OFFICIAL REPORT
AITHISG OIFIGEIL

Public Audit and Post-legislative Scrutiny Committee

Thursday 23 March 2017

Session 5

The Scottish Parliament
Pàrlamaid na h-Alba

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PUBLIC AUDIT AND POST-LEGISLATIVE SCRUTINY COMMITTEE
8th Meeting 2017, Session 5

CONVENER

*Jenny Marra (North East Scotland) (Lab)

DEPUTY CONVENER

*Liam Kerr (North East Scotland) (Con)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)
*Monica Lennon (Central Scotland) (Lab)
*Alex Neil (Airdrie and Shotts) (SNP)
*Gail Ross (Caithness, Sutherland and Ross) (SNP)
*Ross Thomson (North East Scotland) (Con)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Steven Corbishley (National Audit Office)
Caroline Gardner (Auditor General for Scotland)

CLERK TO THE COMMITTEE

Terry Shevlin

LOCATION

The Adam Smith Room (CR5)

Scottish Parliament

Public Audit and Post-legislative Scrutiny Committee

Thursday 23 March 2017

[The Convener opened the meeting at 09:30]

The Convener (Jenny Marra): Good morning and welcome to the eighth meeting in 2017 of the Public Audit and Post-legislative Scrutiny Committee. I ask everyone to switch off their electronic devices or to switch them to silent mode so that they do not affect the committee's work. This morning, in particular, I ask everyone to double-check that they have done that.

I am sure that all members will wish to join me in sending our condolences to the families and friends of those who lost their lives in London yesterday, and in paying respect to all those who displayed outstanding bravery in trying to help others.

There will be a minute's silence across the Scottish Parliament this morning in solidarity with our colleagues at Westminster. At 9.33, I will invite all witnesses, members of the public in the gallery and staff to join committee members in observing the silence. We will then resume our business. The cameras will be on us as we observe the minute's silence, so please bear that in mind.

09:33

A minute's silence was observed.

Decision on Taking Business in Private

09:34

The Convener: Our first item of business is a decision on whether to take agenda item 3 in private. Do members agree to do that?

Members *indicated agreement.*

"The Administration of the Scottish Rate of Income Tax 2015-16"

09:34

The Convener: Under agenda item 2, we will take oral evidence on the Comptroller and Auditor General's report entitled "The Administration of the Scottish Rate of Income Tax 2015-16". I welcome to the meeting Steven Corbishley, who is director at the National Audit Office, and Caroline Gardner, who is the Auditor General for Scotland.

Unfortunately, Sir Amyas Morse, who is the Comptroller and Auditor General, is not able to attend today's meeting. He was caught up in the lockdown at Westminster following yesterday's events and could not leave until very late in the evening. Therefore, Steven Corbishley will provide an opening statement in his place.

Before I invite opening statements, I will briefly explain why we are taking evidence from both the National Audit Office and the Auditor General for Scotland. Since April 2016, the Scottish Parliament has set a Scottish rate of income tax. The accounts of HM Revenue and Customs, which is responsible for collecting and administering the SRIT, are audited by the National Audit Office on behalf of the Comptroller and Auditor General.

To ensure that HMRC's collection and administration of the Scottish rate of income tax are subject to scrutiny by the Scottish Parliament, the Comptroller and Auditor General is required to report to us. In turn, the Auditor General for Scotland provides additional assurance on that audit work by also submitting a report to the Scottish Parliament.

I invite an opening statement from Caroline Gardner, to be followed by an opening statement from Steven Corbishley.

Caroline Gardner (Auditor General for Scotland): Thank you, convener.

The Scottish Parliament's financial powers are changing substantially, as a result of its gaining new responsibilities for taxes, social security and borrowing through the 2012 and 2016 Scotland acts. My latest report on progress across the new financial powers was published today, and I look forward to briefing the committee on that report at a later date.

The purpose of today's session is to look at the auditing of one element of the new powers, which is the Scottish rate of income tax. Specifically, the reports that the committee has before it relate to 2015-16, during which time preparations for implementing the first tranche of devolved income tax powers continued, prior to their introduction in April 2016.

In considering the reports, it is important to bear in mind the respective responsibilities of those involved. First, on income tax, HMRC is responsible for the collection and administration of the tax, and for the project to implement the Scottish rate. The Scottish Government is responsible for funding the project and for seeking assurances that the new system collects the correct amount of tax.

Secondly, on the respective responsibilities for auditing, the National Audit Office audits HMRC's accounts, and the Comptroller and Auditor General is responsible for reporting to the Scottish Parliament on HMRC's administration of Scottish income tax. I report to the committee to provide it with additional assurance on the NAO's audit work, in line with a recommendation from the predecessor Public Audit Committee. This is the second year of that arrangement.

