HM Revenue & Customs

COMPLIANCE COST REVIEW

REFORM OF THE CORPORATE DEBT, FINANCIAL INSTRUMENTS AND FOREIGN EXCHANGE GAINS & LOSSES REGIMES

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 (prior to creation of the new department, HMRC). The measure was implemented in October 2002. 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 reform was a simplification of the legislation covering a range of regimes, taking the opportunity to amend some of the detailed rules. The main impacts were:

- legislation reduced from 200 pages to 70;

- better alignment of accounting and tax rules (effectively reducing the number of calculations required); and
- some one-off compliance costs associated with getting used to the new rules, but a long term saving.

The reforms also reduced the chance of tax avoidance, although that is mentioned only briefly in the RIA because the RIA was focusing on compliance costs.

The policy area has been reviewed and changed further since the RIA was issued. Business were in favour of the broad thrust of the recommended option at the time.

2.2 Anticipated compliance costs or savings

The RIA identified the following:

Short-term (one-off)
- Costs - familiarisation with new rules; IT and system changes; training staff; possible need to obtain specialist advice on the use of the new regime. Costs not quantified.

Long-term (recurring)
- Saving – fewer calculations required when submitting tax returns, and more consistent use of figures across different requirements. Not quantified.
- Saving – some potential for greater certainty of tax treatment without the need for setting up complicated structures (because the new rules are simpler). Firms which previously endured uncertainty over their treatment should no longer do so.
- Saving – simpler rules should lead to fewer errors and queries once the system has bedded in.

Throughout the RIA, there was no quantification of these effects. Consultation prior to the RIA did ask for estimates but the response was muted (partly because the focus of the consultation was on ideas for changing the rules, rather than compliance costs specifically.)

The RIA did state that around 800,000 firms were subject to at least one of the regimes covered by the RIA. However, it suggested that the vast majority would be unaffected by the changes, or at least not affected significantly. The bulk of the impact was forecast to fall on larger firms, who were generally more likely to be involved with foreign currency and/or derivatives.

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 accordingly PricewaterhouseCoopers 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?	Those consulted agreed that the relevant impacts had been mentioned in the RIA but there was disagreement over the relative savings and costs. A near universal opinion was that the expected savings had not been observed. There are two possible explanations for this: (1) the savings did not occur and (2) the savings did occur but were either not measurable or were too small to make a noticeable difference. Feedback suggests that a mix of these two effects is what happened. In terms of costs, around half felt the RIA was accurate and half identified one-off burdens in excess of the RIA prediction. The RIA mentioned a benefit in terms of reduced uncertainty and respondents had not seen that happen either (although they admitted it would be very difficult to measure). Because of small samples these findings are indicative, but they are consistent across all those consulted.
Were costs/savings incurred at the expected time?	No. In addition to savings not being observed some of the one-off costs associated with familiarisation had in fact become recurring

	because of the ongoing complexity of the regimes. It is difficult to divorce the impact of this RIA from other changes since but the evidence does suggest that one-off costs continued for longer than would normally be expected.
Were costs/savings incurred by the expected people?	Yes. The RIA did not include much detail on this but suggested that larger firms would be most affected. Respondents agreed with that.
Were any other costs/savings, not identified in the RIA, incurred ?	A number of respondents cited opportunity costs as being an issue, with time spent on dealing with the regimes detracting from other business activity. It is not entirely clear from the comments made what the impact of the specific RIA under review was (as opposed to the regimes generally) but HMRC accepts that any compliance burden will have an opportunity cost attached.
If the type of costs/savings varied from the original estimates, why was that?	Costs were higher for some firms, particularly where they had needed to buy in consultancy support to assist with the transition and/or provide advice in special situations. Other costs, such as training, were generally not too much of a problem.
Could such variances have been foreseen at the time?	The activities that firms might need to do were foreseen. The possibility of outsourcing that work was not mentioned but would have been predictable at the time.
What is the assessment now of the total value of costs and savings?	The RIA did not quote hard numbers and indeed respondents did not believe that a reliable figure could have been produced. This is because of difficulties isolating the impact of this RIA from other changes to the regimes, and from the costs of operating the regimes generally. Qualitative comments indicate that the RIA was optimistic and the benefit to cost ratio predicted has not been achieved.
If different from the original RIA, what has caused the discrepancies?	The main feeling expressed by those affected is that legislative complexity was not significantly reduced by this measure. The reduction in legislation from 200 pages to 70 was to some extent cancelled out by statutory instruments and subsequent changes to legislation.

With hindsight, were the compliance cost estimates accurate?	No. The predicted balance between short-term costs and long-term savings was optimistic. Material savings have not been observed.

