

# PARTIAL REGULATORY IMPACT ASSESSMENT (RIA)

## Part 7, ITEPA 2003 Reporting Requirements

### Purpose and intended effect of the measure

#### *The policy objectives*

1. To make improvements to the process of reporting employment-related securities information by employers with the aim of reducing the compliance burden and administration costs on businesses.

#### *Background and introduction*

2. Part 7 of Income Tax (Earnings and Pensions) Act 2003 (ITEPA) provides the tax rules that apply to shares and securities acquired in connection with an employment. Collectively these are referred to as employment-related securities. The rules also set out the reporting requirements that apply to employment-related securities. For the purposes of this Regulatory Impact Assessment the term 'Form 42 reporting obligation' is used to refer to these requirements.

3. The tax rules in Part 7 are designed to ensure that when value in the shape of employment reward passes from the employer to the employee via an employment-related security, that value is subject to income tax and National Insurance at the time it passes to the employee. Employment-related securities can take a number of different forms and the timing and extent to which value passes depends on that form. The rules therefore have to cater for the different types of security used.

4. The reporting requirements serve two purposes.

- They provide the information we need to check that the rules in Part 7 of ITEPA are being properly applied, and,
- they provide valuable data which enables us to gauge the impact of changes in policy and the likely cost or yield from these changes to the Exchequer.

Crucially, the information provided on Form 42, compared to that provided under the previous rules, is proving much more effective in monitoring compliance and contributing data to policy development. Under the old rules companies and their advisors often refused to provide information on the basis that there was no legislative requirement to do so. The range of transactions that needed to be reported was very limited and the requirement only applied to shares. Those who refused could not be compelled to provide the information. The new reporting rules have also led to a clear improvement

in the number of companies reporting on time, thus providing a more efficient flow of data for compliance and policy purposes.

5. For 2003-04, over 6,000 Form 42's were submitted by companies reporting what can be broadly termed as taxable employee share incentive schemes. In addition, a further 405,000 forms were received reporting the creation of employee shares through new incorporations in the United Kingdom.

*Rationale for the reporting regime*

6. Employment-related securities are an area of high risk to the tax base. In order to check that the rules are being properly applied compliance activity focuses on how both the employer and the employee have applied them. Cases are selected for enquiry on the basis of a risk assessment process. This process looks at data on such things as, for example:

- How many employment-related shares and securities have been issued/granted/awarded.
- What types of shares and securities have been used.
- How many employees have received them.
- How much value is involved.

7. We also need detailed information on employment-related securities to help us gauge the possible effect of any policy changes to the rules. For example:

- While some information on the Form may be about transactions, which pose a low immediate risk in tax terms, it has a high value in relation to monitoring and forecasting the impact of policy changes.
- "Founder shares" which are employment-related securities are relatively low risk at that stage of a company's life cycle, but they give us valuable information about the extent of employee shares acquired at the start of the company.
- "Grants of options" are another low risk transaction, since there is no tax charge at that point, but we have no other way of measuring them and it is important to do so for risk assessment and policy monitoring and development.
- Similarly information on "exercise of options" can help in assessing the impact of changes to the rules in this area.

The need for robust reporting requirements in relation to employment-related securities is therefore a given, and this RIA considers options for making the reporting process easier and less burdensome.

### *The concerns being addressed*

8. Representatives of employers and business tell us they would like the reporting process to be simpler, to help reduce the burdens on business, particularly small businesses. Concerns exist about the wide scope of the Form 42 reporting obligations, particularly its impact on new small companies where the founder shareholders are also directors or employees. Companies House reported around 390,000 and 330,000 new incorporations in Great Britain in 2003-04 and 2004-05 respectively.

9. There are also concerns about HM Revenue & Customs (HMRC) gathering information about share transactions where no chargeable events occur, and the value and use of the information provided on the Form. There are also concerns about the costs to business in completing the Form. Anecdotal evidence from information given to us suggests accountants are charging between £40 to £200 for completing the simplified version of Form 42 for newly incorporated companies.

10. The primary aim of this review is therefore to simplify the Form 42 reporting process as much as possible and help reduce the compliance and administration burdens on small companies, but consistent with our need to have reliable data for risk assessment and policy development purposes. This is commensurate with the current HMRC Public Service Agreement objective to improve customer experience, support business and reduce the compliance burden.

### **Options**

11. **Do Nothing.** All new processes and obligations that require some action from businesses place a certain amount of administrative burden on those businesses. Experience shows that some of the initial concerns tend to dissipate once those affected by the relevant legislation become familiar with the requirements of that legislation. Those employers who offer tax advantaged share incentives to their employees, for example, Save As You Earn or the Share Incentive Plan, will be familiar with the reporting requirements. Form 42 is relatively new and familiarity with it will enable easier compliance over time.

12. We recognise that although Form 42 is providing valuable information on remuneration through employment related securities it has created additional burdens for some companies. Based on the feedback and comments received when companies were completing the Form for the first time for the 2003-04 year we decided to make some immediate improvements. As a first step in this direction we have recently produced detailed guidance on the application and use of Form 42 for reporting events in tax year 2004/05. We have also produced a simplified version of Form 42 to be used by newly incorporated companies. All three documents were circulated in draft outside the Inland Revenue for comments. Links to the documents are provided at Appendix B.

13. But we still need to consider whether the burden it places on employers, particularly on smaller companies in particular, is out of proportion to the value of information submitted on Form 42. As long as the need for the information remains we need to consider how the additional burden can be reduced.

