Dear Cabinet Secretary

Thank you for your letter dated 15 November in which you welcome the Committee’s views on the draft Memorandum of Understanding between the Scottish Government and Her Majesty’s Revenue and Customs (HMRC) in relation to the Scottish rate of income tax (SRIT).

As you will be aware the Committee has taken evidence on the audit arrangements for the SRIT at its meetings on 21 and 22 November. The Official Reports of those meetings can be found at: [http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/29862.aspx](http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/29862.aspx)

The Committee is grateful to those who gave evidence and for the openness and frankness with which they shared their views with the Committee. We hope that this meaningful dialogue can continue as the MoU evolves over the next few years.

At its meeting on 22 November the Committee considered the evidence received and agreed to write to you with its views (which are set out in Annexe A). The Committee recognises that the draft Memorandum of Understanding (MoU) relates specifically to the relationship between the Scottish Government and HMRC and in that regard does not comment on role of the National Audit Office and Audit Scotland in auditing the SRIT.
That said the MoU does comment on the relationship between the Scottish Government, HMRC and the Scottish Parliament and therefore the Committee’s response focuses on these three stakeholders. The Committee also recognises that the draft MoU has no expiry date but will cease to have effect if the SRIT is repealed.

As you may be aware, the Committee has agreed that early next year it will report to Parliament its views on the audit landscape for the SRIT including the roles of Audit Scotland, the National Audit Office, the Scottish Government and HMRC as well as their relationships to the Scottish Parliament. The Committee is particularly concerned to ensure that Audit Scotland has a clear role in this audit landscape.

The Committee’s response has identified a number of areas where it would wish the draft MoU to be amended. There are also some areas where the Committee has either requested further information or clarification. We would welcome a response by the end of January 2013 from the Scottish Government on the issues raised and the recommendations made by the Committee but please do not hesitate to contact the clerk if this deadline causes you any difficulties.

Should you require any further information please do not hesitate to contact the Clerk, Jane Williams on 0131 348 5207 or by email at pa.committee@scottish.parliament.uk.

Yours sincerely

Iain Gray MSP, Convener
Annexe A

The Scotland Act 2012 – the Scottish rate of income tax

Public Audit Committee response on the draft Memorandum of Understanding

1. The Committee welcomes the level of detail provided in the opening paragraphs and the principle of openness which underpins the draft MoU. In that spirit the Committee will publish this response on its webpage.

2. The Committee has not commented on all the matters discussed in evidence but rather focussed its comments on those issues of most relevance to the remit of the Public Audit Committee.

Paragraph 4.6 – Dispute Resolution

3. The Committee welcomes the dispute resolution procedure set out in paragraph 4.6. However, as was confirmed by the Scottish Government in oral evidence, this procedure is limited to disputes relating to payments.\(^1\) From the terms of paragraph 4.6 this would appear to relate to disputes relating to payments arising from the set up and ongoing administration of SRIT.

4. The Scottish Government explained in oral evidence that it would need information from HMRC in relation to areas such as tax collection levels, compliance work, tax arrears etc in order to be able to judge how well SRIT is being implemented and subsequently how well the tax is being collected.\(^2\) At present any disputes between the Scottish Government and HMRC in relation to standards of HMRC’s performance would not be subject of the dispute resolution procedure. As the MoU is intended to operate until such time as SRIT may be repealed, the Committee considers it is important that the agreed procedure should address all areas in which disputes may arise.

5. The Committee therefore recommends that the draft MoU should be amended to include procedures for resolving disagreements arising in relation to the performance of HMRC in setting up, administering and collecting the SRIT.

6. JEC decisions in relation to disputes could potentially impact on payments made by the Scottish Government or, should this dispute procedure be widened to include HMRC performance, on HMRC operations in relation to the SRIT. At present there would not appear to be any mechanism for such decisions to be notified to the Parliament quickly. The Committee welcomes the comments of the Scottish Government that it would not wish to see any reoccurrence of the circumstances which arose when the Parliament was not initially told of a significant change in the arrangements for the Scottish Variable Rate.\(^3\)

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7. The Committee therefore recommends that the dispute resolution procedure is amended to include for the Scottish Parliament to be notified by the Scottish Government of any decision taken by the JEC under the dispute resolution procedure immediately after this decision is taken.

Paragraph 6.2 – Accounting, Audit and Assurance

Annual Implementation Reports

8. The Committee welcomes the provision of an annual implementation report, made under section 33 of the Scotland Act 2012. The first of these reports is due in spring 2013 which will be laid in the Scottish Parliament by Scottish Ministers. Scottish Ministers must also make and lay a similar report each year.

9. HMRC estimated the costs of implementing the SRIT as being £45 million, of which approximately £10 million relates to the IT costs. In oral evidence HMRC explained that whilst the operational requirements of identifying Scottish tax payers and issuing appropriate codes to employers of Scottish tax payers will be significant, it does not involve doing anything particularly new. HMRC also confirmed that over the past 5-6 years, more than ninety percent of its IT projects have been delivered on time.

10. In evidence, HMRC confirmed that it would expect to include within the annual implementation report a substantial level of detail about the progress being made.

