

Summary: Intervention & Options

Department /Agency:

HMRC

Title:

Advance Agreements

Stage: Implementation

Version: Final

Date: 21 July 2008

Related Publications: Review of Links with Large Business

<http://www.hmrc.gov.uk/largecompanies/reviewlinks-large-bus.shtml>

Available to view or download at:

<http://www.hmrc.gov.uk/better-regulation/ia.htm>

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

A business's decision whether or not to undertake an investment may partly depend on the tax treatment of the transaction. The proposal introduces a system of advance agreements to give the certainty that UK and international businesses need in these circumstances.

This reform shares a lot of common ground with recent changes to non-statutory clearances, subject of a separate Impact Assessment.

What are the policy objectives and the intended effects?

The objective is to give UK and international businesses certainty about the tax consequences of significant inward investments and corporate reconstructions and to improve international competitiveness of the UK as a destination for inward investment.

From October 2007 HMRC have introduced an Advance Agreements Unit which provides a single point of contact for significant inward investors, to advise on and resolve issues across all relevant taxes and give binding rulings.

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

The Review of Links focused on prioritising the concerns of large business and developing outcomes and proposals to address them. One of the key issues raised was the provision of greater certainty of tax treatment. The review recommended a number of options for addressing this, all of which were supported by business, and all of which were accepted. This impact assessment assesses the particular recommendation to provide advance rulings and agreements, and measures the expected impact relative to the default option of keeping the status quo. The Review's other recommendations are complementary rather than alternatives, and as such are considered in separate impact assessments.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? In the initial period both qualitative and quantitative research will be undertaken to test processes and guidance and assess customer satisfaction. The satisfaction survey will continue on an annual basis.

Ministerial Sign-off For 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:

Jane Kennedy

..... Date: 21 July 2008

Summary: Analysis & Evidence

Policy Option: Preferred	Description: Introduce a system of advance rulings and agreements in line with Sir David Varney's Review of Links proposals
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' Businesses: cost of preparing applications, over and above the status quo. HMRC: setting up centre of expertise to coordinate applications; staff costs, updating guidance; improvements to IT and data systems.		
	One-off (Transition)			Yrs
	£ Negligible			1
	Average Annual Cost (excluding one-off)			-
	£ Negligible	Total Cost	£ Negligible	
Other key non-monetised costs by 'main affected groups' The marginal cost associated with this reform is negligible: most of the cost of seeking certainty was incurred already under previous arrangements. The cost to HMRC of running the Advance Agreements Unit is about £100k p.a. but this again represents largely a shift rather than a brand new cost.				

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' All the benefits are qualitative in nature. Businesses: increased certainty of tax treatment; better quality of service; extended scope to range of advice available; clearer lines of communication; faster advice. HMRC: improved expertise, efficiency & awareness of trends		
	One-off			Yrs
	£ Nil			
	Average Annual Benefit (excluding one-off)			
	£ Not quantifiable	Total Benefit	£ Not quantifiable	
Other key non-monetised benefits by 'main affected groups' Businesses: The biggest benefit is increased certainty of tax treatment. This cannot be quantified precisely, but is expected to exceed the total cost, given the size of transaction at which the service is aimed.				

Key Assumptions/Sensitivities/Risks

Because the benefits are largely qualitative, HMRC will monitor developments continually, and review the effects of reform, to confirm the desired objectives are being achieved. This reform will not affect the amount of tax collected.

Price Base Year 2008	Time Period Years 1	Net Benefit Range (NPV) £ Not quantifiable	NET BENEFIT (NPV Best estimate) £ Significant, but not quantifiable
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What is the geographic coverage of the policy/option?	United Kingdom
On what date will the policy be implemented?	October 2007
Which organisation(s) will enforce the policy?	HMRC
What is the total annual cost of enforcement for these organisations?	These issues are not especially relevant in this particular case.
Does enforcement comply with Hampton principles?	
Will implementation go beyond minimum EU requirements?	
What is the value of the proposed offsetting measure per year?	
What is the value of changes in greenhouse gas emissions?	
Will the proposal have a significant impact on competition?	No
Annual cost (£-£) per organisation (excluding one-off)	£Nil. A cost will only be incurred if a business chooses to make a clearance application, and such costs are one-off / non-recurring.
Are any of these organisations exempt?	The service is aimed at investments valued at £250 million or more.

