SUBMISSION FROM LOW INCOMES TAX REFORM GROUP

Who we are

1.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes.

1.2 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT’s primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

2 Scottish rate of income tax – effect on low-income, unrepresented taxpayers

2.1 Question 4 of the Call for Evidence asks:
‘The Scotland Bill proposes a Scottish income tax derived from reducing the UK rates by 10 pence and giving the Scottish Parliament the power to add a fixed amount on to each of the basic, higher and additional rates. The block grant will be reduced to accommodate for these tax-raising powers, by an as yet unspecified mechanism. What do you think the effect of these proposals will be on (a) the finances of the Scottish Parliament and its ability to fund public services and (b) the ability of the Scottish Government to stimulate economic growth?’

2.2.1 As our mandate is to represent the interests of the low-income unrepresented taxpayer, our sole concern with the Scotland Bill is with the likely effect on that constituency of introducing a Scottish rate of income tax. Although Question 4 does not focus on that aspect of the Scottish rate, we are concerned that its innate complexities could lead to high levels of both taxpayer and official error unless the measure is very carefully implemented, with robust computer systems and accurate, comprehensive guidance to back it up.

2.2.2 The likelihood of error is greater still when set alongside other changes to the administration of the UK tax and welfare happening at the same time. As the House of Commons Scottish Affairs Committee has observed, this could result in an unacceptable burden falling on small businesses, employers and individuals. It is also likely to increase the burden of compliance on unrepresented taxpayers who will have to bear the consequences of any system malfunction or mistakes by officials.

1 See the Report on the Scotland Bill by the House of Commons Scottish Affairs Committee (Fourth Report of Session 2010-11, HC 775-1) to whose inquiry we submitted written evidence (Ev w25). See in particular para 67ff of the Committee’s report.
2.2.3 In short, too much complexity could damage growth if the taxpayer is expected to shoulder the burden with no help from the State.

3 Technical issues

3.3.1 Already individual taxpayers face a multiplicity of tax rates and thresholds: above the appropriate personal allowance, a basic rate of 20%, higher rate of 40%, additional rate of 50%, a starting rate for savings of 10% for taxpayers with low incomes and small amounts of savings, and three rates of tax on dividend income – the ordinary dividend rate of 10%, then an upper dividend rate of 32.5%, and finally an additional dividend rate of 42.5%.

3.3.2 On top of this complex pattern of allowances, rates and thresholds, Scottish taxpayers will soon be paying tax at the Scottish rate on their non-savings income, instead of the basic, higher and additional rates, but alongside the UK rates on their savings income (or the starting rate on savings if so entitled) and the dividend rates on their dividend income.

3.3.3 If the new arrangements are to succeed, Scottish taxpayers will need to understand what income is taxed at the Scottish rate, what income is taxed at the UK rate, and how the Scottish rate interacts with (for those on low and modest incomes) universal credit or other means-tested benefits. There will be a need for abundant guidance that is comprehensive and comprehensible, as well as easily accessible for all.

4 PAYE reform and the introduction of real-time information

4.4.1 By the time the Scottish rate is implemented, the PAYE system will have undergone two major reforms – the National Insurance and PAYE System (NPS) in 2010, and Real-time Information (RTI) scheduled for 2013.

4.4.2 According to the National Audit Office HMRC are now making significant progress in stabilising the administration of PAYE. However, there remains a huge backlog of records which the PAYE computer system that preceded NPS was unable to match to individual taxpayers and which HMRC, affected by staffing cuts, were unable to process manually. The problem affects mainly those people who have had more than one source of income within PAYE, typically pensioners with (say) a state pension, occupational pension, late spouse’s pension, small annuity, and perhaps a wage from part-time employment.

4.4.3 The introduction of NPS in summer 2010 has begun the task of updating taxpayers’ records and grouping them by taxpayer rather than by source of income. Once NPS has bedded down, the high error levels affecting mainly taxpayers with more than one source of PAYE income should decrease.