11. The draft MoU identifies at paragraph 2 the arrangements for developing the IT and administrative arrangements for SRIT including consultation between HMRC and the Scottish Government on plans, timetables, estimated costs and progress. Where there are options for developing such systems HMRC will discuss these together with cost, risk, efficiency, effectiveness or customer impact factors with the Scottish Government before an option is selected.

12. These are all areas on which the Committee would expect to see progress reported in the annual implementation report. The Committee would welcome the inclusion of information relating to those options which have been rejected together with an indication of the reason for their rejection. This will enable the Parliament to more effectively scrutinise the value for money decisions taken by the Scottish Government and HMRC in setting up the SRIT.

13. Given the SRIT is to be operational by April 2016, the Scottish Parliament will have 3 such section 33 reports laid during the set up phase of the SRIT. The Committee welcomes reassurance provided by HMRC about its previous

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track record in delivering projects on time.\textsuperscript{6} However, delays in achieving the key milestones could significantly impact on costs of implementing SRIT (given it is to be operational by April 2016), the Committee is concerned that there may be a delay in the Scottish Parliament being notified given the annual nature of this report.

14. The Public Audit Committee would therefore request that the Scottish Government includes in its 6 monthly Major Capital Projects update to the Public Audit Committee, a section setting out the progress in setting up the SRIT. The Committee notes the comprehensive range of information set out at paragraph 2 of the MoU which should assist the Scottish Government in this.

15. The Committee would also welcome confirmation from the Scottish Government of the key milestone target dates once these have been agreed by the Inter-Governmental Assurance Board.

HMRC Annual Accounts

16. The Committee welcomes confirmation within the draft MoU that HMRC will include within its annual accounts, separate identification of expenditure and tax receipts relating to the SRIT. The Committee also welcomes the confirmation, within the draft MoU, that the Scottish Parliament will receive from HMRC an additional SRIT extract covering all matters relating to the SRIT. However as was recognised by HMRC and the Scottish Government, what level of detail will be provided within the annual accounts and the extract has yet to be determined.

17. The Committee heard that it is this level of detail which will be crucial in determining the level of audit to be carried out by the National Audit Office. The C&AG explained that “Having to separate it out will be new, and we need to give ourselves a reasonable run-up to be able to do that securely.”\textsuperscript{7} Whilst the Scottish Government explained that “it is sensible and wise to signal well in advance what management information or accounting information we would find it helpful to have so the computer systems, for example, can be designed from the beginning to produce it. That is likely to be cheaper than it would otherwise be and provision would be much easier.”\textsuperscript{8}

18. HMRC confirmed that the IT implementation is unlikely to take place until the start of the 2014-2015 financial year.\textsuperscript{9}

19. In evidence to the Committee the AGS commented that the Parliament would want to reassure itself that HMRC will be able to provide a clear picture about compliance rates, and the variation that might exist between those and the rest of the UK income-tax base. Other areas Audit Scotland recommended should be included within HMRC’s accounts were its performance in collecting

the SRIT and the level of SRIT write offs. In oral evidence Audit Scotland explained that this data should be readily and separately identifiable for Scotland.\textsuperscript{10}

20. If the Parliament is to effectively scrutinise HMRC performance in administering and collecting the SRIT over time then it is vital that a comprehensive range of HMRC’s activities are reported on to the Scottish Parliament from the start of April 2016. The Committee notes that currently HMRC reports on a wide range of tax collection activity at UK level including:

- Compliance
- Prosecution rates
- Error and fraud levels
- The tax gap (difference between all tax theoretically due and that actually collected)
- Proportion of tax debt arising in the year that is cleared within 90 days (debt roll rate)
- Taxes written off and tax dispute settlements

21. As HMRC acknowledged, where it can provide information it will, however it highlighted that there may be costs associated in disaggregating performance data held at a UK level to be able to also report at the Scottish tax payer level. Those costs would fall on the Scottish Government although it would be for HMRC to decide whether it could prioritise the resource and opportunity costs of the people who would have to do that work.\textsuperscript{11}

22. Given these comments and those of the AGS and the Scottish Government regarding the level of detail and potential cost benefits in agreeing that detail early on, the Committee recommends that the Scottish Government should explore with HMRC, at the earliest opportunity, the costs and ease of reporting in the areas identified at paragraph 20 above.

23. The Committee recognises that there may be additional costs to the Scottish Government in HMRC reporting to the Scottish Parliament on each of the above areas specifically in relation to the SRIT. Therefore the Committee would welcome an on-going dialogue with the Scottish Government on the areas on which it will be seeking reassurance from HMRC, given HMRC could also report on those areas through its accounts and the SRIT extract to the Scottish Parliament at no additional cost.

24. The Committee would welcome an update from the Scottish Government by June 2013 on the progress made in agreeing the level of tax collection activity to be reported to the Scottish Parliament by HMRC.

25. The Committee notes that payments made by the Scottish Government to HMRC for administering the SRIT would be subject to audit by Audit Scotland.

