

## ***COMPLIANCE COST REVIEW***

### **NORTH SEA TAXATION: REFORM OF THE NOMINATIONS SCHEME AND RULES FOR DEALING WITH BLENDED OILS**

#### **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 Impact Assessment when the associated legislation is laid before Parliament. Where a consultation document is published during the analysis period, it is accompanied by a consultation stage Impact Assessment.

This document summarises the outcome of a post-implementation review of the final Impact Assessment that was published in March 2006 for the above-mentioned measure by HMRC. The measure was implemented with effect from July 2006. A copy of the published final Impact Assessment is attached.

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

- whether the estimates of compliance costs used in the Impact Assessment 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 Impact Assessment 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 Impact Assessment**

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

This measure sought to reduce distortions to commercial decision making arising from tax driven opportunities presented by existing legislation. In particular to minimise the practice of ‘tax spinning’, which in effect involves a company deciding to some extent on what price of North Sea oil it should be taxed. This measure also changed to tax treatment of co-mingled oil in order to reduce tax minimisation activities stemming from the different tax rates which apply to different oil fields.

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

The Impact Assessment considered that oil companies would not need to maintain additional records in order to comply with the measure, and that many oil companies would benefit as a result of no longer needing to submit nominations to HMRC, or only needing to submit a nomination in limited circumstances. The number of nominations was expected to fall from around 380 per year to around 40 per year.

The Impact Assessment noted that in future larger oil companies are likely to pay smaller companies less for term deals, in order to reflect the reduced arbitrage opportunities on offer. The Impact Assessment noted that these reduced costs relate to tax minimisation behaviour rather than to compliance costs as such.

The Impact Assessment explained that terminal operators in particular are likely to experience increased administrative burdens. The Impact Assessment mentioned that some terminal systems as currently configured would require the generation of large quantities of documentation, which need to be examined and signed off before oil is loaded.

The Impact Assessment considered that in the short term, companies with a large number of field interests would need to run a separate parallel tax allocation record in addition to the commercial record.

The Impact Assessment considered that in total the measures would affect only the 120 or so entities undertaking oil and gas exploration activities.

## **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.

Evidence relating to the accuracy of the compliance analysis in the Impact Assessment, to its appropriateness and reasonableness in the circumstances, and to how improvements might be made in the future, were obtained from a small group of interviewees, selected to ensure a diverse range of opinion. The selection process took the following factors into consideration; (i) range of industries covered; (ii) size of organisations both in turnover and employee numbers; and (iii) mix between trade bodies, representative organisations and actual businesses.

This evidence was complemented by an independent internal examination and review of HMRC’s paperwork and electronic files, and a detailed interview of those responsible for this policy area and for producing the original Impact Assessment. 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 Impact Assessment actually incurred? (e.g. reading legislation, filling in forms, updating IT systems, saving time etc.)	<i>Yes, the particular reductions and increases in costs identified in the Impact Assessment seem to have been incurred.</i>
Were costs/savings incurred at the expected time?	<i>Yes. Although some businesses queried whether running separate tax and commercial allocation systems might not be short term and might generate an ongoing increase in compliance costs, in practice this does not appear to have materialised.</i>
Were costs/savings incurred by the expected people?	<i>Yes, the business population affected was well understood.</i>

<p>Were any other costs/savings, not identified in the Impact Assessment, incurred?</p>	<p><i>To some extent. The Impact Assessment was published before all of the lengthy and detailed consultations with business had concluded. As such the Impact Assessment probably did not capture all of the administrative implications of the measures. Indeed this would not have been possible as the measures remained somewhat fluid for a short while after the Impact Assessment was published.</i></p>
<p>If the type of costs/savings varied from the original estimates, why was that?</p>	<p><i>The limited variance perhaps stemmed from the fact that the measures remained somewhat fluid at the time the Impact Assessment was published.</i></p>
<p>Could such variances have been foreseen at the time?</p>	<p><i>Probably not, as they stemmed from HMRC's understanding of how the measures would impact those businesses affected, and this understanding was informed by HMRC's continuing detailed dialogue with business.</i></p>
<p>What is the assessment now of the total value of costs and savings?</p>	<p><i>The assessment now of the size of the costs and savings is largely in line with that provided in the Impact Assessment.</i></p>
<p>If different from the original Impact Assessment, what has caused the discrepancies?</p>	<p><i>Any differences stem largely from the administrative and commercial details of how the measures are implemented by terminal operators.</i></p>
<p>With hindsight, were the compliance cost estimates accurate?</p>	<p><i>The compliance cost estimates in the Impact Assessment were generally accurate.</i></p>

