Full Regulatory Impact Assessment

Implementation of the European Union Savings Directive

The Reporting of Savings Income Information Regulations 2003

Purpose and intended effect

1. This Regulatory Impact Assessment (RIA) accompanies the Government's legislation implementing European Directive 2003/48/EC on the taxation of savings in the form of interest payments ("the Directive"), which was adopted at a meeting of the ECOFIN Council on 3 June 2003. This is designed to combat tax evasion by individuals on cross-border savings income. Under the Directive, information will be collected automatically about the payment of savings income to residents in certain other countries and exchanged with tax authorities in those countries. During a transitional period, until they implement automatic exchange of information, three Member States, Austria, Belgium and Luxembourg will instead apply a withholding tax on cross-border interest payments made to individuals.

2. The regulations published set out the detailed rules for the UK scheme implementing the Directive. As is made clear, the adoption of the Directive effectively constrains the options that are available in practice to the UK. This RIA considers how the implementation of the Directive will affect UK businesses and individuals. It builds on information gathered during extensive consultations and interviews with, and from information received from questionnaires completed by, relevant external stakeholders who may be affected by the scheme.

3. Information on the Directive and its implementation in the UK can be found at http://www.inlandrevenue.gov uk/esd/index.htm

Risk Assessment

4. These regulations address three key risks:-

   (i) **Loss of tax on savings income both to the UK Exchequer and to other prescribed territories' exchequers.** At present, individuals are often able to avoid any form of taxation in their country of residence on savings income paid to them in another country simply by not declaring it. This causes losses in tax revenues while savers' decisions on where and how to invest are distorted by the possibility of evading tax.

   (ii) **An EU-wide withholding tax.** The adoption of the Directive and automatic exchange of information puts an end to proposals for a harmonised one size fits all EU-wide withholding tax, which would have damaged the competitiveness of financial markets.

   (iii) **EU sanctions for non-implementation of the Directive.** The UK Government is obliged by European Community law to implement European Directives into domestic law, and there are sanctions for non-implementation.

Options

5. Three possible options for responding to the adoption of the Directive have been identified:

    (a) Do not implement the Directive;
    (b) Introduce a new reporting regime specifically collecting information required by the Directive;
    (c) Introduce a reporting scheme, building upon the current reporting regime, enabling the UK to implement the Directive.

Non-Implementation

6. Option (a) is not feasible as it is mandatory for the UK to implement the European Directive into its national law. Were the UK not to comply with this obligation, the European Commission could take action in the European Court of Justice to enforce the obligation.

A Stand-alone scheme

7. Option (b) would require paying agents to have separate systems to generate the reports required by the Directive, and make a separate return of reportable payments. There is considerable overlap with the Directive requirements and the information already provided under the current reporting regime (sections 17 and 18 Taxes Management Act 1970). This option would result in the same information being collated from paying agents and then supplied twice. Consequently, it would involve duplication of effort and additional costs for both the private sector and the Revenue.

Building on current reporting arrangements

8. Option (c) would allow paying agents to build upon the current reporting regime (sections 17 and 18 Taxes Management Act 1970), by modifying their current systems to add the information solely required by the Directive. Paying agents who have obligations under the Directive and also make returns under the current scheme would still have the option of creating a separate system to extract information required by the Directive, but it would need to be returned to the Inland Revenue in the format common to both systems. This option would be no different to option (b) for paying agents who do not make returns under the current system, such as registrars, but would clearly impose a lower burden upon those affected by both. The Government therefore believes this is the best option.

Business sectors affected

9. Businesses and public bodies that make savings income payments to, or collect savings income payments for, residents in certain other countries will have to report details on the individuals, and the payments made, to the Inland Revenue. This will include savings income payments by:
    - building societies, banks and other deposit-takers;
    - registrars, custodians and nominees;
    - authorised unit trusts and open-ended investment companies; and
    - any other person who makes savings income payments in the course of their business (for example, lawyers and stockbrokers).

There are in the region of 600 banks, building societies, interest funds and other financial institutions that may be affected and range from small professional firms to large multinational financial institutions. For a sizeable proportion of these, however, the consequent costs would be negligible, as the small number of non-resident customers would make it unnecessary to incur the costs of information systems changeover. This is discussed in more detail in the cost section.

Issues of Equity and Fairness

10. Under the current situation there is an obvious inequity between UK residents who receive savings income in this country and pay tax on that savings income and UK residents who receive savings income from overseas, do not declare it and thus do not pay tax on it. The sharing of information between prescribed territories on non-resident's savings income as required by the directive will reduce this unfairness and help to achieve a level-playing field by helping all member states to enforce their tax regimes.

Benefits

11. There are benefits associated with implementing the Directive, including the avoidance or mitigation of the risks identified in the earlier Risk Assessment section of this document. However, the key benefits centre around the exchange of information under the Government's scheme.

