

## ***COMPLIANCE COST REVIEW***

### **FUEL SCALE CHARGE**

#### **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 April 2002 for the above-mentioned measure by the Inland Revenue. The measure was implemented with effect from April 2003. 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**

The Government introduced a new system for taxing the benefit of providing free fuel for private journeys in company cars. The purpose was to follow the environmental principles of the company car tax reform which was introduced in April 2002 and to be easy for employers to understand and implement.

Employees are liable to income tax on these free fuel benefits, and employers are liable to Class 1A National Insurance Contributions (Class 1A NICs).

Under the old system, the tax and Class 1A NICs were set on the basis of engine size and fuel type (petrol or diesel). Under the new system, tax and Class 1A NICs are set on the basis of the CO<sub>2</sub> emissions for the employee's car applied to a set amount, which is currently £14,400. This information should already be held by the employee and employer as it is needed to comply with the new company car taxation regime, which was introduced in April 2002.

In addition, the new fuel benefit tax system provides discounts for alternative fuels (e.g. gas) and an apportionment scheme for those opting out of the system before the end of any given tax year.

These reforms pre-date the merger of the former Inland Revenue and HM Customs & Excise Departments and were not accompanied by parallel reforms to the fuel scale charges which apply in relation to VAT. These continued to be set on the basis of engine size rather than CO<sub>2</sub> emissions, but are now being reviewed.

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

The RIA anticipated two types of compliance cost; non-recurring costs associated with the introduction of the new scheme, and recurring compliance costs associated with ongoing implications of the new scheme.

#### Non-recurring costs

A range of costs were identified relating to the activities of understanding and explaining the new scheme, including providing training.

These costs included time spent and 'other resources', including 'minor changes to software'.

It was anticipated that such costs would fall to employees, employers and agents.

A figure of 'around £5m' was attached to these costs.

### Recurring costs

The RIA only considered costs affecting employers, not employees or agents.

The RIA stated that 'employers should not face significantly different compliance costs' compared to the old system and that 'administrative burdens will be kept to a minimum'. The RIA explained that employers would 'simply' perform a new calculation using data which they already hold.

The RIA explained that employers would need to keep new records relating to the apportionment scheme, in particular records of when employees stop receiving free fuel, and records of their business mileage.

The RIA believed that employers would be able to avoid the compliance cost of finding and obtaining records of engine size, as this information is no longer needed under the new regime.

The RIA stated that the overall annual effect on recurring compliance costs would be negligible.

### **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. The staff in the review team were completely independent of those involved with the original policy change.

Evidence relating to the accuracy of the compliance analysis in the RIA, to its appropriateness and reasonableness in the circumstances, and to how improvements might be made in the future, were obtained from a large business, from an established large agent, from a business trade body specialising in this particular area, and from an agent trade body with detailed knowledge of this issue. Detailed questionnaires were sent to these bodies, and in some cases their responses were discussed with them orally.

This evidence was complemented by an independent internal examination and review of HMRC's paperwork and electronic files, and a detailed interview with

those responsible for this policy area and for producing the original RIA. This considered, amongst other issues, HMRC's decision-making processes and analysis of compliance costs.

#### 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 actually incurred? (e.g. reading legislation, filling in forms, updating IT systems, saving time etc.)	<i>In relation to non-recurrent cost, yes. In relation to recurrent costs, the expected benefit of no longer needing to obtain and keep records on engine size did not materialise as this was still needed for VAT purposes. Other costs, savings and complexities relating to synergies between this direct tax fuel scale regime and the VAT fuel scale regime were not identified. (This RIA was prepared before the merger of Inland Revenue and HM Customs &amp; Excise. At the time, therefore, the two regimes were handled, both in terms of policy and administration, by the two different Departments).</i>
Were costs/savings incurred at the expected time?	<i>Yes, although the RIA did not specify for how long non-recurrent costs might be incurred, nor whether any element of the non-recurrent costs might become recurrent.</i>
Were costs/savings incurred by the expected people?	<i>Partly. The RIA did not provide an estimate of the total number of business affected, but did provide figures relating to the number of small companies affected.</i>
Were any other costs/savings, not identified in the RIA, incurred ?	<i>Partly. With hindsight, the RIA did not consider the possible complexity of basing a direct tax fuel scale charge on CO<sub>2</sub> emissions and list price, whilst retaining a VAT fuel scale charge based</i>

