

## **COMPLIANCE COST REVIEW**

### **REFORM OF TAXATION OF INTANGIBLE ASSETS**

#### **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 and implemented in April 2002 for the above-mentioned measure by the Inland Revenue (prior to creation of the new department, HMRC). 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 purpose of the reforms was to produce a comprehensive tax regime for intangible assets that gave relief on a consistent basis and reflected the key role of intangible assets in the knowledge-based economy. The proposals formed part of the Government's programme to create a modern tax system for companies based on the principles of fairness and competitiveness. Some of the key features of the policy change were:

- relief for expenditure on the full range of intangible assets and goodwill based on amortisation rates in companies' accounts;
- profits on sales of assets would be taxed as income;
- tax on sale profits in excess of original cost could be deferred through a new form of roll-over relief if the company reinvested in newly acquired intangibles; and
- transitional rules under which existing assets would continue to be taxed under the then current rules, although the new roll-over relief would apply to sales of such assets.

There was little controversy over these changes at the time and they remain in force today.

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

The RIA provided a basic breakdown of compliance costs and savings:

- One-off set-up costs - £750 per firm (£15m - £23m in total)
- Recurring savings - £250 per firm per year (£5m - £7.5m per year in total)

This assumed that between 20,000 and 30,000 businesses would be affected by the changes. Although not stated in the final RIA, an hourly rate of £50 was used to value any time costs. As such, the components of the costs and savings were:

- Set-up costs - understanding the new regime and putting it into practice – 15 hours per firm
- Ongoing savings – time required to comply with the intangibles regime – reduction from 20 hours to 15 hours per firm (a net saving of 5 hours per annum).

The RIA did not specify whether and how the average costs and savings might vary according to the nature of each individual firm.

## **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?	Yes. None of the businesses interviewed had incurred significant one-off costs, and the only such cost of note was training within larger firms' tax departments. The cost for small firms is likely to have been negligible.
Were costs/savings incurred at the expected time?	Respondents said they did expect to see falls in costs on an ongoing basis, but that these savings were yet to fully materialise because at present they still have assets taxed under the old regime. Gradually this will filter out of the system, but full achievement of benefits will take a long time. This was known at the time and acknowledged in the RIA (particularly in explaining the need for transitional arrangements) but respondents identified it as a significant issue.
Were costs/savings incurred by the expected people?	Yes. Respondents raised a few queries with aspects of the regime (see section 6.1 below) but nothing to suggest the affected population was different from that predicted.
Were any other costs/savings, not identified in the RIA, incurred ?	No.
If the type of costs/savings varied from the original estimates, why was that?	Respondents generally found it difficult to relate to the cost per firm figures quoted in the RIA because they were averages. Individual circumstances could lead to impacts being very different in some cases and there was little in the RIA to identify that.  They also disputed the cost per hour used in the RIA, saying that although reasonable for internal staff, it would not reflect the full costs if a firm

	<p>employed external specialists.</p> <p>Finally, the assumptions about time spent or saved were challenged – partly because their basis was not explained in the RIA. HMRC records indicate that the estimates were in fact based on discussion with a very limited number of larger businesses. This could have been stated along with any caveats around extrapolating the numbers to (e.g.) small firms.</p> <p>Notwithstanding these issues, the overall policy change was well received and respondents agreed that the benefits would outweigh the costs once the change had fully bedded in.</p>
Could such variances have been foreseen at the time?	The time required for benefits to filter through should have been mentioned.
What is the assessment now of the total value of costs and savings?	The overall assessment remains unchanged: a small one-off cost followed by larger benefits in time. However the costs and benefits will vary according to the nature of each firm and the number of intangible assets they have.
If different from the original RIA, what has caused the discrepancies?	Not applicable.
With hindsight, were the compliance cost estimates accurate?	In terms of magnitude – yes. In terms of timing – 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?	The RIA was produced through collaboration between policy staff, analysts and Better Regulation Advisors.
Was an adequate audit trail maintained?	Yes – mostly electronically. There were some minor gaps on the analytical side caused by staff turnover.