12. The Government is committed to fostering international co-operation between tax authorities, and firmly believes that automatic exchange of information between these authorities, on as wide a basis as possible, is the most efficient and effective way to combat tax evasion by individuals on cross-border savings income. The Feira European Council endorsed this principle in June 2000.

13. Exchange of information delivers the right amount of tax to the right country at the right time, as the tax authorities in the individual taxpayer's home country receive the information they need to determine the tax due on the overall income of their residents. The home country can therefore collect the tax properly due under its laws. This is a key goal of Government tax policy in relation to the EU. Exchange of information does not impinge on how a country chooses to tax with its own residents and so protects the sovereignty of individual nation states. Turning around the debate in Europe from a harmonized one-size fits all withholding tax to the present Directive has been a major achievement for the Government in rejecting tax harmonisation that would have damaged the competitiveness of financial markets.

14. The sharing of information on non-residents' savings income therefore strengthens the ability of all member states to enforce their tax regimes. This should improve the ability of the resident country's tax regime to achieve aims such as progressivity and redistribution. In addition, the strengthening of Member States' savings tax regimes may go some way to reduce the distortion in individuals' capital allocation decisions, by causing them to be based more on economic grounds than on opportunities to evade tax.

15. Exchange of information will provide the Inland Revenue with information about savings income flowing cross-border to UK residents. The Inland Revenue will then be able to check to ensure that this income and where relevant, the source of the underlying capital, has been appropriately declared by the individual concerned. By countering tax evasion, the scheme will also help ensure fairness

and equity to taxpayers by reinforcing the UK and other Member States' tax regimes. The UK government will provide information on relevant cross-border saving's income paid by UK paying agents to non-resident payees and certain entities. This will help to ensure a level-playing field amongst the prescribed territories.

16. The European Commission in their own Impact Assessment on the Directive felt that the present lack of co-ordination between Member States in this area was leading to distortions in the operation of the single market and losses in tax revenue for Member States. They also said that the European financial market could not deliver its full benefits if savers' decisions were determined by the possibility of avoiding tax instead of rational comparisons between investment alternatives.

17. In the modern, highly globalised world, exchange of information and the transparency that results from it are not only important for tax purposes but are also essential for effective competition, vital to efforts to combat money laundering and the financing of terrorism and may contribute to a reduction in financial crime and market abuse more generally.

18. The benefits of the Directive described above are clear and while it is hard to precisely quantify them the Government believes that the benefits, taken together, should be substantial both for the UK and for other Member States.

19. Alongside the intangible benefits described earlier, at an operational level, exchange of information will deliver specific Exchequer benefits to the Government through better compliance:

    - individuals who do not pay tax on their offshore savings income and possibly on the underlying capital will be encouraged to make a full declaration to the Inland Revenue in order to reduce the risk of an inquiry into their affairs; and
    - information provided by other Member States will allow the Inland Revenue to investigate and detect undisclosed savings income and capital.

20. For a transitional period some countries will not exchange information but will impose a withholding tax. Those countries that have opted for this option will be required to tax relevant savings income at 35% (although initially at 15%) and then pass 75% of the tax withheld to the individual's Member State of residence, retaining the other 25% to cover its costs.

21. By strengthening the correct incentives to declare savings income, the income tax take through self-assessment would be additionally protected and possibly enhanced. The total direct tax yield from the Directive in the first full year is estimated to be in the region of £60 million to £70 million. This yield should prove relatively sustainable over time.

22. As time progresses and countries move toward sharing information, rather than applying withholding taxes, the intangible benefits of the Directive would become more valuable. Dependent on the way savers react to the Directive, it may also be the case that the revenue yield of the Directive would be boosted by moving to information sharing, due to the respective countries no longer retaining some revenues to cover their own costs.

Costs

23. The Government has consistently emphasised its desire to minimise the burdens to business that will result from implementation of the Directive. During the extensive consultations we conducted with people likely to be affected by the Directive, we asked whether they would prefer the introduction of a new reporting regime specifically to collect information required by the Directive, as opposed to building on the current reporting arrangements (sections 17 and 18 Taxes Management Act 1970). The overwhelming response from these stakeholders indicated a very clear preference for introducing a system that builds upon the current reporting arrangements wherever possible, rather than introducing a new system altogether. This seems eminently sensible and is in line with the Government's own view that this is the best option to adopt. The option for a stand-alone reporting regime is therefore not considered any further in this RIA.

24. Our research has pointed to distinct differences in the costs incurred by the larger economic operators, such as banks and registrars, and the small businesses that are affected, such as the small lawyer or accountant firms.