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of	£ Negligible	Decrease of
	£ Negligible	Net Impact
	£ Negligible	£ Negligible

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

1. The Issue

- 1.1 The Review of Links with Large Business, led by Sir David Varney, was commissioned by the Chancellor of the Exchequer to address business concerns about the nature of the relationship between large business and HM Revenue and Customs (HMRC). Government and business have a common goal of maintaining and enhancing the attractiveness of the UK as a place to do business in and do business from. The relationship between large business and HMRC and the efficiency and effectiveness of the administration of the tax system are important in achieving this goal. The aim of this review was to fundamentally improve the nature of this relationship.
- 1.2 The Review of Links with Large Business report, which can be found at <http://www.hmrc.gov.uk/large-business/review-report.pdf>, was published in November 2006 and identified four key outcomes that both business and HMRC wanted to see: -
- Greater certainty;
 - An efficient risk based approach to dealing with tax matters;
 - Speedy resolution of issues; and
 - Clarity through effective consultation and dialogue.
- 1.3 Feedback received during the course of the Review of Links and in the subsequent consultation demonstrated that providing certainty on the tax consequences of a particular transaction is of paramount importance to business.
- 1.4 Certainty means getting a definitive answer as to HMRC's view of a particular circumstance, which is binding on HMRC and can therefore be relied upon by the customer. Being able to obtain certainty has the potential to make a real difference to the competitiveness of the UK in relation to tax administration.

2. Policy Objectives and Intended Effects

- 2.1 The Review of Links identified that the largest businesses involved in significant inward investments and corporate reconstructions have particular needs. Following its publication, we consulted businesses and advisers informally to identify these needs and how they would best be met. The comments received indicated:
- The importance of certainty to businesses contemplating a major inward investment;
 - The nature of inward investments. Businesses we spoke to said that it is now relatively rare for inward investments to be a big "green field" project. Inward investors are more likely to establish a small base from which they grow organically; acquire a UK base through mergers and acquisitions; or expand existing UK operations;
 - Tax will be a more important factor in some investment decisions than others;
 - Significant inward investments and corporate reconstructions are likely to cover a bundle of key issues over a number of different tax products;
 - There is no point in providing certainty if big inward investors find it difficult to manage our basic processes. They also need help in managing these basic processes and their relationship with HMRC. We need to keep under review the areas where difficulties arise.
- 2.2 Taking these views into account, we consulted formally on introducing an Advance Agreements Unit offering a range of services to inward investors including:

- Rulings which business can rely on, consistent with administrative law, across all taxes where there is uncertainty about the application of existing law to the specific transaction;
- A “one stop shop” to co-ordinate responses from different parts of HMRC depending on the taxes and duties involved;
- A fast track towards agreement where time is of the essence;
- Help for inward investors who need advice on our taxes and systems.
- In addition, we proposed the Unit would support key customer facing staff to ensure that they have speedy access to the advice that will enable them to provide rulings on which business can rely, consistent with administrative law.

Responses to the consultation welcomed the idea of a central unit providing these services direct to inward investors and supporting corporate reconstructions.

- 2.3 The Advance Agreements Unit has been providing these services since October 2007.
- 2.4 This reform shares a lot of common ground with recent changes to non-statutory clearances.

3. The Options

- 3.1 The Review of Links focused on prioritising the concerns of large business and developing, alongside large business, outcomes and proposals to address these concerns. One of the key outcomes identified as important for large business was the provision of greater certainty, to be addressed by a number of measures including a system of advance rulings or agreements and the extension of the existing clearances system.
- 3.2 The findings of the Review of Links and responses to the subsequent consultation clearly demonstrated that improvements to day to day working practices were required by both large business and HMRC. Successful delivery of the Review of Links proposals was seen as fundamental to improving the relationship between HMRC and business.
- 3.3 The business sector fully endorsed the proposals set out in the Review of Links report, stating that *‘when taken together, the proposals represented a significant package which will make a real difference in taking forward the relationship between business and HMRC. The proposals, when delivered and with the support and engagement of HM Treasury, will contribute to the competitiveness of the UK and will foster and encourage an environment in which business can flourish’*.
- 3.4 The Review of Links clearly set out that HMRC would provide business with greater certainty by the *‘the introduction of advanced rulings to give business certainty about the tax consequences of significant investments and corporate reorganisations. From Pre-Budget Report 2007, HMRC will provide binding rulings across all relevant taxes to those that provide clear plans for investment, reconstructions and reorganisation including proposed legal structures and financing.’*
- 3.5 In light of the support of business for the proposals contained within the Review of Links, and recognising the importance of building on our relationship with business to maintain and enhance the attractiveness of the UK as a place to do business in and to do business from, we have implemented the proposal on introducing an advanced agreements service as laid out in the Review of Links document.

