

## **COMPLIANCE COST REVIEW**

### **DOUBLE TAXATION RELIEF**

#### **1. Introduction**

##### **1.1 Background**

In line with Government commitments to reduce the compliance burdens that are placed on businesses, HM Revenue & Customs (HMRC) assesses the likely change in compliance costs whenever a policy is introduced or changed. The results of that analysis are published in a final Regulatory Impact Assessment (RIA) when the associated legislation is laid before Parliament. Where a consultation document is published during the analysis period, it is accompanied by a partial RIA.

This document summarises the outcome of a post-implementation review of the final RIA that was published in July 2001 for the above-mentioned measure by the Inland Revenue (prior to creation of the new department, HMRC). The measure itself was implemented in phases between March 2000 and March 2001. A copy of the published final RIA is attached.

This review re-assesses the compliance cost analysis published in the original RIA and addresses two main questions:

- whether the estimates of compliance costs used in the RIA were correct, with hindsight; and
- whether the processes used to estimate compliance costs were appropriate and reasonable, given the circumstances at the time.

HMRC intend to use this review to improve the RIA process, and also to assist in future policy development and evaluation work in general. As such, the emphasis is on identifying learning points for future assessment of compliance costs. The review does not revisit the original policy decision.

#### **2. The published RIA**

##### **2.1 Description of the policy change**

Double taxation occurs when a company pays tax on the same income or gains in more than one country (e.g. in the country where the income is earned, and in the country where the company is based). To avoid this problem, the UK provides double taxation relief (DTR), which essentially allows companies to offset foreign tax paid against their UK liability.

The rules for DTR were changed first in Budget 2000, and then again in Budget 2001. The 2001 changes were a mix of new rules and adjustments to what was done in 2000. The RIA summarises the outcome of both sets of changes.

The net effect reported in the RIA is a tax concession of £25 million, together with a net saving in recurring compliance costs of £0.9 million. The changes also had an impact on tax avoidance and this meant that overall, there was a positive impact for the Exchequer. The RIA excluded a quantification of the impact on avoidance (in line with guidance at the time) and the relevant figures were published in the Budget (the *Treasury Red Book*) instead. A partial RIA was issued for consultation prior to implementation.

The changes are still in force, although DTR was subject to further change in the Finance Act 2005.

## **2.2 Anticipated compliance costs or savings**

The RIA states that around 5,200 companies would be affected by some or all of the changes, and a breakdown by sector is included in the RIA. The expected costs and savings were:

- one-off familiarisation costs (not quantified although the partial RIA sought views);
- one-off reorganisation costs (stated as affecting very few firms);
- one-off set-up costs for firms claiming relief for the first time (£50 per firm, number affected not specified);
- recurrent data management and claim administration costs (detailed in Annex 3 of the RIA – total cost of £0.8 million);
- recurrent savings of various kinds (detailed in Annex 3 of the RIA – total saving of £1.7 million); and
- an overall reduction in compliance costs of around £0.9 million per annum, taking all the above into account.

## **3. Conduct of the review**

Each compliance cost review is conducted individually, and the review process is adapted to suit the particular circumstances applying in each case. The emphasis is on making sure that the review itself - and any burden of consultation - are sufficient to meet the objectives of the review, but proportionate to the likely benefits.

In this case, the review was led by an HMRC project team supported by consultants. The staff in the review team were completely independent of those involved with the original policy change.

An essential element of the review was consultation with those actually affected, and consultants were commissioned to carry out a small number of targeted in-depth interviews with some of those affected and their trade bodies. The research was not intended to deliver any degree of statistical robustness (to do so would have been costly

and impractical) but instead to provide indicative findings. Coupled with the consultants' own knowledge and expertise, this has allowed the research to identify the major issues and any associated learning points.

The external research was complemented by an internal review of HMRC paperwork and electronic files.

#### 4. Were the original estimates of compliance costs accurate?

This section addresses two main aspects – the nature of the change in compliance costs (i.e. what did people have to do differently) and the monetary impact of that change (what did it cost or save them).

