

## **COMPLIANCE COST REVIEW**

### **PAYROLL SERVICES      ELECTRONIC END-OF-YEAR FILING OF EMPLOYER TAX RETURNS (2003)**

#### **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 September 2003 for the above-mentioned measure by the Inland Revenue (prior to creation of the new department, HMRC). The measure was implemented with effect from April 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 Government considered that the best way to assist employers in dealing with payroll tasks was to encourage the greater use of new technology. The reform introduced compulsory electronic filing of company returns, with incentives to encourage smaller firms. The new rules were:

<b>Size of business</b>	<b>Requirement</b>
250+ employees	required to start filing electronically in 2004/05.
50-249 employees	required to start filing electronically in 2005/06.
<50 employees	no requirement yet, but incentives offered to file electronically voluntarily. Further legislation was expected to make the requirement compulsory from 2010..

The RIA cited a range of benefits for both employers and HMRC<sup>1</sup> including:

- reduction in error rates;
- faster HMRC response times and acknowledgments;
- more secure transmission;
- more accurate calculation and payment of benefits and/or tax liabilities;
- greater access to other online services; and
- some savings in paperwork, printing, postage and time.

The legislation encouraged, but did not require, smaller businesses to file online. Therefore, the analysis of costs and benefits focused on large and medium employers only. The RIA made clear (in section 8.2) that the costs and benefits for smaller businesses would be considered in detail in a further RIA as and when further legislation was introduced.

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

The RIA anticipated both one-off and recurring costs for businesses, associated with changing their systems to file electronically, ongoing payment of fees to software houses and an expected increase in intermediary fees.

The benefits to business were described in qualitative terms, but the RIA said that “it is expected that by looking across the range of employers, with 50 or more employees, the compliance benefits are broadly in balance with the compliance costs estimated for the first seven years”. For smaller firms, the costs were expected to be outweighed by a £420 million incentives package<sup>2</sup>.

The detailed calculations were shown in sections 5-7 of the RIA (annexed to this CCR).

## **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.

<sup>1</sup> The RIA was published by the Inland Revenue, before the 2005 merger with HM Customs & Excise. This CCR refers to HMRC for convenience, but references should be taken to mean “Inland Revenue up until the merger and HMRC thereafter”.

<sup>2</sup> In respect of the 2004-05 employer returns, HMRC have paid out £225m. The figure for 2005-06 is likely to be in the region of £295m.

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. 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>Yes. The two main areas affected were payroll and IT. As expected, the main change was in relation to new software. The implementation costs were not seen by respondents to be particularly significant (between £0 - £1,000) but this would vary depending on what systems the firm had in place already.</p> <p>Training costs varied from nothing up to a 2-day course for all affected staff. Some attended free Government-run courses (though that still takes time).</p> <p>Some interviewees noted that operating the software to file online took a little extra time, but that this is reducing with familiarisation. Looking ahead, no significant ongoing costs were identified by any of the respondents.</p>
Were costs/savings incurred at the expected time?	<p>Yes. Some respondents said that additional savings in time and/or cost might arise in the longer term. This might cover things such as a reduced risk of arithmetic error when filing online, which would reduce time spent on correcting returns later.</p>

<p>Were costs/savings incurred by the expected people?</p>	<p>Yes. The take-up of online filing by small employers far exceeded estimates. 892,000 filed their 2004-05 Returns online (just under 51% of all small employers) and benefited from the online filing tax-free incentive for doing so.</p>
<p>Were any other costs/savings, not identified in the RIA, incurred ?</p>	<p>Most respondents said “no”. A few mentioned the need to test new IT systems and software, possibly in parallel with legacy systems, and that this had been quite time-consuming.</p>
<p>If the type of costs/savings varied from the original estimates, why was that?</p>	<p>Ongoing costs were much lower than anticipated, and the RIA seems simply to have erred on the side of caution in predicting a significant ongoing burden. Most of the cost seems to have been loaded up front for those who switch.</p> <p>Some respondents also suggested that some of the anticipated costs were costs they would have incurred anyway, and as such were not increasing the burden. This covers things like better IT, software or internet connections. Obviously not all businesses would be buying these items, but for those that were, the marginal compliance cost could be significantly reduced.</p> <p>The bottom line is that costs depend primarily on the type of systems and software already present in the business – and that can be very variable.</p>
<p>Could such variances have been foreseen at the time?</p>	<p>Possibly. It appears that the RIA erred on the side of caution by overestimating ongoing costs.</p>
<p>What is the assessment now of the total value of costs and savings?</p>	<p>Implementation costs incurred were as expected but respondents said that ongoing costs were not expected to be significant.</p> <p>The RIA anticipated miscellaneous savings from reductions in paper volumes, printing, storage of paper files and postage plus some overhead savings in respect of staff time in handling paper. Feedback from those affected confirms that these savings were achieved, but that they were small.</p> <p>None of the respondents changed their payroll method to use the services of an intermediary. Respondents also said that the costs of IT upgrading were minimal or not significant.</p>

If different from the original RIA, what has caused the discrepancies?	The most likely explanation is that those switching first (mainly large companies and smaller firms who are IT-enabled) are likely to find the transition easier than those leaving it until later.
With hindsight, were the compliance cost estimates accurate?	Based on the feedback received, there were, and will be in the future, one-off costs for those making the switch. But there are unlikely to be any significant ongoing costs. The RIA was therefore broadly accurate, but overestimated ongoing costs – possibly erring too far on the side of caution. Some respondents found it difficult to judge the accuracy of the RIA because the basis for some of the numbers was not specified.

