

COMPLIANCE COST REVIEW

VAT : CLARIFICATION OF HMRC POWERS TO INSPECT GOODS

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 an Impact Assessment (IA) when the associated legislation is laid before Parliament. Interim “consultation stage” IAs may also be published as part of consultation prior to implementation.¹

This document summarises the outcome of a post-implementation review of the above VAT Powers IA published on 15 March 2006. The measure was implemented with effect from 19 July 2006. A copy of the published IA is attached.

This review re-assesses the compliance cost analysis published in the original document and addresses two main questions:

- whether the estimates of compliance costs used in the IA 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 IA 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 or its wider impacts.

2. The published Impact Assessment

2.1 Description of the policy change

This measure formed one of a series of measures designed to combat Missing Trader Intra Community (MTIC) fraud within the VAT system. This type of fraud involves fraudsters registering a company for VAT, acquiring goods VAT-free in another EU country, charging VAT to their customers, and then disappearing without paying the VAT to HMRC. Carousel style frauds are a more sophisticated version involving the

¹ Impact Assessments were previously known as Regulatory Impact Assessments, but were renamed in 2007 for simplicity.

same goods being moved repeatedly between countries, with the VAT being stolen on each circuit. In most cases, the goods themselves tend to be small but high value, such as mobile phones or computer chips.

This measure provided explicit authority for HMRC officers to “stamp and scan” goods or their packaging. Typically this would involve stamping the outside of the packaging with a date stamp, and scanning any barcodes to create an electronic record of serial numbers applicable to the goods.

HMRC already had the right to inspect goods, and to do so in a safe and efficient manner. As such, the right to stamp and scan was implied within the prevailing rules. But it was not stated explicitly in law, and some businesses had challenged the right to stamp or otherwise mark their goods. The measure clarified the wording in the VAT Act to avoid any ambiguity and confirm that HMRC was entitled to carry out these procedures.

The IA made clear that while the provisions applied universally, in practice HMRC would only use them in the course of operational activities designed to combat fraud. This would limit the number of businesses directly affected.

The IA compared clarification of the law with maintaining the status quo, and did not identify any other workable options.

2.2 Anticipated compliance costs or savings

The IA took the view that the measure simply clarified existing rules and did not change them². Given this, there would be no change to the number of inspections carried out and no change to the burden on business.

Maintaining the status quo would also avoid any increase in direct costs to business. However, in this case there might be some indirect costs associated with legal uncertainty, and the fact that some freight forwarders might face pressure from their customers not to allow stamping and scanning.

The implication was that the status quo was sub-optimal, and that the proposed clarification would reduce the indirect costs faced by some businesses. It would also, of course, assist with the identification of fraud.

The IA did not provide quantitative estimates of the impact because the direct impact of this particular clarification was expected to be negligible. The IA did make reference to a possible increase in the duration of inspections, but said that HMRC would work with affected businesses to minimise any costs arising.

² This view is not necessarily shared by the businesses affected. We discuss this issue in more detail in section 4 below.

3. Conduct of the review

Each compliance cost review (CCR) 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 drawing on the consultants' expert knowledge of those affected, and their ability to engage with them through a mix of informal consultation and in-depth interview. 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. 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).

The key issue in this particular review is the extent to which the cost of inspections can be attributed to this specific clarification measure. There are two questions:

- did the measure constitute a real change in regulations, as opposed to confirming a prevailing power?
- can any change in the number or depth of inspections be attributed to this clarification measure, or was it a result of other anti-fraud initiatives?

The IA assertion that the measure simply clarified existing powers was based on advice from HMRC lawyers, but was not tested in court and has been disputed by some businesses.

On the second bullet, there is clear evidence that concerns about fraud have led to a (justifiable) increase in inspections. Any resultant costs may be attributable to that change in operational practice, and not to this particular clarification measure. This would directly affect the content of this particular impact assessment.

This review focuses on improving the IA process, and in doing so has identified various learning points around extending the guidance on handling situations of this nature.

