THE COLLECTION OF SOCIAL SECURITY CONTRIBUTIONS - ADMINISTRATIVE IMPLICATIONS

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ABSTRACT

This dissertation is intended to analyse the shortcomings that are found in the method of collection of social security contributions.

The Social Security Act emphasises that the payment of social security contributions is to be the principal obligation of every insured person, to secure the amount of revenue required for the expense of contributory benefits.

The analysis indicates that the shortfall in revenue collected results from the lack of enforcement on employers and on self-employed who tend to fail to affect their due payments within the time limit. Also, employers tend to fail to transfer social security contributions to the State on behalf of their employees, whilst the self-employed tend to declare a low income in order to affect a low rate of payment.

This study also indicates the link that exists between the Social Security Department and the Inland Revenue Department - which acts as the collecting agent of the former. Lack of co-ordination between the two main departments gives rise to inefficiency in the system of collecting revenue due as social security contributions.

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I would like to express my sincere thanks to my parents and to all my family. Their continuos encouragement and patience throughout the two years, helped me to complete this course. To them, I would like to dedicate this dissertation.

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Nevertheless, all of the above are not to be held responsible for the opinions expressed in this dissertation, or for any errors of fact, which are entirely my own.

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CHAPTER ONE

INTRODUCTION

Social security programmes in Europe aim to stabilise income for those families and individuals whose earning power decline for various reasons. At the same time they aspire to act as an incentive to work. The programmes' objective is not, therefore, specifically directed to eliminate poverty although they contribute towards keeping poverty in check at least in part.

A similar approach has been adopted in Malta. The Maltese experience was effectively developed on that of the United Kingdom. In fact, Britain adopted the social insurance principle with the introduction of the National Insurance Act 1911. In Malta, a similar Act was introduced in 1956, as a result of the influence of Britain on the Maltese Government. The social insurance scheme was designed to bring about a sharing of risks and pooling of resources. In fact, in Britain the principle was adopted following the increase in the number of recipients eligible to allowances and benefits. The only coverage at the time was against sickness and unemployment, but the system became no longer effective with the increase in the rate of unemployment in the post-war period.

Thus, Beveridge suggested that "Every person .... will pay a single security contribution by a stamp on a simple insurance document each week..." **(The Beveridge Report, HMSO 1942).** This scheme suggested that benefits were to be related to the contributions paid. This type of scheme helped to introduce new benefits. Hence, it was this system that the Maltese Government had adopted with the introduction of the National Insurance Act 1956.

In fact, the National Insurance Act offered contributory benefits, allowances and pensions calculated according to the contributions accredited to each contributor. Up to 1986, the system of Social Security in Malta was also subject to the Old Age Pensions Act 1948 and the National Insurance Act 1956 which offered non-contributory pensions and assistance in cash and/or in kind related to financial means. However, in January 1987 all three Acts were repealed and a consolidated Social Security Act introduced instead.

In Malta, apart from the problem of an ageing population, the continued improvement in the types of benefits given out to various categories of the population continued to widen the welfare gap. Indeed, in Malta, the various pensions, allowances and benefits are funded by contributions under the form of a national insurance scheme, to which citizens subscribe to qualify as recipients.

Such contributions are paid by three partners - workman, employer and government. Hence, the statutory employer liability measures culminated in the emergence of workman's compensation. This casts the employer into the role of one of the tripartite social security financiers. It also fostered the proposition that recipients of employer-financed social security benefits were not receiving charity, but rather employment-related benefits as a matter of right.

Indeed, the social security contributions' cost are a burden not only to the employers but also to employees. Such contributions reduce the take-home pay of employees and they raise the wage-bill for employers. Thus, for employers, the cost per worker is the wage plus the social security contributions; for employees, the return is the wage less the social security payment and income tax. **(Delia, 1993)**

The percentages to be paid by the insured person and the employer are established by law. In fact, from 1993 to date, the burden on the employer is felt more since his share adds up to 10% of the employee's weekly basic wage whilst that of the employee adds up to 8.33% of the weekly basic wage.

On the other hand, self-employed persons pay their contributions according to their income, that is, a bipartite financing. The State also contributes 50% of the amount paid by self-employed.

Since the financing of the Welfare System is important to Government, thus the Collection of Social Security Contributions is one of its main objectives. Social Security Contributions should contribute to balance out the expenditure of benefits given out through the Social Security System.

Thus, the scope of this dissertation is to present an analysis of the shortcomings that are found in the method of revenue collected from social security contributions. This analysis also indicates that the provisions of the Social Security Act should be applied effectively in order to curb up abuses. In fact, employers tend to fail to transfer to the State the social security contributions withheld from employees' wages, whilst self-employed persons tend to declare a low income in order to pay a low rate of contributions but on reaching retirement age, they prefer to declare a higher income in order to gain a higher pension.

The explanations and analysis made in this dissertation are based on personal experience at the Social Security Department and through discussions held with personnel in the same Department, namely people working closely with the system of Collection of Social Security Contributions. For the purpose of this study, any reference made to Schedules and Sections refer to the Social Security Act, 1987.

This study is divided as follows. Chapter Two consists of three sections of which Section One provides a brief interpretation of the Social Security Act with special reference to who is liable to pay Social Security contributions, whilst in Section Two an account is given of the present system of the collection of Social Security Contributions, including a description of the three main sources of revenue: Government, Employer and Self-employed.

In Section Three, the amount of estimated revenue, that is, the revenue which the Government hopes to collect is compared with the amount of actual revenue collected. For the scope of this study, the comparison of the resulting revenue gap is taken over the period 1987 and 1995. The reason being that in 1987, the three individual Acts were consolidated in a single Social Security Act.

In Chapter Three, the shortcomings in the systems of collecting revenue are examined. The various reasons that give rise to the loss in revenue include the lack of enforcement of the provisions of the Act and the lack of co-ordination between the Department of Inland Revenue and the Department of Social Security. An efficient system in the collection of social security contributions helps to control abuses by employers and self-employed who fail to affect their payments.

Chapter Four includes a comparison between the systems implemented in the United Kingdom and in Malta. In fact, it could be noted that the method of collection of social security contributions used in Malta is quite similar to that used in Britain. This chapter also includes recommendations that might help to improve the present system of collection of social security contributions.

For the scope of this dissertation, the analysis of the study covers the period between 1987 and 1995. Any changes currently proposed or in prospect for the Social Security Act 1987 are not being discussed in this dissertation.

CHAPTER TWO

THE SOCIAL SECURITY ACT: INTERPRETATION, STRUCTURE AND OUTCOME

The Social Security Act outlines the government's social policy that affects citizens throughout their lives. The Act establishes a scheme of social insurance providing cash benefits for marriage, sickness, unemployment, industrial injury, widowhood, orphanhood, and old age. Thus a social insurance scheme is designed to bring about a sharing of risks and pooling of resources. It is contributory and therefore social security contributions have to be paid by insured persons and employers. The State also binds itself to make a special contribution, in addition to any contribution to which it may be liable in respect of its own employees covered by the scheme.

2.1 The Interpretation of the Social Security Act.

Social Security is a mechanism for the transferring of financial resources from the working generation to those who cannot work because of age, disability or dependency status. Thus the payment of social security contributions is the principal obligation imposed by the Social Security Act.

The burden of payment falls principally on the gainfully occupied, on the employers and also on the State. The Social Security Act provides that 'every person who has passed his sixteenth birthday, but not yet reached his retirement, shall become insured under this Act either as an employed person or as a self-employed person' **(Section 3)**. Therefore, social security contributions are paid by every adult who is gainfully occupied in an insurable employment or self-occupied between the age of sixteen years and that of sixty-five years. On the other hand, persons who are employed for less than eight hours in a calendar week and whose earnings from any activity do not exceed Lm390 per annum, are not liable to pay social security contributions.

The Social Security Act provides that individuals who have reached the pensionable age, that is, sixty years for women and sixty-one years for men, may continue to work but are not liable to pay contributions as employed persons, if their earnings do not exceed the minimum basic weekly wage of that particular year. If, on the other hand, their earnings exceed the minimum basic weekly wage, they would be considered as self-employed or employed.

Whilst a small category of people could be exempted from paying social security contributions, the majority of the gainfully occupied people are liable to contribute by paying contributions. In fact, the

Social Security Contributions are classified under two classes - Class I Contributions and Class II Contributions.

2.1.1 Class I Contributions.

The Act provides that for every person considered to be in insurable employment, three social security contributions are paid: one by the employed person, one by the employer and one by the State payable out of the Consolidated Fund.

Contributions are paid by all those individuals who are in an insurable employment. All those employees who are employed outside Malta, but normally reside in Malta and whose employer has a place of business in Malta are liable to pay contributions as employed persons. Such types of employment include crew members of Maltese registered ships and of any aircraft licensed in Malta.

The Act specifies that the President of Malta, the Speaker, Ministers, Parliamentary Secretaries are subject to pay Class I contributions. In the case of the Members of the House of Representatives, the Act provides that a person who is not gainfully occupied in a self-employed capacity is liable to pay Class I contributions.

The Act also provides that any individual who is following a full-time course of studies or is in any training scheme that is provided by Government, will pay contributions for that period for which he is receiving remuneration. The individuals are considered as employed persons, but the Act establishes different categories for this section of employees. The amount paid by such individuals is less than the normal rate paid by employees in full-time employment. Different rates correspond to an age limit - if the individual is under eighteen years, he pays only 1/12 of his weekly pay up to a maximum of Lm 1.57, whilst if the individual is over eighteen years, he pays 1/12 of his weekly wage up to maximum of Lm 2.84.

The Act provides that if a person has more than one insurable employment, he is deemed to have his contributions deducted by that insurable employment which carries the highest basic wage.

Another category of people who are considered to pay Class I contributions are those who work on a part-time basis. An employment is considered as part-time if the individual works for less hours than that stipulated by the Wage Regulation Order governing his activity in a calendar week, and the weekly basic wage does not exceed the minimum basic wage as stated in Government's legal notices.