	<i>on engine size. But as mentioned above, this RIA was prepared before the merger of Inland Revenue and HM Customs &amp; Excise.</i>
<i>If the type of costs/savings varied from the original estimates, why was that?</i>	<i>Non-recurrent costs appear to have been more significant than recurrent costs, as suggested by the RIA. Evidence from business indicates that costs of familiarisation with the new regime were significant. The RIA did not shed much light on the complexity of new calculations required, including in relation to the apportionment scheme. One interviewee thought these were not negligible, although the RIA suggested they were.</i>
<i>Could such variances have been foreseen at the time?</i>	<i>Maybe, in particular the possible synergies between the direct tax and VAT systems. At the time the RIA was produced, it was probably reasonable to expect business to flag up such issues if they were significant.</i>
<i>What is the assessment now of the total value of costs and savings?</i>	<i>Non-recurrent compliance costs appear not to have been negligible, as identified by the RIA. A precise costing has not been undertaken but one interviewee suggested that familiarisation costs were significant over the first months of the new regime. One interviewee suggested that recurrent compliance costs were significant in relation to the apportionment scheme. Other aspects of the new regime appear to generate no major costs or savings.</i>
<i>If different from the original RIA, what has caused the discrepancies?</i>	<i>The RIA believed that there would be record-keeping savings relating to engine size data, as this data is no longer needed for the new regime. These savings did not materialise. The RIA believed that the burdens of new calculations required would be negligible. This might not be so in all cases.</i>

<p>With hindsight, were the compliance cost estimates accurate?</p>	<p><i>On balance, the assessment of overall compliance cost changes appears to have been broadly accurate, although, with the benefit of hindsight resulting from the merger of Inland Revenue and HM Customs &amp; Excise, improvements might have been possible in one or two areas. The balance between non-recurring and recurring costs appears to have been reasonable, but some anticipated savings did not materialise. The RIA implied that overall, this was not a big measure in terms of compliance costs, and this appears to have been the case.</i></p>
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**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
<p>Who worked on the original RIA?</p>	<p><i>Members of the policy team, HMRC Better Regulation Unit and HMRC analysis team.</i></p>
<p>Was an adequate audit trail maintained?</p>	<p><i>Yes, in relation to industry views and policy development. The audit trail was more limited in relation to the compliance cost analysis, for example derivation of the £5m non-recurring cost.</i></p>
<p>Was Cabinet Office and/or internal HMRC guidance on RIAs followed correctly?</p>	<p><i>Yes.</i></p>
<p>How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?</p>	<p><i>Some effort was made to consider who might be affected, to identify non-recurrent and recurrent costs, and to identify administrative requirements. This foundation could, and probably should, have been taken to the next level to provide a more accurate costing and to consider in more detail exactly what</i></p>

	<i>administrative requirements are involved. Given the overall scale of compliance cost changes, the overall level of effort was broadly proportionate.</i>
Were the right people (both internal and external) consulted, and were their views reflected appropriately?	<i>Not entirely. Consultation with industry was thorough and industry views were reflected appropriately. Consultation or other liaison between the Inland Revenue and HM Customs &amp; Excise could have been better.</i>
	<i>Those consulted at the time did not express specific views about the reasonableness of the RIA process.</i>
	<i>Those consulted as part of this exercise did not voice specific concerns about the reasonableness RIA process as such, although the comments of one interviewee imply dissatisfaction with the process of consultation between Inland Revenue and HM Customs &amp; Excise, and dissatisfaction with the depth of compliance costs analysis.</i>
Were compliance costs estimated for all options mentioned in the RIA?	<i>No, only for the lead option which emerged from the consultation process.</i>
Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?	<i>No breakdown was provided amongst different sizes or types of business, and no per business costs were published. The analysis of recurrent costs seemed to apply only to employers and not to employees or agents, unlike the analysis of non-recurrent costs. Whilst it might have been desirable to provide this extra information, in the circumstances the analysis presented in the RIA was not unreasonable.</i>
Was an appropriate analytical approach used, with economists or other analysts consulted	<i>Departmental analysts and economists were involved. Although the depth of analysis could have been improved in a</i>

