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Dear Ms Baillie

At our appearance before your committee on 15th June, Sarah Walker and I undertook to provide further information on the potential cost implications for the Scottish Government of Scottish income tax rates or thresholds being set close to the start of the tax year.

I also understand that, after subsequent consideration of our evidence, the committee requested further information and reassurance on HMRC's compliance strategy.

Scottish Rate Resolution

I should like to be clear from the outset that, however close to the start of the tax year a Scottish rate resolution (SRR) is passed, HMRC will ensure that the income tax collected from Scottish taxpayers reflects the rates and thresholds set by the Scottish Parliament. This note merely provides further detail on how the timing of a SRR might affect HMRC's administration.

Prior to the start of every tax year, HMRC provides employers with new tax codes for all employees - enabling the correct amount of tax to be deducted through the PAYE system. These tax codes are calculated and issued through HMRC's annual 'coding run' process. The coding run normally starts in early December and lasts about ten weeks – usually finishing in mid to late February.

To enable the inclusion of Scottish rates/thresholds in the annual coding run, the Memorandum of Understanding between HMRC and the Scottish Government requires an indication of the following year's rates and thresholds by 30 November[1]. However, some flexibility exists around this date - HMRC has accommodated a mid-December Scottish draft Budget in the last two years without adverse impact on the coding run or additional cost to the Scottish Government.

Once started, it is not possible to stop and restart the annual coding run. If Scottish rates or thresholds therefore change after the coding run has started, the only manner in which HMRC can ensure Scottish taxpayers and their employers receive the correct PAYE code is to undertake a separate, corrective, coding exercise for Scottish taxpayers after the annual run has completed[2]. It is this second coding run and the activity associated with it that is the primary driver of potential additional cost to the Scottish Government.

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[1] As we indicated in evidence on 15th June, this date may need revisiting in light of UK & Scottish Budgets potentially being held later in the year.
[2] This would also be the case if a UK rate/threshold changed after the annual coding run commenced.

As indicated in our evidence to the committee on 15th June, there are a considerable range of scenarios and factors which might influence the nature and extent of this second coding run and therefore the cost to the Scottish Government. The following are among the main factors:

- the extent of any changes made to the rates and thresholds - changes to the band structure would take more time/resource to design, test and implement than a change to a single rate or threshold;

- the number of Scottish taxpayers affected by a change to proposed rates/thresholds and thus requiring a different, corrective tax code;

- the extent to which any changes made resulted in increased HMRC contact by Scottish taxpayers and employers;

- when Scottish rates/thresholds are set – clearly the earlier this occurs the greater HMRC's ability to minimise cost through inclusion in existing processes.

Although this range of factors and scenarios preclude a definitive answer on costs, an illustration of the level of cost associated with a change to the proposed Scottish rates/thresholds can be gained from this year's minor change to planned thresholds:

- the annual coding run commenced in December using the rates and thresholds for Scottish taxpayers proposed in the Scottish Government's draft Budget;
- the SRR for the 2017/18 tax year was passed on 21 February, maintaining the higher rate income tax threshold for Scottish taxpayers at £43,000;
- HMRC carried out a separate coding run for higher rate Scottish taxpayers after the annual coding run had ceased;
- this second coding run resulted in some customers receiving both an initial coding notice (from the annual coding run) and a second, correcting coding notice (from the subsequent and separate Scottish coding run);
- the cost of this exercise was approximately £103,000.

<u>Compliance –further information/assurance</u>

Please find below a short paper which hopefully provides the reassurance and clarity that the committee is seeking.

JHarra

Jim Harra

Scottish Income Tax
Compliance Approach - 2017/2018

SUMMARY

Scottish taxpayer identification

The exact nature of the compliance activity HMRC undertakes to identify Scottish taxpayers for any given year will depend on income tax decisions made by the UK and Scottish Parliaments. In broad terms, the greater the divergence between the two regimes, the greater the risk of a non-compliant behavioural response by customers requiring HMRC compliance activity to address.

HMRC have therefore agreed with the Scottish Government that we will each year produce an assessment of risk, a plan of activity to address that risk and annually publish high level compliance outcomes relating to that activity. The exact timetable for production and publication is still under discussion with the Scottish Government but this paper outlines planned activity for the 2017/18 tax year.

Compliance into tax affairs of Scottish taxpayers

HMRC will continue to assess risk and undertake compliance activity into the wider, generic tax affairs of Scottish taxpayers, in the same manner as it does now, as part of its administration of the UK income tax system as a whole. HMRC will apply risk based compliance activity to the collection of Scottish income tax in the same way as is applied to the collection of income tax from taxpayers in the rest of the UK. The Scottish Government will not be recharged for this activity.

CONTEXT

Scottish rates/thresholds for 2017/18

The Scottish income tax rates and thresholds set by the Scottish Parliament for 2017/18 mirror those which apply elsewhere in the UK, with the exception of the higher rate threshold. The Scottish Parliament chose to keep the threshold for Scottish taxpayers at £43,000, whereas the UK Parliament decided to raise the threshold for taxpayers in the rest of the UK to £45,000.

