

COMPLIANCE COST REVIEW

EXTENSION OF VAT ANNUAL ACCOUNTING SCHEME AND FLAT RATE SCHEME, AND RELAXATIONS TO THE VAT DEFAULT SURCHARGE SYSTEM (originally published on 10 April 2003 and came into force on 10 April 2003)

CHANGES TO VAT FLAT RATE SCHEME (originally published 10 December 2003 and came into force on 01 January 2004)

CASH ACCOUNTING SCHEME AND ANNUAL ACCOUNTING SCHEME (originally published on 17 March 2004 and came into force on 01 April 2004)

VAT FLAT RATE SCHEME: CHANGES TO THE POSTAL AND COURIER SERVICES SECTOR (originally published on 17 March 2004 and came into force on 01 April 2004)

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 4 final RIAs listed above. Copies of the published final RIAs are attached at Annex A.

This review re-assesses the compliance costs published in the original RIAs and addresses two main questions:

- whether the estimates of compliance costs used in the RIAs 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 decisions.

2. The published RIAs

2.1 Description of the policy changes

The RIAs covered changes designed to reduce the costs to small businesses of complying with their VAT obligations. The majority of the changes were to simplification schemes that provide small businesses with alternative methods for VAT accounting. The changes aimed to make the schemes more attractive to small businesses and boost take-up, so that the compliance cost benefits of simplified accounting and some cash-flow benefits, could be enjoyed by more.

The changes included:

- increases in the turnover ceilings below which businesses are eligible for the Flat Rate scheme (FRS) in April 2003, Annual Accounting scheme (AAS) in April 2003 and 2004 and the Cash Accounting scheme (CAS) in April 2004.
- further enhancements of the FRS in January and April 2004, which included reductions to the flat rates applying to businesses using the scheme; a minor technical change to correct an error in the calculation of flat rates for couriers; and new guidance and application methods, to help businesses consider the benefits of the scheme and make application easier.
- an increase in the turnover ceiling used to test whether a default surcharge (DS) should be issued, to reduce the likelihood of small businesses receiving automatic penalties (surcharges) for late payment and to align the turnover ceiling for this relaxation, with turnover ceilings for FRS and AAS.

All of the VAT schemes covered by this review are optional. This means that only businesses that use, or decide to use, the schemes are affected.

2.2 Anticipated compliance costs or savings

None of the changes presented any additional compliance costs for businesses. The changes to the CAS and DS provided no reduction in compliance costs. However, savings were forecast for changes to the FRS and AAS.

Flat rate scheme

Potential savings in compliance costs for businesses joining the scheme after April 2003 were estimated, on average, at around £825 per scheme user. In the light of ongoing research and feedback from business, this estimate was reduced to £600 in the RIA published in December 2003, for changes that took place in 2004. The compliance cost for the correction in flat rates applying to couriers was not assessed, as the change was so small. Any costs to couriers who may have chosen to leave the scheme as a result of the change, would be more than balanced by the unintended tax benefit they had

enjoyed by using the lower rate. All affected parties were contacted and given a long transitional period to adjust their flat rate.

Annual accounting scheme

The RIAs foresaw a compliance cost benefit for businesses that decide to join the scheme. This was from having to fill in three fewer VAT returns per year. The overall benefit was estimated at £75-£80 per business, per year.

3. Conduct of the review

Each PIR is normally conducted individually, and the review process is adapted to suit the particular circumstances applying in each case. However in this case, because of the similarity between these 4 RIAs they have been grouped together for review purposes. 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, alterations to take-up of the schemes by businesses has been monitored by interrogation of the VAT mainframe monthly, and sampling of the business population. Perceptions and attitudes to the schemes have been evaluated by independent market research in 2003, 2004 and 2005. This review has also drawn on responses to the small business consultation *Working towards a new relationship* published towards the end of 2005 and research into the impact of tax on small business cash flow commissioned by HMRC.

HMRC VAT Accounting, Schemes and Exports policy team (VASE) in CT & VAT Products and Processes function have lead this evaluation, assisted by Knowledge, Analysis & Intelligence (KAI), Marketing and HMRC's Small and Medium Enterprise and Employers Unit.

4. Were the original estimates of compliance costs accurate?

This section addresses two main aspects – the nature of the change in compliance costs (that is, 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 (for example, reading legislation, filling in forms, updating IT systems, saving time etc.) incurred?	Yes. Compliance cost savings in terms of time were anticipated for businesses using the FRS and AAS and our research indicates that these were secured. However, the total value of savings for both schemes varied from the original estimates, as reported below.
Were costs/savings incurred at the	Yes.

expected time?	
Were costs/savings incurred by the expected people?	Yes.
Were any other costs/savings, not identified in the RIA, incurred?	We have found no evidence of this and the original assessments remain comprehensive.
If the type of costs/savings varied from the original estimates, why was that?	This is because the savings will depend, amongst other things, on business experience and business type. The savings were a best estimate based on business responses to consultation available at that time. The revised figures for FRS and AAS take into account further feedback from businesses and surveys carried out since the changes.
Could such variances have been foreseen at the time?	Given the complexity of forecasting compliance cost benefits for scheme members and the information drawn from business consultation, it is difficult to see how the variances could have been foreseen at the time.
What is the assessment now of the total value of costs and savings?	FRS - there is some limited evidence that estimates of time saved and accountancy costs are too high at £600. Research will continue, but it is important to emphasise that this figure is only an average benefit for the use of an optional scheme. A stated range might have proved to be better presentationally. AAS - we now estimate the saving per business, per year, for completing one VAT return instead of four, at around £110. This represents an increase in savings of £30-£35 per year for AAS members, compared to the original estimates.
If different from the original RIA, what has caused the discrepancies?	Results from market research and a number of separate business surveys since the changes, have enabled us continuously to refine estimates of time saved and associated accountancy and clerical costs.
With hindsight, were the compliance cost estimates accurate?	No - although we believe that the changes have been a success. See below.