In summary, my report says that I am satisfied that the NAO's audit approach was sufficient and robust, and that it covered the key audit risks. I am also satisfied that the findings and conclusions in the Comptroller and Auditor General's report are reasonably based.

I will pass on to Steven Corbishley to provide opening remarks on behalf of the Comptroller and Auditor General on the outcome of the audit work at HMRC on the administration of the Scottish rate of income tax.

Steven Corbishley (National Audit Office): Good morning. I pass on Sir Amyas's apologies for not being with you today. He wanted to be here, but circumstances meant that he was unable to make it, which I am sure that you will understand. I am deputed to take our report forward, so please bear with me as I take you through it.

As has already been pointed out, the C and AG's role in respect of HMRC is to scrutinise the accounts that it produces, to oversee the value for money programme and to report to the United Kingdom Parliament on those activities.

However, as the convener alluded to, the C and AG has powers under the amended Scotland Act 1998 to report to both Westminster and the Scottish Parliament on HMRC's administration of the Scottish rate of income tax, because of the devolved nature of certain activities in HMRC, particularly in relation to the Scottish rate. That is why I am here today.

This is our second report, and in it we consider the implementation phases of HMRC's administration of the Scottish rate. Our first report, to your predecessor committee, covered 2014-15 activity. Today's report looks largely at activity in 2015-16, which, from HMRC's perspective, is the final formal year of the implementation process.

Our key findings in the report, which I will talk you through, look at the progress on some of the key risks that HMRC has faced in implementing the project. The year 2016-17—I realise that that is the year that we are just about to complete—is the first year for those devolved powers.

We will look at the effectiveness of the controls and the implementation when we audit HMRC's 2016-17 accounts for our next report. I might be able to talk you through some issues now, but some are still to be resolved by HMRC.

I am of course happy to take any questions on our report and to put our report in context. However, as you will probably appreciate, some questions might be better directed to HMRC in due course.

We have worked closely with the Auditor General for Scotland and her colleagues, under our memorandum of understanding, to help her to provide assurances on the work that we have done. It is safe to say that it is a very good, challenging and productive working relationship, which we valued greatly when pulling the report together.

We are in your hands, convener.

The Convener: Thank you very much. We will move to questions.

Colin Beattie (Midlothian North and Musselburgh) (SNP): I am looking at page 11 of the report, in connection with the error in the design of HMRC's taxpayer identification. HMRC does not have a great track record on information technology. Was there any cost to the Scottish Government of that error?

Steven Corbishley: There was a cost, but HMRC tells me that it has not passed it on to the Scottish Government. The cost was around £150,000.

Colin Beattie: It was £150,000.

Steven Corbishley: Yes, that was the cost to put the error right.

Colin Beattie: The Scottish Government did not have to cough up that money, so to speak.

Steven Corbishley: HMRC tells me that it did not.

Colin Beattie: Good.

Paragraph 2.5, on page 16, says that

"approximately 850,000 records with a Scottish postcode were not flagged as Scottish", and that HMRC

“estimated that 420,000 of the 850,000 ... were potential Scottish income taxpayers”.

Why is that difference there? HMRC identified 850,000 people who apparently could be Scottish taxpayers, but that figure was suddenly halved.

Steven Corbishley: HMRC is of course a tax-gathering authority, but it also pays tax credit and child benefit, so, through the whole suite of its activities, it holds records on various people who might be regarded as Scottish taxpayers. Further distillation by a data analysis process honed those records down to the figure of about 400,000 that we talk about in that paragraph. They are potential Scottish taxpayers, as opposed to people who have a record in HMRC’s database.

Colin Beattie: Are you saying that the balance of 430,000 records are for people who are on a benefit, as opposed to being potential taxpayers?

Steven Corbishley: Or that they have some other type of record, which does not necessarily mean that they are potential taxpayers. In a nutshell, yes.

Colin Beattie: If they are on a benefit and they get a job, will HMRC pick that up?

Steven Corbishley: That is what the process was designed to look at. HMRC would argue that, when the database has been properly cleansed and is being maintained, it will be able to pick up whether someone is a Scottish taxpayer. The flow of people moving from benefit into being a taxpayer is more of a question for HMRC, but it is not a linear process, obviously.

Colin Beattie: It all seems a wee bit hit and miss, and as if everyone is feeling their way. I am looking at paragraph 2.12 on page 18, which suggests that we are very reliant on employers doing the right thing in order to maintain the list of taxpayers.