4. Costs and Benefits / Impacts

- 4.1 Advance agreements are designed to reduce uncertainty, and hence to reduce the risk associated with business decisions where the tax treatment is unclear. Businesses and HMRC incur an upfront cost in making and processing the application for an agreement, but benefit in the longer term. In practice, however, most of the work would need to be done anyway. This reform does not change the requirement on taxpayers to agree the tax treatment of transactions they undertake – it simply improves the efficiency with which such agreement can be reached.
- 4.2 The services provided by the Unit have not previously been available in a coordinated and centralised form. Previously, when HMRC were asked to advise on a significant inward investment, arrangements for preparing and discussing that advice were set up ad hoc. There was also an advertised contact point for inward investors seeking advice, but the service provided was limited in scope. This is essentially a new service which has two effects. First, the quality of service, and hence level of benefits, should rise. Secondly, demand for advice and agreements may rise relative to the status quo.

COSTS

Costs to business

- 4.3 The application process is voluntary. No business will incur costs unless they choose to (i.e. if they expect the benefits to outweigh the costs on average).
- 4.4 For those that do make applications, the main cost is the resource spent on preparing the clearance application itself, although in most cases this cost would already be incurred under the status quo.
- 4.5 The total cost to the business community of making applications depends primarily on the number of applications made. The Unit works with applicants to ensure the application process is as cost efficient as possible and takes account of the circumstances and needs of the individual business. Approaches can be made by a variety of routes, including in writing, by e-mail and by phone. As far as possible the Unit works in discussion with applicants.
- 4.6 The cost of making an application is very variable. It is also difficult to separate the specific costs associated with the application from the analytical costs that a business would incur anyway as part of tax and/or normal business planning. Where an applicant has most of the information to hand, business has indicated that the marginal (additional) cost of making an application can be quite small.

Costs to HMRC

- 4.7 HMRC has incurred a number of one-off costs at the outset: administrative set-up costs, staff training and IT systems. Most of these costs have been fairly low and absorbed within normal running costs.
- 4.8 On a recurring basis, HMRC will need to process applications, consider whether or not to accept them, analyse and discuss the proposals and issue agreements. Supporting activities, such as management information systems, will be required as well. The annual running costs of the unit are estimated at £100,000 per year, but much of this would have been incurred anyway, and the marginal cost associated with this reform is negligible.
- 4.9 The services of the Unit are targeted at significant inward investments amounting to £250 million or more in value. Support will also be provided when HMRC agrees with the applicant that an inward investment below that figure is of importance to the national or regional economy or in the wider public interest. We plan that the Unit will handle up to 30 applications a year and HMRC have resourced it accordingly. We base this on data about the value of foreign acquisitions in the UK, collected from a variety of published sources. This reflects the understanding of the businesses we spoke to, that inward

investment is now likely to take the form of mergers and acquisitions. Allowing for variations in the sources of data, the research indicates that, over the three year period 2004-06, the number of foreign acquisitions in the UK valued at £150m and above averaged 30 to 40 per year. Those valued at £250m and above averaged 20 to 30 per year.

Other costs

4.10 The guidance provided for the advance agreements service and on other clearances and rulings offered by HMRC will need to be kept up to date to remain effective. HMRC expect to absorb the associated costs within the “business as usual” category..

BENEFITS

Greater certainty of tax treatment

4.11 HMRC aim to provide businesses with a view on the tax consequences of significant inward investments. This is the biggest benefit of the advance agreements regime. It provides:

- a clearer framework for making business decisions; and
- a substantially reduced risk of incurring unexpected tax charges.

4.12 In the absence of an application for an advance agreement or for a clearance, a business may be able to reduce the level of uncertainty to an extent (for example by seeking consultancy advice). However, the ability to seek an advance agreement from HMRC specifically may (i) be cheaper, because the Unit offers a “one stop shop” service to businesses (and their advisers), and (ii) reduce uncertainty to a greater degree.

4.13 The benefits of certainty are significant, but are likely to vary substantially from case to case. They are also intangible and difficult to quantify precisely. Nevertheless, the ability to make more informed decisions can have a direct effect on commercial profitability. Some businesses have stated during consultation that they attach very large values (potentially £millions) to this benefit. Even where an application is rejected, that rejection can itself help a business make more robust decisions.

