggest that although the number of complaints are higher than before the start of the regime, the general level of non-compliance has remained steady over time. Therefore, it may be concluded that the penalty regime did not seem to have a deterrent effect on non-compliance. Possible reasons for this could be employers' lack of awareness of the penalty regime and also a lack of understanding about the NMW and the difficulty in finding suitable guidance (also demonstrated in research with employers and workers). Broader issues outside the regime such as the recession were also reported to affect compliance.

- However, the enforcement measure of non-compliance, i.e. the strike rate (the number of cases investigated by HMRC to be non-compliant), has steadily increased since the changes took place, demonstrating the rise in non-compliance in the cases investigated by HMRC.
- It was of the view of HMRC staff and employers that the penalty is not an effective deterrent due to employers' lack of awareness of the existence of a penalty for underpayment of the NMW. Research has also shown that both employers and workers were unaware of the penalty for not paying the minimum wage.
- Furthermore, employers and compliance officers reported the major reason for underpayment was due to a lack of understanding of the NMW. Therefore, for the penalty to act as a deterrent the Government need to ensure that employers are aware of the different rates and deductions that can be made.
- The £5,000 maximum penalty was not seen as an effective deterrent to larger businesses by employers and compliance officers as they could make significant savings or gain other cash flow advantages by not paying or delaying payment of the NMW

3.2.1 The effect of the penalty regime on non-compliance

To date, much of the evidence about non-compliance has been qualitative and mostly explores reasons for non-compliance and the varying levels of awareness of the NMW enforcement regime according to different sectors and worker type.

This paper will aim to use multiple data sources to make an estimate of the level of non-compliance with the NMW and identify whether there has been a change in levels of non-compliance since the introduction of the changes to the penalty regime.

Currently, our best estimate of non-compliance is from the Annual Survey of Household Earnings (ASHE). However, findings from the survey do not take into account the fact that some workers can be paid below the NMW for legitimate reasons. Therefore the figures may overestimate the level of non-compliance²⁷.

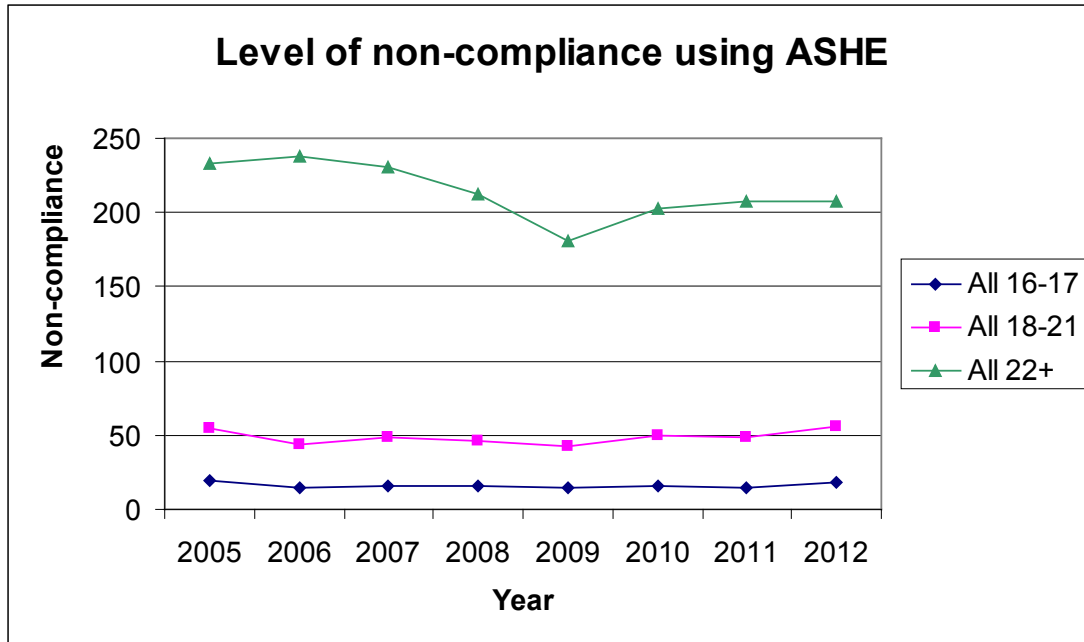
Figure 4 outlines the number and percentage of jobs below the national minimum wage. Figures show that the trend in non-compliance is fairly stable for young

