

COMPLIANCE COST REVIEW

National Insurance Contributions Bill, April 2002

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

As stated in the original RIA, the purpose of the reforms was to provide extra funds for the Government's spending plans. There are two parts to the package of reforms which were referred to in the RIA and took effect from 6 April 2003:

- An additional 1% National Insurance Contribution by employers, employees and the self-employed, including on earnings above the upper earnings and profits limits; and
- A freeze of the personal tax allowance for those aged under 65, the National Insurance (NI) primary and secondary thresholds and the lower profits limit for the self-employed for the year 2003/04.

The first part of these measures (i.e. the 1% increase on employer, employee and self-employed NI rates, including on all earnings above the upper earnings and profits limits) was the subject of the impact assessment and of this review. HMRC does not usually publish RIAs for rate changes. In this case the change required businesses to complete an additional calculation and an RIA was published to reflect the compliance costs of this.

2.2 Anticipated compliance costs or savings

The RIA stated that for employers using payroll software, the administration impact would be minimal as it would simply involve a change in the figures the software used to calculate both the employer and employee contributions. Where the employer uses a commercial payroll package this would simply involve installing the upgrade from the provider. These changes would pick up the additional calculation, but would need to be made anyway to take into account changes in rates.

However, for employers operating a manual payroll, it was anticipated that there would be a small potential extra cost resulting from the change to the employer NI contribution. This was due to an extra level of calculation required when working out employee NI. The RIA calculated that this would take two minutes per employee and apply only to those earning above the upper earnings threshold. Given a wage rate of £20 per hour, and an upper limit of 180,000 employees affected, the overall burden was estimated at £1.5m per annum.

HMRC did not believe that the impact of the increase would be significant on the self-employed. HMRC considered that the vast majority of the self-employed use agents to deal with their personal tax compliance requirements and the RIA stated that HMRC did not believe that the marginal amount of extra work involved in completing the tax return would lead to agents increasing their fees.

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. Interviewees were selected based on considerations such as covering a broad range of industries, sizes of organisations, trade bodies and listed and private businesses. 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
<p>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>	<p>The RIA identified that the compliance cost of the change would be marginal to nil. The feedback from the respondents agreed with this. They identified that the cost of the change was marginal to nil and was incurred by the areas of their business originally anticipated.</p> <p>The only change specifically identified in the RIA was two minutes extra per calculation, per employee, per payday, where employers prepared payroll calculations on a manual basis. However, only a minority of businesses are affected by this, and none of the businesses willing to be interviewed by the consultants prepared payroll calculations on a manual basis. One respondent, who was a small business, commented that if they had prepared their payroll manually, the process of complying with the legislation would have been “considerably more involved”. However, another respondent,</p>

	<p>who also acts as a self-employed payroll advisor, commented that she often undertakes manual payroll for her clients. She advised that the extra time cited in the RIA in relation to undertaking payroll calculations was “more than enough”, suggesting that HMRC may have slightly overstated the amount of time it would take employers operating a manual payroll to implement the legislation.</p> <p>This is backed up by the paper files, which show that the time estimate published was at the upper end of the range considered.</p>
Were costs/savings incurred at the expected time?	Yes.
Were costs/savings incurred by the expected people?	Yes.
Were any other costs/savings, not identified in the RIA, incurred ?	Some of the businesses interviewed identified small costs that were additional to those set out in the RIA. These costs were payroll testing, training, communications, explaining the change to employees who received reduced take-home pay and dealing with additional queries as a result of this change. These could have been considered at the time the RIA was drafted. However, respondents commented that these additional costs had been minimal.
If the type of costs/savings varied from the original estimates, why was that?	Although additional types of costs were identified, it was felt by business that the impacts were negligible. Therefore their omission had little impact on the compliance cost estimates.
Could such variances have been foreseen at the time?	Yes, although including these costs would not have made a significant difference to the compliance cost estimate it may have helped businesses prepare for the change.
What is the assessment now of the total value of costs and savings?	Unchanged from the RIA.
If different from the original RIA, what has caused the discrepancies?	Not applicable
With hindsight, were the compliance cost estimates accurate?	The external research comments that the estimates provided in the RIA were viewed by all