Prior to 1993, the weekly rate of contributions payable by the employee and the employer were on an equal basis: that is 8.33% (1/12) of the weekly basic wage, where the basic wage exceeded the minimum. On the other hand, if the maximum weekly basic wage is exceeded, a fixed rate is paid as established by the Act. **(Vide Appendix 1)**

On the other hand in 1993, the Social Security Act was amended by Act XXIV, which provided an increase in the social security contribution rate payable by employers from 8.33% to 10% **(Government Estimates 1993)**. In turn, the State pays 50% of the combined weekly contributions paid by both the employer and the employee out of the Consolidated Fund.

In the case of employed persons, the employer is held responsible for paying the social security contributions on the employees' behalf as stated in the Act. Such payments have to be paid at the Department of Inland Revenue at monthly intervals within such time and in such form and manner as may be determined by the Director after consultation with the Commissioner of Inland Revenue.

2.1.2 Class II Contributions

These types of contributions are payable by persons who are gainfully occupied in a self-employed capacity. For every contribution paid by a self-employed person, another contribution is paid by the Government. The rates of social security contributions payable by a self-employed person varies according to net income. Up to the year 1990, the rates for self-employed contributions were on a fixed basis, since no increase in pay was given by the Government. Thereafter, the rates for Class II social security contributions continued to increase together with the income bracket.

Any individual, whether unemployed or self-employed, whose earnings from any activity (being rents or income from his sole occupation) exceeded Lm390 per annum is to be considered as a self-occupied person, as defined by the Act. In contrast, a self-employed person is defined in the Act as a person who has not yet passed his sixty-fifth birthday, and who is not an employed person. The payment of Class II contributions is based on a limited income linked to the various categories of contributions. Each category corresponds to a particular income bracket. **(Vide Appendix 2)**. In 1993, the two lowest rates were amalgamated, since it was found that only 5.6% of self-employed persons were paying the highest rate, whilst 62.8% paid the lowest rates. This indicated that self-employed persons are instigated to declare low income, that is, up to Lm1800. **(The Times, Oct 1993)**.

In the budget for 1996, the Government proposed that the Social Security Act should be amended with regards to the gainfully occupied self-employed persons. Up to 1995, Class II contributions were based on an annual net income which included also interests, dividends and rents in the previous year. It is now being proposed that the rate would be based only on the annual income from a business or profession.

Payments are to be made every four months; end of April, August and December.

The Social Security Act also states that 'any directors in any partnerships, wherein such partnership has been entered into between, or among persons that are related to one another, up to and including cousins of the first degree are themselves such partners or the spouses of such partners' **(Schedule 1.6)** should effect their social security contributions as Class II and not as employed persons.

Another category of people who are liable to pay Class II contributions are all those individuals whose shares constitute the majority in any partnership. Also, as defined by the Act itself, any person 'shall be deemed to be a majority shareholder if, although the number of his shares does not constitute the majority, the value or powers attached to his holding exceed the aggregate total value or powers attached to the holding of the other shareholders in that partnership.' **(Schedule 1.7)**. Thus, any person who holds the majority of shares in a company and especially if he is the

Director, according the Act, is deemed to pay Class II contributions.

In 1988, with the employment of the Casual Social Assistants by the Department of the Care for the Elderly of the Government of Malta, the Social Security Act provided that the individuals concerned would pay Class II contributions.

2.1.3 Exceptions to the rule

In 1991, the Act was amended so that Maltese workers were allowed to pay contributions in Malta - at their own request - under the Employed Category (Class I) whilst working under a definite contract of service abroad. Thus, they were accorded the right to pay Class I contributions based solely on their own share of such Class I contributions and not on both the employee's share and that of the employer. **(DSS, Annual Report 1991)**. Consequently, the contributions are payable in the same way as those paid by the self-employed persons, that is every four months.

With effect from the 6th January 1992, a self-employed person, who is a member of a farmers' or fishermen's co-operative primary society in terms of the Co-Operative Services Act and who is considered by the Director of Agriculture and Fisheries to be a full-time farmer or a full-time fisherman, shall be entitled to retrieve from the Director of Agriculture and Fisheries the equivalent of 1/2 of the contribution which he would have been liable to pay by way of social security contributions, on the part of his annual net income derived solely from farming and fishing. This concession applies also to dairy farmers, animal, poultry or fish breeders and animal poultry or fish rearers. **(DSS, Annual Report 1992)**. Tourist guides and drivers of Government impressed vehicles also benefit from this type of agreement .

Another concession provided by the Social Security Act is that an individual who is liable to pay Class I contributions but who is also self-occupied may on his own request and with the approval of the Director, pay Class II contributions. Thereafter, such a person would not be able to revert to a Class I contributor unless and until he ceases to be self-occupied and informs the Director of such a change **(Section 14).**

Although the Social Security Act emphasises that social security contributions should be paid by all the gainfully occupied, it also provides exceptions to minimise disincentives for work.

Another point that is emphasised by the Act is that all individuals should pay the correct rate of social security contributions, especially as regards the self-employed. In fact, social benefits, such as sickness benefits, the two-thirds pension, and widows entitled to survivor's pension were introduced for the self-employed category. Failure to meet their contributions under the Act would deprive self-employed persons of additional benefits besides pension.

2.1.4 Exemption from paying contributions

The Social Security Act allows individuals to be exempted from paying social security contributions of any type. In fact, a person who is not gainfully occupied or is not self-occupied can request an exemption from paying Class I or Class II contributions. Such a request is made to the Director who in turn has to be satisfied that the concerned person is 'not self-occupied and whose yearly means calculated in accordance with the provision of Part 1 of the second Schedule to this Act, **(Section 12)** do not exceed:

i Lm 630 in the case of a married man who is wholly maintaining his wife and who is not herself self-occupied or in insurable employment.

ii Lm 430 in the case of any other person.'

This certificate of low income is valid for twelve months and has to be renewed every year. This certificate of low income could also be applied for by those persons who are employed for less than eight hours or by self-employed persons whose earnings do not exceed Lm390 per annum.

2.2 The Method of Collection of Social Security Contributions.

At present, it is the Department of Inland Revenue which is responsible for the collection of social security contributions, in respect of employees employed in the Private Sector and those paid by self-employed persons. On the other hand, the Department of Social Security is the collecting agent in respect of employees employed in the Public Service and Para-Statal bodies. Thus, this system of collection of social security contributions is based on a close inter-relationship between the Inland Revenue Department and the Department of Social Security. In fact, the collection of Social Security contributions is carried out in three different ways:

i Government employees and Para-Statal bodies through the Bulk Payment System.

ii Non-Government employees - payment is made on a monthly basis.

iii Self-employed persons - payment effected every four months.

These systems are examined in turn.

2.2.1 Government Employees and Para-Statal Bodies.

Social Security Contributions paid by Government Departments and Para-Statal Bodies are accounted for under the Bulk Payment System. The number of employees covered by this system was 53,161 for 1995. The Department of Social Security is informed of the commencement of employment of a new recruit by the department concerned through the form NI 12. On the other hand, the department has to inform the Department of Social Security, if an employment is terminated. This is done by sending the form NI 13. The employing department is also responsible for informing the Department of Social Security by sending the form NI 14 when an employee is on no pay, in which case no contribution would be due.

Thus, a government employee will continue to be credited with the contributions for every year, excluding that period where an NI 14 or an NI 13 is recorded.

2.2.2 Non-Government Employees

Non-government employees include all those employees employed in the private sector and those working in Public and Para-Statal Corporations. The number of employees covered under this system amounted to 86,322 in 1995.

The payment of Social Security Contributions regarding these employees is taken care of by their employers. It is the employers' responsibility to deduct the correct amount from the employees' weekly basic wages. Also, the employers have the obligation to forward by the established time all the workers' contributions which they deduct from their wages. Together with the contributions employers are obliged to pay in respect of every employee they employ.

These payments are made by sending monthly returns (TX 34) showing all the information regarding the employees. This method was introduced in 1978. These documents were sent by the employers to the Department of Inland Revenue, who in turn send a copy of each TX 34 **(Vide Appendix 3)** to the Department of Social Security.

Together with the TX 34s of each employer, a Transfer Voucher is forwarded by the Department of Inland Revenue bearing the amount of the money received. This system will continue to be used only by those employers who enact late payments concerning years prior to 1995. This is duc to thc fact that as from January 1996, the system has been changed. In fact, as it was quoted in the Budget for Year 1995, the TX34s are going to cease to exist and the employers are to effect payments on the TX 35 (Remittance Certificate) **(Vide Appendix 4).** The TX 35 includes only the amount paid. The only information received by the

Department of Social Security is a copy of the Remittance Certificate together with the Transfer Voucher.

At the end of the year, the employers have to submit a consolidated Yearly Return (P6) **(Vide Appendix 5)**, which is sent to them by the Department of Inland Revenue. The total amount of the P6 has to agree with the total of the amount remitted monthly to the Department of Social Security. The amount of each employee is audited and then the paid contributions are transferred to the individual employee's record.

2.2.3 Self-employed Persons.

This category includes all those people who are self-occupied and thus pay the Social Security Contributions according to their annual net income. The number of employees covered by the Class II contributions amounted to 16,329 in 1995. Self-employed persons usually make quarterly payments. Payments are effected at the Department of Inland Revenue together with the provisional tax.

The amount received by the Department of Social Security is compared with the total of the Transfer Voucher forwarded by the Inland Revenue Department. The self-employed can effect their quarterly payment within the following four months after the due date.

2.3 The Estimates of the Revenue Gap 1987 - 1995.

The Social Security Act provides for a system of contributory and non-contributory benefits. Such benefits are financed from several sources. Contributory benefits are financed under the contributory social security scheme from payments made by employees, employers, the self-employed and the State. Non-contributory programmes are financed entirely from government sources.