²⁷ A limited number of groups are classified as workers but are exempt from the NMW under NMW law. For example:

- students undertaking work experience as part of their UK higher or further education course,
- participants in specified government back to work programmes
- A voluntary worker who works for a charity, voluntary organisation, associated fund raising body or a statutory body
- Individuals on the Apprenticeship NMW

people since 2009. There is also a relatively stable trend for adults with a dip in non-compliance in 2009.

Figure 4 Level of non-compliance by age-group

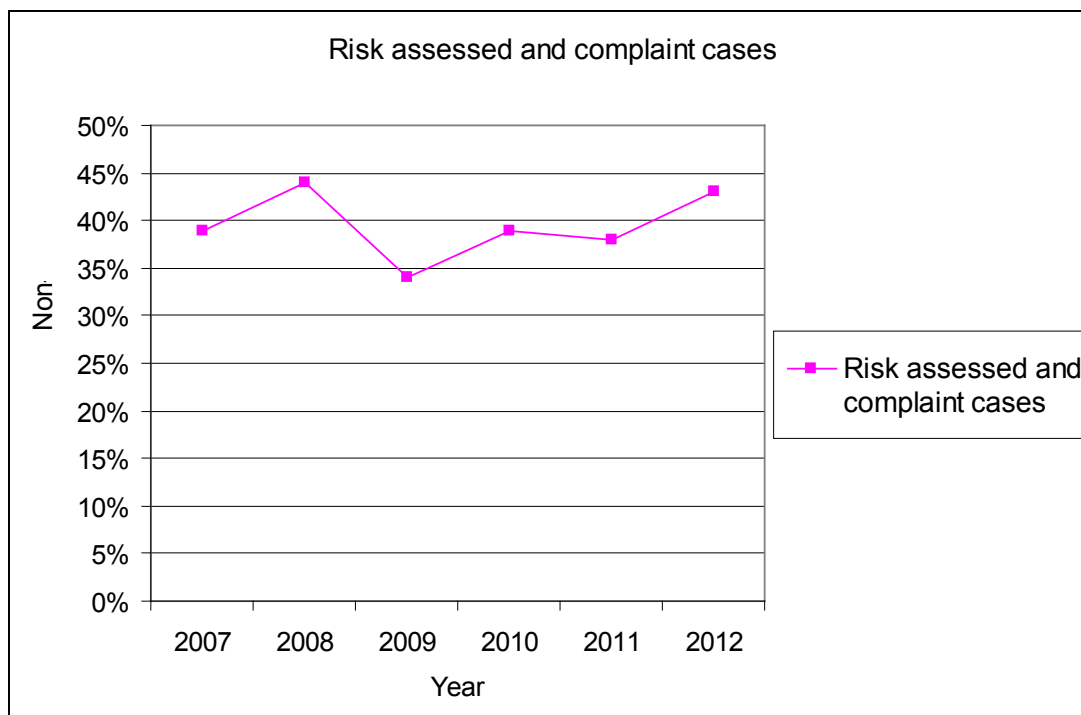


Strike rate

HMRC define the strike rate as the number of cases where non-compliance is identified for risk assessed and complaint cases investigated.

Figure 5 shows that non-compliance in the cases investigated by HMRC has steadily increased since the changes took place.

Figure 5. Level of compliance measured by the strike rate.



Note the figures for 2007 are from April – Dec.

However, there are a number of problems with using the strike rate as a measure of non-compliance. Firstly, the level of non-compliance for risk assessed cases will depend on HMRC's risk assessment strategy rather than a true measure of non-compliance or any changes as a result of the penalty regime. The level of non-compliance may increase or decrease depending on the type of cases HMRC choose or are instructed to investigate²⁸.

Second, the level of non-compliance from complaints will only reflect the level of non-compliance amongst people who have reported being underpaid.

