

## **COMPLIANCE COST REVIEW**

### **SUBSTANTIAL SHAREHOLDINGS EXEMPTION**

#### **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 on 15 April 2002 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 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**

This measure formed part of the Government's programme to create a modern, competitive and fair corporate tax regime that would provide stability for business in the longer term. It introduced a new relief to put the UK in a similar tax position to other countries that already operated exemption systems. It had the effect of no longer penalising businesses that restructure with large capital gains tax bills. The policy remains in force today.

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

The RIA said that there would be a “modest but worthwhile saving” in compliance costs. It was not possible to provide quantitative estimates, and indeed the businesses and representative bodies consulted at the time were also unable to provide estimates for compliance costs.

The RIA did estimate the number of firms affected, saying that “The Inland Revenue’s 1998/9 survey of company gains suggested that about 2,000 companies made gains on substantial shareholdings in that year. Taking account of companies that might expect to make such disposals but did not in that survey year, about 5,000 companies might expect to be directly affected by this exemption. Three-quarters of the yield on gains from share disposals came from just over 700 companies in 1998/9.”

The bulk if not all of the compliance cost savings would be for medium and large sized businesses. Small businesses were unlikely to be affected by the change.

## **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 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?	<p>The RIA did not provide a lot of detail on the components of any costs or savings. The research interviews with stakeholders found broad agreement with that description, and indeed the RIA appears to have “got it right” in most respects.</p> <p>One respondent disagreed with the assertion that the SSE regime would have made it easier for businesses to restructure, but others did agree and the RIA comment appears reasonable as a broad generalisation. It could have been qualified to say that not all firms would benefit in this way.</p>
Were costs/savings incurred at the expected time?	Yes.
Were costs/savings incurred by the expected people?	Yes – however some firms may not have benefited if their affairs were particularly complex or unusual. One of the trade bodies consulted suggested that 8 out of 10 affected firms would have benefited.
Were any other costs/savings, not identified in the RIA, incurred ?	No.
If the type of costs/savings varied from the original estimates, why was that?	Several respondents said that the costs of familiarising themselves with the new rules were significant, and higher than the RIA had implied. Again this was not a uniform finding: the evidence suggests that the RIA was correct for medium and “typical” groups. For the largest and/or atypical groups the costs were underestimated.
Could such variances have been foreseen at the time?	No – because the variances are (a) in a minority and (b) dependent on individual circumstances. However, the RIA could usefully have qualified any general statements to make clear that although positive for most firms, the benefits in an individual case could vary.
What is the assessment now of the total value of costs and savings?	The RIA assessment stands.
If different from the original RIA, what has caused the discrepancies?	Not applicable.

With hindsight, were the compliance cost estimates accurate?	Yes in general terms. Most firms have benefited and for them the costs and benefits are in line with the commentary in the RIA. Some firms (the larger or more complex) may have incurred higher costs, particularly initially, and this was not mentioned prior to implementation. At the time, businesses were unable to offer any concrete cost estimates themselves.
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**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 RIA was produced through collaboration between policy specialists, analysts, Better Regulation Advisors and others.
Was an adequate audit trail maintained?	The audit trail within the policy teams was excellent. Some of the analytical support work was less well documented (mainly because there was little quantitative analysis available at the time).
Was Cabinet Office and/or internal HMRC guidance on RIAs followed correctly?	Yes. There is good evidence of procedures being followed correctly throughout. A partial RIA was put out for consultation prior to the final version.
How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?	<p>Relatively little was said about compliance costs because they were not felt to be significant (and the majority of recent feedback from stakeholders supports that). No businesses commented on the correctness of the estimates that appeared in the partial RIA. HMRC interpreted this lack of response as business accepting what had been written about compliance costs. The review team considers that this was a correct interpretation in this case, but that it should not be taken as a precedent for RIAs generally. There are many reasons why a response might not be given.</p> <p>In terms of the overall effort spent on estimating costs, the original team considered the significance of the policy change, the feasibility</p>