Since total revenue falls short of the total expenditure under the Social Security Account, a Welfare Gap has been recorded in recent years. The **Welfare Gap** is officially defined as **the difference between all items of expenditure and contributions made in terms of the Social Security Act 1987. (Vide Chart 1).**

REVENUE FROM SOCIAL SECURITY CONTRIBUTIONS AND EXPENDITURE ON BENEFITS 1987/1995

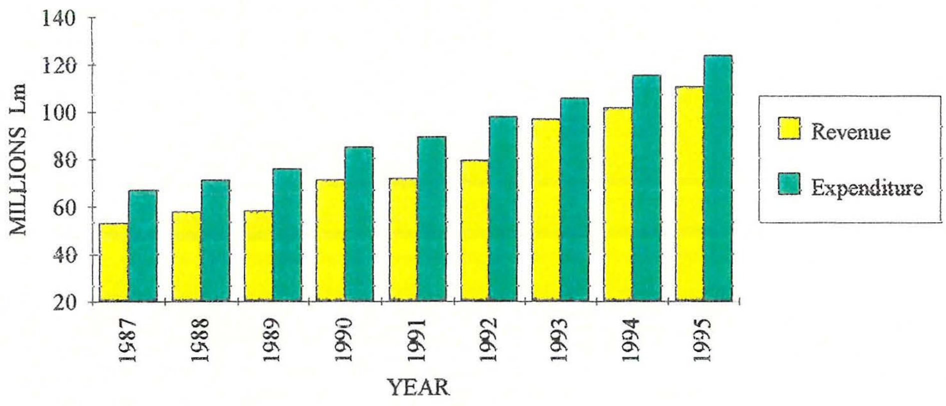


CHART 1

An illustration of the Social Security Accounts is presented in Table 1, for the year 1995. In 1995, the Welfare Gap amounted to Lm 37.1 million or 24.7% of the total payments.

The expenditure side of the Social Security Account includes the following items: Contributory Benefits, Non-contributory Benefits, Administration Expenses and Expenses in connection with Health Recurrent Services. In 1995, Health Recurrent Services expenses represented Lm48.9 million (32.5%), from a total of Lm150.5 million.

Since 1987, expenditure on the Social Security Account has increased by 55.7.% to settle at Lm123.9 million in 1995. In the meantime, social security contributions increased from Lm53.5 million in 1987 to Lm110.8 million in 1995; recording a gain of 47.4%. This difference in growth rates widened the Welfare Gap in 1995. **(DSS, Annual Reports 1987- 1995).** Chart 2 illustrates this.

However, Trade Union leaders maintain that the Welfare Gap is non-existent in Malta at least, in so far as social security contributions are concerned. They argue that if Medical Health Recurrent expenses, as well as non-contributory payments are deducted in 1995, the so-called 'gap' turns into a surplus. Hence, the contributory scheme could be self-financing.

Table 1 - Table of Estimates for 1995

(Expressed in thousands of Maltese Liri)

Source of Funds	Lm	Lm	Application of Funds	Lm	Lm
I Income in respect of Contributory Benefits			**A Contributory Benefits payable under the Social Security Act, 1987**		
A Class I Contributions					
1 Government employees	10,986		1 Retirement Pensions	48,900	
2 Non-Government employees	19,680		2 Children's Allowance	16,475	
3 Government as employer	13,184		3 Bonus	8,630	
4 Non-Government employers	23,628		4 Other Benefits	25,813	
		67,478			99,818
B Class II Contributions			**B Administrative**		
Self-employed persons		8,122	**Expenses**		1,815
C Direct Contributions by Government in terms of Social Security Act, 1987			**C Expenses in connection with Health Recurrent Services**		
i State grant equal to half the total amount contributed by all employees & employers	33,739		1 Hospitalisation and Community Care	40,848	
			2 Elderly and Special Needs	8,019	
ii State grant equal to half the amount paid by self-employed persons	4,061				48,867
		37,800			
		113,400			
II **Welfare Gap** - Difference between all items of expenditure & contributions made in terms of Social Security Act, 1987		37,100			
Total receipts		150,150	Total Payments		150,150

THE RISE OF THE WELFARE GAP 1987/1995

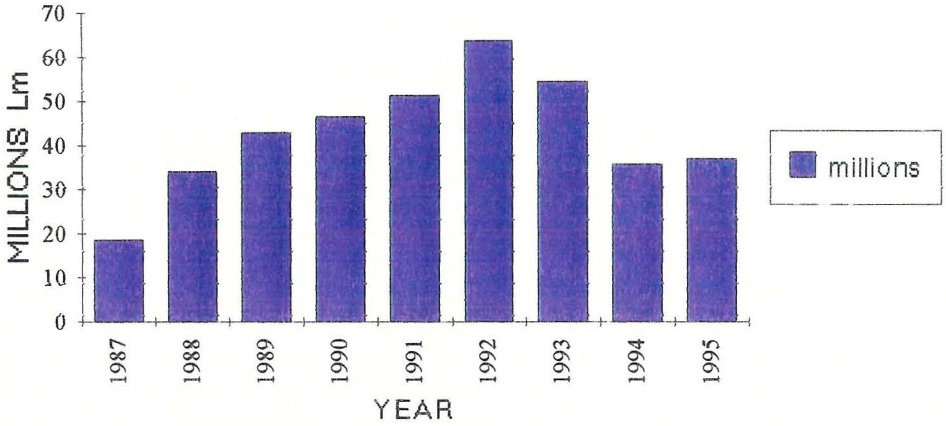


CHART 2

However, the Ministry of Finance is projecting an increase in such a deficit, primarily emerging out of a longer life expectancy for the Maltese and a higher dependency ratio - the ratio of the over-60 in the total gainfully occupied population. This implies that the over-60 population is to increase at a much faster pace that the increase in the working age population.

The burden of payments of social security contributions falls mostly on the gainfully occupied population. Thus, the amount of revenue collected depends also on the expansion of the labour force and the net rate of job creation in the three sectors of the labour market - that is, the public sector, the private sector and the self-employed. These are examined below.

2.3.1 The projection of the gainfully occupied.

Movements in the gainfully occupied population composition for the period 1987 - 1995 may be observed from Table 2. The term Public Sector is usually taken to include Public Administration and the Independent Statutory Bodies. But, for the purpose of the Social Security Act 1987, the Independent Statutory Bodies are included under the Private Sector even though social security contributions are collected in the same way as those of government departments.

Table 2 - Gainfully Occupied Population

Year	**Public Sector**	**Private**	**Sector**	**Self-Employed**
		Para-statal	Private	
1987	34,710	20,269	66,942	15,328
1988	36,276	20,430	68,267	15,357
1989	36,490	19,510	70,135	15,728
1990	36,376	19,045	71,775	16,095
1991	36,728	18,945	75,183	17,180
1992	37,039	19,133	75,437	16,751
1993	36,934	18,496	76,829	16,280
1994	36,640	18,569	78,691	15,985
1995	36,395	16,766	86322	16,329

SOURCE: Economic Trends 1987/1995

The main features of gainful employment between 1987 and 1995 may be summarised as follows:-

The **Public Sector** complement accounts for 24.4% of the gainfully occupied population. This percentage includes the manpower in the Government Departments together with temporary employment. (Table 2). The only increase in the public sector complement was between 1987 and 1988. The increase of 1566 is accounted for partly by new recruits in the clerical category, and partly by the setting up of the labour corps under the Auxiliary Worker Training Scheme in 1988.

Between 1988 and 1994 the public sector complement remained stable with only slight fluctuations. This indicates that throughout the years, the drop in temporary employment was offset by the increase in the Government Departments' manpower. Mainly, the new recruits were employed in the clerical, technical and professional categories.

The **Private Sector** complement made up 64.9% of the gainfully occupied population, of which 12.4% are employed with the Independent Statutory Bodies.

From Table 2, it can be observed that employment with the Independent Statutory Bodies is on the decline. The Independent Statutory Bodies incorporates the Para-Statal Bodies and the Public Corporations. Although Public Corporations such as the Water Services Corporation have been recently set up, other companies administered by MIMCOL in which the Government was a majority shareholder were wound up or, in some cases, privatised.

At the same time, the Private Sector showed an increase in job provision between 1987 and 1994. However, some of the jobs apparently created in the early nineties could have been the outcome of an improved system of recording the gainfully occupied following the Amnesty given by Government in 1990. The Amnesty gave employers the opportunity to regularize their positions and that of their employees with the Employment and Training Corporation. A similar situation arose in 1995 following the introduction of Value Added Tax. Indeed, private sector employment increased by 3290 between December 1994 and March 1995. Value Added Tax brought to light activity carried out in the underground economy.

The **Self-employed** made up 10.7% of the gainfully occupied population. This category registered only a marginal increase in the past nine years. A marked increase of 6.3% was observed in 1991. This was accounted for by the Government amnesty granted in late 1990 to persons who had been working without a workbook. Another factor contributing to this upswing was the fiscal incentives designed to assist the unemployed and members of Auxiliary Workers Training Scheme to set up business, announced by Government in late 1990.

However, self employment has since then been on the decline. The number of self-employed fell by about 1200. This decline suggests that individuals prefer to be employed rather than work on their own.

2.3.2 The increase in the rate of social security contribution.

As already stated and as emphasized by the Act, social security contributions are paid by the gainfully occupied and by the State. With the introduction of the National Insurance Act 1956, contributions became income-related, meaning that the contributions were paid according to the weekly wage, subject to a minimum and a maximum weekly limit. In fact, social security contributions are a flat-rate tax on earnings for employees and a form of payroll tax for employers. Between 1956 and 1992, three equal contributions were payable - one by the employed person, one by the employer and one by the State.

The rate of such contribution was equivalent to 8.33% of the employee's weekly basic pay. These rates continued to be effective up to 1992, when the Government proposed an amendment to the Social Security Act whereby the social security contribution rate payable by the employer was raised from 8.33% to 10%. The employees' rate remained the same but was increased proportionately in line with the cost of living increase awarded in wages.

An increase in employers' social security contributions disturbed the finely balanced ratio that had been established since the fifties. Apart from an increase in rate, changes in social security contributions for employers mean a rise in the cost of labour. These new measures also meant increased Government expenditure since its own contributions would increase proportionately to the increase borne by the employers. In fact, the Government has to contribute one-half of the contributions paid by employers and employees.