Therefore this measure should only be used to describe the level of non-compliance detected in the cases investigated.

No. of complaints from workers

Figure 6 shows that the number of complaints from workers has increased since the PWRH was established, rising sharply from 2012.

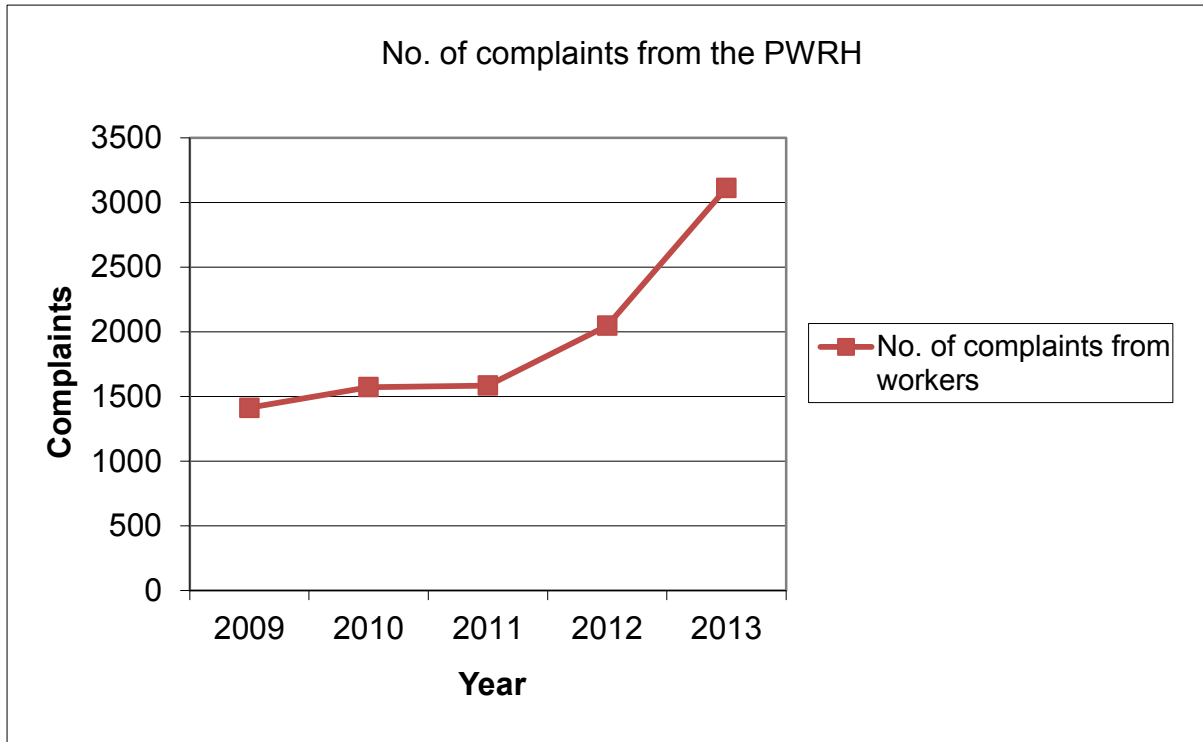
As the PWRH was established at the same time as the changes to NMW regime, there is no direct comparison of the number of complaints prior to the regime from

²⁸ HMRC are required to fast track certain types of cases (e.g. interns) which will impact on the overall strike rate.

this source. However data from HMRC indicate that the number of complaints were decreasing prior to the new regime (2007/8- 2391 and 2008/9 – 2002).

The increase in the number of complaints may be due to workers being more aware of their rights and entitlements and therefore, more likely to complain.

Figure 6. Number of complaints on the PWRH



Awareness of the enforcement regime

The purpose of the introduction of the civil penalty was to create a clearer deterrent than already existed. A key to deterrence is the awareness that an enforcement regime exists and that non-compliance will be detected and addressed through a punitive regime.