Question	Comments
<p>Were the specific types of cost and benefit identified in the IA (e.g. reading legislation, filling in forms, updating IT systems, saving time etc.) incurred?</p>	<p>The IA indicated that compliance costs would not be significantly affected by this clarification. However, various references suggested that some costs might occur (paras 10.33 and 10.34 referred to longer inspections and difficulties associated with accessing wrapped goods in order to stamp or scan them).</p> <p>It would be wrong to attribute all the costs of inspection to this particular measure. Nonetheless, the references in the IA indicated that some changes in costs were possible.</p> <p>Businesses have reported modest transitional costs associated with the measure, and more significant continuing costs associated with supervising HMRC presence on business premises and general disruption to trade. Broader costs associated with inspections generally may include professional advice, training, equipment, security, administration and insurance.</p> <p>In so far as the reform may have increased the duration or depth of inspections, these costs have certainly been incurred.</p> <p>Respondents did not believe that the anticipated reduction in the level of disputes had materialised, although the law itself is now indisputably clearer.</p>
<p>Were costs/savings incurred at the expected time?</p>	<p>The IA did not anticipate that there would be substantial additional costs, and so did not explicitly consider timing. Respondents indicated that business incurred costs both before and after the changes, although it is difficult to isolate the specific costs resulting from the clarification, as opposed to those arising from wider reforms or changes in operational practice.</p>

<p>Were costs/savings incurred by the expected people?</p>	<p>Yes, although there is a potential learning point around considering knock-on impacts along the supply chain. The IA did not discuss that in detail.</p>
<p>Were any other costs/savings, not identified in the IA, incurred?</p>	<p>Respondents have asked that in future HMRC give greater consideration to (1) the fact that their employees may need to stop work during inspections and (2) that the inspections themselves may delay delivery and increase costs. The CCR team has passed these representations to the relevant policy staff in HMRC.</p>
<p>If the type of costs/savings varied from the original estimates, why was that?</p>	<p>In the view of respondents, the original estimate was inaccurate because it failed to take into account the costs incurred with regard to staff attendance at premises, training, professional fees, equipment and insurance.</p> <p>The CCR team considers that these costs should indeed be considered, alongside risk, when deciding whether to inspect goods. However, we do not believe that such costs have arisen solely because of the legal clarification. The learning point must be that any such IA should explain very clearly how a reform will interact with other changes, so that the overall impact on cost can be assessed by those affected.</p>
<p>Could such variances have been foreseen at the time?</p>	<p>Yes they could, but the real issue is about clarifying the scope of an IA when presenting cost and benefit information to stakeholders. It may be very difficult for those affected to appreciate how several simultaneous changes will collectively affect them. This IA focused on one very specific element of change and could perhaps have devoted more time to presenting the wider picture. HMRC guidance needs to be extended to cover this sort of situation.</p> <p>The CCR team accepts that with all anti-fraud initiatives there may be limitations on the amount of detail that can be made public.</p>

<p>What is the assessment now of the total value of costs and savings?</p>	<p>We consider that the impact of the clarification was, on its own, small. However it was greater than the negligible cost predicted in the IA because the potential costs identified in the IA were indeed incurred.</p> <p>If the coincidental increase in the level of inspection is factored in then the cost impacts are much more significant. The IA could perhaps have explained more strongly that such a possibility existed (subject to the point above about publishing sensitive information).</p>
<p>If different from the original IA, what has caused the discrepancies?</p>	<p>The IA assumed that the law had been clarified but not changed. This view was reasonable (it was supported by legal advice within HMRC), but it was also contentious. If disputed, then any costs arising from additional stamping and scanning in future would count as a marginal increase in the burden on business.</p> <p>We consider that the IA could have considered the situation from a business perspective and discussed the likely costs involved with stamping and scanning. Even if the conclusion was that such costs would have been incurred anyway (because the law had not changed) the extra discussion and context would have been helpful. It would also have reinforced the message that HMRC understood the burdens and was doing everything it could to minimise them, while addressing the very real risk of fraud.</p>
<p>With hindsight, were the compliance cost estimates accurate?</p>	<p>We consider that the picture presented to businesses in the IA was optimistic for 3 reasons:</p> <ul style="list-style-type: none"> • it assumed that the law already gave HMRC the right to stamp goods, when this view was not necessarily shared by business and could be challenged; • it did not consider in depth the interaction between the legal clarification and other changes to the inspection regime; and • where it identified possible costs to business arising from longer inspections, it did not attempt to quantify those costs.