Apart from the increase in the employers' share of contribution, the Act was also amended with regard to the contributions paid by the self-employed. In fact, in 1993, the rates of contributions payable by the self-employed were increased by 25c per week, with the exclusion of the lowest rate which was raised from Lm4.65 to Lm6.20 per week. **(DSS, Annual Report 1993).**

Changes were made in the lowest rate to counteract the fact that many self-employed under 50 years were paying the lowest rate. Indeed, only 5.6% of self-employed paid contributions equal to the higher rate of Lm13.95 per week. The raising of the lowest rate from Lm4.65 to Lm6.20 was meant to curb abuses of the self-employed, thereby increasing revenue and leading to a reduction in the Welfare Gap, everything else being equal.

2.3.3 *Revenue Projections*

In order to estimate the expenditure concerning social benefits together with the introduction of any new benefit, the Government has to estimate the total revenue for a particular year from all the sections of the labour force. The estimates of the revenue are projected by the Accounts Section of the Social Security Department. The estimates are handed in to the Ministry of Finance by October, since the Budget is usually presented to Parliament in November. Thus, the projections on the amount to be collected from social security contributions are worked out on the latest statistics available of the gainfully occupied population. Another factor affecting the estimates would be the rise in pay given by the Government related to the cost of living increase.

As regards the Public Service, projections take account of any Agreements entered between the Management and Personnel Office and the trade unions regarding the increase in wages in the public service. In recent years such Agreements were undertaken following recommendations by the Public Service Reform Commission. These estimates exclude the promotions of employees during the year.

For the purpose of carrying out cost projections, the term Government employees refers only to those entities where the Government is the employer, such as the Government Departments.

Non-Government employees include all the Private Sector together with the Independent Statutory Bodies in which the Government is a shareholder. Self-employed persons include all those individuals who are self-occupied.

The movements of both the **projected** and the **actual revenue**, from the collection of social security contributions can be observed in Tables 3 and 4. **(Vide Chart 3)**. Table 3 suggests that between 1987 and 1995, the projected amount increased by 51.8%. Also, during the same period, the actual amount of revenue registered an increase of 51.7%. When compared with the projected amount, a difference of 0.1% results.

In 1994 and 1995, a decline is observed between the actual amount and the projected amount of revenue collected. In fact, in 1994, a drop of 2.1% is recorded whilst in 1995, the decline increased to 2.6%. Such a difference is accounted for by a decline in revenue collected from the Government Sector and the Self-employed.

The total actual revenue after 1990 includes the amount of 'further contributions'. **(Section 119)**. These contributions are paid by those employers and self-employed who fail to pay their social security contributions in due time. In fact, the amount collected added up to Lm 365,086 (0.4%) of the total revenue.

Table 3 - Estimated Revenue Lm

Year	Government	Non-Government	Self-Employed	State Grant	Total Revenue
1987	11,600,000	21,040,000	3,854,000	18,247,000	54,741,000
1988	11,900,000	20,916,647	3,850,000	18,333,332	55,000,000
1989	12,200,000	21,700,000	4,200,000	18,900,000	56,700,000
1990	12,894,000	26,156,000	3,528,000	21,289,000	63,867,000
1991	14,600,000	26,500,000	4,300,000	22,700,000	68,100,000
1992	15,400,000	27,800,000	5,000,000	24,100,000	72,300,000
1993	21,112,000	33,456,000	7,270,000	30,863,000	92,588,000
1994	22,138,000	39,680,000	7,441,000	34,629,000	103,877,000
1995	24,170,000	43,308,000	8,122,000	37,800,000	113,400,000

Table 4 - Actual Revenue Lm

Year	Government	Non-Government	Self-Employed	State Grant	Total Revenue
1987	11,322,038	21,072,318	3,266,960	17,830,658	53,491,974
1988	11,634,096	23,647,821	3,343,562	19,312,739	57,938,218
1989	12,377,505	22,578,251	3,969,359	19,462,558	58,387,673
1990	13,882,431	26,665,783	6,964,214	23,704,998	71,234,689
1991	14,884,943	28,475,055	4,572,271	24,025,482	72,041,864
1992	16,551,534	30,536,938	5,844,812	26,466,633	79,520,126
1993	19,908,719	38,076,585	6,303,008	32,617,129	97,005,085
1994	20,365,453	40,208,797	7,151,751	33,863,000	101,769,865
1995	21,111,878	45,058,985	7,444,657	36,807,760	110,788,366

ESTIMATED REVENUE AGAINST ACTUAL REVENUE 1987/1995

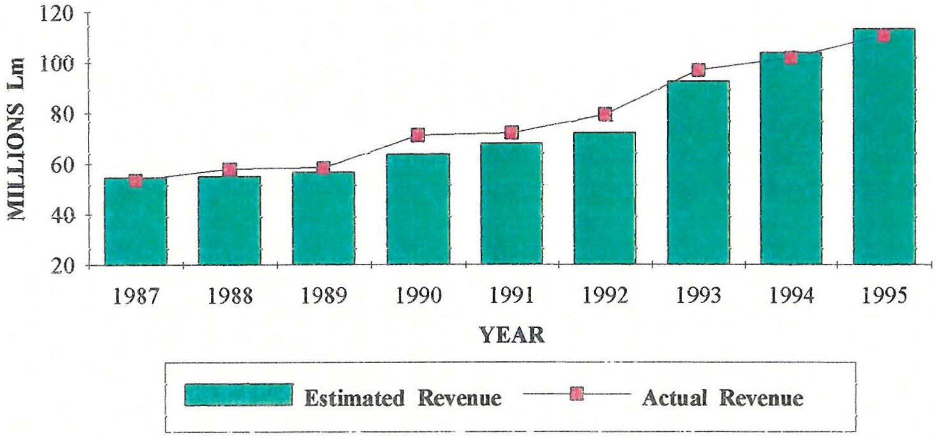


Chart 3

The **Public Sector** showed a negative difference between the estimated and the projected revenue, during 1987 and 1988. Also, in 1994, a shortfall of 8% is observed between the actual revenue and the projected revenue collected by the public sector. This is accounted for by the fact that the projection included a salary reform which was not implemented.

During the same period, the actual revenue collected by the **Non-Government Sector** was more than that estimated. For 1991, there was an increase of 6.9%, indicating that the effect of the Amnesty granted as per Act XVI of 1989 had been effective. This suggests that the effect of the Amnesty was not evident in the revenue collected at the end of 1990, but in the following year. In fact, companies in the private sector which had fallen in arrears in the previous years preferred to sign a formal agreement with the Department. Amounts due in arrears were substantial.

In 1993, with the increase of the employer's rate, the estimated amount increased substantially. This is significantly noted in the private sector which showed an increase of 12.3%.

The highest amount collected was from the **Self-employed** persons during 1990. The increase recorded was of 50% over the estimated value. In fact, this significant increase was that by virtue of the Social Security Act, the Amnesty as per Act XVI of 1989 was granted whereby any self-employed person who was in default up to December 1988 could pay his outstanding social security contributions without the imposition of the Department Fine. This is effective as long as the concerned person paid his dues, together with any **current** contributions that might have been due, by not later than 30.4.90 **(DSS, Annual Report 1989)**.

Regarding the self-employed, the actual amount of revenue continued to increase over the estimated total. The reason being that people might have become more conscious in not falling in arrears in the payment of social security contributions. On the other hand, although in 1993, a drive has been made for the self-employed to pay the correct rate according to their net income, a decline in revenue is noted. This is also the case for 1994, where a decrease of 3.8% might also be the effect of a decrease in self-employment as indicated in Table 2.

Apart from the revenue collected from the private sector and the self-employed, the burden of payments of social security contributions is also carried by the State. In fact, the Act emphasises that the State has to contribute 50% of the total value paid by the gainfully occupied in all three sectors of the labour market, apart from the 10% of the value paid by the public sector.

Moreover, the contribution estimated to be paid by the State will emanate directly from government resources which in turn are derived from other flows of the Consolidated Fund. The difference noted in the State Grant is due to its dependence of the total revenue collected.

2.4 Conclusion

The Social Security Act aims at promoting equality between all citizens and to provide benefits, assistance and pensions to the poor, sick, elderly and the unemployed, but it also emphasises the obligation of the payment of social security contributions by employees, employers, self-employed and the State. Hence, the main objective of the Act is to ensure the timely collection of social security contributions.

The Act also classifies the various sections of the labour force and thus the type of contributions they are liable to pay. In fact, the collection of social security contributions incorporates three systems. The three systems include the Bulk Payment System which incorporates the Government employees and Para-statal Bodies, whilst the private sector effect their payment on a monthly basis. The other system incorporates the self-employed persons who effect their payments on a quarterly basis. The latter two pay through the Department of Inland Revenue.

The three sectors of the population are the main contributors to the social security fund. The revenue collected from the social security contributions is used to balance out the expenditure of the Social Security Department, with regard to the payment of benefits, social assistance and pensions. The Department's main aim is to reduce the Welfare Gap considerably.

Thus, the gap between the actual amount of revenue collected when compared to the estimated amount could be considered as a sign of the effective measures to be taken in order to collect social security contributions due. Recurrent differences between these two sets of statistics could suggest shortcomings in the collection system.

CHAPTER THREE

PROBLEMS IN THE COLLECTION OF REVENUE

This chapter examines shortcomings in the systems of collecting revenue, indicating the various factors that may lead to the shortfall in revenue. The powers given to the Director of Social Security are in turn discussed, followed by an analysis of the shortcomings in the three main collecting systems, that is, in the government sector, private sector and self-employed.

Apart from the obligation of who is liable to pay social security contributions, the Act emphasises the measures that have to be taken to enforce the provisions. The Director of Social Security is vested with the power to ensure that the Act is abided by the three social partners.

Overall, the method of collection of social security contributions can be identified as a 'chain'. **(Vide Appendix 6)**. In fact, if there results a backlog at the Social Security Contributions Section due to a breakdown in the system at the Inland Revenue Department, the Enforcement Section in turn cannot identify defaulters and thus contributions cannot be credited to the insured person's records. Hence, it is important to have an efficient 'chain' armed with co-operation both inter- and intra-departmental in order to have an efficient system in the collection of revenue.

3.1 Enforcement powers of the Director of Social Security

The **Social Security Act** emphasises the obligation of both employers and employees to pay social security contributions. It contains provisions relating to the administration and the enforcement of such provisions.