Research with employers and workers showed that awareness of the different enforcement actions that HMRC took was low. Overall, employers were not aware that inspections to check compliance with NMW legislation could take place until they were informed of a planned visit. Those who had been inspected were surprised that such visits occurred. Employers that were found to be non-compliant tended to be more aware through experience, but even these individuals only had an awareness of the penalties that were levied for their misdemeanours. Hardly any interviewees had faced the more severe enforcement options such as criminal proceedings, and, none of the other employers interviewed knew about these enforcement options prior to the inspection.

Employers who had not had an inspection were equally unaware of the specifics of the legislation and some were not aware that an inspection to check compliance with the NMW could be performed by HMRC.

Several employers felt that the maximum penalty of £5,000 was not a disincentive for large employers, especially if they could make some significant savings or gain other cash flow advantages by not paying or delaying payment of the NMW.

Process review

Consistent with the above finding, COs reported that some employers had a limited understanding of the NMW resulting in them making errors in the amount they paid their workers. Although it was felt that information on new rates were well advertised, the COs often heard employers stating that they were not aware of certain technical elements of NMW (these issues were also highlighted in the research with employers) for example;

- What should be regarded as working time (e.g. care industry where travelling between visits is involved),
- Accommodation offset issues (the supply of living accommodation to workers is often a big issue for employers as they do not see that they are doing anything incorrect as they are providing decent accommodation for the market rate. Some feel that they are discriminating against their own workers by not being able to offer them the accommodation.²⁹
- Deductions or payments to an employer for a work related item i.e. uniform will affect gross pay regardless of the fact that it is a deduction or payment to the employer or a third party, however it is difficult in some cases to determine when/the amount of the payment.
- What constitutes a worker performing salaried hours work,
- Apprentices (awareness of rates, employers are often given advice by training providers which contradicts NMW rules but ends up with training providers receiving more funds from Government)
- Status of worker
- Employers' lack of awareness in premium payments such as overtime or unsocial hours rates not counting for NMW. This is also a major problem when asking employers to carry out their own calculations as you would need to train the employer in all technical aspects of calculating arrears to trust them to complete them accurately.

²⁹ The offset rate for accommodation charges is £4.91 a day or £34.37 a week. If an employer charges more than this, the difference is taken off the worker's pay which counts for the minimum wage. This means the higher the accommodation charge, the lower a worker's pay when calculating minimum wage. If the accommodation charge is at or below the offset rate, it doesn't have an effect on the worker's pay. If the accommodation is free, the offset rate is added to the worker's pay.

COs also shared the same view as employers, stating that the penalty was not an effective deterrent due to employers' lack of awareness of it. They also suggested increasing the £5,000 maximum for large businesses as this may discourage some larger employers from risking some of the schemes they chose to use to circumvent paying the NMW.

Wider issues affecting non compliance

Employers

COs reported that due to competitors underpaying the NMW, employers who were willing to comply with NMW were forced to lower pay rates simply to remain in competition with other employers who are willing to underpay NMW rates. It was reported that large agencies undercut small ones offering cleaning services to hotels for reduced amounts and do this by paying workers less.

Workers

As with employers, there were some issues with awareness of the specifics in relation to their rights and what they were entitled to. Some COs felt that there was a lack of publicity about how a worker can complain. Further impediments reported by the COs are listed below (many of these were consistent with the research carried out with workers).

- High level of “informal economy” operating in cash trades and lack of paperwork
- “Salaried” workers obliged to perform countless hours of unpaid overtime where their “salaries” are stretched to cover these hours.
- Overcoming “disguised employment” issues – where self-employment is foisted onto a worker to disguise the fact that they should be workers.
- The recession and the fear of losing their job in high areas of unemployment
- Becoming unemployable in the market place
- Some workers are also located in rural areas with poor infrastructure and therefore getting £6.00 per hour is better than travelling miles for hours to receive £6.19.

4. Power to remove records

The use and effectiveness of the new powers to remove records were assessed.

4.1 Key findings

- The introduction of the power to remove records has very little impact as this did not change the working practices of the COs. The process for removing records remained the same as prior to the changes.
- Employers were generally co-operative when asked to remove records therefore, this power did little to incentivise employers.