4.14 It is not possible to put a figure on this benefit, for two reasons. First, measuring the value of certainty can only really be attempted on a case by case basis, and is not something where a typical or average value is particularly meaningful. Secondly, it is difficult to separate the specific impact of this reform (a more efficient service that may boost demand for agreements) from the level of certainty that would have been provided under previous, more ad-hoc, system. As a result, the certainty-related benefits to business are classed as “significant but not quantifiable. As stated above, businesses are only likely to engage with the (voluntary) advance agreement process if they believe the benefits are worthwhile.

“One stop shop”

4.15 Inward investors may have little or no existing relationship with the Department prior to, say, acquiring an existing UK business. Without a single point of contact, large inward investors would be put to the cost and inconvenience of finding their way round HMRC without our assistance. The Advance Agreements Unit provides a relationship comparable to the service that Client Relationship Managers and Customer Managers provide to the largest UK businesses.

4.16 The small, dedicated unit offers a service to significant inward investors and supports our involvement with businesses undergoing major reorganisation. It provides the investor

with a single point of contact to advise on and resolve issues across all relevant taxes. It agrees with the investor a timetable for this and the information that will be required. Once an agreement is reached, the unit hands over responsibility to a Client Relationship Manager or Customer Manager, who will be responsible for our continuing relationship with the investor.

- 4.17 One of the unit's roles will be to build and maintain a network of contacts within HMRC's regime-specific business units (Product and Process Groups). Contacts will provide advice or assistance to the unit as necessary.
- 4.18 The new centralised unit is better placed to provide fast, reliable and coordinated advice. This applies both to formal applications for agreements, and to ad-hoc requests for guidance from businesses. Obviously this has value, and we are monitoring the new service to make sure it delivers. Overall, the benefits of improved service are classed as "small but worthwhile", and this is in addition to the other impacts mentioned in this part of the impact assessment.

Reduced costs associated with audits & inspections

- 4.19 If a business has provided information to HMRC within an application, and HMRC have given agreement, then there is a much reduced need to reproduce the same work during any subsequent audit or inspection by HMRC. Where such an inspection takes place, some of the potential costs will have been incurred upfront in the course of making the application.
- 4.20 It is not possible at this stage to estimate the likely size or prevalence of any reduction in audit costs, but HMRC will keep the situation under review as part of wider reforms of the audit and inspection regime.
- 4.21 Finally, early dialogue about issues will almost certainly improve mutual understanding between HMRC and its customers. That will have knock-on benefits, such as a reduced chance of problems not being tackled, or of penalties being applied.

Benefits for HMRC

- 4.22 To a large extent, HMRC will benefit from improvements to the application process in a similar way to businesses. The benefits include:
- efficiency benefits arising from centralisation, improved guidance and training;
 - enhanced awareness of trends, particular in terms of which technical issues are generating most requests for advance agreements.
 - continuing improvements in HMRC's relationship with large business, and in awareness of the issues of concern to those businesses;
 - an enhanced ability to maintain and update guidance in line with recent and anticipated trends; and
 - a centralised repository of knowledge and management information reacting to advance agreements, enabling a better service to be provided.
- 4.23 These benefits are qualitative in nature, and have not been quantified accordingly. HMRC will continue to monitor developments to ensure that all benefits (whether quantifiable or not) are maximised.

5. Administrative Burden.

- 5.1 Within the overall compliance cost to business, HMRC track one component in particular. The "administrative burden on business" is defined very specifically as the time and cost on compliant businesses of retaining information and/or sending it to the Department and/or a third party. As such, it includes (e.g.) the burden of completing forms and

returns, and of complying with audits and inspections. All government departments have targets to reduce administrative burdens and HMRC impact assessments provide an itemised figure accordingly. This does not mean that other types of burden are ignored: it means simply that HMRC are taking additional steps to address business concerns that the administrative burden, as defined, is minimised.