<p>Was Cabinet Office and/or internal HMRC guidance on RIAs followed correctly?</p>	<p>Yes. The relevant advisors were contacted very early by the RIA authors – facilitating the process considerably.</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>A fair amount of effort went into determining the level of compliance costs, from consulting with business to working on estimates in house. This work was essential. The RIA could have presented more of the detail and assumptions to facilitate interpretation.</p>
<p>Were the right people (both internal and external) consulted, and were their views reflected appropriately?</p>	<p>The proposals followed active consultations with industry and representative bodies. More recent respondents emphasised the importance of considering all types of business. Small businesses may not have the level of representation, or the resource, of larger firms. This wasn't a big problem in this case but it is clearly an issue – and it may have made a difference to some of the figures used (such as the cost per hour of staff time).</p>
<p>Did those who were consulted when the RIA was written express views on the reasonableness of the process?</p>	<p>Not on the RIA process – most comments were focused on the desirability of the policy change itself.</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. The main concern was the lack of transparency behind the cost assumptions quoted in the RIA. Although the figures themselves have turned out to be broadly accurate as an average, their credibility was undermined by the absence of explanation. Respondents made a number of comments about the need to consult more broadly with business (particularly smaller businesses) to help improve the basis for any calculations, and to identify possible differences in impact across different types of business.</p>
<p>Were compliance costs estimated for all options mentioned in the RIA?</p>	<p>No – but the main alternative was maintaining the status quo which would not have caused any change in compliance costs.</p>
<p>Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?</p>	<p>The RIA provided estimates of the one off and ongoing compliance costs and savings for all business. Key groups were not discussed separately and nor were the potential reasons for any variation from the average.</p>

Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?	The approach used was reasonable in terms of providing a rounded figure for the change overall. But insufficient explanatory detail, and the absence of any data for particular types of firm, made interpretation difficult.
Was there sufficient time to produce a robust assessment of compliance costs?	Yes.
Were any assumptions reasonable, given the circumstances at the time?	The review team considers the answer to be “yes”, but that the assumptions should have been explained more fully.
Were any estimates of compliance costs caveated appropriately?	The RIA did not go into detail and caveats could usefully have been added.
Were any risks correctly identified, addressed and explained?	There were some gaps – the obvious one being the time delay before benefits could be realised.
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 were no obvious disagreements. Businesses generally welcomed the introduction of this policy simplification.
Would HMRC do anything differently if the exercise were repeated, and hence could the RIA process have been improved?	Several respondents felt that presentation of the supporting analysis was not detailed enough and there are several associated learning points identified below.

## 6. Learning points arising from the review

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

- Interviewees identified a few queries with the policy itself. This is outside the scope of this review but they have been brought to the attention of policy staff within HMRC. The main points concerned (a) interpretation of the new rules with respect to assets which straddled the policy implementation date, and (b) possible barriers to transition to the new regime.
- Interviewees report some difficulty with estimating the time savings for issues whose implications are very variable depending on the particular type of asset(s) being considered. This kind of variability should be mentioned in similar RIAs, although it is unlikely to be quantifiable.

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

- All RIAs should include an explanation of when costs and benefits are likely to be incurred/achieved. Any risks that might cause that timing to change should be identified. This applies to both set-up and ongoing effects, both of which might take time to bed in.
- RIAs which provide estimates of compliance cost savings should explain the basis for those figures if they are to have maximum value. If average costs are quoted then any reason for likely variation between different businesses should be stated.
- Prior to policy announcement it may not be possible to consult widely and hence analysis may of necessity be based on small samples or focus groups. In such cases, the associated caveats must be explained so that readers can judge the validity and impact of the RIA on them.
- Respondents have requested that, where possible, draft RIAs should be exposed to business experts and professionals to enhance accuracy. This is already done in many cases, particularly where partial RIAs are issued, and it is viewed as best practice.
- Where an RIA makes assumptions about hourly rates (cost per hour of business time) then those assumptions should be stated. If some businesses might be expected to do the work themselves, but others might need to buy in external resource, then the difference in cost for those scenarios should be explained. In this case, most of the familiarisation was expected to be done in house but individual cost components should be considered on their merits.
- Where impacts are expected to be substantially different for small businesses, the RIA should identify that fact. This particular RIA did mention small businesses but said only that the measure would affect all types of firm. This was true, but more detail would have been welcomed.
- All RIAs should present a brief description of alternative options, even if they are clearly inferior to the proposed course.
- There are some learning points around internal HMRC documentation and these will be taken forward.

## **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 intangible assets policy specifically:

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**ANNEX : THE PUBLISHED REGULATORY IMPACT ASSESSMENT**