4.2 The effectiveness of the power to remove records

Prior to the 2008 changes, at an inspection, where an employer or other relevant person refused to copy the material part of the records (either because he is being obstructive or photocopying equipment is not available) the officer had no power to remove the records from the relevant premises to allow for copies to be made. Equally there may have been too much information for the officer to copy at the relevant premises in the time available or there may be too much information for him to sift through in order to determine the material parts of the records that he wished to copy.

Consequently, the power was extended to remove records from the relevant premises in order for an officer to make copies to make the information gathering process more effective. However these changes have had no effect on the enforcement regime as the procedure to remove records remains the same as prior to the changes.

Records are only removed by the COs with consent (if an employer refuses then the matter may be considered as a matter of obstruction rather than COs forcefully removing records).

HMRC do not use this power in a formal fashion or collect information on how often compliance officers remove records from the premises. However, anecdotal information suggests that compliance officers regularly take records away from the employers premises with very little objection. Furthermore, COs very rarely had to demonstrate that they have the 'Power' to remove records as employers were co-operative when asked for records. Therefore, this change has had very little effect on the enforcement regime.

5. Power to search and Seize

The use and effectiveness of the new powers to search and seize were assessed.

5.1 The effectiveness of the power to search and seize

Search and seize powers have only been used once since their introduction as they are only used to investigate the most serious cases to support a prosecution³⁰.

The criteria to meet when submitting cases for prosecution is high because of the need to prove the employer's guilt beyond reasonable doubt as in any criminal regime. Since the changes to the policy took place in 2009, there have been 3 successful prosecutions.

³⁰ This enabled HMRC criminal investigators to seize records which provided the offences for which an employer was convicted in March 2013.

6. Conclusions

Fair arrears

The fair arrears regime has worked well in terms of achieving the policy objective of ensuring that the arrears paid back to workers take into account the amount of time that has elapsed since the original underpayment and ensuring that calculations are based on the current rates. Furthermore, the simplicity in administering the penalty and the way arrears are calculated has resulted in very few formal complaints from employers.

Evidence from the review suggests that the fair arrears policy worked better for employers who kept good quality records and were co-operative during an investigation. Compliance officers (COs) reported that poor records or employers' lack of co-operation in sharing the appropriate information had an impact on HMRC's resources as the time spent on investigations increased and consequently, the payment to the workers was delayed.

Previous research with employers demonstrated that a key component of non-compliance was inadequate record keeping. Employers are required to keep NMW records by law. Where their records fell short of the legal requirement, HMRC found it difficult to satisfy themselves that the NMW had been paid and employers were unable to demonstrate that they were compliant. Furthermore, workers find it difficult to ascertain if they have been paid correctly when they are not presented with adequate records (e.g. payslips and contracts).

The fact that there is no sanction for employers who keep poor records or don't fully co-operate during an investigation could be further explored (taking into account proportionality and cost). Considerations may want to be given to improving guidance given to employers around record keeping to ensure employers take greater responsibility for storing and providing adequate information.

Employers and COs felt that the penalty was not proportionate for small businesses in cases where the employer had underpaid a worker a small amount due to genuine error. However, it was agreed that there are difficulties associated with proving that underpayment was a 'genuine error' and that any application of discretion may have an impact on increasing the number of appeals. Although there is a question about proportionality that may need to be considered by policy makers it would also be necessary to consider the effects and costs of any changes made.

It was also apparent that the current process for issuing a NoU was seen as time consuming by COs. Some of the issues identified were inherent in any enforcement process such as general administrative burdens and record keeping.

However, the Government may want to look into improving employers understanding of the NMW as COs reported that some employers had difficulty in understanding how the arrears were calculated. Consequently, this increased the burden on the

compliance officers as they had to spend more time explaining these to the employers. The lack of understanding is partly due to; the difference in calculating the NMW dependent upon the type of worker and how it is presented/explained to the employer. To note, the former is not a consequence of the changes in April 2009, instead, this relates to wider understanding of the specifics of calculating the NMW.