- 5.2 In the case of advance agreements, the cost of making an application is included within the definition of administrative burden. So too is any cost incurred during audits and inspections. Therefore, the impacts on administrative burdens are:
- A possible increase, because the reform may increase demand for applications, and such applications might impose an administrative cost on business; and
 - A reduction, because the new unit will be more efficient than the former ad-hoc system; and
 - A possible reduction, because the cost of audits and inspections may fall.
- 5.3 It is the marginal burden that is relevant, namely the burden net of any current costs incurred in an attempt to gain some certainty (e.g. a business may currently incur professional fees or costs in trying to get advice from HMRC in the absence of a one stop shop). Given that the population is so low (up to 30 cases per year) and the fact that some of these effects cancel each other out, our assessment is that the net impact on admin burden will be negligible.
- 5.4 The key message is that while the administrative burden is likely to remain largely unchanged overall, the unquantifiable benefit of certainty is significant and likely to outweigh any costs on average. Additionally, the voluntary nature of advance agreement applications means that businesses are able to decide whether the benefits of each individual application are likely to outweigh the cost.

Exchequer effects

- 5.5 Advance agreements are designed to clarify the tax treatment of business situations. They do not in themselves change that treatment: they simply explain what the treatment is likely to be, so that businesses can make informed decisions.
- 5.6 As such, HMRC do not expect this reform to affect the total amount of tax raised.

6. Implementation Plan

- 6.1 Prior to full implementation we consulted informally with businesses and advisers to identify their needs; and undertook formal consultation on proposals between June and September 2007. The outcome of the consultation was published in October 2007 in *Making a difference: clarity and certainty* <http://www.hmrc.gov.uk/pbr2007/lb-review-of-links.pdf>
- 6.2 The Advance Agreements Unit came into operation on 18 October 2007.

7. Impact Tests.

Small firms impact

- 7.1 Advance agreements are specifically targeted at large businesses involved in significant inward investments valued at £250 million and more. Inward investors below that threshold are encouraged to speak to the Advance Agreements Unit if they need advice

about whom to contact within HMRC. All businesses seeking binding clearances on individual transactions are also able to use HMRC's clearance process.

Competition effects

- 7.2 We do not anticipate any significant impacts on competition arising from this and its associated reforms. The benefit of increased certainty will enable businesses to make more informed, and hence better, planning decisions. This may help those businesses become more competitive than they would otherwise have been.
- 7.3 There may be some indirect effects on third party advisors. If a business applies for an advance agreement then they may or may not choose to employ consultants or accountants to assist them. Equally, if they do not apply they may choose to employ advisors to help them reduce uncertainty in other ways. We do not believe these reforms will distort the market in any significant way, but there may be a slight shift away from advisors providing advice on certainty and towards those advisors helping inward investors apply for advance agreements.

Other impact tests

- 7.4 All the other tests in the annex have been considered, but are not materially affected by this reform.

8. Caveats and Risks.

Caveats & risks associated with the reform itself

When a business can rely on an advance agreement

- 8.1 Our starting point is that business should be able to rely on any advice we provide. All the relevant facts must be included in the application and the customer must draw attention to all relevant issues (for example, by providing information on related transactions where relevant)
- 8.2 There may be a very small number of cases where we provide an advance agreement that is incorrect in law. Where this happens, we will be bound by the advice we have given if the business reasonably relied on it and there could be financial detriment. In those cases it is possible that to apply the statute would be so unfair that it could amount to an abuse of our powers. Where we have given an incorrect agreement, our primary duty is to collect the correct amount of tax as required by the law and therefore there will be some, very rare, circumstances when we would not be bound by the advice we have given.

Tax Planning

- 8.3 The advance agreements policy is firmly based on the understanding that decisions will not be sought or given in respect of arrangements which could be considered as tax planning. HMRC have made it clear in the guidance and Consultation Document that, while clearances and rulings will be available for a wider range of transactions than is currently the case, they will not become involved in any tax planning activities.

Caveats & risks associated with the analysis

- 8.4 The impacts of this reform are difficult to assess, mainly because "certainty" cannot readily be quantified. Other benefits, such as better quality of service, are qualitative rather than quantitative in nature. The conclusion that the benefits outweigh the costs is

robust, however, and is fully supported by the outcome of earlier consultation with affected businesses.

9. Monitoring and Evaluation.

- 9.1 The service provided by the Advance Agreements Unit will be evaluated on the basis of feedback from the applications when a case is completed.
- 9.2 Implementation arrangements will be subject to formal post-implementation review once the reforms have bedded in and suitable data becomes available. This is likely to be in autumn 2008.

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

HMRC has considered all of the above implications. The first two are most relevant to the advance agreements system and are discussed in the main evidence base section of this assessment. The remaining tests have not identified any significant implications arising from this reform.