	<p>respondents as broadly accurate.</p> <p>It was not possible to adequately substantiate whether the estimates for business operating manual payrolls were correct. As described above, respondents differed in their opinion as to the accuracy of the impact on manual payroll employers. Our best interpretation is that the costs were accurate.</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
Who worked on the original RIA?	Members of the Policy Team, the Better Regulation Unit and the department's analysts worked on the RIA.
Was an adequate audit trail maintained?	Yes in terms of the compliance cost calculations. It is not apparent from the files whether any consultation was conducted prior to the publication of the RIA.
Was Cabinet Office and/or internal HMRC guidance on RIAs followed correctly?	Yes.
How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?	A good attempt was made to quantify the affect on a manual business and it was presented in such a way that a business could understand the impact. Possibly more time could have been spent considering wider impacts on businesses without manual payrolls, but the impact on the overall compliance cost would be negligible according to the businesses interviewed.
Were the right people (both internal and external) consulted, and were their views reflected appropriately?	It is not apparent from the files whether any consultation was conducted prior to the publication of the RIA.
Did those who were consulted when the RIA was written express views	No. There was a general lack of consultation for this measure,. This was a sensitive budget

<p>on the reasonableness of the process?</p>	<p>measure and it was felt that consultation could have had a behavioural impact in anticipation of the changes.</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>Many of the interviewees commented on the apparent absence of consultation and said that this was something they would have liked to have seen discussed in the RIA. This was a result of Budget purdah. Some commented that, given the nature of the change (mainly a rate change), it was probably not necessary for HMRC to consult businesses extensively on the proposed legislation.</p>
<p>Were compliance costs estimated for all options mentioned in the RIA?</p>	<p>An alternative option (creating another class of contributions) was considered and rejected on the grounds that it would impose additional recording and accounting obligations for employers. However, the compliance cost of this alternative was not quantified</p>
<p>Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?</p>	<p>Yes. The compliance cost impact to businesses with a manual payroll differed from those with an automated payroll, and so the two groups were treated separately in the RIA.</p>
<p>Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?</p>	<p>Given the limited nature of the compliance costs, a fairly simple methodology was used to estimate the likely impact and this was appropriate.</p>
<p>Was there sufficient time to produce a robust assessment of compliance costs?</p>	<p>Although time was tight to produce the RIA, the assessment produced was robust.</p>
<p>Were any assumptions reasonable, given the circumstances at the time?</p>	<p>The main assumptions made were the number affected, the wage rate of business owners and the time taken to complete the new obligation. In all cases the assumptions made appear to be on the high side (in particular the number of businesses affected and the time taken). Given the mixed feedback and the difficulties of consulting with smaller businesses, this approach was reasonable.</p>
<p>Were any estimates of compliance costs caveated appropriately?</p>	<p>The original estimate produced by the analytical team included a compliance cost range to give an indication of the uncertainty in the assumptions. This was not used in the final RIA,</p>

	instead just the worst-case costing was used. Presenting a range may have given a better indication of the uncertainty, but the text of the RIA did make clear that the figures used were highly conservative.
Were any risks correctly identified, addressed and explained?	The RIA identified the risks that the change would increase the error rate initially and that the extra work on the tax return may have lead agents to increase their fees for the self employed. There is no evidence from the interviews to suggest that either of these had a significant impact.
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 evidence of any problems here.
Would HMRC do anything differently if the exercise were repeated, and hence could the RIA process have been improved?	If it had been possible, improved consultation may have highlighted early on that the impact of the changes may have been smaller than expected. However, due to difficulties engaging with the smaller businesses affected by this measure a cautious approach to the costing of the impact on smaller businesses remains advisable.

6. Learning points arising from the review

6.1 Learning points for future work in this policy area

- It is useful to distinguish between businesses with a manual and an automated payroll
- Where measures go beyond rate changes, informal consultation (e.g. with trade bodies) may help judge whether the assumptions in the RIA are reasonable prior to publication, even if precise details of the change can not be consulted on. However, this needs to be weighed up against any potential behaviour impact.
- Where there has been no consultation prior to publication this should be stated in the RIA and a reason given.
- Impacts on business should be stated, even when it is expected that they may have negligible costs, as this helps business plan for implementation.

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

- Should we publish impact assessments for rate changes? There will be one-off costs of change, although as this CCR has illustrated, the costs are likely to be negligible.
- Where there is uncertainty surrounding the estimates of compliance costs and the underlying assumptions, ranges rather than point estimates should be used.
- We should consider the scope of compliance costs, for example whether we should include costs of businesses dealing with employee queries.

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

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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

[National Insurance Contributions Bill, April 2002 \(PDF 87K\)](#)