

COMPLIANCE COST REVIEW

REDUCED RATE OF VAT ON THE INSTALLATION OF WOOD-FUELLED BOILERS

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 reviews of the above IA, published in November 2005. The reduced rate was implemented with effect from 1 January 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.

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

2. The published Impact Assessments

2.1 Description of the policy changes

The reform extended the scope of the 5% reduced rate of VAT to the installation of wood-fuelled boilers², previously subject to the standard rate of 17.5%. The change was designed to promote and encourage the use of sustainable energy sources and new technologies. Again, the reform formed part of wider initiatives on carbon emission reduction.

Financially, the reform was expected to give annual reductions in VAT (and hence a cost to the Exchequer) of £0.6m initially, rising to £1.7m with time.

2.2 Anticipated compliance costs or savings

The IA stated that any compliance burden would fall on boiler installers, because they would “have to deal with multiple VAT rates”. The time and cost was not quantified, but was implied to be very low for two reasons. First, most installers were likely to have experience of applying multiple rates (given similar past changes elsewhere in the industry). Secondly, the number of affected installers was expected to be very low.

The reform was not expected to have a significant impact on competition, although some increase was expected (and intended) in the use of wood-fuelled boilers at the expense of less environmentally-sustainable alternatives.

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 this was used in lieu of formal consultation for this particular CCR (further consultation was not judged to be a cost-efficient use of resource given the relatively uncontroversial nature of the reform). The research was not intended to deliver any degree of statistical robustness (to do so would have been impractical) but instead to provide indicative findings. This has allowed the research to identify the major issues and any associated learning points.

² The term “wood-fuelled boilers” is used for convenience. As the attached IA explains, the extension covered any sort of vegetal matter, provided the boiler used only those fuels. The concession was also restricted to installations in private homes and certain residential or charity buildings.

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 IA (e.g. reading legislation, filling in forms, updating IT systems, saving time etc.) incurred?	The IA did not itemise the costs in detail, but anticipated them to be minimal. Our consultants advise that this assessment is reasonable as many installers were already established in the energy industry and may well have experience in dealing with multiple VAT rates. Therefore the costs incurred due to the introduction of the reduced rate should not impact too greatly on business.
Were costs/savings incurred at the expected time?	No comment was made in the IA with regard to the timing of any compliance costs. In practice, a small cost might be incurred at the time of the installer's first post implementation VAT return; this would be due to the installer adjusting their invoicing and VAT accounting procedures to accommodate the new reduced rate. Such a cost would be a one-off and (for most businesses) negligible for the reasons in the previous box. It is possible that a minimal recurring cost would be incurred at the time of each VAT return submission for businesses where varying rates of VAT were not generally incurred prior to the reform.
Were costs/savings incurred by the expected people?	The IA said boiler installers would be the main group affected and there is no reason to doubt this. The IA could have mentioned other stakeholders (such as boiler manufacturers, or fuel suppliers) and clarified whether and how they might be impacted.
Were any other costs/savings, not identified in the IA, incurred ?	There is no evidence of this. Installers would be liable to comply with the new extended legislation upon its implementation and any compliance cost would be unavoidable.

	However the size of this cost is likely to be small and broadly in agreement with the original IA.
If the type of costs/savings varied from the original estimates, why was that?	The general assessment was one of a small impact on business. There is no reason to believe that the actual costs would vary significantly from this estimate.
Could such variances have been foreseen at the time?	Not applicable.
What is the assessment now of the total value of costs and savings?	We continue to believe that any direct compliance costs associated with the changes were negligible (i.e. a small compliance cost to business). Our consultants concur.
If different from the original IA, what has caused the discrepancies?	There are no notable discrepancies between the IA view on compliance costs, our consultants' view or HMRC's current assessment.
With hindsight, were the compliance cost estimates accurate?	Yes.

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?	The original work was led by VAT policy experts, supported by colleagues. Other agencies, such as the Dept. of Trade and Industry and DEFRA, provided advice.
Was an adequate audit trail maintained?	Yes – the audit trail was good, particularly in documenting the consultation process as the policy was developed.
Was Cabinet Office and/or internal HMRC guidance on IAs followed correctly?	Yes – the original IA covered all the issues it should have done.
How much effort was devoted to compliance cost estimation, and was that effort proportionate in the context of the policy measure?	The reform was not expected to have a significant impact on compliance costs, and the amount of resource reflected that. Our consultants agree that any attempt to identify

