

## Summary: Intervention & Options

<b>Department /Agency: HM Revenue &amp; Customs</b>	<b>Title: New Company Triage: reducing the administrative burden</b>	
<b>Stage:</b> Final Proposal Stage	<b>Version:</b> 1	<b>Date:</b> 8 November 2010
<b>Related Publications:</b>		

**Available to view or download at:**

<http://www.>

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**What is the problem under consideration? Why is government intervention necessary?**

HMRC is changing the process by which it identifies inactive companies. The current process involves Companies House notifying HMRC of newly registered companies. HMRC then use this information to contact each company to ascertain whether it is actively trading or not. A company is under no obligation to reveal its trading status. If a company does not confirm its trading status, it is assumed that trading is taking place and a notice to file a Corporation Tax return is automatically issued. This places a filing obligation upon a company which is not trading. This is an unnecessary administrative burden.

**What are the policy objectives and the intended effects?**

The objective is to identify when a company is inactive and update HMRC systems to reflect this inactive status as soon as a company has registered with Companies House. This will prevent a notice to file a return being issued to the company and stop further pursuit / penalties being imposed. The dormant company will then be subjected to a regular data review process to identify signs of activity, issue the notice to file and address risk of evasion.

The intended effects of the policy are to make processes more efficient, free up high-value resource for more productive work, and to directly reduce the burdens currently placed on customers.

**What policy options have been considered? Please justify any preferred option.**

Option 1: Do nothing;

Option 2: Treat all new incorporations as inactive at the outset, relying on the company to advise it is active;

Option 3 (preferred): Identify new incorporations that are inactive by performing new internal HMRC data matches and remove them from the return cycle, before a notice to file is automatically issued. This option will remove customer burden at the outset.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? Within 3 years.**

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) the benefits justify the costs.*

Signed by the responsible Minister:



.....Date:

29 November 2010

## Summary: Analysis & Evidence

<b>Policy Option: 2</b>	<b>Description: Identify new incorporations that are inactive by performing new internal HMRC data matches and remove them from the return cycle.</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' The costs for HMRC accrue from the new process to identify new companies as inactive and take subsequent clerical action. This cost is estimated to be negligible and will be offset by greater savings from the reduction in wasted effort to pursue returns and debts from inactive companies.	
	<b>One-off</b> (Transition)	<b>Yrs</b>		
	<b>£ Neg</b>	1		
	<b>Average Annual Cost</b> (excluding one-off)			
	<b>£ Neg</b>	5	<b>Total Cost (PV)</b>	<b>£ Neg</b>
Other <b>key non-monetised costs</b> by 'main affected groups' None				

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' Administrative burden will be reduced as this option will remove the need for customers to receive, handle and respond to unnecessary post. There will also be a benefit to HMRC as there will be a saving on the operational costs involved (i.e. less forms / postage used).	
	<b>One-off</b>	<b>Yrs</b>		
	<b>£ Nil</b>	1		
	<b>Average Annual Benefit</b> (excluding one-off)			
	<b>£ 1.2 million</b>	5	<b>Total Benefit (PV)</b>	<b>£ 5.4 million</b>
Other <b>key non-monetised benefits</b> by 'main affected groups' All figures are based on the assumption that by 2011 around a third of all new incorporations will be classed as dormant and will not receive a notice to file a return. It is assumed a minimum of 1% of the 100,000 cases that will be assigned as dormant under this option would currently contact HMRC.				

**Key Assumptions/Sensitivities/Risks** The totals above, and the net benefit figures below, have been calculated over a 5-year timeframe, with an annual discount rate of 3.5% assumed. All figures are quoted in 2010 present-day terms except for the admin burden figure at the bottom of the page.