	<p>of obtaining a numerical estimate, whether the change affected large numbers of businesses, and whether the compliance costs themselves were felt to be significant. On that basis, the team concluded that a small amount of analysis would meet the need. Both the review team and recent research endorse that view.</p>
<p>Were the right people (both internal and external) consulted, and were their views reflected appropriately?</p>	<p>Yes. There was extensive consultation over a number of years as the policy was developed. A partial RIA was published and well over 50 businesses and representative bodies responded to the various stage of consultation before the final RIA was signed. The policy was amended in light of the responses received during this consultation process. Although compliance costs were not identified as a major issue within this particular policy change, the compliance costs quoted in the RIA were informed by feedback from stakeholders and a number of specific interviews with them.</p>
<p>Did those who were consulted when the RIA was written express views on the reasonableness of the process?</p>	<p>The majority of those who contacted the Inland Revenue through the consultation period welcomed this new strategy in principle but wanted it tweaked slightly in their favour. Nobody commented on the reasonableness of the RIA process specifically – the focus was on substantial shareholdings policy.</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>Yes – and the comments are generally positive. This RIA was well-prepared and based on substantial consultation, including the earlier partial RIA. There are learning points but nothing to suggest that the original process was flawed in any significant way.</p>
<p>Were compliance costs estimated for all options mentioned in the RIA?</p>	<p>No. Just for the main option.</p>
<p>Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?</p>	<p>No. But this measure was primarily for large and medium business any impact on small businesses would have been very small. No attempt was made to distinguish large and/or unusual firms and this has attracted comments from stakeholders (albeit with hindsight).</p>

Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?	Yes. The analysts at the time were unable to provide quantified estimates of costs and benefits, but that appears to have been reasonable at the time. The decision to publish a qualitative assessment, rather than potentially unreliable numbers, has attracted positive feedback from stakeholders (although HMRC observes that in other RIAs respondents have argued for more detail even if tentative). The important thing is how the information is explained and presented.
Was there sufficient time to produce a robust assessment of compliance costs?	Lack of compliance cost data was an issue, but time was not a problem.
Were any assumptions reasonable, given the circumstances at the time?	Yes – subject to the learning points noted in section 6.
Were any estimates of compliance costs caveated appropriately?	Ditto.
Were any risks correctly identified, addressed and explained?	The risks were discussed at length during the consultation period and the policy adapted to address some of the concerns. Recent consultation has identified one or two issues and these are listed in section 6.1.
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 obvious disagreements and business largely welcomed the introduction of this policy strategy. Their only real problem was in how the detailed rules could be structured to best suit their individual circumstances.
Would HMRC do anything differently if the exercise were repeated, and hence could the RIA process have been improved?	No. The learning points stand but the basic process was applied correctly and usefully. The RIA was well produced and (after consultation in partial form) well received.

## 6. Learning points arising from the review

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

- Respondents identified two complexities which had not been mentioned in the RIA. First, there has been some uncertainty over whether groups and sub-groups qualify as “trading” or “non-trading”. Secondly, there has been doubt over whether various

types of overseas companies fall within the regime. Both of these issues would have taken time to sort out (and hence given rise to a small compliance cost).

- Several respondents said that compliance costs could have been reduced had guidance on these and similar issues been provided sooner.
- Respondents provided favourable feedback on the consultation process used in this case and confirmed it had led to improvements in the detail of the policy change.

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

- In cases where robust quantified analysis is not available, RIAs can provide either a qualitative assessment, very tentative numbers or both. In this case, respondents endorsed the decision to provide only the qualitative assessment. This may or may not be appropriate in all RIAs but was a good decision in this one.
- Similarly, the arguments for and against basing analysis on small samples or limited data are not clear cut. HMRC considers that whether or not this is appropriate will vary according to the particular policy change and the importance of compliance costs within that change. The important thing is to explain the basis for any analysis so that their applicability and reliability are clear and open to challenge.
- Where costs or benefits are detailed in RIAs, any reasons for variances between different types of firm should be stated. If detailed information is not available then a caveat should be included to explain that the analysis is indicative and expected to apply to most, but not necessarily all firms. Individual circumstances may increase or decrease costs and benefits away from the average.
- Where possible, all RIAs should distinguish between one-off and recurring costs and benefits. If detailed analysis is not available, a written description of the likely effects will add value.
- Where compliance cost analysis is presented for consultation (for example in a partial RIA) and few or no comments are received, HMRC should take care in interpreting that lack of response. It may indicate that the assessment is agreed and there is little to say, but it may not and other evidence (including oral consultation with focus groups or trade bodies) should be taken into account.

## **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 substantial shareholdings policy specifically:

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For issues relating to the compliance cost review programme generally:

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**ANNEX : THE PUBLISHED REGULATORY IMPACT ASSESSMENT**