Question	Comments
Were the specific types of cost and benefit identified in the RIA (e.g. reading legislation, filling in forms, updating IT systems, saving time etc.) incurred?	The RIA provided quite a lot of detail in terms of likely costs and savings, and also on the numbers of firms affected. The respondents' view is that the types of costs and savings were correctly identified, but that the magnitude was not. Respondents are unanimous: the RIA significantly underestimated compliance costs and the promised savings have not been achieved either.
Were costs/savings incurred at the expected time?	Costs were incurred at the times expected. As stated, respondents report that savings were not achieved (or conceivably were outweighed by the planning or compliance costs needed to achieve them).
Were costs/savings incurred by the expected people?	Yes.
Were any other costs/savings, not identified in the RIA, incurred ?	<p>No. The RIA noted a few potential costs that might occur (mainly in sections 6.6 and 6.11) and those were indeed incurred by some firms.</p> <p>The review does highlight the issue of distinguishing between compulsory compliance costs (the minimum activity needed to comply with changes to legislation) and optional planning costs (extra activity which is not required but may be undertaken voluntarily to maximise any advantage within the new rules, or for customer service reasons). Such planning or restructuring is of course perfectly legitimate, but guidance on whether all such costs should</p>

	<p>be regarded as being “compulsory” could be enhanced to avoid any ambiguity.</p>
<p>If the type of costs/savings varied from the original estimates, why was that?</p>	<p>Various reasons are identified:</p> <ol style="list-style-type: none"> <li>(1) The RIA mentioned that some firms might need to restructure, but did not provide any costs estimates for doing so. Respondents report that such costs were significant.</li> <li>(2) Some of the comments in the RIA were based on previous consultation with business. Circumstances, and the proposed changes, were changing and some of the analysis no longer held true or was applied out of context.</li> <li>(3) The changes were more complicated to implement than expected.</li> <li>(4) Some of the RIA comments were reasonable for “typical firms” but not for larger or more complex firms.</li> <li>(5) Some of the changes caused uncertainty and required extra time to clarify.</li> </ol> <p>Some elements of the RIA were accurate – particularly around the introduction of rules concerning overseas tax consolidation – but the overall picture was not.</p>
<p>Could such variances have been foreseen at the time?</p>	<p>Respondents agreed that it was difficult to predict the behavioural response to these changes. They also accepted that there was consultation prior to implementation and that for compliance costs, responses were limited. However, the consultation material did not include all the final changes, and some of the feedback was applied to a situation different from the one on which it was based.</p> <p>The review team considers that while the risk of forestalling would prevent consultation on some of the anti-avoidance provisions, there was scope for improvement in the way the RIA was presented and the analysis done.</p> <p>Respondents have identified several cases where the RIA may have omitted some relevant information, and hence where variances could have been foreseen. For example, para 3.3 of the RIA described benefits in terms of greater flexibility but did not mention that such flexibility might require action (i.e. a compliance cost) on the part of the beneficiary.</p>

What is the assessment now of the total value of costs and savings?	A quantified estimate is not available, but the evidence suggests that the RIA was very optimistic and did not reflect the true costs of the change. Separability (i.e. isolating individual changes and attempting to quantify their effects independently) is very difficult in this instance.
If different from the original RIA, what has caused the discrepancies?	See previous answers above.
With hindsight, were the compliance cost estimates accurate?	No.

### 5. Was the process used to estimate compliance costs reasonable?

Irrespective of whether the analysis turned out to be correct, the review has considered whether the original analysis was completed in a reasonable way.

Question	Comments
Who worked on the original RIA?	Policy experts, analysts, Better Regulation advisors and other staff were all involved.
Was an adequate audit trail maintained?	Yes, however at the time, the potential for a post-implementation review was not foreseen, and that has created a few problems with some documents assuming a high level of knowledge.
Was Cabinet Office and/or internal HMRC guidance on RIAs followed correctly?	Yes. There was some lack of clarity over whether RIAs should be produced for anti-avoidance measures and more recent external interviewees have echoed that. Guidance can usefully be improved here.
How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?	In general, the measures only affected a relatively small population (large organisations trading overseas). A lot of options had to be presented in the consultation with business and feedback on each option was limited as a result. The consultations at the time could only achieve subjective results, which could then be reviewed by the analysts. Considerable attention was focused on the revenue implications, as well as on compliance costs, but nevertheless the detail on the latter in the RIA was extensive. The review team considers that the level of detail provided in the