Price Base Year 2010	Time Period Years 5	<b>Net Benefit Range (NPV)</b> <b>£ 5.4 million</b>	<b>NET BENEFIT (NPV Best estimate)</b> <b>£ 5.4 million</b>
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What is the geographic coverage of the policy/option?			United Kingdom		
On what date will the policy be implemented?			November 2010		
Which organisation(s) will enforce the policy?			HMRC		
What is the total annual cost of enforcement for these organisations?			£ n/a		
Does enforcement comply with Hampton principles?			Yes		
Will implementation go beyond minimum EU requirements?			No		
What is the value of the proposed offsetting measure per year?			£ n/a		
What is the value of changes in greenhouse gas emissions?			£ n/a		
Will the proposal have a significant impact on competition?			No		
Annual cost (£-£) per organisation (excluding one-off)		Micro £0	Small £0	Medium £0	Large £0
Are any of these organisations exempt?		No	No	No	No

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)		
Increase of	£ 0	Decrease of	£ 0.9million	<b>Net Impact</b>	<b>£ -0.9 million</b>

Key:

Annual costs and benefits: Constant

(Net) Present Value

## Evidence Base (for summary sheets)

### Background

The current HMRC process for dealing with new companies wastes resources and provides a poor customer experience for those companies that we have failed to identify as inactive. We need a better process.

Currently, a company comes into existence when it is registered at Companies House. Within 6 weeks of a company being registered, Companies House sends their details to HMRC. The address held by Companies House, and hence passed onto HMRC, is the “Registered Office” of the company.

HMRC sends out an introductory pack containing a form (CT41G) asking the company if it is active or dormant.

If no response is received from the company, a reminder letter is sent. If there is still no response, HMRC assumes that the company has started trading from day one and includes it in the main cycle of pursuit and enforcement action:

- Thirteen months after registration, we issue a notice requiring the filing of a corporation tax return
- If the return is not received, we then issue a range of reminders and demands
- Two years after registration, we impose fixed late filing penalties for non-filing
- Six months later, the case is reviewed to see whether a tax determination is needed.

This activity is costly, and wasted if the company proves not to have been active.

### Policy Objective

The objective of this operational policy is to identify if a company is inactive and update HMRC systems to reflect this “dormant” status. This new process will run after the initial reminder has been sent to the company, following no communication, during the 11 months following registration. Instead of then assuming the company has started trading from day one and issuing a notice to file a return, HMRC will identify and act upon existing corporation tax data which points to active/inactive status. It will then identify whether the company has already interacted with other HMRC processes, i.e. registration for VAT. Subsequently, if there appears to be no indication of business activity for the company, HMRC will assume it is dormant and issue a letter to the company to explain this assumed status, re-affirming the obligation placed upon the company to advise when it has started to trade.

This will prevent an unnecessary notice to file a tax return being issued to the company, saving wasted further pursuit / penalties being imposed. The company will not be permanently relieved from receiving a notice to file a return; HMRC will run a regular, automated risk assessment programme to identify signs of business activity and resurrect the established return cycle where appropriate. This will bring about compliance through addressing the risk of evasion.

The intended effects of the policy are to make more efficient use of resources, freeing up high-value resource for more productive work, and to reduce the burdens we currently place on customers.

### Policy Options

Option 1: Do nothing;

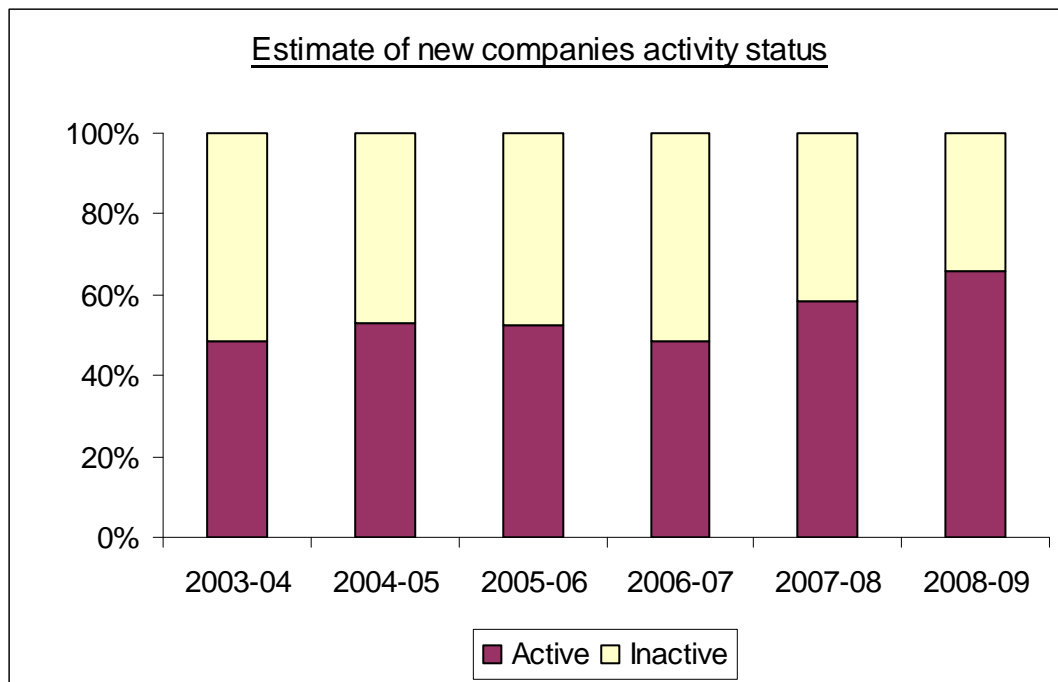
Option 2: Treat all new incorporations as inactive at the outset, relying on the company to advise it is active. This would create a significant risk as a company could choose to carry out its’ trading activity without notifying HMRC that that trade had commenced;