25. For the larger economic operators, the main cost will be in the initial changes that will enable companies to record and report the new data required. Compliance costs for the private sector will be composed of three parts:

    - Costs of IT systems changes building on the reporting requirements of Sections 17 and 18 Taxes Management Act 1970;
    - staff training costs; and
    - staff time costs.

26. From consultation with systems developers it emerged that the approach to systems development by the larger economic operators would vary according to the size of the institution affected. Large institutions would be more likely to develop their own software, whereas small to medium businesses are more likely to purchase an 'off-the-peg' package where the cost of change to the system will be borne by the software developers. In either case there will be higher initial changeover costs followed by lower additional ongoing costs.

27. Based on feedback received from our consultation questionnaire, we estimate that for most companies already required to report under Sections 17 and 18, changeover costs in the first year will range from zero or negligible for institutions such as lawyers, accountants and the financial institutions with very small numbers of foreign-resident individuals, to upwards of around £350,000 for the largest of institutions (although due to their large number of affected customers two or three institutions may have commensurately larger costs of several times this). After the introduction of the Directive, the ongoing additional costs are expected to be low and stable of the order of £10,000 to £20,000 per year, per institution, and much less for smaller operators.

28. From the feedback we have received it is possible to say that small firms of solicitors and accountants do not hold money for many of their overseas clients. For those that do hold money, they seldom pay interest. For this reason the Directive is unlikely to impinge significantly on such firms. Feedback from the big four accountancy firms suggests that, having branches in all major cities, they do not tend to hold foreign residents' money either. In the few cases where they do, they are likely to report manually, rather than having a purpose built IT system.

For these reasons we estimate compliance costs to lawyers and accountants whether large or small businesses to be either non-existent or negligible.

29. Also to be considered are the costs to the Inland Revenue in adapting their systems to be able to collect and send on the necessary information and also the systems to be able to analyse the information obtained from other countries. We estimate the total of these costs for the Government and spread over a number of years to be in the region of £1 000 000.

Securing Compliance

30. It is proposed that, as far as possible, the compliance regime will follow arrangements currently in place for sections 17 and 18 TMA 1970. Therefore, if a paying agent fails to comply with a notice, or fraudulently or negligently makes an incorrect return, he will be liable to a penalty under section 98 TMA.

31. The penalty for failing to comply with a notice will be, as for sections 17 and 18, an amount not exceeding £300 and, if the failure continues, penalties of not exceeding £60 a day may be imposed.

32. The penalty for fraudulently or negligently making an incorrect return will be, as currently, an amount not exceeding £3,000. As with the compliance frameworks for returns under sections 17 and 18, the completeness and accuracy of returns will be checked by means of a risk-based audit.

33. The Government has also decided that the obligation to notify will be underpinned by a new penalty, not exceeding £3,000.

Competition Assessment

34. As noted earlier, two or three of the larger institutions affected may incur commensurably larger implementation costs, however due to economies of scale, the Government does not expect the burden of compliance costs to fall disproportionately more heavily on this or any other particular size or type of firm. New entrants to the UK savings and investments market, without an existing customer base, would immediately need to report all information on a post implementation basis. However, it would seem most likely that new entrants would be subsidiaries of existing agents or buyouts of existing agents and thus would inherit a customer base not very different from incumbent firms. As such this is unlikely to give rise to any significant competition impacts on UK paying agents.

Small Firms Impact Test

35. The only small businesses impacted by these requirements would be small accountancy and legal firms. We have met with the representative bodies of both accountancy and legal firms in England, Scotland, Wales and Ireland as well as sending out questionnaires to these bodies and a wide range of other stakeholders in order to ascertain both cost and impact implications. The cost of implementation for these small firms would appear to be either non-existent or negligible as discussed in the cost section and therefore the implementation certainly does not have a disproportionate impact on small businesses.

Monitoring and review

36. We intend to continue discussions with key stakeholders on the impacts of the changes, and suitability of the new system.

Consultation

37.

(i) **Within Government:** We have consulted with the Treasury, Cabinet Office's Regulatory Impact Unit and the Department of Trade and Industry's Small Business Service.

(ii) **Public Consultation:** We have consulted extensively both informally and formally with all areas of affected Industry. We have consulted both on the general points of implementation through the discussion papers and, building on the results of this, on the more detailed regulations to be laid. We met all the representative bodies such as the British Bankers' Association and key members of City financial institutions as well as regional representative bodies such as the Law Society of Scotland and the Institute of Chartered Accountants in Northern Ireland. We also met with the Institute of Chartered Accountants in England and Wales, The Law Society, The Association of Chartered Certified Accountants, the Institute of Directors and the Forum of Private Business. Questionnaires were sent to large proportions of the affected groups to ascertain implementation impact and cost for both large and, particularly, small businesses.

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Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

Dawn Primarolo

Date 16/12/2003