## 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 Impact Assessment?	<i>Members of the HMRC policy team, HMRC Better Regulation Unit and HMRC analysis team.</i>
Was an adequate audit trail maintained?	Yes.
Was Cabinet Office and/or internal HMRC guidance on Impact Assessments followed correctly?	<i>Largely, although the final Impact Assessment was published shortly before the details of the measures were finalised.</i>
How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?	<i>The amount of effort devoted appears to be proportionate to the scale of compliance costs involved.</i>
Were the right people (both internal and external) consulted, and were their views reflected appropriately?	<i>The right people seem to have been consulted, and consulted in some depth. Their views were taken into consideration, and much time was taken to develop a detailed and constructive dialogue. Implementation of the measure was delayed until a workable solution was developed jointly with industry.</i>
Did those who were consulted when the Impact Assessment was written express views on the reasonableness of the process?	<i>Those consulted at the time did not express views that the consultation process was unreasonable.</i>
Have those who have been consulted now as part of this compliance cost review expressed views on the reasonableness of the process?	<p><i>Some businesses were happy with the level of consultation undertaken, others would have preferred more.</i></p> <p><i>The consultation process took a long time, reflecting both the technicality of this measure and industry's views towards it.</i></p>

Were compliance costs estimated for all options mentioned in the Impact Assessment?	Yes.
Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?	Yes.
Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?	<i>Yes, Departmental analysts and economists were fully involved.</i>
Was there sufficient time to produce a robust assessment of compliance costs?	<i>Yes, although the timing of the Impact Assessment was an issue in this case, i.e. when the strike the balance between publishing an Impact Assessment and identifying and assessing accurately all of the compliance cost implications.</i>
Were any assumptions reasonable, given the circumstances at the time?	<i>Assumptions appear to have been reasonable.</i>
Were any estimates of compliance costs caveated appropriately?	Yes.
Were any risks correctly identified, addressed and explained?	<i>No, the Impact Assessment did not include a risk analysis.</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 particular disagreements were identified in relation to the compliance cost analysis.</i>
Would HMRC do anything differently if the exercise was repeated, and hence could the Impact Assessment process have been improved?	<i>Key to this Impact Assessment was establishing a constructive dialogue with business on exactly how the measures should be implemented. Whilst it would be possible to say with hindsight that it would have been better for a more open exchange of views to have taken place sooner, what happened also reflects industry's stance towards this exercise.</i>

## **6. Learning points arising from the review**

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

- In this complex area engaging with business seems to be more important than in other areas in order to devise workable solutions with minimal compliance costs.

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

- Risks associated with the compliance cost implications should be identified and explained where possible. Where there are no significant or probably risks this should also be mentioned.
- A careful balance needs to be struck between publishing an Impact Assessment early in the process and publishing an Impact Assessment which contains the most accurate identification and assessment of compliance cost implications.
- In some instances business views should be sought not just from their tax departments but also from other departments with more direct commercial responsibilities.

## **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 Impact Assessment 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 Impact Assessment process and development.

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

For issues relating to the North Sea oil tax pricing rules specifically:

Mike Crabtree  
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22 Kingsway  
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For issues relating to the compliance cost review programme generally:

Richard Bowyer  
3E/14, 100 Parliament Street  
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Telephone: 020 7147 0062  
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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.

**ANNEX: THE PUBLISHED IMPACT ASSESSMENT**

<http://www.hmrc.gov.uk/ria/ria-north-sea-taxation.pdf>