Option 3 (preferred): Identify new incorporations that are inactive by performing new internal HMRC data matches and remove them from the return cycle. By carrying this out before a notice to file is automatically issued – which places a statutory obligation on the company to then file a return – this option will remove customer burden, additionally preventing unnecessary reminders and penalties.

## Estimating the activity rate of new companies in the UK

Each month, data is published by Companies House containing weekly incorporations in the United Kingdom. These figures contain all new companies, but cannot identify companies that have actively started trading.

Combining this data with further information from the Office for National Statistics (ONS) Business Demography Statistics (<http://www.statistics.gov.uk/StatBase/Product.asp?vlnk=15186>), we are able to estimate the number of new companies that have had contact with HMRC either through PAYE and/or VAT registers. Taking this as a signal that some form of trading is taking place, we are then able to determine those companies that are inactive.



The activity rate fluctuates between 48% and reaches 66% in 2008-09 leaving approximately one third of all incorporations inactive. This takes into account companies that were active at any time during the reference year in question.

### Pilot exercise

The Corporation Tax Computer System (referred to as COTAX) assumes that any company is live, unless HMRC is advised to the contrary. Whilst this does deliver an assurance that every live company will be issued with a Notice to file a company tax return, it was imperative to test new data matching which indicated that a significant proportion of these assumed live companies were in fact dormant. A 2009 pilot exercise was held to test the Company Triage process. Using the latest COTAX data, new data automation through the Connect matching tool and resource at CT Operations, Twickenham, the triage demonstrated that 59% of new companies had already contacted HMRC notifying their current status of activity. Using the proposed triage methodology, we were able to identify a further 30% of new companies as inactive and make these cases "Dormant" on the COTAX system. This prevented the issuing of the Notice to deliver a company tax return and all further pursuit and enforcement action. These dormant companies would then be subjected to a more appropriate cycle of review to identify signs of activity and the risk of evasion.

### Estimate of the number of companies affected

The number of new company registrations fluctuates. In 2008-09 there were approximately 330,000 new companies formed. This increased to 370,000 in 2009-10. Recent process changes, to make it easier for companies to tell us they are inactive, have had only a marginal effect - most still do not tell us that they are inactive, leading to unproductive costs in large numbers of cases. Assuming an additional 30% of new companies will be identified as being "dormant" under the company triage project, approximately 100,000 new companies will then be removed from the company tax return cycle leading to reduced administrative burdens and a reduction in the output costs for HMRC.

## Costs and Benefits

### *Benefits to Business - Administrative burdens*

The administrative burdens relieved as a result of this policy option are calculated using the Standard Cost Model. More information relating to this model can be found in the annex. Based on our evidence, we have calculated the administrative burdens using 60,000<sup>\*</sup> dormant companies who will no longer be obliged to complete the corporation tax return (CT600). Analysis of HMRC corporation tax customers identified as having an incorporation date between 01/08/2009 and 31/10/2009 showed that approximately one third of companies engage a tax agent to deal with their corporation tax filing obligations. This is also taken into account in the calculation. We have assumed an average saving of £8.50 for companies who deal with their affairs directly and a £30 saving for companies who outsource. This results in the administrative saving of just over £900,000 per annum.