Changes to the civil penalty in April 2009

The introduction of the penalty was examined in relation to its effectiveness as an enabler to compliance and its deterrent effect. The review demonstrated that on average 63 per cent of the employers paid back the arrears within 14 days in order to benefit from the fifty per cent reduction in penalty. Therefore illustrating that employers are more likely to co-operate and pay back arrears in time if they are presented with an incentive to do so. Although this represents a large number of employers, Government may want to monitor the impact of increasing the penalty to 100 per cent of the arrears to see whether a higher number of employers pay back the arrears within the 14 day window.

The introduction of the changes to the penalty regime in April 2009 did not seem to have a deterrent effect (as the compliance level has remained steady over time). This may be due to employers and workers' lack of awareness of the penalty for underpayment of the NMW. The Government may wish to explore ways to increase awareness of the (new) penalty to enable it to act as a deterrent. Awareness raising should be targeted across the board as research with workers showed that those that sought out information about the NMW had done so on promoting by family and friends.

Employers and compliance officers felt that the £5,000 maximum penalty was not an effective deterrent to larger businesses due to the significant savings or gain from other cash flow advantages by not paying or delaying payment of the NMW. In order to address this and to target rogue offenders across the board, the Government has taken a tougher approach to NMW enforcement. The revised NMW Naming and Shaming scheme which came into effect on 1 October 2013 made it easier to name employers that break National Minimum Wage law and five employers have already been named. By naming and shaming employers it is hoped that bad publicity will be an additional deterrent to employers who would otherwise be tempted not to pay the NMW.

The Government has also increased the financial penalty percentage that employers pay for breaking minimum wage law from 50 per cent to 100 per cent of the unpaid wages owed to workers and the maximum penalty from £5,000 to £20,000. The increase came into effect on 7 March 2014. The Government will also bring in primary legislation as soon as possible so that the maximum £20,000 penalty can apply to each underpaid worker.

At the same time there may have been other factors affecting compliance. For example, compliance officers, employers and workers reported that the recession influenced their compliance the NMW. However, it is difficult to judge whether this is true.

Power to remove records

The introduction of the powers to remove records had very little impact on the enforcement regime or the evidence gathering process. HMRC reported that they followed existing processes when removing records and very rarely had to demonstrate that they have the 'power' to remove records as employers were generally co-operative when asked for records.

Search and seize powers

As HMRC's main objective is to recover arrears for workers who are not paid the NMW rather than to prosecute employers, it is not surprising that there were very low instances where the power to search and seize was exercised. The main reason for this was the strict criteria that needs to be satisfied for prosecutions. The decision on whether to prosecute or not is made by the Crown Prosecution Service (CPS) who will consider the evidence provided in support of prosecution and whether it is in the public interest to prosecute.

Furthermore, the fact that most of the arrears are for small amounts and that qualitative research points to non-compliance as a result of technical error rather than being deliberate demonstrates that the number of prosecutions are likely to be relatively small.

Key points for consideration:

- The Government has recently introduced tougher civil sanctions by increasing the financial penalty and revising the naming scheme to target the more serious cases of non-compliance. Further to this, non-compliance at the other end of the spectrum could be reviewed taking into account proportionality, impact and the costs of these. Education and information for employers who are non-compliant *due to genuine error* may be a good way to address this (e.g. improve communication about the technical details of the NMW and how to apply the correct rate for different types of workers).
- Consider what more the government could do to help employers improve their record keeping and explore any incentives or sanctions for employers who refuse to co-operate with investigations
- Continue to increase awareness of the enforcement regime for employers and workers
- Explore how current enforcement processes could be improved to be less onerous for CO and employers

Annex 1

Questions for Compliance Officers and relevant HMRC staff

The goal of this exercise is to

- i) Understand what changes to processes there have been since the introduction of the new enforcement regime in 2009, and;
- ii) If there are any good practices / obstacles that were introduced by the new regime.

Some of the questions are specific to before the changes were implemented, consequently only staff who have worked in National Minimum Wage since before the change in regime will be able to answer these questions.

Section A Background

This section looks at interviewees' background, career history and asks for contact details. By agreeing to give this information interviewees' recognise that it may be used for a follow up conversation with BIS if necessary.