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 owners, analysts and Better Regulations advisors were all involved.
Was an adequate audit trail maintained?	Yes.
Was Cabinet Office and/or internal HMRC guidance on RIAs followed correctly?	Yes – the guidance changed in the middle of the exercise (addition of the competition assessment section) but all rules in force at the time were followed, and any uncertainties appear to have been clarified prior to the RIA being published.
How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?	The effort on estimating compliance costs specifically was low relative to other aspects, partly because of the problems associated with measurement. A request for information in the partial RIA / consultation was subsumed within more substantial discussion of the changes themselves and the response on compliance costs was muted. A number of respondents said they were unaware of any consultation taking place, although that may have been at individual level (consultation documents were put in the public domain). Respondents agreed it would have been difficult to provide hard numbers.
Were the right people (both internal and external) consulted, and were their views reflected appropriately?	See previous answer.
Did those who were consulted when the RIA was written express views on the reasonableness of the process?	Not in detail. The focus of discussion was on the policy change generally rather than compliance costs specifically.
Have those who have been consulted now as part of this	Learning points are identified in section 6. The main concern was with the level of profile given

compliance cost review expressed views on the reasonableness of the process?	to particular consultations, and whether HMRC could do more to engage with those stakeholders who are not "regular members of consultative bodies" or are not represented by trade bodies. There were also some concerns over whether the RIA itself was a *fait accompli.* By the time it is published an RIA carries a ministerial endorsement supporting the proposed option. This may discourage respondents from providing feedback unless they feel the proposed option is still under discussion. The review team observes that the process as a whole (partial RIA, consultation, final RIA) is intended to mitigate against this. A number of HMRC policies have indeed been modified in the light of feedback received on an RIA.
Were compliance costs estimated for all options mentioned in the RIA?	Not in detail. The only alternative option mentioned was the status quo, although the audit trail indicates that other options were considered during the earlier consultation phase. Inferior options were omitted when the final RIA was produced.
Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?	No, although the RIA states that most of the impacts would fall on larger firms. The analysts at the time were unable to obtain reliable data at a more detailed level.
Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?	Economists were consulted throughout. The situation meant that only a qualitative analysis was possible in the RIA. Respondents were sympathetic with this. The review team observes that there is nothing wrong with analysis being difficult, but that any such analysis should be caveated if its conclusions are uncertain.
Was there sufficient time to produce a robust assessment of compliance costs?	Timing was not a significant issue, although some of the consultation periods were quite tight. Respondents noted that where time was limited they had given priority to technical matters. Compliance costs (which would have been difficult and costly to estimate anyway) may have taken a back seat.

Were any assumptions reasonable, given the circumstances at the time?	There was considerable consultation and stakeholders did have the opportunity to comment. To complete full research into compliance cost impacts would have been very costly and respondents agree that it would have been impractical. Given these two facts, the review team believes that the original assumptions were acceptable in the circumstances.
Were any estimates of compliance costs caveated appropriately?	Very little information was supplied on this. Given the uncertainty, early monitoring of compliance costs and savings would have been useful.
Were any risks correctly identified, addressed and explained?	No risks are mentioned as regards compliance costs, but the RIA was published in advance of implementation to allow time for guidance to be written and businesses to adapt. The RIA does discuss the high-level risks associated with the making or not making the policy change itself. The main problem with hindsight was simply that the regimes remain very complex and hence that the predicted benefits to business were low in comparison to the baseline.
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)?	Yes. The RIA noted an outstanding concern about non-elective matching, where proposals to avoid undue compliance costs were still being discussed. The compliance cost estimates themselves were not disputed at the time and the impacts did not become clear until after implementation.
Would HMRC do anything differently if the exercise were repeated, and hence could the RIA process have been improved?	Measurement of compliance costs in this case was extremely difficult. Businesses were unable to gauge the impact at the time. Subsequent events have proved that the RIA was optimistic and a number of learning points are identified in sections 6.1 and 6.2 below. The most significant learning point is that in cases where measurement is very difficult, the RIA should be caveated and an early review promised.

6. Learning points arising from the review

6.1 Learning points for future work in this policy area

- Most of the learning points are generic and covered in 6.2 below.
- The complexity of some of these regimes increases the likelihood that firms may need specialist support to help them implement changes. The implied costs of consultancy and the need for guidance should be factored in to future RIAs explicitly.

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

- A better understanding of the current level of compliance burden will help HMRC present any changes to that in an appropriate light. One of the problems with this RIA was that savings were predicted, and may well have been achieved, but they were not significant enough to be noticeable and hence make a real difference to business. This is a generic point but it applies particularly in the regimes covered by this RIA.
- Several of the benefits identified in the RIA would have applied only to specific types of firm or in particular situations. Generalisations should be avoided.
- Alternative options were not really covered in depth in this RIA. There was pressure to reduce the length of the RIA at the time, but a brief outline of alternatives should be included. HMRC needs to consider how much of the content in a partial RIA should be repeated in a final one (to help explain context, decision chains and so on). If the final version literally replaces an earlier partial then some audit trail and/or analysis may be lost.
- Where RIAs mention costs or benefits which are very subjective (such as a reduction in uncertainty) then additional explanation of how that might be measured would be helpful (or failing that appropriate caveats).
- Likewise, early monitoring and review will be more important where effects are uncertain (although it is accepted that difficulty with measurement can make early monitoring infeasible in some cases).
- Where costs are described as one-off, the RIA should consider whether there are any risks that such costs might continue beyond the initial stages, and if so flag them up.
- Guidance on whether and how RIAs should deal with opportunity costs and benefits could be enhanced.
- The purpose of an RIA is not always clear to readers and the initial preamble could be reviewed to rectify this.
- During consultation, the relative importance of the various issues should be explained where known. If there is a risk of compliance costs becoming secondary to higher profile issues then HMRC should recognise that and take action if it is likely to cause problems later.
- Finally, respondents are keen for HMRC to ensure that consultations are seen by the right people and publicised effectively accordingly. Publication on the HMRC website, or circulation to trade bodies, may not reach all those affected.

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 policy issues relating to corporate debt and the other regimes:

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ANNEX : THE PUBLISHED REGULATORY IMPACT ASSESSMENT