	<p>RIA was good – enabling stakeholders to understand the component parts of the compliance cost estimates. It did not always explain the source of the estimates and this may have hampered independent quality assurance. It is difficult to judge proportionality because of the complexities caused by including or excluding anti-avoidance measures from an RIA. With hindsight, more time might have produced better estimates.</p>
<p>Were the right people (both internal and external) consulted, and were their views reflected appropriately?</p>	<p>The RIA indicates that there was fairly substantial consultation prior to implementation – the partial RIA was used to gauge views. There were problems with some of the final changes not being included in the consultation and some out-of-date feedback being used in analysis. Learning points are identified in section 6 below.</p>
<p>Did those who were consulted when the RIA was written express views on the reasonableness of the process?</p>	<p>Most of the consultation took place in 1999 and 2000. Its focus was on the various policy options rather than the RIA process.</p>
<p>Have those who have been consulted now as part of this compliance cost review expressed views on the reasonableness of the process?</p>	<p>Yes – and several learning points are identified. Respondents have identified concerns around consultation (making sure all options are included in discussion), use of feedback (not taking it out of context), use of small samples for research (subject to uncertainty) and whether omission of compliance cost estimates for certain options should be taken as an indication that HMRC does not believe those options to have a significant cost attached.</p>
<p>Were compliance costs estimated for all options mentioned in the RIA?</p>	<p>Other options were considered, but no detail was provided on the options or on the associated compliance costs/savings. Guidance at the time said that all options should be costed (and they were – but they weren't presented in the RIA).</p>
<p>Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?</p>	<p>The RIA mentions those types of firms likely to be affected and goes into a fair amount of detail. The breakdown of compliance savings was good, analysing large and small firms separately. Presentation of costs and savings</p>

	was handled a little inconsistently – with the former covered mainly in the text, and the latter tabulated in an annex.
Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?	The environment was very difficult for analysis (Budget confidentiality, complex regime, need to analyse a large number of options, consultation not providing much detail on compliance costs). A genuine attempt was made to assess the impacts, and a full breakdown of assumptions was included in the RIA to facilitate interpretation. This was all reasonable in context. It is difficult to divorce the analytical approach used from the fact that the estimates are now disputed. If the learning points in section 6 are addressed, the problems now seen will be much less likely to recur.
Was there sufficient time to produce a robust assessment of compliance costs?	With hindsight, more time would have been useful – but this was not a major factor when compared with some of the other issues faced at the time.
Were any assumptions reasonable, given the circumstances at the time?	Respondents do not believe that the assumptions were reasonable because they did not seem to reflect all available information. A small group of tax managers from large corporations were consulted, but an opportunity to validate findings through wider consultation within the Inland Revenue was missed.
Were any estimates of compliance costs caveated appropriately?	With complex anti-avoidance changes like these, estimates of the costs are likely to be very difficult to achieve with any great degree of accuracy (and those affected by the changes agree with this). The RIA doesn't make this point, however, and could have been suitably improved by adding a caveat.
Were any risks correctly identified, addressed and explained?	Not explicitly.
Were any disagreements identified and reflected appropriately (e.g. if the figures were disputed by businesses, or if more than one set of figures was available)?	There was only one set of figures, but some of the data used (e.g. on dividend streaming) was 3-4 years out of date (albeit the most recent available) and was therefore seen to present an unreliable picture of the current tax situation.