### 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?	Policy staff were supported by Departmental economists and Better Regulation advisors.
Was an adequate audit trail maintained?	Yes – the audit trail was good. Possibly the explanation behind some of the analysis could have been expanded.
Was Cabinet Office and/or internal HMRC guidance on RIAs followed correctly?	Yes – no problems have been identified.
How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?	The RIA presented a lot of detail on costs and this is evidence of the above-average amount of work that was done. Feedback from businesses is that the reform was relatively straightforward but that the RIA was overly complicated, with too much detail. The effort was proportionate given the large number of firms affected, but possibly some extra time could have been spent drawing the analysis together into a more compact summary. Respondents suggested that the balance wasn't quite right between covering all bases, and presenting the information in a concise form.

<p>Were the right people (both internal and external) consulted, and were their views reflected appropriately?</p>	<p>Yes – although some respondents felt HMRC might have underestimated the need for communication and consultation with smaller businesses. The fact that a further RIA is planned on small businesses specifically, will address any concern.</p>
<p>Did those who were consulted when the RIA was written express views on the reasonableness of the process?</p>	<p>Not at the time, no.</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>No particular problems have been identified. The majority of the interviewees commented that the RIA was reasonably clear in terms of format, aims and consultation.</p>
<p>Were compliance costs estimated for all options mentioned in the RIA?</p>	<p>The RIA went into a good level of detail with alternative options. The analysis focused on the preferred option.</p>
<p>Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?</p>	<p>Yes, although some respondents noted that e-literacy varies considerably between industries and professions. Possibly this could have featured more prominently in the analysis.</p>
<p>Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?</p>	<p>Yes – but the results could have been summarised in a more concise and user-friendly way. The quantification of benefits could have been beefed up. The RIA focused heavily on costs, whereas the two were expected to balance out. Besides the incentive payments, benefits were not analysed quantitatively.</p>
<p>Was there sufficient time to produce a robust assessment of compliance costs?</p>	<p>Time was not a problem.</p>
<p>Were any assumptions reasonable, given the circumstances at the time?</p>	<p>The absence of any explanation as to how the costs were calculated made it difficult for respondents to form a view of how accurate they were. In general, though, the RIA made reasonable assumptions.</p>
<p>Were any estimates of compliance costs caveated appropriately?</p>	<p>Partly. Respondants would have liked more information on the background detail, particularly on how costings were arrived at.</p>

Were any risks correctly identified, addressed and explained?	Yes.
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)?	Not applicable.
Would HMRC do anything differently if the exercise were repeated, and hence could the RIA process have been improved?	<p>Respondents were generally positive, with comments like:</p> <ul style="list-style-type: none"> <li>• “HMRC’s RIA appeared reasonable and accurate from my reading of the RIA”</li> <li>• “The RIA is reasonably clear, although it is more complicated than it needed to be”</li> <li>• “I noticed quite a lot of costs and figures on their documentation; I am not sure where they got all these figures from or how accurate they were”</li> </ul> <p>The main learning point seems to be one of simpler presentation of the key facts, perhaps with supporting detailed annexed rather than presented in the main body of the RIA.</p>

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

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

- Some respondents felt that HMRC could have done more to explain exactly what was required in order to comply with any changes. (The CCR team believes this refers more to explanation in the RIA, rather than to provision of guidance etc. later).
- If any particular sectors are likely to need additional help or advice to encourage or support online filing, then that could usefully be mentioned in the RIA.

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

- Where costs or savings might be incurred anyway, independently of HMRC requirements (e.g. routine IT upgrades) then that should be stated. If costs or savings are attributed to the particular reform, there should be evidence to back that up.
- RIAs should quantify both costs and benefits where possible (in this case costs were quantified but some of the benefits were not).
- There is a balance to be struck between covering all relevant facts and presenting those facts concisely, but ease of interpretation should be the deciding factor. Compliance costs analysis should be summarised in as clear and concise a way as possible. Detail can be annexed, but ideally not included in the main body of the RIA unless it is essential.

- The basis for, and assumptions behind, any analysis should be detailed in the RIA (or an annex) to facilitate interpretation.
- Similarly, analysis, data sources and the basis for any costings should be fully documented as part of an RIA audit trail.
- Where a reform is relatively straightforward, the RIA should make that clear. A highly detailed RIA may give the impression that the reform is more complex or burdensome than in actually the case.
- RIAs should consider the one-off costs of piloting or testing new systems or software, where applicable.
- The use of ranges can be helpful where compliance cost impacts, or underlying assumptions such as take-up, are uncertain.
- Further guidance could usefully be developed on whether, when measures are introduced to offset compliance costs, the measures themselves should be classed as part of the compliance cost burden. In this case, financial incentives were offered to smaller firms and it is a grey area as to whether such incentives should be included in any assessment of net costs or savings to business (and hence covered in more detail in any RIA).

## **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 electronic PAYE filing specifically:

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Telephone: 020-7438-7142  
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For issues relating to the compliance cost review programme generally:

Richard Bowyer HMRC 100 Parliament Street London SW1A 2BQ  
Telephone: 020-7147-0062  
Email: [richard.bowyer@hmrc.gsi.gov.uk](mailto:richard.bowyer@hmrc.gsi.gov.uk)

For issues relating to your own corporate tax affairs, contact our Employer helpline:  
Telephone: 0845-714-3143 (Mon-Fri 8am-8pm, Sat-Sun 8am-5pm).

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