	<i>few key areas, the level of analysis presented seems to be reasonable given the size and nature of this measure.</i>
	<i>Yes, time constraints did not appear to curtail the scope for compliance cost analysis.</i>
Were any assumptions reasonable, given the circumstances at the time?	<i>Most assumptions appear to have been reasonable, apart from some assumptions underpinning the analysis of compliance cost savings (in particular, the assumption relating to engine size data no longer being required for other purposes).</i>
Were any estimates of compliance costs caveated appropriately?	<i>Presentationally the RIA might instead have given the impression that costs and savings were not entirely certain. Instead phrases such as 'will be £5m', 'will be negligible' and 'simply' perhaps gave the wrong impression. But this needs to be balanced against providing estimates which are so heavily caveated that they are unclear for business.</i>
Were any risks correctly identified, addressed and explained?	<i>The RIA did not identify any risks, and instead gave the impression of certainty.</i>
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)?	<i>No disagreements were identified in relation to the compliance cost analysis.</i>
	<i>More explanation of the £5m non-recurrent cost figure could have been provided, including the provision of per business figures. Greater consideration could have been given to possible complexity in the new system, and to the burden of precise administrative activities required. Greater consideration could have been given to possible risks. Presentationally, the RIA could have</i>

	<i>given the impression that costs and savings were subject to a degree of uncertainty.</i>
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## **6. Learning points arising from the review**

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

- Possible synergies between the fuel scale charges applying to direct tax and to VAT should be considered explicitly in future, including to reduce the degree of complexity within the tax system and to ensure that possible compliance savings (e.g. record keeping on engine size) actually transpire in reality. Following the merger of the Inland Revenue and HM Customs & Excise, this should now happen automatically.
- Information on CO<sub>2</sub> emissions and list price is readily available as part of the company car taxation regime (hence the cost of reusing this information for another purpose is small). However, some interviewees commented that obtaining list price information in the first place is unduly burdensome. When considering future policy changes, opportunities for HMRC to lighten existing requirements should be taken into account where possible.
- Precise administrative requirements should be considered in more detail where possible, including in relation to the possible complexity of calculations, especially for the apportionment scheme.

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

- Any figures should be accompanied by a supporting analysis explaining their derivation. This should include per business compliance costs figures for different sizes and types of business.
- Administrative requirements should be specified in detail and accompanied by relevant costings. Applying the Standard Cost Model should address this point in future.
- Effective consultation with business and agents should be accompanied by effective consultation within HMRC to ensure that all synergies are identified and exploited.
- Compliance cost analysis should aim to identify possible risks and other uncertainties surrounding estimated likely costs and benefits.

- Presentationally, the impression of certainty surrounding costs and benefits should be avoided unless there is strong justification. Instead costs and benefits should be presented for what they are – estimations subject to variance and uncertainty.
- The compliance cost analysis could include a general disclaimer clarifying that not all types of cost or benefit applying to all types of stakeholder might have been identified.
- The compliance cost analysis should be the basis for stakeholders to contact HMRC if they are affected by unintended or unanticipated costs or benefits.

## **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 fuel scale charges policy specifically:

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Telephone: 020-7147-2476  
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For issues relating to the compliance cost review programme generally:

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If you have a query about your own affairs in this tax area, please contact the HMRC helpline number on 08457 143 143.

## **THE PUBLISHED REGULATORY IMPACT ASSESSMENT**

[Fuel Scale Charge \(PDF 19K\)](#)