	Our view is that the IA was accurate in what it actually said, but that it should have said more to address these 3 issues.
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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 IA?	Policy experts prepared the IA with support from Better Regulation advisors, Departmental analysts and HMRC legal counsel.
Was an adequate audit trail maintained?	Yes – the audit trail was comprehensive and useful.
Was Cabinet Office and/or internal HMRC guidance on IAs followed correctly?	Yes. The IA was fully compliant with the guidance available at the time. Unfortunately the guidance did not cover some of the issues which have arisen in this review (such as a possible disagreement over whether the law had in fact changed).
How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?	Because the costs were expected to be negligible the amount of analytical resource used was low. Other things equal, this would have been proportionate, but we consider that more analysis would have been useful in tackling the 3 bullets at the end of section 4 above.
Were the right people (both internal and external) consulted, and were their views reflected appropriately?	Internal consultation was good. The need to clarify the law arose from discussion between HMRC and businesses at the front line, and in that sense was based on feedback received. The IA itself was published without further consultation because of the need to make swift progress in tackling fraud, and because legal advice within HMRC was that the law was not changing. Nonetheless, some businesses have said they would have valued more consultation prior to making what they see as a genuine

	change.
Did those who were consulted when the IA was written express views on the reasonableness of the process?	We are not aware of any issues arising at the time (noting that consultation was limited to HMRC at the time).
Have those who have been consulted now as part of this CCR expressed views on the reasonableness of the process?	Yes, and they have expressed reservations as outlined above. The main concern was that the IA had been published without consultation.
Were compliance costs estimated for all options mentioned in the IA?	The use of two options for comparison was fine. Technically, the baseline for comparison should measure what would happen in the absence of the reform. The IA stated that this would be a continuation of costs associated with disputes, but it did not attempt to quantify those costs. Even if accurate estimates were unavailable, an indication of prevalence would have been useful.
Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?	The IA focused on freight forwarders and could perhaps have discussed impacts on other stakeholders along the supply chain. Even if such stakeholders were unlikely to be affected there might be value in acknowledging that their needs had been considered.
Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?	The methodology was fully appropriate given the underlying assumptions about the law not changing and that the IA should limit itself to the one reform in isolation.
Was there sufficient time to produce a robust assessment of compliance costs?	There are no indications that lack of time was a major factor. This IA was prepared at the same time as a number of other measures, some of which were more significant. Resource would have been allocated accordingly.
Were any assumptions reasonable, given the circumstances at the time?	<p>The IA assumed that as the changes were clarifying existing powers their impact would be minimal. It also restricted comment to the specific impact of the clarification, without discussing interactions with other changes.</p> <p>It is certainly the case that some businesses consider these assumptions to have been unreasonable, and the IA to present an unduly optimistic and/or incomplete picture as a result.</p>