	<p>more specific costs and savings would likely have been relatively time consuming and not cost effective, given the minimal impact of the reform.</p>
<p>Were the right people (both internal and external) consulted, and were their views reflected appropriately?</p>	<p>Yes. The level of consultation was good, and indeed the IA referred to some of the views expressed.</p>
<p>Did those who were consulted when the IA was written express views on the reasonableness of the process?</p>	<p>The CCR review team is not aware of any specific comments being made about the IA process, and there is no evidence of any problems.</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>There is no evidence of any major concerns. We have drawn out a number of minor learning points in section 6 below.</p>
<p>Were compliance costs estimated for all options mentioned in the IA?</p>	<p>Yes, albeit in qualitative terms. The IA considered only two options, the reduced rate and the status quo. Compliance costs were not expected to be a significant factor in either case.</p>
<p>Were compliance costs estimated separately for key groups (such as small businesses, large businesses, self-employed)?</p>	<p>The IA included a small business impact assessment. The reform was expected to benefit both households and certain charities, but the IA did not provide separate estimates for these two groups (because of difficulty in obtaining suitable data). Given the expected low impact on costs overall, we consider this omission to have been reasonable at the time.</p>
<p>Was an appropriate analytical approach used, with economists or other analysts consulted appropriately?</p>	<p>Analysis was focused more on Exchequer and environmental impacts than compliance costs (and we consider this to have been appropriate given the nature of the reform).</p> <p>For context, it would have been useful to include data on the typical cost of a boiler installation, and how its (reduced) price would compare with alternative energy sources.</p> <p>The IA did quote statistics on the number of firms affected and that was helpful. One very minor point on consistency is that the IA used rough estimates in places even where more precise figures were quoted elsewhere in the IA.</p>

	<p>The environmental impact is largely outside the scope of this review, but it would have been helpful to quote a net impact figure in addition to the separate comments on emissions in the costs and benefits sections. Such summaries can help judge whether compliance costs are proportionate to the policy outcome, and the trade-off between the two.</p>
<p>Was there sufficient time to produce a robust assessment of compliance costs?</p>	<p>Yes, although in practice the likely impact meant that detailed analysis was better focused on environmental and Exchequer impacts.</p>
<p>Were any assumptions reasonable, given the circumstances at the time?</p>	<p>There is no evidence that the reform was inappropriate, but the IA could perhaps have beefed up the explanation of why this reduced rate was the best option overall (rather than simply being better than doing nothing). The reform did affect only the price of installation, rather than subsequent running and maintenance costs. Equally, the IA did not explain whether the cost of an installation was correlated with the likely level of use and/or the likely change in carbon emissions. The learning point is simply to explain and justify the final choice of options explicitly.</p>
<p>Were any estimates of compliance costs caveated appropriately?</p>	<p>Yes.</p>
<p>Were any risks correctly identified, addressed and explained?</p>	<p>Yes, and a further safety check was provided by the (standard) monitoring and evaluation process.</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>The IA listed a number of organisations that supported the proposed reform. The IA did not say whether this support was unanimous, and could usefully have done so (or if not unanimous, explained and refuted any alternative views).</p>
<p>Would HMRC do anything differently if the exercise were repeated, and hence could the IA process have been improved?</p>	<p>There is no evidence to suggest that a change in process is required.</p>

6. Learning points arising from the review

6.1 Learning points for future work in this policy area

- We have not identified any learning points unique to this policy area, but various generic ones are shown below.

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

- For context, it can be helpful for IAs to include background data on costs and prices for any good or service affected by a reform. If there are problems obtaining representative numbers then the IA could explain that and/or attempt to clarify the picture through consultation.
- Where a reform is expected to have some impact on different groups (private homes and certain residential / charity buildings in this case), an IA could usefully attempt to gauge the impact on those groups individually. If that is not possible, the IA should say so.
- All IAs should state explicitly when they expect any compliance costs or savings to be incurred.
- There is value in attaching a full stakeholder analysis to ensure that all those affected (both directly and indirectly) are identified in the final IA. Even where stakeholders are unlikely to experience any impact, it may be helpful to state that.
- Wherever possible, an impact assessment should make clear what the net impacts are expected to be. Costs and benefits should be discussed and analysed separately, but if they then offset each other to some extent, the net assessment should be identified.
- Where IAs present a small number of options, the text should explain why those options are better than logical alternatives. If other options have been rejected then the reasons for their rejection will help justify the IAs recommendation.
- If an IA summarises feedback received during consultation, it should make clear whether the views expressed were unanimous or varied, particularly if the feedback is used to justify the recommended option.

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 VAT affairs, please contact our National Advice Service:

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

For issues relating to VAT policy on wood-fuelled boilers specifically:

Bob Morrison

Grouping, Reliefs & Input Tax Team

HM Revenue & Customs

100 Parliament Street

London

SW1A 2BQ

Telephone: 020-7147-0568 E-mail: bob.morrison@hmrc.gsi.gov.uk

For issues relating to the compliance cost review programme generally:

Richard Bowyer

3E/14, 100 Parliament Street

LONDON

SW1A 2BQ

Telephone: 020 7147 0062

E-mail: richard.bowyer@hmrc.gsi.gov.uk

ANNEX : THE PUBLISHED REGULATORY IMPACT ASSESSMENT

<http://www.hmrc.gov.uk/ria/vat-wood-fuelled.pdf>