### *Benefits to HMRC - Compliance costs*

New Company Triage will identify and remove around 100,000 cases each year from the established Returns cycle. This is around a third of all cases, where we currently assume the new company is active. This will radically reduce the entries on the work list which triggers human intervention to risk assess non-return cases, decide whether to make a tax determination and impose a tax related penalty.

Previous Internal Audit sampling has shown that we only make a tax determination in 11% of the cases which appear on the work list for review. It follows that the vast majority of these cases for review show no sign of activity and many have already ceased, or been wound up. The triage removes the staff time wasted in reviewing these cases. We will be able to produce fewer, better quality, determinations. Overall, around 237,000 cases hit this work list each year and the triage will prevent a minimum of 42% of these cases ever appearing for review.

Working on the basis of 100,000 cases at 5 minutes per case, over a 7 hour day and 200 working days a year, the saving on un-necessary work list attention is 6 FTE of Band O time.

Notices, reminders and demands issued to an inactive company occasionally prompt a letter or telephone call but are generally ignored. We then assume the company is active and further outputs follow unfettered. The triage will stop the flow of these outputs and, in turn, allow better focus on real tax loss. It will also remove the need for customers to handle and perhaps respond to this unnecessary post.

By removing 100,000 cases annually from the live company population we will achieve output savings of:

Year 1 saving	£15,385
Year 2 saving	£140,695
Year 3 and subsequent annual saving	£179,394

### *Costs to Business*

None

### *Costs to HMRC*

The costs for HMRC are accrued from the process underlying the identification of new companies as "dormant". This cost is estimated to be negligible and will be offset by greater savings from the reduction in wasted effort to pursue returns and debts from inactive companies.

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\* The figure of 60,000 is taken from the Standard Cost Model, which is base-lined at 2005. The higher figure, of 100,000, is present day. Furthermore, admin burden savings have already been made on other measures relating to the issue of removing dormant companies from the Return cycle, such as the new CT41G "dormancy insert" form. Therefore, to maintain integrity in our calculations, the admin burden saving has been based upon the lower figure, which specifically avoids double counting of savings.

## Other benefits not captured in the summary

### Creation of spurious debt = £394million

Overall, the creation of approximately £394 Million spurious debt, equivalent to 26.3% of all CT debt currently under one year old, can be avoided. This can be broken down into the following benefits:

#### *Uncollectible fixed penalties=£19.9m*

Around 80% of current CT debt items are under £10,000. HMRC Debt Management & Banking operate a risk-based assessment of debt with varied approaches to different customer segments and debt values, via campaigns. Pursuit of low value single debt items is not cost-efficient. 70% of total CT debt items are flat-rate penalties of £100 or £200. The triage will stop the indiscriminate issue of flat-rate and subsequent tax-related penalties.

By making inactive companies dormant based on our increased data confidence, the triage will remove 30% of the new company cases on which we currently make automatic fixed penalty determinations. This will cut un-collectible fixed penalties by £19.9M, around 44% of all fixed penalties issued in a year.

#### *Remove from determined debt=£340m*

Likewise, the triage will reduce by 30% the number of CT determinations we issue, in absence of a return. We estimate that this will remove £340 Million from the annual average level of £1,150 Million determined debt. This is likely to be a conservative estimate. It is based on a minimum view of the likely level of determinations made on a new incorporation. An alternative model based on a reasonable view of a likely upper level would support estimated savings of £487 Million.

#### *Tax-related penalties=£34m*

The number of tax-related penalties, based on tax determinations, will also reduce by 30%. This will remove £34 Million from the annual average level of £115 Million tax related penalty debt.

## Risks

The triage is based on the assumption that a company is inactive if it does not respond to HMRC contact. The consequent risks are:

- An active company that is keen to evade tax may be made dormant and so be removed from our routine pursuit processes.
- An inactive company which later becomes active may be less likely to tell us if we have removed it from our routine live company processes.

The triage process mitigates the first risk by cross-matching between HMRC systems, to look for signs of company activity outside the CT system. The pilot included an automated check using the Connect tool. This ensured that no company with a live VAT record was treated as inactive for CT purposes.