Name:

Email address:

Telephone number (both landline and mobile if available):

Job title:

Length of time in current job (in years):

Brief description of current job:

Section B Fair arrears regime

This section is specifically exploring the changes to the collection of NMW regime arrears and the fair arrears regime.

1. What aspects of your working practices outlined under the categories below have changed since the implementation of the new regime in April 2009 (*please can you only mention changes that are specifically due to the new legal regime*):

a) evidence gathering

b) initial contact with the employer

c) the inspection

d) post inspection e.g. case for non-compliance and whether the arrears were paid.

- 2) What is your opinion about the practicality of the new regime in relation to the areas below (i.e. what works well/any impediments to getting your job done):

a) evidence gathering

Works well:

Impediments:

b) initial contact with the employer

Works well:

Impediments:

c) the inspection

Works well:

Impediments:

e) post inspection e.g. case for non-compliance and whether the arrears were paid.

Works well:

Impediments:

3) What is your opinion of the a) advantages b) disadvantages of the way arrears are calculated in relation to ease of understanding/application to various types of workers?

a) Advantages

b) Disadvantages

4. What is your opinion of the a) advantages b) disadvantages of the way arrears are calculated compared to before the changes were made in April 2009?

a) Advantages

b) Disadvantages

5. What is your opinion of the a) advantages b) disadvantages of the current way the Notice Of Underpayment (NOU) is issued in relation to its discretionary element?

Prompt - should everyone be issued with a NOU/ should people who have made a genuine error be exempt/should we apply a deminimus?

6. Do you think the minimum (£100) and maximum penalty (£5,000) is an effective deterrent? *Please explain your answer*

Section C Enablers to compliance

This section will concentrate on whether the regime has effective incentives in place to encourage employers/workers to comply with it and examine the enforcement regime to ascertain whether it is an effective deterrent.

7. In your opinion, do you think the current regime provides an incentive for employers to co-operate with investigations (with particular emphasis on the reduced penalty if paid within 14 days)?

8. In relation to enforcement, what are the barriers and what works well?

Barriers:

Works well:

9. What are the barriers to compliance for employers and workers and what works well? *Please separate answers for employers and workers.*

Barriers for employer:

Works well for employers:

Barriers for workers:

Works well for workers:

10. What improvements do you think could be made to the enforcement regime?
Please explain your answer.

Section D Value for money

The aim of this section is to take consider if the current enforcement regime offers value for money, and if it can be altered to be more efficient.

11. What is your opinion about issues related to the proportionality of the level of penalty and the cost of appeal? Do you think we are getting value for money? Yes/No? If not, how could this be improved?

Yes/no?

If above no, how could this be improved?

12. Do you think that the current regime allows us to get value for money when comparing the administrative cost and time spent collecting penalties to the actual penalty? Yes/No? If not, how could this be improved?

Yes/no?

If above no, how could this be improved?

Annex 2

Table 1. Breakdown of participant's roles.

HMRC staff role	Number of respondents
Operational Support Manager/advisor	2
NMW Compliance Officer	8
People Leader	2
Senior Investigating Officer	1

Annex 3

The table below lists the key changes to HMRC's working practices as a result of the fair arrears regime as described by the COs. Note, these are the views of COs rather than from formal HMRC documentation).

Evidence gathering	Initial contact with employer	Post inspection
<p>A NoU has to be issued in every occasion (Previously, a notice was only issued if enforcement was needed.)</p> <p>If employer has self-corrected prior to date of visit it is now necessary to determine the date the self-correction took place and compare this to initial date of contact.</p>	<p>The initial contact letters issued to employers notifying of a visit were adapted to include details of the altered powers plus an information sheet describing the penalty regime. When introducing oneself at a visit it is now important to explain the penalty regime & how arrears would be calculated.</p> <p>The report of meeting also documents whether an employer has read and understood the changes.</p>	<p>COs are required to contact 5 workers per investigation to ensure payment received (now COs have to contact employers after 21 days and 35 days after appeal).</p>

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