

COMPLIANCE COST REVIEW

Interest and Royalties Directive, 2004

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 March 2004 for the above-mentioned measure by the Inland Revenue (IR). The measure was implemented with effect from January 2004. 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 aim of this reform was to implement the Interest and Royalties Directive, which was adopted by the Council of the European Union on 3 June 2003 and came into force on 1 January 2004. The purpose of the Directive was the elimination of source taxation of payments from interest and royalties made between associated companies of different Member States. The intended result was that income would be taxable only in the country where the recipient is resident.

2.2 Anticipated compliance costs or savings

The Implementation of the Directive was expected to have a negligible effect on the compliance costs of UK companies paying interest and royalties to associated companies in other Member States.

According to the RIA, the reform was expected to affect all businesses in the same way. Relief would be given in the same way as the UK already gave relief to non-residents from UK source taxation of interest and royalties income under double tax treaties.

The RIA also stated that, with some Member States, source taxation had already been abolished through the relevant double tax treaty.

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 impact on compliance costs was expected to be negligible, and the CCR was correspondingly scaled down.

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 businesses affected by this policy change. 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?	<p>The RIA predicted that the directive would have a negligible impact on costs. Those businesses that were interviewed tended to agree with this, particularly when the costs were compared with those of existing double taxation relief treaties.</p> <p>One respondent stated that there could have been compliance cost savings if:</p> <ul style="list-style-type: none"> • Clearance had been granted automatically, • Implementation had been harmonised throughout the Member States, or • The scope of the Directive was made broader.
Were costs/savings incurred at the expected time?	The costs were incurred at the expected time.
Were costs/savings incurred by the expected people?	The costs were incurred by the expected people.
Were any other costs/savings, not identified in the RIA, incurred?	<p>Some respondents mentioned a side benefit in terms of greater certainty and reassurance.</p> <p>The Directive also resulted in some costs savings, where businesses would previously have spent extra time on tax planning.</p>
If the type of costs/savings varied from the original estimates, why was that?	There is no evidence of any major variation from the RIA.
Could such variances have been foreseen at the time?	Not applicable.

What is the assessment now of the total value of costs and savings?	The RIA assessment of negligible change remains.
If different from the original RIA, what has caused the discrepancies?	Not applicable.
With hindsight, were the compliance cost estimates accurate?	Yes. Those businesses that were interviewed agreed that the impact on compliance costs was insignificant. In practice, few businesses would have been affected. Some businesses thought that if this directive had been implemented in a slightly different way there could have been a potential compliance costs saving.

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?	This RIA was completed by tax policy experts, analysts and Better Regulation advisors. No problems have been identified.
Was an adequate audit trail maintained?	There is a good audit trail. Information on compliance costs specifically was limited, but that is to be expected given the negligible impact on them.
Was Cabinet Office and/or internal HMRC guidance on RIAs followed correctly?	Yes – although the directive was implemented a couple of months before the RIA was published, and because of this the RIA only mentioned one policy option rather than a range of options as the relevant guidance recommends.
How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?	Compliance costs were not the primary focus of the reform and were forecast to be negligible. The time devoted to them was therefore low, and subsequent feedback confirms that this approach was reasonable.
Were the right people (both internal and external) consulted, and were their views reflected appropriately?	Yes. A Partial RIA was published in December 2003 and this was used as a consultative vehicle
Did those who were consulted when the RIA was written express views on the reasonableness of the process?	No. Those who responded to the consultation welcomed this change in legislation but did not comment on the reasonableness of the process.

Have those who have been consulted now as part of this compliance cost review expressed views on the reasonableness of the process?	Yes – generally, those businesses consulted now thought that the RIA process was reasonable.
Were compliance costs estimated for all options mentioned in the RIA?	Only one option was included in the RIA.
Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?	No – but it was not appropriate to go to this level of detail given the low impact on compliance costs generally.
Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?	Departmental economists were consulted appropriately throughout.
Was there sufficient time to produce a robust assessment of compliance costs?	Yes. Analysts were contacted at least 5 months before the RIA was signed off.
Were any assumptions reasonable, given the circumstances at the time?	Yes, and this is supported by those recently consulted.
Were any estimates of compliance costs caveated appropriately?	Not applicable.
Were any risks correctly identified, addressed and explained?	The RIA clearly states that the existing double taxation treaties were in place. So that there really were no risks involved with this policy change. Recent interviews with business confirm this.
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)?	No disagreements occurred.
Would HMRC do anything differently if the exercise were repeated, and hence could the RIA process have been improved?	Overall this RIA was accurate and reasonable. The only question raised was whether only one policy option should have been included in the RIA. There were also some minor suggestions from respondents about improving the clarity of RIAs generally.

6. Learning points arising from the review

6.1 Learning points for future work in this policy area

- EU directives should be considered as early as possible, to ensure enough time to consider and/or consult on a range of implementation options.

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

- Where appropriate and proportionate, RIAs should contain a full range of possible policy options with a clear demonstration of why the preferred option is best (and this applies even if some options have been rejected following a partial RIA).
- RIAs should be clear with expansive discussion around the purpose and intended effect.
- If there has been consultation during the RIA process the results of that consultation should be reflected fully in the final RIA (or referenced, if they are available in a separate document elsewhere).
- Future RIAs should consider the effect of policy changes from the perspective of business as well as that of HMRC, and make sure that presentation is geared to that audience (as well as meeting the needs of any other stakeholders.)

