HM Revenue & Customs

COMPLIANCE COST REVIEW

SIMPLIFICATION OF EMPLOYEE SHARE SCHEMES (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 March 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 10 July 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

The RIA covered a variety of reforms to approved share schemes, all designed to simplify the operation of Share Incentive Plan (SIP), Company Share Option Plan (CSOP) and Save As You Earn (SAYE) schemes and reduce compliance costs for companies offering these schemes to their employees.

Feedback after the introduction of the SIP suggested that the scheme was too elaborate and created unnecessary administration. The changes implemented by the legislation allowed:

- employees to purchase partnership shares annually rather than through regular salary deductions, providing greater flexibility and reduced administrative costs, particularly for smaller companies;
- employers to disregard variable salary elements when calculating amounts that can be spent on partnership shares and thereby reduce administrative complexity; and
- employees to participate in more than one SIP in the same year, where a group restructured or employees moved within a group.

The SAYE and CSOP changes were designed to modernise the schemes by aligning rules and processes with those of the SIP and Enterprise Management Incentive (EMI) schemes. The reforms:

- aligned the definitions of ‘material interest’ in SAYE, CSOP and SIP;
- allowed minor changes to SAYE and CSOP plans without the need to submit to HMRC for approval;
- aligned SAYE with CSOP in terms of allowing tax advantages to be retained if options were exercised on retirement, redundancy or disability;
- aligned CSOP with SAYE and SIP by allowing employees who lost their job through injury, disability, redundancy or retirement to retain the tax and NI advantages if they exercised their CSOP options during the relevant holding period; and
- removed the rules that prevented CSOP options being exercised within three years of the previous tax-relieved exercise.

2.2 Anticipated compliance costs or savings

The intended impact of the changes was to simplify the administration associated with employee share schemes, reduce uncertainty and reduce compliance costs.

The RIA anticipated that the changes would lead to reduced administration in the day–to-day running of approved share schemes, but that a small implementation cost would be incurred in learning the new rules.

The reduction in administration costs was expected to have a greater impact on SMEs. Small companies were particularly anticipated to benefit where payroll was operated in-house and carried out by a small number of key staff.

The RIA recognised that costs were dependent on the existing skills already in place at the company, as this would affect the level of additional work required. Depending on the work to be undertaken, a company might have paid an hourly rate of £50 for payroll staff and up to £500 for a lawyer or adviser. As companies have choice and flexibility in how they implement the share schemes, the RIA was not able to place a figure on the exact reduction in costs as a result of the legislative changes.

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. 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?	The main types of costs were identified but they were not quantified because of the considerable variation, choice and flexibility in how these schemes are implemented. The RIA identified that the implementation of the change would be focused around the payroll operation, including the cost of legal advice and employer familiarisation. In practice, the majority of costs for most of the respondents revolved around the administration of the share schemes, rather than payroll amendments (although the latter was still an issue).
Were costs/savings incurred at the expected time?	Yes - respondents have confirmed this.

Were costs/savings incurred by the expected people?	Yes – again, respondents have confirmed this. The main affected areas of business were the payroll, finance, tax and human resources departments. However, the majority of respondents stated that the changes were fairly minimal, and hence that the level of interaction between departments, and likely additional work for each department, was minimal.
Were any other costs/savings, not identified in the RIA, incurred ?	The RIA explained that companies have considerable choice and flexibility in how they implement the different share schemes, but did not elaborate on all the factors affecting costs. For example, some companies offer more than one approved share scheme, and it is precisely these companies that incurred the most significant amount of costs in complying with the legislative changes. Some respondents felt that HMRC did not fully outline the costs of seeking legal and professional advice. The RIA identified all other significant issues.
If the type of costs/savings varied from the original estimates, why was that?	The main difference (professional fees) would not have affected all businesses. The RIA could perhaps have discussed a wider range of individual company circumstances, and thus identified the full range of costs and savings that (some) businesses might have incurred. One respondent commented that the estimates were so wide-ranging in scope that it was difficult for them to be accurate for all businesses.
Could such variances have been foreseen at the time?	All interviewees were aware of this change in advance, and at the time they assessed there would be either little or no impact to their compliance costs. This was mainly because the changes were considered to be relatively minimal, particularly for employers operating CSOP and SAYE schemes. This general view has been borne out in practice.
What is the assessment now of the total value of costs and savings?	The majority of respondents did not incur significant costs as a result of the changes. But equally, the majority of respondents did not identify any savings, either financially or administratively. Some felt that future savings

	could be realised if more employees were to contribute to their SIP scheme. It remains difficult to put specific figures on both costs and savings. One respondent, a large company, estimated that the costs in complying with the legislation did not exceed £10,000. Another large company also identified costs of approximately £10,000 per year in relation to advice taken on an employee communication sent on an annual basis. A further £8,000 of internal costs were incurred following the introduction of the changes, which included legal fees, HMRC correspondence and employee communications. In addition, the respondent estimated that the cost of training and familiarisation by the in-house team amounted to approximately £15,000 to £20,000. One smaller company respondent identified a cost of £2,000 for a third party advisor to review their scheme and ensure that the changes had been effected accurately. However, the majority of respondents viewed the costs as low and absorbable, and have not identified them as a major cause for concern.
If different from the original RIA, what has caused the discrepancies?	The (qualitative) estimates of “low cost” are unchanged. Benefits are not perceived to have been very significant, not because they don’t exist, but because they are seen to be fairly small in the overall scheme of things.
With hindsight, were the compliance cost estimates accurate?	The RIA appears to have been accurate and reasonable in terms of the aims of the legislation (namely that this would be a simplification). For smaller companies, the implementation cost estimates were accurate, although many did not feel that the changes were significant enough to incur substantial costs or savings. Larger firms were more affected with some one-off costs, but again view the change as relatively minor.