Hence the Director of Social Security is responsible for ensuring that employers and self-employed persons comply with the obligations and responsibilities as stated in the Act. The powers and duties of the investigative staff in the Enforcement Section are also defined and delimited. In fact, the penalties that may be imposed by the Director of Social Security on defaulters are defined in Section 116 of the Act.

The Act provides that 'in cases where defaulters fail to settle the contributions due together with the aforesaid further contributions within three months of the aforesaid prescribed time, the Director may without prejudice to any other right competent to him, by means of judicial letter served on the person by whom such contributions or further contributions are due, claim such payment.....' **Section 116(2)**.

In the event of non-compliance, the Act gives the power to the Director of Social Security to take further actions as provided by the Act itself. Judicial action may be initiated against those employers who persist in refusing to pay social security contributions due on behalf of their employees or fail to reach an Agreement with the Department to pay arrears over a period of months. In fact, warrants are issued only if defaulters tend to ignore both the intimation and the judicial letter sent to them by the Department through the Attorney General's Office. The Director of Social Security is thus enabled to enforce the provisions of the Act in order to provide an efficient administration in the collection of social security contributions.

3.2 Government Departments and Public Corporations

The **Bulk Payment System** (Government Departments and Public Corporations) is the one having most defects, since there is no accountability that the amount being recorded on the individual's record is actually paid. The money is received by the Accounts Section of the Social Security Department on a collective basis, that is, an amount for the whole department without any indication of the employees concerned and the distribution of payments per employee. Thus, there is no collaboration between the Accounts Section and the Staggers Section where the individual's record is kept.

The system works on a 'negative process'. It depends on a Government Department notifying the Social Security Department of any changes in personal payments, such as when an employee is not paying contributions because he is either sick or on unpaid leave. In these cases, the Social Security Department continues crediting the employee's account with contributions. At times, newly engaged public sector employees would have their social security contributions collected by the Department in which they are engaged, but these funds are not transferred to the Department of Social Security on behalf of the employees. Furthermore, the unpaid contributions form (NI 14) is not sent regularly especially where civil servants are transferred on loan to Para-Statal bodies which do not pay social security contribution on the bulk payment system. This gives rise to a loss of revenue to the Social Security Account from the Government Departments and contributions are actually allocated, when in fact no contributions are being paid. Hence, this system gives rise to quite a number of abuses regarding payments. These could be reduced if Government departments inform the Social Security Department of any changes in the complement of their staff.

3.2.1 Non-enforcement on Government Departments

The provisions of the Social Security Act concerning the enforcement of the payment of social security contributions in time are emphasised mostly where non-Government employees and self-employed persons are involved. At the same time, such provisions of enforcement are not applied to Government Departments or entities where the government is a majority shareholder. An example is the case of the Malta Drydocks which has accumulated a debt of Lm 7.4 million up to 1995 in social security contributions. In fact, this amount had to be paid at the rate of Lm 0.5 million per year over a ten year period according to the 1989 Government - Malta Drydocks agreement. But the amount is still outstanding. (**Malta Business Weekly, 22-28 Feb 96, pg2**)

Thus, although the Act gives extensive powers to the Director, these powers are limited with regard to Government Departments and other entities in which the Government is a shareholder. In fact, the Act only refers to 'Employer'. It does not distinguish between an employer in the private sector and an employer in the Public Sector. Therefore, this confirms that the provisions of the Act should be enforced on equal basis to all employers.

3.3 Non-Government Sector

As already mentioned, the Inland Revenue Department acts as the collecting agent for social security contributions for the **Non-Government Sector**. But it is the Social Security Department which is responsible for inputting data on contributions and taking enforcement action against defaulters.

The money deducted from an employee's pay as social security contributions are expected to be forwarded by the employer to the

Inland Revenue Department. Many employers abide by this condition. But there are also others who irresponsibly abuse of funds raised as contributions and deducted from their employees' salaries, thereby leaving them bare of insurance cover. The Enforcement section of the Department is actively pursuing these employers to straighten up the trends.

There are 7116 employers. Of them 308, or 4%, employ more than 50 employees. These represent the large employers. The Department considers that firms employing more than 50 employees are the worst defaulters. For example, in 1990, out of 308 such employers 84% were late in paying their employees' contributions. This relatively high rate of lapsers is even more significant since Government had already tried to remedy such deficiencies by announcing an Amnesty in 1989. Indeed, one may conclude that employers have been ignoring the provision of the Act even since then, the rate of defaulters reached 98% in 1994. Social Security Funds are apparently being used instead of overdrafts to finance firms' cash flows, reducing interest rate payments in the process, and thus enhancing a firm's profitability.

3.3.1 Activities of the Enforcement Section

Furthermore, in 1995, the Enforcement Section has issued about 701 Further Contributions Documents. These documents consist of a fine and are sent to those employers who make delayed payments. At the same time, the 701 documents issued could involve the same employers but include various months. To be effective, the process has to be carried out consistently and regularly and keep arrears to a minimum.

In 1995, 1011 applications were received from Class I contributors to seek 'deeming'. This is a request to the Director of Social Security to deem as paid any contributions deducted by the employer from the employee's wage but not remitted to the Commissioner of Inland Revenue.

One of the main task of the Enforcement Section is to identify the defaulters. These are then notified through an Intimation letter indicating the amount due in arrears. If the employer is not in a position to settle the amount due in social security contributions with immediate effect, the Enforcement Section generally reaches an agreement with the employer to pay the amount due in a series of instalments. Thus, Agreements are reached between the employer and the Social Security Department, whereby the employer agrees to pay all outstanding contributions over a definite period. The Agreement is set out in a way that the employer will effect a payment for the current year together with another payment from the previous years. In 1995, only 36 defaulters reached agreement, whilst in 1994, there were 58 defaulters who signed the agreement. **(DSS Annual Report, 1994 - 1995)**. Consequently, the reduced number of Agreements reached in 1995 could result from the fact that employers, on receiving the intimation letter might prefer to settle down the outstanding balance immediately.

In 1995, Judicial Action was initiated against 481 defaulters whilst in 1994, action was initiated against 709 defaulters. These defaulters persisted in refusing to pay social security contributions on behalf of their employees or to reach an agreement with the Department to pay arrears over a period of months. The high number of actions taken in 1994 suggests that a backlog had accumulated, and this may indicate a deficiency in the process. Such a situation arises from a lack of co-ordination between the Department of Social Security and the Attorney General's Office. Indeed, the Department is entirely dependent on the Attorney General's Office, since it does not have its own legal department.

Agreements reached between the Department and the employer refer to an estimated amount based on previous months. However, such payments may not always be backed up by supporting documents. Evidently, this is a set-back for the efficiency of the system and should be rectified as quickly as possible. Failure to submit documents jeopardises an employee's interest.

To date, such payments have been made by 240 employers. These payments on account may have been paid recently but might have been due for previous years. Those employers who fail to produce the TX34's, can be fined according to Section 125 of the Social Security Act. In fact, Section 125 states that, 'Any person who at any time has or has had in his employment any employed person shall furnish to the Director or Commissioner of Inland Revenue on behalf of the Director, such information concerning such employed person .... if any person fails to provide such information .... he shall be liable on conviction to a fine of not less than Lm 50 for each such offence and to a further fine of not less than Lm 1 for every day during which the said offence continues.'

Unfortunately, such payments are on the increase and as time goes by, it becomes more difficult to obtain the documents from employers, that is, documents required might date ten years back. Thus, if the provision of Section 125 is enforced, it is likely to reduce the number of those employers who fail to produce the required documents.

3.3.2 Inter-Departmental Interaction

The present system of the collection of social security contributions requires the co-ordination between two Government Departments, namely, the Social Security Department and the Inland Revenue Department. The two departments implement government's policy within the terms of reference that define the division of responsibilities for each respective department under the Social

Security Act. They are expected to liaise between them and for all intents and purposes could be considered as equal partners in a joint venture.

At the same time, the present system puts the Social Security Department at a disadvantage since it has to deal with inputs, namely, personal income declared, accepted by the Inland Revenue Department. Thus, if the Inland Revenue Department fails to communicate forms TX34s, the Social Security Department has to turn to the employer in order to obtain a copy of the forms missing from its files. Such a system is cumbersome. It leads to lags in enforcement and to the duplication of efforts.

Employers do not take these procedures lightly. They often point out that they should be informed straightaway that certain documents are mislaid. In these situations, the Social Security Department's officials find it difficult explaining to employers the procedure whereby the documents are first sent to the Inland Revenue Department together with the relevant payment. Since the Inland Revenue Department is a collecting agent only, the officials of the Inland Revenue Department are primarily interested in recording the amount paid as social security contribution.

It was expected that the computerisation of the Inland Revenue Department would have improved on the situation, as observed by S Spiteri, 'that the computerisation of Inland Revenue, which some years back has taken over the collection of NI contributions from Social Security Department.......... is going to provide for effective follow-up action to avoid the accumulation of arrears in the future.' **(The Employer Nov 1993)**. However, this step has not to date eliminated deficiencies in the system.

The inter-departmental complementarity will be effective if the Inland Revenue Department is in a position to supply timely and correct information to the Department of Social Security. As a result of a break down in the system at the Inland Revenue Department, on various occasions the work at the Social Security Department was held back. The way the system is functioning at present implies that the Director of Social Security cannot enforce the law effectively, since no data are available to check whether any employers have fallen in arrears.

Besides in some cases, the data transferred from the Inland Revenue Department cannot be reconciled with the amount shown on the Transfer Voucher handed over to the Accounts Section of the Social Security Department. In such cases, the department continues to receive the revenue but inefficiency results in the reconciliation of employers' documents. This arises from the lack of co-ordination between the two departments, especially if the situation continues for months without any intervention taking place to remedy the situation.

This indicates that the Department of Social Security seems to give a relative importance to the collection of revenue rather than in maintaining an updated record of every insured person. In fact, a person could be deprived of a benefit due to an incomplete record, showing that an individual may not have the required amount of contributions paid up to the date of claim.