HMRC's approach to compliance

All aspects of HMRC's compliance activity in relation to Scottish income tax will be undertaken as part of and within HMRC's UK-wide approach to income tax compliance:

- **Promote** – designing processes to encourage and help customers get things right first time (i.e. before they file returns or we make repayments).
- **Prevent** – designing processes and exploiting our digital channels, using what we know about customers, to prevent them from getting things wrong and give them the opportunity to correct their mistakes before they reach HMRC.
- **Respond** – tailoring our activity when we have to intervene to investigate compliance risks and correct non-compliance.

COMPLIANCE STRATEGY OVERVIEW

Whilst 2017/18 Scottish rates and thresholds differ from those across the rest of the UK, the difference is both small and affects a relatively small proportion of taxpayers. As a result, HMRC considers the likelihood of customers changing behaviour in response to be very low and our compliance approach is tailored accordingly.

In the context of the minor divergence between regimes and resultant low risk of avoidance behavioural response from customers, the key features of HMRC's planned activity to address the risk are detailed below:

<u>Address assurance</u>

- HMRC will compare our address data against third party address data (as we did in 2015) to identify potential instances of out of date addresses (i.e. potentially incorrect Scottish taxpayer identification through a customer forgetting to inform us when they move) and maintain the accuracy of our data.
- For all individuals, whether in Self-Assessment or PAYE, HMRC will continue to monitor cross-border migration trends to identify possible evidence of customer behavioural response and also validate the accuracy of reported moves and the completeness of its address data.
- HMRC will continue communications activity reinforcing to customers the need to update address details with HMRC when they move.

<u>Knowledge building</u>

- HMRC will, for 2017/18, mirror the 2016/17 approach by using the relative lack of divergence in regimes to build up our knowledge of the Scottish taxpayer base – e.g. within the Self-Assessment population we propose to continue tapping into on-going (non-Scottish tax payer status) investigations to better understand the population and the likelihood/nature of behavioural changes/trends that might occur should future rates diverge.

<u>Wealthy Individuals</u>

- HMRC will continue to use the existing Customer Relationship Manager (CRM) model and other interactions with wealthy customers to raise awareness, educate customers of their Scottish income tax obligations and assess risk related to mis-representation of Scottish taxpayer status.
- A specific Scottish income tax lead, within HMRC's Wealthy Taxpayer Unit, has been appointed in East Kilbride to oversee activity in relation to Scottish wealthy customers

<u>Employer compliance/assurance</u>

- HMRC are keen to ensure that the Scottish 'S code' is being accurately and correctly applied in the PAYE regime and will therefore include checks in regular ongoing employer compliance activity.
- HMRC will additionally validate that the 'S code' is being correctly applied in on-site PAYE assurance work and visits, including both Scottish and UK based employers.

<u>Timing</u>

While activity aimed at promoting compliance and preventing non-compliance for 2017/18 is already ongoing, any active enquiry work into either Scottish taxpayer status risks or more generically into the tax affairs of Scottish taxpayers will start at different times:

- for employees - checks, as part of regular ongoing employer compliance activity, that 2017/18 Scottish rates are being correctly applied will take place during the tax year;

- for self-employed customers - they will still be on an annual return cycle, and their self-assessment return forms are not required to be formally submitted until 31 January 2019. Investigative respond work would therefore commence in 2019.

COMMUNICATIONS OVERVIEW

HMRC will be continuing to use the extensive existing channels of communications it has with taxpayers to reinforce key Scottish income tax messages

Channel	**Activity**	**Audience**
UK-wide Personal Tax Account campaign	• Non-Scotland specific but key message is to update address details using the online personal tax account	General public
Employer bulletin	• Standing item on every issue informing of the need to update address details • Issued 6 times per year	Employers
Agent bulletin	• Standing item on every issue informing of the need to update address details • Issued 6 times per year	Tax agents and advisers
Direct communications	• Email to payroll managers in public bodies and large businesses based in Scotland (including flyers targeting Scottish residents) • Employer Letter and Employer Paper Pack	Payroll managers Employers
Customer Relationship Managers	• Regular messaging reminding employers to make sure their employees' addresses are correct	Large businesses and public bodies
GOV.UK	• Updated landing page, separate section for those moving to and from Scotland • News releases	General public
Social media	• Regular HMRC Twitter releases	General public
Employer Forums	• Standing item at regular forums throughout year	Employers
Vulnerable Group Forums	• Standing item at regular forums • Messaging through bodies like Citizen's Advice, Association for the Blind, Age Concern	Vulnerable groups

In addition, further potential avenues of communication for 2017/18 are also currently under consideration with Scottish Government, for example; further Scottish media campaigns and, depending on how successful the initial campaign was in persuading customers to open Personal Tax Accounts (PTA) to update their address, a 'Scottish boost' to future UK-wide PTA advertising campaigns.