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. Most documentation related to the period immediately prior to the the RIA being produced. This is not necessarily a bad thing at all, but it raises the issue of how far in advance the need for this RIA was anticipated.
Was Cabinet Office and/or internal HMRC guidance on RIAs followed correctly?	Yes - the RIA followed the relevant guidelines.
How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?	Precise estimation work was limited because of the wide variation in possible company circumstances. Given that the costs and benefits are assessed as small, this was proportionate and appropriate. Any additional work could have been used to consider a range of example scenarios for individual businesses, an enhancement that some businesses say would have been helpful.
Were the right people (both internal and external) consulted, and were their views reflected appropriately?	Yes. Paragraph 22 of the RIA states that regular contact was made with external share scheme stakeholders who (e.g.) helped identify a number of the reforms to be implemented.
Did those who were consulted when the RIA was written express views on the reasonableness of the process?	No problems were identified at that stage, and indeed the RIA itself was addressing concerns raised earlier by business.
Have those who have been consulted now as part of this compliance cost review expressed views on the reasonableness of the process?	Feedback is mixed, with some respondents feeling the RIA process was appropriate, and others saying that consultation was insufficient and should have included a more varied employer base and/or advisors. There was a feeling that some issues may affect only individual firms and hence not warrant the inclusion in a RIA. This is somewhat at odds with other comments

	requesting more individual examples to help firms judge the precise impact on them. Getting the balance right is key.
Were compliance costs estimated for all options mentioned in the RIA?	Most of the analysis and commentary focused (rightly) on the preferred option. However, there was scope to include more detailed analysis of alternatives in the RIA. Some of those affected have said they thought the RIA was presented in a way which exaggerated the attractiveness of the lead option (though not to the point of altering the correct way forward).
Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?	Many of the respondents felt that the RIA included unnecessary detail, with too much emphasis placed on the anticipated administrative benefits for small and medium sized companies. No mention was made of the possible costs to large companies.
Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?	Yes – although the fact that the analysis was pitched at a fairly high level, means that some respondents felt that they offered no real indication of the potential cost of compliance to the individual employer.
Was there sufficient time to produce a robust assessment of compliance costs?	Yes – although the process needed to comply with the Finance Bill cycle and timing was to some extent fixed.
Were any assumptions reasonable, given the circumstances at the time?	Yes, although some of those affected believe that although the RIA was helpful, it presented the reforms in an overly-positive light, which did not get across the fact that the impact on both costs and benefits would be relatively small. Although it is not a compliance cost issue, respondents also noted that the RIA did not assess the likely increase in employee participation, reward and retention.
Were any estimates of compliance costs caveated appropriately?	Yes – although the issues of (1) the overall impact being small and (2) there being wide variation in individual company circumstances, could both have been given greater emphasis.

Were any risks correctly identified, addressed and explained?	The risks section of the RIA focused on the benefits of making this change, compared with what might happen if there were no change. It did not mention whether there were any risks associated with the preferred option.
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)?	There were no disagreements. All of the respondents agreed that the RIA effectively expressed the purpose of the change. As outlined above, some felt that the impact and cost analysis was focused solely on small or medium sized employers, with no commentary on the likely impact to larger employers.
Would HMRC do anything differently if the exercise were repeated, and hence could the RIA process have been improved?	Overall, this RIA was accurate in predicting fairly low compliance costs. It may have over-stated the benefits slightly. A number of learning points are identified in section 6 below.

6. Learning points arising from the review

6.1 Learning points for future work in this policy area

- One issue concerns companies who offer more than one approved share scheme. This possibility should be considered in any relevant future reforms, since such firms may have above average compliance costs.

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

- The main concern raised by respondents was the RIA's focus on SMEs, with relatively little analysis of the implications for larger businesses. It is accepted that the Government has particular objectives for reducing the burden on smaller businesses, but all types of business should given appropriate coverage in an RIA.
- Subject to the importance of the reform, RIAs should consider presenting a range of example scenarios for individual businesses, an enhancement that some businesses say would have been helpful. The balance between presenting this extra detail, and presenting too much detail, would need to be considered on a case by case basis. At the same time, any impacts should be explained clearly so that readers can judge whether they would affect all firms, or merely those in particular circumstances.
- Some of those affected have said they thought the RIA was presented in a way which exaggerated the attractiveness of the lead option. Fuller consideration in the RIA of alternatives would address this.
- If a reform is likely to be “small” in the context of the overall burden, then the measure should be described as such.
- Any risks associated with implementing the lead option should be clearly stated. It is not sufficient to argue that the preferred option is best solely because the

alternatives have disadvantages. If there are no risks with the lead option then that can and should be made clear.

- The costs of seeking legal and professional advice should be considered carefully, provided they are an essential consequence of the policy reform.
- If a business needs to reform its systems, the costs of testing and validating that new system should be included in the compliance costs analysis (provided that such activity is a result of the specific reform being made, and not simply part of general assurance activity or accounting).
- It was not clear in this case when the need for an RIA was first anticipated. There is a possible learning point both for documenting very early work in the RIA process, and for commencing such work at the right time.
- Budget secrecy notwithstanding, some of those affected wanted to see improvements in the communication of proposed legislative changes to businesses before the RIA stage.
- RIAs could usefully state who exactly their target audience is.

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 employee share schemes policy specifically:

Hasmukh Dodia, HMRC, 100 Parliament Street London SW1A 2BQ
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For issues relating to the compliance cost review programme generally:

Richard Bowyer HMRC 100 Parliament Street London SW1A 2BQ
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Email: 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).

THE PUBLISHED REGULATORY IMPACT ASSESSMENT

Simplification of Employee Share Schemes (PDF 97K)