3.3.3 Intra-Departmental Interaction

The sections of the Social Security Department that deal with the collection of contributions, the enforcement of laws and to accredit contributions are the **Social Security Collections Section**, the **End-Of-Year Return Section** and the **Enforcement Section**. The **Benefits Section** deals with the insured persons claims for short-term benefits such as Unemployment, Sickness and Marriage Grant. Although, the Social Security Collections Section and the End-Of-Year Return Section are two separate sections, yet they collaborate very closely to meet their objectives which are:

i the collection of the money in due time as specified by the Social Security Act and by the Inland Revenue legal provisions.

ii the allocation of social security contributions to the respective records of the individual.

iii the reconciliation of the amount of money paid by employer with the total amount of all employees.

On dealing with an individual's claim for any type of benefit, the officials of the Benefits Section have to ensure that the social security contributions are allocated accordingly. On the other hand, the Enforcement Section carries out investigations and keep trace of defaulters.

The lack of co-ordination between the Inland Revenue Department and the Social Security Department, also leads to inefficiency in the intra-departmental relations, that is between the Social Security Collections Section, End-of-Year Return Section, Enforcement Section and Benefits Section. In fact, progress depends on the Social Security Collections. If there is a delay in the reconciliation of the documents, the Enforcement Section would not be able to check whether employers have fallen in arrears in paying their employees' contributions. At the same time, the Benefits Section would not be able to allocate social security contributions to the employees' respective record.

Therefore, in order to have an efficient and effective administration, co-operation has to be thorough both at an interdepartmental and intradepartmental level.

3.4 Self-Employed

The collection of **Self-employed** contributions depends wholly on the declaration of income made by the individual himself. A permit indicates the rate of payment a self-employed person is liable to pay for the current year, based on the income declared in the previous year. The Department of Social Security emphasises that the self-employed are expected to renew their Permit every year, in order to establish their correct rate of payment. According to the 1995 Annual Report, 1390 applicants had their Permit changed from one category to another whilst 1719 applicants updated their existing Permits. Compared with the 16,329, which are registered as self-employed persons by the Employment and Training Corporation, the number of individuals who tend to update their Permit is considerably small.

Hence, it can be noted that some self-employed individuals tend to ignore the provisions of the Act. In fact, their mentality still shows that they are likely to pay the lowest possible rate of contributions and they increase their rate of payment in the last few years on approaching retirement age. Thus, the self-employed can be accused of under declaring their income for social security purposes.

In fact, in 1993, it was found that out of 16,280 self-employed persons, 77% are paying the lowest rate of social security contributions. Also, 12,535 persons, some 80% are under 50 years of age. Thus, such persons were declaring a net profit slightly above Lm 2,000 per annum. **(Vella, 1994)**. These self-employed persons were well under 50 years of age, therefore they were not worried about their Pension entitlement. On the other hand since, the final ten years before Retirement Age are considered for pension purposes, those concerned are encouraged to declare a higher income. In fact, the highest rate of Social Security Contributions is paid by some 50% of those over the age of 51. **(Vella, 1994)**.

Also, with regard to the self-employed, it is relatively easy for them to make a false declaration on income, although on renewing their permit, they have to produce a copy of the Income Tax Return (I T 1). It is very likely that the individual might produce a false copy of the Income Tax Return. This would be to the individual's benefit.

Consequently, the Act provides that 'a self-employed person who knowingly or recklessly makes any false statement or false representation or produces or furnishes .... any document or information which he knows to be false in a material particular; shall be liable, on conviction, to a fine of not less than Lm 500, but not more than Lm 1000'. **(Section 117).**

Unfortunately, the said provision is seldomly enforced, since no full proof is available that the individual might have produced a false I T 1. Co-ordination between the Social Security Department and the Department of Inland Revenue, a fact referred to above, is impractical under the existing system of operation. This co-ordination could help establish a system which facilitates the updating of self-employed permits according to the correct value of income declared.

According to the publication **Economic Trends**, the number of self-employed increased from 15,985 in 1994 to 16329 in 1995. On the other hand, the 1995 **Annual Report** of the Department of Social Security indicates that a total of 1129 self-employed persons were issued with permits enabling them to pay Class II contributions at one of the lowest rates. From the above it can be concluded either that individuals are not issued with the relative permit instantly, or else that individuals do not apply to the Department of Social Security for a permit, although they inform the Employment and Training Corporation of their status of employment. Hence, again this shows a lack of co-ordination between the Department and the Employment and Training Corporation which does not furnish the Social Security Department with the relevant information.

The Social Security Department enforces the Act with regard to late payments. In fact, self-employed persons are asked to pay a penalty of 5% if they exceed the four months in which they have to pay the previous four months' contributions. Until they effect the payments of their fine, contributions are not recorded on their personal records. Through an amendment of the Act in 1987, all directors - having a majority share holding or the company being a family concern - should be considered as self-employed. This provision in the Act is rarely applied and in fact it is only considered by those individual approaching pensionable age. The individual might have paid Class I contributions but through the process of Insurability, the individual might be asked to pay Class II contributions. Due to the above-mentioned circumstances the said contributions have to be transferred to Class II.

3.5 Conclusion

The Act provides the Department of Social Security with the necessary tools to enforce the law. The Director has the power to enforce the law but the Act itself delimits the action that can be taken against the lapsers. The enforcement of the law will definitely help to reduce the gap between the estimated amount and the actual amount of revenue collected from social security contributions.

The Department of Social Security needs the collaboration of other government departments to bring about an efficient administration in the collection of social security contributions. In fact, the Inland Revenue Department acts as a collecting agent for the Social Security Department whilst the Attorney General's Office supports the Department by legal advice and their contribution to the administration in the collection of penalties. Thus, as Vasquez argues 'co-ordination' should be viewed as a function 'which seeks to bring coherence to different activities to achieve a single goal by avoiding the duplication of effort and divergence' **(Parada Vasquez, 1986, 72,73).**

The enforcement varies for the three systems of collecting revenue. In fact, the law is not enforced at all vis-à-vis Government Departments or those companies in which the Government is a majority shareholder. At the same time, private companies are penalised if they effect their payments after the due date. The Act prescribes penalties but the procedure used is still not thoroughly enforced with the result that employers tend to delay their payments.

Self-employed can mislead the Department by making a false declaration of income and they fall in a lower category of contribution.

It is important that the Department of Social Security adopts different measures to enhance the administrative efficiency in the collection of Social Security Contributions. Interdepartmental collaboration is a prerequisite for the success of the system Only in this way can the Social Security Act be thoroughly implemented to the advantage of the employers and employees.

CHAPTER 4

INTER-COUNTRY COMPARISON AND RECOMMENDATIONS

Inter country comparisons are useful for policy making. They shed insight into the strengths and weaknesses of systems in implementation, more so, if the systems happen to be basically identical. A comparison of evolution of the British Social Security System could be a useful guide for the evolution of the system in Malta. As observed above, the Maltese system was structured on the lines of the British.

Over time, the United Kingdom has improved the system both for the benefit of the Department - to improve its efficiency - and also to the benefit of the social partners. Employers were given greater responsibility and penalties raised for those who do not abide by the regulations issued by the Department of Social Security in collaboration with the Department of Inland Revenue.

4.1 Comparison between the two systems - United Kingdom vs Malta

The revision of the system of collection of social security contributions could render the system less complicated, easier to maintain and be even less costly. As described earlier, Malta's system varies for the three different sectors in which the labour force is divided, that is, government sector, non-government sector and the self-employed.

Malta initially adopted a system of collection based on methods operated at the time in the United Kingdom. In 1988, the Department of Social Security in Malta commenced the process of computerization of the Collections Section.

In the meantime, the United Kingdom has introduced a new system of collecting national insurance contributions by setting up a Contributions Agency with the Inland Revenue collecting some contributions on behalf of the Agency. The present United Kingdom system incorporates four different categories of contributions:

i Class I paid by people who work for an employer

ii Class II paid by people who are self-employed

iii Class III voluntary contributions

iv Class IV paid in addition to Class II contributions by self-employed people whose profits or gains are above a certain limit in any one tax year.

Class II and Class III contributions are directly collected by the Contributions Agency whilst Class I and Class IV contributions are usually assessed and collected on behalf of the Agency by the Inland Revenue.

4.1.1 Self-employed persons

Class II contributions are paid by the self-employed on a flat-rate basis. At the same time, the individual concerned - whose profits or gains are over a certain amount - may have to pay Class IV contributions as well. The latter are earnings-related and are assessed by the Inland Revenue. This system differs from the one used in Malta, which consists of various categories of self-employed rates depending on a range of net income. In Malta the self-employed are liable to pay only one type of contribution, that is Class II. The system adopted in the United Kingdom could be more effective since it is related to the profits or gains declared to the Inland Revenue. The process of collecting contributions from the self-employed in the United Kingdom is either by direct payment every month or by a quarterly bill every thirteen weeks. The direct debit system implies that a monthly debit from the Bank Account is payable to the Contributions Agency. Through the Direct Debit, the individual is more likely to pay the right amount on time. It will also ensure that the individual will not be taking the risk of losing his entitlement to any type of benefit.

On the other hand, those individuals who opt for the quarterly bill, are sent a bill every thirteen weeks automatically informing them that their social security contributions are due. The Direct Debit is encouraged in the United Kingdom, since it promotes efficiency. With the increased efficiency shown by the Maltese Banks, the Direct Debit System could be easily adopted in Malta. The contributor has to instruct his bank to debit his account monthly by the relevant amount. At the same time, the Social Security Department has to keep in mind that ideally the system should also incorporate the issuing of self-employed permits. Since the self-employed effect their payment according to their net income derived from their business activity, the individual or the Department must make sure that the Bank concerned is notified of the changed rate of payment. If the Direct Debit System is adopted, the Government is sure to collect the right amount due from the self-employed, and in due time.

In the United Kingdom, the collection of contributions is closely related to the benefits system. Thus, if contributions are not paid within the time limit, the individual might risk his entitlement to a benefit. Also, the Contributions Agency can take any necessary action to obtain payment.

4.1.2 Private Sector

With regards to the Private Sector, the system adopted in the United Kingdom involves entirely the employers. Similar to the Maltese system, Class I National Insurance Contributions are made up of the employer's share and the employee's share. National Insurance contributions are calculated on a payment - by - payment basis according to the earnings period. In fact, employee's contributions are paid on earnings up to and including what is known as the upper earnings limit. From the 6th April 1995, this limit was set at £440.00 a week. There is, however, no upper earnings limit for the employer's share.