<p>Would HMRC do anything differently if the exercise were repeated, and hence could the RIA process have been improved?</p>	<p>The aim of an RIA can only ever be to deliver the best estimates available at the time and present them in an effective way. At the time, the RIA was produced in difficult circumstances and quality was affected accordingly. Section 6 identifies a range of learning points which should help improve future RIAs.</p>
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## 6. Learning points arising from the review

### 6.1 Learning points for future work in this policy area

- Most of the learning points are in fact generic and covered in 6.2 below.
- The review has provided a useful insight into how businesses react to changes of this kind and that insight has been fed to the relevant policy team.
- Some concerns have arisen from small business over the complexity of the rules. If the complexity is such that external advice has to be bought in, that may substantially increase compliance costs.
- The decision to include detailed tables of predicted costs and savings within the RIA was helpful and has enhanced the ability of respondents to comment retrospectively.

### 6.2 Learning points for the RIA and compliance cost process in general

- Businesses often have difficulties in estimating the impact of a tax measure until it is in a precise (Finance Bill) form. The final options chosen should be put out to consultation in that form wherever possible (and in some cases it may be worth delaying the final RIA). This is the best way of obtaining accurate feedback on the proposed change. It does not remove the need to consult earlier as well, through partial RIAs, focus groups or similar.
- When changes are made to proposed changes between the partial RIA and final RIA, the fact that businesses may not have been consulted on all options should be stated, and ideally an opportunity to comment given. An early post-implementation review may be appropriate in such cases.
- Where analysis is based on data provided by the trade, any attempt to apply that data to different proposals from those consulted on should ideally be avoided. If unavoidable, appropriate caveats should be included.
- Where RIAs quote a range of costs but quantify some and not others, the text should include a specific explanation of why this is the case. Any inadvertent implication that unquantified costs are low should be avoided.
- Descriptive costs should be accompanied by some estimate (qualitative if necessary) of their magnitude. In this case restructuring costs were mentioned in passing without stating that they could be very significant for those firms affected.
- Where some costs or savings might be expected to have a particularly large or small impact on certain types of firm that should be stated.
- Any risk that proposals might be seen as complex and hence require extra time to interpret or apply, should be identified.

- Guidance on the handling and presentation of anti-avoidance measures within or outside RIAs should be improved. At the time it was not clear which changes were appropriate to the RIA and which to other media.
- Any compliance cost saving which might require extra action on the part of the beneficiary in order to qualify for or attain it should be caveated accordingly.
- Where several changes impact simultaneously the impacts can be analysed either collectively or independently. Whichever method is chosen, any caveats or disadvantages with the methodology should be identified.
- All RIAs should consider alternative options and present a summary of why the preferred option is the best.
- Where analysis is based on data which may be out of date or otherwise not reflect current circumstances, appropriate caveats should be given. Likewise if small samples are used.
- Analysis of costs and benefits should be presented in similar formats where possible, to ease comparison.
- Opportunities to validate research or analysis within HMRC should be sought and used, particularly where the analysis is uncertain. Time constraints may limit the scope for this, but early identification of possible experts or data systems would help.
- RIAs should include fuller detail on what, when and how changes will be reviewed after implementation (this learning point has already been addressed within HMRC).
- Guidance could be enhanced on the distinction between compulsory compliance costs (the minimum activity needed to comply with changes to legislation) and optional planning costs (extra activity which is not required but may be undertaken voluntarily to maximise any advantage within the new rules, or for customer service reasons).
- When documenting decisions and analysis, authors should assume minimal knowledge on the part of the reader, particularly if any post-implementation review might be carried out after a number of years, or by independent staff.

In summary, this was a difficult series of changes to analyse and hindsight suggests that the RIA was unduly optimistic. The predicted compliance cost was not borne out in practice. The review has identified a number of learning points, clarifications and issues which can usefully be taken forward by HMRC. This should help ensure that future RIAs are as accurate as possible, and that any inaccuracies will be identified quickly.

The review team notes that DTR has been reformed again since these changes were made. Some of the issues mentioned will have been addressed already.

## **7. The way forward**

Comments are invited on any aspect of this report or the wider compliance cost review programme.

The learning points are being fed into the policy development process directly if particular to one RIA or policy area. More generic recommendations are being collated across the review programme overall, and will be used to create an action plan for HMRC to take forward to improve the RIA process and development.

## **8. Contact points for further information**

For issues relating to double taxation relief policy specifically:

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**ANNEX : THE PUBLISHED REGULATORY IMPACT ASSESSMENT**