

COMPLIANCE COST REVIEW

NORTH SEA OIL TAX PRICING RULES

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

In the face of evidence that commercial decisions were being distorted by tax driven opportunities in existing legislation, this measure sought to establish a more tax neutral environment, with the aim of reducing the scope for tax minimisation and reducing the level of tax loss to the Exchequer.

In particular, tax distortions existed due to the different tax regimes applied to arms length sales and non-arms length sales, combined with the way non-arms length prices were calculated. The reform involved changing the way that non-arms length prices were calculated. In essence an average price for a one month period was replaced by an average price for a five day period.

2.2 Anticipated compliance costs or savings

The Impact Assessment considered that there would be no additional regulatory burdens for business, and that companies' administrative requirements may fall if there was no longer such an incentive to engage in tax minimisation activities.

The Impact Assessment considered that the measure 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
<p>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.)</p>	<p><i>Yes, on the whole. The Impact Assessment suggested that business administrative requirements “may fall” as a result of engaging in less tax minimisation behaviour. Business has queried the size of such savings, but the language adopted in the Impact Assessment was probably appropriate – flagging up the possibility of cost reductions in this area but not suggesting anything sizeable.</i></p>
<p>Were costs/savings incurred at the expected time?</p>	<p><i>Yes.</i></p>
<p>Were costs/savings incurred by the expected people?</p>	<p><i>Yes, the business population affected is well understood.</i></p>
<p>Were any other costs/savings, not identified in the Impact Assessment, incurred?</p>	<p><i>Yes. Business felt that the new pricing arrangements provide greater certainty about how some prices are calculated, and this benefit was not identified explicitly in the Impact Assessment.</i></p> <p><i>Business suggested that they initially needed to check price calculations more than in the past, although this would appear to be an initial teething issue and the ongoing increased costs of checking do not appear to be significant.</i></p> <p><i>Business explained that the compliance saving of no longer having to complete a return for category 1 oil had not been identified in the Impact Assessment, nor had the increased compliance cost of providing information on the point of delivery for crude sales (although this was not felt to be a significant cost).</i></p>
<p>If the type of costs/savings varied from the original estimates, why was that?</p>	<p><i>Variance perhaps stemmed from the increased difficulty in engaging with business in relation to an anti-avoidance measure.</i></p>

Could such variances have been foreseen at the time?	<i>Some of the smaller changes could probably have been identified, such as the requirement to identify the point of delivery.</i>
What is the assessment now of the total value of costs and savings?	<i>One-off costs seem to have been slightly higher than suggested, largely due to initial teething issues with the new pricing rules. The ongoing change in compliance costs seems to be similar to that suggested by the Impact Assessment, i.e. no significant change or possibly a reduction in costs.</i>
If different from the original Impact Assessment, what has caused the discrepancies?	<i>Aside from initial teething issues, a key difference is that the benefit of reduced in business uncertainty was not identified explicitly in the Impact Assessment.</i>
With hindsight, were the compliance cost estimates accurate?	<i>Overall the Impact Assessment was broadly accurate in its assessment of compliance costs.</i>

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 policy team, HMRC Better Regulation Unit and HMRC analysis team.</i>
Was an adequate audit trail maintained?	<i>Yes.</i>
Was Cabinet Office and/or internal HMRC guidance on Impact Assessments followed correctly?	<i>Yes.</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>Yes, there was a lot of close working with industry in order to devise a pricing mechanism which reflected the way oil is priced in the commercial world. Some businesses felt that more consultation could</i>

	<i>have taken place before the Impact Assessment and initial regulations were published as this might have avoided some of the subsequent teething problems (which were resolved following further discussions with business).</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 were generally appreciative of HMRC's efforts to devise the most workable pricing mechanism.</i>
Have those who have been consulted now as part of this compliance cost review expressed views on the reasonableness of the process?	<i>Some businesses felt that industry had been widely consulted before the changes were made and they appreciated this, others suggested that perhaps more consultation could have taken place at an earlier stage.</i>
Were compliance costs estimated for all options mentioned in the RIA?	Yes.
Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?	<i>Yes, to the extent that key groups exist within the small and specialised business population affected.</i>
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, this measure was subject to extensive research and consultation prior to the Impact Assessment being published.</i>
Were any assumptions reasonable, given the circumstances at the time?	Yes.
Were any estimates of compliance costs caveated appropriately?	<i>Yes, suggested possible savings were labelled as such.</i>
Were any risks correctly identified, addressed and explained?	<i>The Impact Assessment did not really explore what sorts of risks might apply to the estimated changes in compliance costs and benefits. Partly this might be because the Impact Assessment considered that, overall, the compliance cost changes would not be significant.</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>Although some of the issues identified in this review could possibly have been addressed better had there been closer engagement with business at an earlier stage, what happened was probably a reflection of the fact that this measure relates to anti-avoidance. It is difficult to conclude, therefore, that HMRC would do anything much differently in future, i.e. that the process itself needs to be improved.</i>

6. Learning points arising from the review

6.1 Learning points for future work in this policy area

- Business views towards this measure, including the way it was devised and implemented, seems to vary noticeably and this might be borne in mind in future consultations.

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

- When compliance cost estimates are built upon commercially generated information HMRC should factor in the extra learning process required.
- When the compliance cost implications hinge upon getting the technical details right HMRC should seek to consult widely.
- In some cases HMRC should be aware of the need to go beyond the tax department in a particular business in order to identify all of the compliance cost implications. This may involve probing which departments in a particular business have been involved in submitting a consultation response.

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:

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

Richard Bowyer
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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-rules.pdf>