This system corresponds to Malta's system where the employee pays 8.33% of his weekly basic wage whilst the employer pays 10% of the same weekly wage with an upper earnings ceiling. In Britain as in Malta, the obligation of payment of social security contributions is the responsibility of the employer. Thus, within 14 days of the end of income tax month, the employer must pay to the Inland Revenue Accounts' Office:

i The National Insurance contributions deducted from the employee's earning during the month.

ii the employer's share on the employee's earnings

iii any income tax due.

The payment covering both tax and national insurance contributions is sent together with the payslip which are provided by the Inland Revenue. In fact, this system of payment has been introduced in Malta as from January 1996. Through this system, the employer has to keep his own records of his employees together with their respective basic wages and the amount of contributions paid. Hence, the employer can effect his payment within the time limit and therefore have no excuses that the forms TX 34s had not reached him.

Since 96% of Maltese employers engage less than 50 employees, a system for small employers could be introduced. Such employers could be given the possibility of choosing to make their payments on a quarterly basis. This system could help the employers to effect their payments regularly.

Also, the system used in the United Kingdom with regard to the private sector includes the End of Year Summary. This Employer's Annual Return includes a summary of every employee's details together with his earnings, national insurance paid and tax payable for each employee. In Malta, this type of form, known as P6, has been in use since 1988 and the information provided by the employer is usually very vague and usually reaches the Department of Social Security very late in the year. As from 1996, the Inland Revenue Department together with the Social Security Department is adopting the United Kingdom system, that is, employers will send in their Annual Return to the Department of Inland Revenue with all the details required. In the United Kingdom, any employer will suffer a penalty if he forwards the End of Year Summary after the due date. Depending on the circumstances, the employer may also suffer a penalty if an underpayment of national insurance contributions and/or tax results.

Up till now, no penalty has been introduced by either the Social Security Department or by the Department of Inland Revenue, but in order to promote efficiency by the Department and the employer, such measures should be taken. Also, in Malta no penalty exists for any underpayments that may arise after checking the amounts paid by the employers for every individual. If a penalty is introduced to force the employers to pay the resulting underpayments, the revenue will increase substantially. In 1992, underpayments resulted due to the change in the employers' rate, suggesting that employers were unaware of the change in the rate of contributions to be deducted.

Recent changes in the proposed Bill empowers the Director to claim 'the payment of any difference due by way of adjustment in the rate, category or class of contributions shall be barred by the lapse of thirty years' **(Section 55; Proposed Bill, 1995)**. Although, this amendment gives the Director the power to collect the revenue due from the self-employed, it does not include underpayments arising from the computation in non-governments' documents. This suggests that the Social Security Act does not enforce equity among all sectors of the labour force.

4.1.3 Government Employees

In the United Kingdom, the bulk payment system with regards to the government employees has since been abolished. Also, in Malta, the bulk payment system is being ignored by those corporations that have been set up lately such as the Water Services Corporation. The bulk payment system is still being used by the main government departments and its abolition would create resistance from these departments since they would have to transfer government accounting systems to commercial accounting.

Through the abolition of the system, the Department of Social Security could enforce the same obligations as it does to the Private Sector. In fact, it is not fair to place obligations on the Private Sector without expecting the same commitment from the government departments. On the other hand, the Departments and other public entities under the Bulk Payment system can hold back payments like any other private company and fall in arrears if the Social Security Department does not enforce the rules.

Hence, this shows that the Department of Social Security has to enforce its regulations without discrimination on all social partners. Recently a constitutional case was filed in Court by a group of companies against the Director of Social Security. Applicants claimed that they had been served with a judicial letter in which they were requested to pay Lm3,216 by way of additional social security contributions. Applicants are contesting this request on the grounds that 'respondent used **two weights** and **two measures** when it came to dealing with persons who paid their social security contributions tardily.' (**The Times, Aug 29,1996, pg 6**).

4.2 Recommendations

Up to 1981, the Department of Social Security in Malta used to inform all insured persons of any deficiency in their contribution records. These deficiency notices should be re-introduced so that the individual could update his records and allow for tracing of defaulters, if the employee is able to forward a relevant P3. It is important to take action immediately against a defaulter, or else if action is taken after a couple of years, the company might have closed down and thus no effective action could be enforced. The worst situation would be if the insured person does not have any relevant information on the employer.

4.2.1 Co-ordination between Departments

An important fact is that the Social Security Department needs the help of other departments together with full co-operation to ensure efficiency and effectiveness in its system of collecting revenue. To ensure co-operation, information must be provided unprocessed by administratively and politically decentralized authorities.

In fact, with the setting up of the VAT Department, the Social Security Department should try to obtain updating information regarding the self-employed. This information could help in updated the system of issuing permits reflecting the correct income of each individual. This system could be effective with regard to the full-time self-employed. Hence, the individual would not have to remember to renew his permit every year but renewal could be done automatically. The individual will then be informed of the change in his status. In turn, the Department could enforce the correct rate.

4.2.2 Enforcement Section

To enforce such measures, the Department should be backed up by an efficient enforcement section which is ready to take the necessary action against all defaulters. Surprise inspections by appointed officials would see that payments are made within the time limit. Thus, the investigative staff of the Department should be responsible for ensuring compliance with the obligations and responsibilities of the Social Security Act. As mentioned in chapter two, it is with the help of the Enforcement Section that the Director of Social Security can enforce the law. Thus, in order to obtain effective results, the investigative staff should be trained and the necessary tools are made available to them, to enable them to take the necessary actions against those who fail to affect their payments within the time limit.

4.3 Conclusion

Enforcement of the provisions of the Act regarding collection is a sign of an effective running of the Department. At the same time, such payments would generate more revenue thereby reducing the Welfare Gap. Of course, further efforts on curbing abuses on claims would improve the Welfare transfer mechanism. It would make a better use of funds collected justifying government's claims on individuals to pay. In future, the funding of pensions could differ from the system of Pay-As-You-Go adopted at present, and funds would be invested rather than spent on welfare payments. It has to be observed, therefore, that the welfare system, regarding unemployment, sickness and other transfers are sustainable in the long run, as the Maltese population starts ageing at a fairly rapid rate in a decade's time.

RATES OF CONTRIBUTIONS PAYABLE FOR 1995
CLASS I CONTRIBUTIONS

Category	Type of Employed Persons	Weekly Rate of Contribution payable by the employed person	Weekly Rate of Contribution payable by the employer
A	Persons under 18 years of age (other than those falling under Category 'E' below) whose basic weekly wage or the weekly equivalent of their monthly salary does not exceed Lm40.38.0	Lm1.95.0	Lm2.34.0
B	Persons over 18 years of age (other than those falling under Category 'F' below) whose basic weekly wage or the weekly equivalent of their basic monthly salary does not exceed Lm40.38.0	Lm3.37.0	Lm4.04.0
C	Persons (other than those falling under Categories 'E' and 'F' below) whose basic weekly wage or the weekly equivalent of their basic monthly salary exceeds Lm40.38.0 but does not exceed Lm116.27.0	1/12, calculated to the nearest cent, of the basic weekly wage or the weekly equivalent of their basic monthly salary.	1/10, calculated to the nearest cent, of the basic weekly wage or the weekly equivalent of their basic monthly salary.
D	Persons (other than those falling under Categories 'E' and 'F' below) whose basic weekly wage or the weekly equivalent of their basic monthly salary exceeds Lm116.27.0	Lm9.69.0	Lm11.63.0
E	Persons under 18 years of age who are following a full-time course of studies or instruction under the Pupil-Worker Scheme, the Student-Worker Scheme, or other similar schemes (including the Extended Skills Training Schemes, but excluding the Worker-Student Schemes) involving distinct work and study periods for which they are receiving remuneration	1/12, calculated to the nearest cent, of the basic weekly remuneration or the weekly equivalent of the basic monthly remuneration up to a maximum rate of contribution of Lm1.57.0	1/10, calculated to the nearest cent, of the basic weekly remuneration or the weekly equivalent of the basic monthly remuneration up to a maximum rate of contribution of Lm1.88.0
F	Persons over 18 years of age who are following a full-time course of studies or instruction under the Pupil-Worker Scheme, the Student-Worker Scheme, or other similar schemes (including the Extended Skills Training Schemes, but excluding the Worker-Student Schemes) involving distinct work and study periods for which they are receiving remuneration	1/12, calculated to the nearest cent, of the basic weekly remuneration or the weekly equivalent of the basic monthly remuneration up to a maximum rate of contribution of Lm2.84.0	1/10, calculated to the nearest cent, of the basic weekly remuneration or the weekly equivalent of the basic monthly remuneration up to a maximum rate of contribution of Lm3.41.0

SELF EMPLOYED PERSONS CLASS TWO CONTRIBUTIONS YEAR 1995

Appendix 2

Category	Persons whose annual net income (excluding Maternity Benefit, Children's allowance and any Ex-gratia Benefit payable under Section 93A of the Social Security Act) during the celender year immediately preceding the contribution year in which the contribution is being paid-	Weekly Rate	January - April 17 Contriutions	May - August 18 Contriutions	September - December 17 Contriutions	Total
NW*	Exceeds Lm 430 but less than Lm 1991	Lm 5.30	Lm 90.10	Lm 95.40	Lm 90.10	Lm 275.60
SA	Does not exceed Lm 2599	Lm 6.75	Lm 114.75	Lm 121.50	Lm 114.75	Lm 351.00
SB	Exceeds Lm 2599 but less then Lm 3129	Lm 8.05	Lm 136.85	Lm 144.90	Lm 136.85	Lm 418.60
SC	Exceeds Lm 3129 but less then Lm 3659	Lm 9.35	Lm 158.95	Lm 168.30	Lm 158.95	Lm 486.20
SD	Exceeds Lm 3659 but less then Lm 4189	Lm 10.60	Lm 180.20	Lm 190.80	Lm 180.20	Lm 551.20
SE	Exceeds Lm 4189 but less then Lm 4929	Lm 12.40	Lm 210.80	Lm 223.20	Lm 210.80	Lm 644.80
SF	Exceeds Lm 4929	Lm 14.75	Lm 250.75	Lm 265.50	Lm 250.75	Lm 767.00

IMPORTANT :

NW* Applicable Only to single persons who are not self-occupied.