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2 National Audit Office: HM Revenue & Customs 2010-11 report and accounts, esp R8ff and R31ff.
4.4.4 But there remains a considerable backlog which is being manually checked at present\(^3\). The success of the next stage of PAYE reform – real-time information (RTI) whereby employers and pension providers will simultaneously pay remuneration or pensions and supply the requisite PAYE and NIC data to HMRC – will depend on this backlog being fully cleared by the proposed start date of April 2013. It will be necessary to eliminate as many existing errors as possible, and prevent new ones from arising, in order to start RTI in 2013 with a clean set of data for each taxpayer.

4.4.5 The success of the introduction of the Scottish rate of income tax will, in turn, depend upon RTI running smoothly by that time.

4.4.6 The experience of the last 12 months shows that if HMRC undercharge tax through PAYE, the taxpayer still has to pay the full amount in due course. There are only limited circumstances in which HMRC will allow remission of debts incurred through official error.

4.4.7 The clear message to Scottish taxpayers is that they cannot rely on the State to ensure their tax is right, and will bear the financial consequences if it is not. As the NAO has warned\(^4\), there is little time between now and the planned introduction of RTI for HMRC to clear the backlog of unmatched PAYE records and to finish stabilising the system, and similarly a short time between then and the proposed introduction of the Scottish rate in which to resolve any teething problems that might accompany the start of RTI. The schedule is extremely tight, and any slippage could see a return to the PAYE difficulties of the past 12 months, albeit confined to Scottish taxpayers.

5 Non-PAYE income

5.1.1 It is also worth noting that not all non-savings income subject to the Scottish rate will be income subject to PAYE. Income from self-employment and property will have to be accounted for separately.

6 Interaction with means-tested benefits

6.1.1 Also scheduled for 2013 is the introduction of universal credit (UC) which will gradually replace income-based jobseeker’s allowance, income-related employment and support allowance, income support, housing benefit, council tax benefit, child tax credit and working tax credit.

6.1.2 Like its predecessors, a person’s entitlement to UC will be based upon their net income, ie their income after tax and National Insurance contributions. Thus, if net income for UC purposes takes account of the Scottish rate, and the Scottish rate differs from the equivalent rate applicable in the rest of the

\(^3\) ibid

\(^4\) Ibid, R29
UK, the UC entitlement of the Scottish taxpayer will follow suit. Thus, if the Scottish rate when introduced is set lower than the basic rate, the UC entitlement of the Scottish taxpayer will decrease; if it is set higher, then the Scottish taxpayer’s UC will go up. It is not yet known whether the DWP plans to take into account any difference in paying benefit to Scottish taxpayers, or whether it will be up to the recipient to check that they are receiving the right amount of benefit taking into account their tax liability. Getting it wrong will mean that the claimant will either lose benefit to which he is entitled, or be overpaid with the risk that the DWP will want to recover the overpayment when the error comes to light.

6.1.3 Sir Kenneth Calman seems to recognise this issue in his report\(^5\), but notes that the devolved administration will be able to make or receive payments to the UK Government departments directly in respect of such costs. Given the complexity of the interactions, this can be only a partial solution.

6.1.4 There is also a power under what will become Section 80G of the Scotland Act 1998 for the Treasury to make an order excluding or modifying the effect of various enactments in consequence of the introduction of the Scottish rate. If exercising this power could affect the calculation of the benefits entitlement of a person subject to the Scottish rate\(^6\), any statutory instrument should be laid in draft with sufficient time for comment and consultation before coming into force.

7 Impact assessments

7.1.1 Because of the complications discussed above, the fiscal proposals of the Scotland Bill are likely to bear most heavily upon Scottish taxpayers on a low income who are unable to afford professional advice. Therefore an equality impact assessment should be carried out well before implementation, and any mitigation action identified should be set in train at an early stage.

7.1.2 The best form of mitigation will be clear comprehensive and accurate official guidance easily accessible to the general public, both online and in paper form for the benefit of those without access to the internet.

Low Incomes Tax Reform Group
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\(^5\) Serving Scotland Better: Scotland and the United Kingdom in the 21\(^{st}\) Century (June 2009), para 3.95

\(^6\) Page 41 of Strengthening Scotland’s Future suggests that the effect of the Scottish rate will be taken into account when determining benefits entitlement.