	<p>The CCR team's view is that because these assumptions were likely to be disputed by those affected, the IA could usefully have acknowledged that fact, and that it could have included additional analysis to help business understand things from their perspective.</p>
<p>Were any estimates of compliance costs caveated appropriately?</p>	<p>The estimate of no significant costs was dependent on the assertion that the reform had clarified, but not changed the law. This was explained clearly enough, but the assertion itself should have been caveated. Whether right or wrong, it may not have accorded with the perspective of business.</p>
<p>Were any risks correctly identified, addressed and explained?</p>	<p>The risks relating to MTIC fraud were identified and addressed. Respondents acknowledged that the reform was targeted on illicit activity, but felt that this was not balanced by a full assessment of the risks associated with the disruption to any legitimate businesses affected.</p> <p>Interaction with other reforms (in particular the increase in the number of inspections) was deemed to be outside the scope of the IA. This was reasonable, but the risk of wider impacts could have been identified.</p>
<p>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)?</p>	<p>Not applicable.</p>
<p>Would HMRC do anything differently if the exercise were repeated, and hence could the IA process have been improved?</p>	<p>Some businesses have expressed concern that the IA was published without consultation (while accepting that HMRC had legitimate reasons for implementing the change quickly).</p> <p>On the content and presentation of the IA itself, we have identified various learning points below.</p>

6. Learning points arising from the review

6.1 Learning points for future work in this policy area

- While accepting that HMRC may have legitimate reasons for publishing an IA without consultation, businesses place considerable value on dialogue and see it as essential if reforms are to have the desired effects. If consultation is absent or limited then those affected should be given an early opportunity to comment, and there might be a case for a formal post-implementation review to take place sooner rather than later.
- By default, all IAs present a full and open assessment of the impact of reform. This should include full analysis, supported by evidence. In the specific case of initiatives which combat crime, there may be security limitations on what can be made public. In such cases, the IA should explain that the relevant issue has been taken into account, but cannot be published. This provides reassurance that the IA is robust. In very exceptional cases it may not be appropriate to publish an IA at all, but where the decision to publish is taken, this recommendation applies.
- Any consideration of the compliance costs associated with audits and inspections should reflect the fact that even if a business “does not have to do anything”, they may need to be present and/or stop work during the inspection. Provided that any such disruption is unavoidable, it should be included in the cost / benefit analysis.

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

- Where HMRC changes the wording of the law to clarify it, an IA should consider whether those affected will see it as a clarification or a real change. If it might be seen as a change, then the associated marginal impacts on stakeholders should be identified. It would be acceptable to exclude any such impacts from the overall cost/benefit analysis.
- Where the impact of a reform is likely to vary depending on the outcome of other reforms, or changes in operational practice, this possibility should be identified. If stakeholders are likely to view a reform (or its impact) as part of a wider whole, then the IA should explain the various interactions briefly to help stakeholders' interpretation. The more fundamental question of whether to publish individual IAs for each component, or a summary IA covering everything, should be answered on the merits of the individual case.
- Where an IA identifies possible costs, it should explain how likely those costs are to occur, and how large they might be. It should attempt to quantify them if possible.
- Where there may be an impact on business, IAs should (possibly within the competition assessment) consider any indirect impacts on costs or working agreements between different firms along the supply chain.
- Where the status quo option includes a cost (or benefit) that will be removed under the recommended reform, the IA should attempt to quantify that impact (or failing that, to provide an indication of prevalence). If this is the only material difference

between options, the importance of demonstrating that the difference is significant becomes even more important.

- All IAs should include caveats and/or highlight any risks associated with the supporting analysis, its reliability or its interpretation. If the analysis is robust and does not need to be caveated then the IA should say so.

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 IA or policy area. More generic recommendations are being collated across the review programme overall, and will be used to improve the IA process as a whole.

8. Contact points for further information

For issues relating to your own tax affairs please contact our National Advice Service:

Telephone: 0845-010-9000 (Mon-Fri 8am-8pm).

For issues relating to HMRC policy on this measure:

David Nickolls

CT & VAT

HM Revenue & Customs

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For issues relating to the compliance cost review programme generally:

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To report concerns about possible MTIC fraud or other suspicious activity, please contact our confidential Tax Evasion Hotline, anonymously if you wish.

Telephone: 0800-788-887 (Mon-Fri 8am to 8pm, Sat-Sun 8am to 4pm)

Website: www.taxevasionhotline.co.uk

ANNEX : THE PUBLISHED REGULATORY IMPACT ASSESSMENT

[VAT – Clarification of HMRC powers to inspect goods](#)