DIPARTIMENT TAT-TAXXI INTERNI

LISTA TA' KULL XAHAR TA' L-IMPJEGATI (Regola 12)

Regoli ta' 1972 dwar tnaqqis (PAYE)

TX 34

'A'

Kemm 'A' u 'B' ghandhom jinthaghtu flimkien meta jsir il-hlas dovut

NOTI:

1. Aghmel "X" hdejn kull impjegat li temm l-impieg tieghu dan ix-xahar jew qabel
2. F'każ ta' mara miżżewġa, is-sena tat-twelid ghandha tkun tar-raġel taghha
3. F'każ ta' min mhux imhallas bil-ġimgha, niżżel ir-riżultat ta' meta tiddividi l-paga ta' sena bi 52
4. Kemm il-nhar it-Tnejn jidhlu fix-xahar jew parti minnu li matulu l-impjegat hadem
5. Jekk hemm "*" hdejn in-numru ta' l-identità tar-raġel jew tal-mara, tfisser li n-numru huwa ħażin

Ċempel lid-Dipartiment biex jitranġa l-żball

Tel. No. 223675/95, 220486

Nru ta' l-identità jew tat-taxxa ta' l-imghallem: ____

Nru tal-folja: ____

Nru tal-P.E. P ____

Xahar u Sena: ____

Nru. Tat-telefon ____ Ext ____

Total ta' PAYE u N.I. li ghandu jithallas: Lm ____ c ____

Niddikjara u nikkonferma li dan it-taghrif kollu hu korrett u komplet

Firma ta' min ihaddem ____ Grad ____

Isem b'ittri kbar ____ Data ____

EMOLUMENTI MILL-BIDU TAS-SENA	EMOLUMENTI DAN IX-XAHAR	TAXXA MNAQQSA MILL-BIDU TAS-SENA	TAXXA MNAQQSA GHAL DAN IX-XAHAR	TMIEM TA' L-IMPIEG (ara nota 1)	KUNJOM U ISEM TA' L-IMPJEGAT/A	NUMRU TA' L-IDENTITÀ TA' L-IMPJEGAT/A	F'KAŻ TA' IMPJEGATA MIŻŻEWĠA: ISEM TAR-RAĠEL	F'KAŻ TA' IMPJEGATA MIŻŻEWĠA: NUMRU TA' L-IDENTITÀ TAR-RAĠEL	SENA TAT-TWELID (ara nota 2)	NUMRU TAS-SIGURTÀ NAZZJONALI TA' L-IMPJEGAT/A	KONTRIBUZZJONI MILL-BIDU TAS-SENA	KONTRIBUZZJONI GHAL DAN IX-XAHAR	PAGA BAŻIKA FIL-ĠIMGHA (ara nota 3)	ĠIMGHAT FIX-XAHAR BLA HLAS MINN	ĠIMGHAT FIX-XAHAR BLA HLAS SA	ĠIMGHAT FIX-XAHAR NRU (ara nota 4)	ĠIMGHAT FIX-XAHAR KAT
Lm	Lm c	Lm	Lm								Lm	Lm c	Lm c				
					TOTALI TAL-PAGNA						TOTAL TAL PAGNA						

Appendix 3

FORM TX 35

ĊERTIFIKAT TAR-RIMESSA
REMITTANCE CERTIFICATE

REGOLI TA' L-1972 DWAR TNAQQIS TA' TAXXA (P.A.Y.E.)
DEDUCTION OF TAX (P.A.Y.E.) RULES 1972

KONTRIBUZZJONIJIET TAS-SIGURTÀ SOĊJALI
SOCIAL SECURITY CONTRIBUTIONS

Isem ta' min ihaddem *Name of Employer*	Indirizz *Address*	Numru ta' min ihaddem *P.E. Number*
....	....	
Tel. No...............................	....	

Xahar .... u Sena 19 .... Nru. tal-Folja (TX 35)
Month *Year* *Folio Number*

Nru. tal-Folja *Folio No.* (TX 34)		Taxxa *Tax* Lm	Sigurtà Soċjali *Social Security* Lm c
	b/f		
	c/f		

Għall-Użu Uffiċjali
For Official Use

Nru. ta' l-Irċevuta
Receipt No.

Data – *Date*

Dis-sezzjoni timtela biss fl-aħħar folja:
Fill this section on the last folio:

	Lm c
Taxxa.. *Tax*	
Sigurtà Soċjali .... *Social Security*	
Ammont Irkuprat (Formola mehmuża) *Recoupment Amount (Form attached)*	
Total..	

Numru ta' Impjegati
No. of Employees

Qed jiġi mehmuż Cheque Nru......................... miġbud fuq............................ Bank
Cheque No. *drawn on* *Bank*

għall-ammont ta' ....
for the amount of

Firma .... Grad .... Data .....
Signature *Status* *Date*

Appendix 5

Isem u Indirizz ta' min ihaddem | Nru ta' l-Identita Tat-taxxa ta' l-Imhallem. | PAYE Imhallas Ghas-sena 1995 | Ybur mhux mimlija

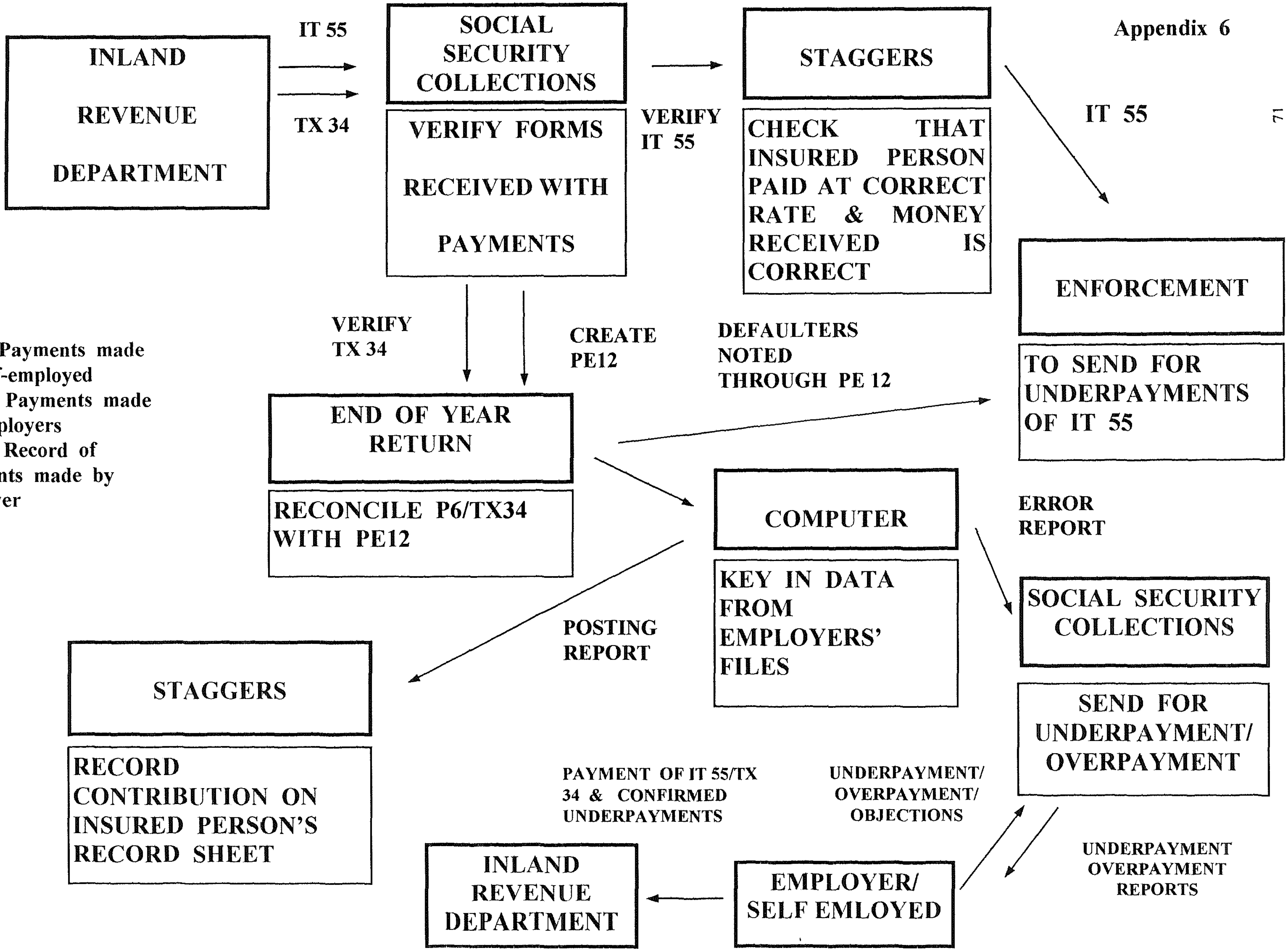
Nru Tal-P.E. | Firma ta' min ihaddem ....

Tel no .... | Grad .... | Data ....

Nru ta' L-Identita	Isem u Lokal ta	Nru. Tas-Sigurta Socjali	Paga bazika Fil-Gimgha Lm	c	Kontri. Imhallsa Mill-Kot	Ammont Total Kontri.	Gimghat Mhux Mhallsin	Sa	Meu
		Total Finali							

Noti 1. Impjegati mmarka b'-'*' ifissru li n-numru ta' l-Identita huwa bazin. Inti mitlub li timla l-vol ta' dawn l-impjegati.
2. Kull tibdil fil-paga bazika ghandu jkun indikat billi tuza linja gdida.
N.B. Ibghat l-original u l-ewwel kopja lid-Dipartiment Tat-Taxxi Interni, Beltissebh (Form P6)

Appendix 6



IT55 - Payments made by self-employed
TX34 - Payments made by employers
PE12 - Record of payments made by employer

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