(such as those listed at paragraph 4.2 of the draft MoU). This reassures the Committee that the Scottish Parliament will be able to scrutinise the value for money of this expenditure as part of the Scottish Consolidated Accounts or through other reports of Audit Scotland. This will be particularly helpful given witnesses confirmed at that estimated administration costs of SRIT of £4.2 million would change if the SRIT was set at a rate other than 10p in the pound.  

Additional data provided to the Scottish Government by HMRC

26. The draft MoU identifies at paragraph 3.4 the range of potential compliance activities that HMRC could undertake in relation to Scottish tax payers. This is in addition to the information identified at paragraph 7.1 which HMRC will provide to Scottish Ministers during the year. In evidence the Scottish Government confirmed that, in addition to audit information, it would be seeking a range of management information about the operation of the tax, including information about the trends on tax collected over time which would give an insight into the economy’s performance. This information would be available to the Scottish Parliament and the Public Audit Committee “on request”.

27. Whilst the Committee recognises that the Scottish Government may require information in order to discharge its duties to the Parliament, it is of the view that this tax trend information would be of value to the Parliament in providing a context in which to scrutinise HMRC’s performance. For example, the Committee heard that approximately 98% of tax receipts are collected without any compliance intervention as it is collected through PAYE returns, VAT and corporation tax. In that regard HMRC noted that the Parliament may be interested in the remaining 2%.  

28. However the Committee notes that these percentages are based on the range and type of UK tax payers. If changes in the Scottish economy resulted in a lower percentage of tax payers paying tax through PAYE, VAT or corporation tax then this may impact on SRIT compliance levels. Similarly if a different rate of SRIT was set by the Scottish Parliament compared with UK income tax levels, then this could impact on HMRC’s tax collection performance.

29. The Committee therefore considers that it is not sufficient for this information to be available to the Parliament only upon request. The Committee recommends that the draft MoU is amended to require the Scottish Government to proactively provide the Scottish Parliament with an annual summary of trends in tax collection at the same time as HMRC reports on its annual accounts and provides an extract to the Scottish Parliament.

30. The Committee would also welcome confirmation from Audit Scotland that the wider tax management information provided to the Scottish Government by HMRC would also be available to Audit Scotland for inclusion within any relevant audit work it may wish to undertake.

31. Given that economic conditions and changes in the level of the SRIT may affect tax payer compliance levels the Public Audit Committee also recommends that any future references in the draft MoU to the provision of performance data by HMRC to the Scottish Parliament, should make clear that this data should be directly compared with the equivalent UK data. This will enable to Parliament to scrutinise performance changes in the collection of SRIT over time but also between income tax payers in the UK and in Scotland. In this regard receiving the additional summary report on tax trends from the Scottish Government will also enable more effective scrutiny of the reasons for any variation in HMRC’s performance over time or between UK and Scotland.

Appendix A - HMRC Additional Accounting Officer Responsibilities

32. The Committee welcomes the appointment by HMRC of an additional accounting officer (AAO) with responsibility for the collection of the SRIT. This is not is statutory role although the draft MoU makes clear the responsibilities expected of the AAO.

33. In evidence the AGS was clear that the AAO does not have a direct reporting line to the Scottish Parliament in the way that Scottish accountable officers do. This accords with the understanding of the Public Audit Committee. The Committee noted with interest the comments of the Scottish Government that the expectation was that although there was no formal or statutory reporting line from the AAO to the Committee, these arrangements should work well "providing that the work required to develop the SRIT project moves smoothly and that tax itself, once operational, does not give rise to any major or unforeseen difficulties".

34. HMRC explained that it could not confirm whether, in the event of significant issues arising in connection with SRIT, the AAO would be able to report to the Parliament, out with its formal relationship with the Scottish Government.

35. Whilst the Committee welcomes the provision of an AAO and commends willingness of HMRC and the AAO to engage with the Committee, we consider that the AAO role is that of a reporting officer. The Committee remains unclear what consequences, if any, would arise if the Parliament (or its Committee’s) expressed dissatisfaction to the AAO about HMRC’s performance.

36. In addition the Committee considers that there is the potential for a conflict of interest to arise given the AAO (whose responsibilities include safeguarding,}

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amongst other things, value for money for the SRIT) reports to HMRC’s Principle Accounting Officer whose assessment of value for money at the UK level may differ from that at the SRIT level. There is potentially more risk of this during times of fiscal constraint when decisions about the allocation of resources may require prioritisation of business requirements.

37. The Committee’s preference would for the AAO to be a statutory role with a reporting relationship to the Scottish Parliament similar to that of Scottish Accountable Officers. The Committee would encourage the Scottish Government to work with HM Treasury to determine whether the AAO for the collection of SRIT could be a statutory post. Until this can be achieved, the Committee is clear that the AAO, as presently established, is a reporting officer.

38. In oral evidence to the Committee, HMRC was not clear whether the Scottish Parliament has any formal power to call the AAO to appear before it. Although the Committee acknowledges the commitment given by the AAO that within reason he would be available to appear before Scottish Parliamentary Committees, we will seek clarification as to the extent that the powers to call for witnesses and documents (contained within the Scotland Act 1998) extend to HMRC and the AAO.