For FRS, although the original estimates of compliance costs savings have been revised, we believe the changes have been successful in attracting businesses to use the scheme. Membership has grown since the changes were introduced, from around 9,000 users to 101,000 users.

For AAS, the changes have made no noticeable impact on the number of users (membership has remained static at around 10,000). There are, however, approximately 2,000 FRS users who also use the AAS and this low cost, low profile change is justified by the additional simplicity for those businesses alone.

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?	The Policy teams responsible for VAT schemes and default surcharge worked on this in consultation with internal analysts. There was also information consultation with accountancy professionals and small businesses during the policy making process. All views were considered in the final analysis.
Was an adequate audit trail maintained?	Yes.
Was the Cabinet Office and/or internal HMRC guidance on RIAs followed correctly?	Yes. The RIA templates were used and completed comprehensively.
How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?	Because the benefits were from use of optional schemes, limited time was devoted to the initial estimates. The approach adopted was to be realistic and to continue to monitor business views and behaviour. We consider this to have been a proportionate approach.
Were the right people (both internal and external) consulted, and were their views reflected appropriately?	The views of external consultees were taken into account where they had commented on compliance costs. The views of HMCE's Small Business Unit were also sought and reflected in the policy decision.

<p>Did those who were consulted when the RIA was written express views on the reasonableness of the process?</p>	<p>The focus of earlier comments was on the policy rather than the process.</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>Independent market research and surveys used in this review did not identify any concerns with the process. As with the original RIAs, the focus was on the policy rather than the process.</p>
<p>Were compliance costs estimated for all options mentioned in the RIA?</p>	<p>Yes.</p>
<p>Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?</p>	<p>Yes. The changes impacted on small businesses only and estimates concentrated specifically on them as a group.</p>
<p>Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?</p>	<p>Yes. KAI analysts were fully involved in developing an appropriate analytical approach.</p>
<p>Was there sufficient time to produce a robust assessment of compliance costs?</p>	<p>Yes. As explained above, although compliance benefits for FRS and AAS were different to that anticipated, the views of external and internal stakeholders were fully taken into account before the changes.</p>
<p>Were any assumptions reasonable, given the circumstances at the time?</p>	<p>Yes.</p>
<p>Were any estimates of compliance costs caveated appropriately?</p>	<p>Yes. The RIA published on 10 December 2003 for changes to the FRS pointed out that estimating the compliance benefits was not straightforward and that research would be ongoing.</p>
<p>Were any risks correctly identified, addressed and explained?</p>	<p>Yes. Any risks were identified as part of the evaluation of options.</p>
<p>Were any disagreements identified and reflected appropriately (for example, if the figures were disputed by businesses, or if more than one set of figures were available)?</p>	<p>We have reacted positively to feedback that the original compliance cost benefits may have been overstated and have surveyed businesses each year in order to refine our information.</p>

<p>Would HMRC do anything differently if the exercise was repeated, and hence could the RIA process have been improved?</p>	<p>As the compliance benefits for FRS were overstated, with the benefit of hindsight, more could have been done to test some of the data. However we believe that the level of effort devoted to the original consultation was reasonable in view of the positive impact of the changes on business. We believe that the process was good overall, but have listed some learning points below.</p>
---	--

On the basis of these questions, we judge the process of estimating compliance costs to have been reasonable. Given that the changes were of minor impact, have only helped small businesses and were not costly to make, we believe that the effort devoted to estimating the costs was proportionate.

6. Learning points arising from the review

6.1 Learning points for future work in this policy area

- Research into business attitudes to the schemes and analysis of compliance benefits will need to continue, to ensure that the VAT schemes continue to meet businesses' needs. Since publication of the RIAs covered by this report, HMRC have responded positively to responses from surveys and consultation in 2005. In his pre-Budget report on 05 December 2005, the Chancellor announced changes to the AAS from April 2006 and, subject to approval of a derogation, changes to the ceilings for CAS in 2007. This will mean that more small businesses can join the schemes and benefit from simplified accounting.
- Estimating compliance cost savings accurately for the diverse business population using these optional schemes is not straightforward. It will be important to continue monitoring results from future business surveys in order to continue refining estimates of time saved and associated accountancy and clerical costs.

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

- Where doubt exists over estimates of compliance costs or benefits, it is important to ensure that this is spelt out clearly in the RIA and data tested during and after implementation.
- The level of effort applied to estimating compliance costs, including input required from external stakeholders such as businesses, should take account of the impact and value of the policy measure.

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 the schemes specifically:

Paul Kinsey
VAT Accounting, Schemes and Exports, CT & VAT Product & Process Group
4th Floor SW Queens Dock
Liverpool
L74 4AA
Telephone: 0151-703-8558
E-mail: paul.kinsey@hmrc.gsi.gov.uk

For issues relating to the compliance cost review programme generally:

Geoff Wootton
Room 2E/13, 100 Parliament Street
LONDON
SW1A 2BQ

Telephone: 020-7147-3068
E-mail: geoff.wootton@hmrc.gsi.gov.uk

ANNEX : THE PUBLISHED REGULATORY IMPACT ASSESSMENTS