**14. Non-legislative option.** Going forward we need to build on the improvements achieved already by looking at, for example, the range of information being provided, the structure of the Form and also consider other easier methods of discharging the reporting obligations. **We would therefore welcome comments and suggestions as part of the informal consultation on what further improvements can be made to the Form 42 reporting process taking into account the purpose of the Form.**

**15. Legislative option.** We hope that consultation will identify improvements that do not require changes to the legislation. To the extent that legislative change may be necessary to secure improvements, then this would need to be approved by Ministers and Parliament.

### **Business sectors affected**

16. Companies that use employee shares or share options regardless of size are affected. All employers and companies are required to report information on transactions in share and securities with employees. These may be part of a formal share incentive scheme or simply a one-off event. Only those companies or businesses that do not utilise employee shares are unaffected by the reporting requirements.

### **Issues of equity and fairness**

17. We do not consider the proposals to make improvements to the process of Form 42 reporting obligations have any issues of equity or fairness as between different groups or sectors. Improvements we hope to deliver to the Form 42 reporting obligation will be of benefit to all those who need to complete the Form. It is likely that the benefits of reducing the reporting burden will be most felt by small companies, both new incorporations and those using employee shares. While large companies generally have most events to report, small companies' compliance costs tend to be more acute because they tend to have fewer reportable events to spread the fixed costs of learning how to comply with their Form 42 reporting obligations over. They are also more likely to have to incur professional advice costs.

### **Benefits**

#### *Economic*

18. The improvements we hope to identify should benefit companies directly by making their processes simpler. At the margin, these should reduce the compliance costs of companies using employee shares and newly incorporated companies both in terms of time and professional advice. This

will free up that time and resource for them to concentrate on their core commercial activities, indirectly benefiting the economy as a whole through the competition process. There should also be consequential benefits to HMRC in terms of staff resources, volume of enquiries and quality of information.

### *Social*

19. These proposals are unlikely to have any social impact.

### *Environmental*

20. These proposals are unlikely to have any environmental impact.

## **Costs**

### *Economic*

21. It is difficult for us to estimate how much it costs a business to complete a Form 42. It seems likely that the cost will vary depending on, for example, the number of employees, type and number of events, use of professional adviser and quality of and accessibility to information held by the employer. As stated earlier, anecdotal evidence suggests newly incorporated companies are being charged between £40 to £200 by accountants for completing the simplified version of Form 42. **We would therefore welcome comments on the level of fees charged for completing the Form, either in its simplified or full version.**

22. Overall the improvements that we hope to achieve should reduce costs particularly for small businesses. For example, if less information was needed or the information could be delivered in a different way or method then this would positively impact on business by reducing the time and resources needed to provide that information. **We would also therefore welcome comments on any other costs associated with the process and the extent to which business consider costs could be reduced by further improvements to Form 42. We would particularly welcome examples of this from businesses affected, telling us about the size of the business and the issues they face in completing the Form**

### *Social*

23. These proposals are unlikely to have any social impact.

### *Environmental*

24. These proposals are unlikely to have any environmental impact.

## **Small Business impacts**

25. The Form 42 reporting obligation has impacted on small businesses when they incorporate or use employee shares. We hope to identify changes that should directly benefit small companies. Although it is not possible to remove particular groups or sectors from the Form 42 reporting obligations we can consider improvements to the reporting process to help reduce the burden on some businesses. **It would be helpful to receive comments or proposals of any changes to Form 42 that can be achieved that would be of particular benefit to small businesses. In this context it would be helpful to receive information about the most common transactions in employee shares that are undertaken by small businesses and their frequency, to demonstrate the extent of the benefits that would flow from the proposed improvements.**

## **Competition assessment**

26. The competition filter has been applied and no effects likely to be detrimental to the competitive process in markets were identified from reducing the compliance burden. If anything, at the margin, such proposals should benefit competition by freeing up more time and resources to be devoted to competing for profitable commercial opportunities.

## **Securing compliance**

27. The Form 42 reporting obligation is part of the process of securing compliance with tax rules that apply to employment related securities acquired by employees. These proposals for simplifying the Form itself are not intended to remove that obligation.

## **Consultation**

28. This RIA is part of informal consultation with external stakeholders that have expressed an interest in the subject. The period of the consultation will run for a period of 12 weeks from the date of publication of this RIA. A list of those who have expressed an interest in taking part in the consultation is at Appendix A to this RIA. But comments are welcome from businesses that feel they are directly affected.

**Contact point**

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**Appendix – List of people/organisations who wish to take part in the informal consultation**

Andrew Hubbard – Association of Taxation Technicians

Fiona Downes – ProShare

Francis O'Mahony – Advanced Studies Group

Graeme Nuttall – Job Ownership Limited

John Hampton – Confederation of British Industry

Rosa Tormo – Confederation of British Industry

Mark Saunders – Chartered Institute of Taxation

Bianca Marsden - Chartered Institute of Taxation

Kate Upcraft - Institute of Payroll and Pensions Management

Claerwyn Hamilton-Wilkes – Small Business Service

Anita Monteith – Institute of Chartered Accountants, England & Wales

Louise Speke - The Law Society

Mavis Sargent

Brian Palmer - Association of Taxation Technicians

Donald Drysdale The Institute of Chartered Accountants of Scotland

## **Appendix B**

1) Form 42 – Employment related securities

<http://www.hmrc.gov.uk/shareschemes/42-2005.pdf>

2) Simplified Form 42 for newly incorporated companies

<http://www.hmrc.gov.uk/shareschemes/form42companies.pdf>

3) Form 42 Guidance

<http://www.hmrc.gov.uk/shareschemes/form42guidance.pdf>