An active evader might succeed in remaining off the radar of any HMRC system. This is a current risk. The triage does not increase the risk, as it simply removes current contacts which are ignored by active evaders. However, the new process will include an HMRC Risk Intelligence Service-managed risk appraisal of new companies which do not respond to contact, and all apparently dormant companies. This approach will use real world information, to look for signs of business activity and organise appropriate interventions. Initially this information will be drawn from Companies House data, although further work is planned to look at using broader data sources which will increase the effectiveness of the risk process. The pilot included a manual check to ensure that no company with an active PAYE record was made dormant. This check will now be automated in the RIS-managed risk appraisal of all dormant companies.

The second risk is reduced by inclusion in the process of a notice to the company telling it of its legal obligation to inform HMRC if it becomes active, and warning of the penalties for not doing so. The risk will also be mitigated by the improved risk appraisal of all “dormant” companies based on real world intelligence.

## **Specific Impact Tests: Checklist**

Full details of the specific impact tests are listed at: <http://www.berr.gov.uk/files/file44548.pdf>. These have been applied to the options considered in this consultation.

### *Competition Assessment*

After initial screening, it has been decided that the new process will not affect competition. This policy will not impact on any business that is actively trading and hence will not reduce the ability of businesses to compete.

### *Small Firms Impact Test*

The Company Triage process is aimed at all new companies that are not actively trading. Initial screening tests identified that small businesses may be affected however the new process will be welcomed by small firms due to the reduction in administrative burdens.

### *Legal Aid*

After initial screening, it has been agreed that there are no legal aid impacts associated with this process.

### *Sustainable Impact Test*

HMRC has committed to five principles of sustainable development:

1. Living within environmental limits
2. Ensuring a strong, healthy and just society
3. Achieving a sustainable economy
4. Promoting good governance
5. Using sound science responsibly

After initial screening, it has been agreed that the Company Triage process will not impact on the first or fifth tests as there is no environmental limitation or use of science. The new process will promote good governance, through justifiably relieving the burden on those new incorporations that need not receive, or respond to, the unnecessary issue of a Notice to File a Return. That in turn supports the principle of a just society and a sustainable economy.

### *Carbon Assessment*

After initial screening, it has been agreed that the new process has no significant carbon emissions impact.

### *Other Environment*

After initial screening, it has been agreed that the new process has no significant other environmental impact.

### *Health Impact Assessment*

Using the Department of Health’s three stage screening questions, it can be seen that Company Triage process has no significant impact on health or well being. A complete health impact assessment does not therefore need to be completed.

*Race, Disability, Gender Equality*

Whilst the consultation process and initial screening tests fully considered all aspects of equality throughout, it has been agreed that there are no impacts upon race, disability or gender arising from the new process.

*Human Rights*

After initial screening, it has been agreed that the new process does not impact upon any human rights.

*Rural Proofing*

After initial screening, there are no indications that the Company Triage process will impact differently in rural areas.

## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

## Annexes

HMRC is subject to quantified targets to reduce one aspect of compliance costs in particular; the admin burden on business of disclosing information to HMRC or to third parties. This burden is assessed through the 'Standard Cost Model', an activity-based costing model which identifies what activities a business has to do to comply with HMRC's obligations, and which estimates the cost of these activities, including agent fees and software costs.

The 'Standard Cost Model' (SCM) has been used to derive an estimate of the costs to business of complying with HMRC obligations to disclose information to HMRC or to third parties. The SCM considers which activities a business has to do to comply with an HMRC obligation, how many businesses have to comply, and how often they need to comply. The SCM considers the burdens applying to different sizes of business.

The SCM estimates the costs of using agents; the costs of undertaking work in-house; and the costs of actually transmitting the information. The SCM does not consider one-off costs or transitional costs. The SCM does not consider costs which a business would have incurred anyway had the relevant HMRC obligation not existed. It considers the costs which apply to a normally efficient business and the costs to businesses which comply. The SCM does not consider wider compliance cost issues, such as the costs of business uncertainty, cash flow costs, or the costs of deciding whether or not to do something.

The Impact Assessment template requires SCM figures to be presented in May 2005 prices, as admin burden reduction targets relate to a May 2005 baseline. The Impact Assessment also uplifts those figures to current day prices.