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 Corporation tax and Value added tax specifically:

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For issues relating to the compliance cost review programme generally:

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For issues relating to your own corporate tax affairs, please contact our Employer helpline:

Telephone: 0845-714-3143 (Mon-Fri 8am-8pm, Sat-Sun 8am-5pm).

THE PUBLISHED REGULATORY IMPACT ASSESSMENT

[Implementing the Interest and Royalties Directive \(PDF 77K\)](#)

Implementing the Interest and Royalties Directive

Introduction

1. The government will include legislation in the 2004 Finance Bill to implement the Interest and Royalties Directive (Council Directive 2003/49/EC). This Directive was adopted by the Council of the European Union on 3 June 2003. It comes into force from 1 January 2004.

Purpose and intended effect

2. The Directive provides, in the interests of addressing international double taxation, for the elimination of source state taxation of payments of interest and royalties made between associated companies of different Member States. The income will only be taxable by the state where the recipient is resident.

Risks

3. As far as UK companies are concerned, the international double taxation at which the Directive is addressed is already addressed by double tax relief where the income of a company resident in the UK has already borne tax in the country of source.

Options

4. The UK will give relief under the Directive in the way in which it already gives relief to non-residents from UK source taxation of interest and royalty income under double tax treaties.

Benefits

5. Under the Directive, companies in other Member States will be relieved from tax in the UK of interest and royalty payments they receive from associated companies in the UK. In some cases, the UK has already given up source taxation of interest and royalties. This is the case with payments to Austria, Denmark, Finland, France, Germany, Greece, Ireland, the Netherlands and Sweden. In the case of Belgium, the UK taxes payments of interest at 15 per cent. In the case of Italy, the UK taxes payments of interest at 10 per cent and payments of royalties at 8 per cent. In the case of Luxembourg, the UK taxes payments of royalties at 5 per cent. In the case of Portugal, the UK taxes payments of interest at 10 per cent and payments of royalties at 5 per cent. In the case of Spain, the UK taxes payments of interest at 12 per cent and payments of royalties at 10 per cent.

6. Under the Directive, companies in the UK will be relieved from source state taxation of interest and royalty payments they receive from associated companies in other Member States. In some cases, other Member States have already given up source taxation of interest and royalties. This is the case with payments from Denmark, Finland, France, Germany, Greece, Ireland, the Netherlands and Sweden. Austria taxes some payments of royalties at 15 per cent. Belgium taxes payments of interest at 15 per cent. Italy taxes payments of interest at 10 per cent and payments of royalties at 8 per cent. Luxembourg taxes payments of royalties at 5 per cent. Portugal taxes payments of interest at 10 per cent and payments of royalties at 5 per cent. Spain taxes payments of interest at 12 per cent and payments of royalties at 10 per cent.

7. The Directive contains transitional rules for some Member States. Greece and Portugal may continue to tax interest and royalties at up to 10 per cent for four years and at up to 5 per cent for a further four years. Spain may continue to tax royalties at up to 10 per cent for six years.

Exchequer effects

8. Implementation of the Directive is expected to have a negligible effect on UK tax receipts in 2003-04, 2004-05 and 2005-06. It is estimated to have a yield of about £5 million a year from 2006-07.

Implementation costs

9. Implementation of the Directive is expected to have a negligible effect on the compliance costs of UK companies paying interest and royalties to associated companies in other Member States. This is because the same rules will apply as already apply for giving relief due under a double tax treaty.

Securing Compliance

10. The UK enforces the liability to UK tax of persons who are not resident in the UK in respect of their UK source interest and royalty income by requiring the payer to deduct tax at source from the payment unless certain conditions have been met. In the case of relief due under a double tax treaty in respect of interest, the payer deducts at source unless the Inland Revenue has issued a notice in response to an appropriate request from the recipient. In the case of relief due under a double tax treaty in respect of royalties, the payer can pay without deducting at source on the basis of a reasonable belief that relief is due. The same rules will apply for giving relief due under the Directive.

11. Relief from UK tax will be restricted under the Directive where there is a special relationship between the payer and the recipient and the amount of the payment exceeds what would have been agreed in the absence of the special relationship. Many of the UK's double tax treaties have similar provisions that apply where there is a special relationship.

12. Relief will also be denied where arrangements exist primarily to take advantage of the Directive. Again, there are equivalent provisions in many of the UK's double tax treaties.

Competition assessment

13. There will be no impact on competition. The rules apply in the same way to all businesses operating in UK markets.

Impact on Small Business

14. The rules will apply in the same way to small businesses as to other businesses. In practice, small businesses rarely have subsidiary companies in other countries and will make or receive few cross-border payments of interest or royalties involving them.

Consultation

15. The draft legislation was made public on 10 December 2003, and four written responses were received. All respondents welcomed the legislation. Some asked that the scope of the legislation implementing of the Directive be widened to include other circumstances outside the terms of the Directive. The Government does not think that it would be appropriate to use this legislation to make such changes.

Monitoring and Evaluation

16. The Inland Revenue will incorporate the monitoring of the new relief with the monitoring of relief given under double taxation treaties.

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