Steven Corbishley: Pay as you earn is managed by employers on behalf of HMRC through a real-time information system, so an awful lot of that particular tax stream relies on employers doing the right thing with the flow of information to HMRC. HMRC has a clear duty to ensure that it captures people in the right way so that Scottish taxpayers are flagged.

However, it is not all about HMRC; there is a lot of discussion with the employer community about ensuring that their information is right. When HMRC comes to cleanse its information, it relies a lot on employer information.

Colin Beattie: In paragraph 2.31 on page 24, you say that

“75% of large businesses have a workforce that is partially Scottish.”

There was some debate at the very start of this process about how big businesses that operate across the border would be able to identify and flag Scottish taxpayers. Has that been resolved?

Steven Corbishley: That is work in progress from HMRC’s perspective. The reaction to the taxpayer identification exercise at the tail end of last year was to consider how HMRC could test its data against information from larger employers such as the Scottish Government. Employer datasets can be compared with the information that HMRC holds in its own records. HMRC will continually refine the information that it uses to identify Scottish taxpayers—it does not just fall off a big cliff. Clearly, HMRC’s database needs to be maintained day after day and year after year. The maintenance of the database is on-going.

09:45

Colin Beattie: Given all those elements, how confident are we that we have captured the real number for the income tax that is being collected in Scotland? At some point in the report, a 4 per cent error rate is indicated. Paragraph 2.31 suggests that there is an issue regarding 25 per cent of employers and their responsibility to log workforce changes. How close are we to getting a real figure?

Steven Corbishley: The easy answer is to say that we will look at that while looking at 2016-17. It is something to explore with HMRC, which has told us that it is continually refreshing and looking again at its database to ensure that it achieves the clear objectives that were rightly set out for this project.

If you ask me to give assurances, I will defer that until we have done some hard audit of the 2016-17 figures, as they start to come through. HMRC is moving in the right direction—that is as far as I would go at this point. It still needs to do work on the on-going maintenance of its database.

Colin Beattie: You are doing the auditing. Do you have a feel for what the real error rate might be?

Steven Corbishley: No, we do not. What shook us all were the 420,000 misidentifications—if I can put it that way—in the first scanning exercise, a year ago. That seemed to have been a procedural formulaic issue that led to a number of people being missed off the initial mailing list. HMRC’s actions will bring the number of misidentifications down to a reasonable figure. There will never be 100 per cent accuracy in that part of HMRC’s activity, because of the flows of people moving house and moving in and out of Scotland. It will never be 100 per cent, but it should be materially correct.

Colin Beattie: As an auditor, what would you say that a reasonable percentage accuracy would be?

Steven Corbishley: You are testing me a little. I would not like to be pressed on that at this point.

Ross Thomson (North East Scotland) (Con): One of the key findings in the report is that, as a result of the divergence of tax rates or thresholds between Scotland and the rest of the UK, there could be

"a significant amount of tax at risk".

Could you explain what is meant by "significant"?

Steven Corbishley: What we are saying is that, as the rates and the thresholds diverge, which we have already seen for 2017-18, it is essential that HMRC maintains its database of Scottish taxpayer records. Otherwise, when it comes to the block grant calculations down the line, there will be a miscalculation and a lot to catch up on as HMRC reconciles the process.

It all depends on the records and how those are extracted to do the calculations for block grant purposes. That is the risk, and it is one that HMRC understands. It knows that it must get down to a reasonable level of accuracy. We have just discussed the issue of what is reasonable.

Ross Thomson: The report highlights that a significant amount of tax could be at risk. Looking to the future, there are two other risks—political decisions could be made to increase the rate of income tax and the United Kingdom Government could raise the UK threshold in line with inflation. Scots could potentially be paying £1,000 more in tax over the next five years.

What work is HMRC doing to mitigate those risks?

Steven Corbishley: Decisions to vary tax are political ones, particularly when there is a national divergence. I do not want to sound as though I am a mouthpiece for HMRC, but it might argue that keeping track of taxpayer records and who is paying tax in the right way is fundamental to following through the financial consequences of those political decisions.

Ross Thomson: How confident are you that HMRC has the ability to do that?

Steven Corbishley: As I have just mentioned, quite a lot of work has been done since the original lack of identification a year or so ago. There has been a continual process of refining, getting other data sources and checking those against HMRC's own records. It is an on-going maintenance issue for HMRC. It is not a static position by any means. Provided that HMRC has in place an on-going process—one that works—to maintain the accuracy of its database, that will address the issues that you have talked about. As rates diverge, it will become much more important to ensure that it does that. HMRC would argue that it is having an on-going discussion with the Scottish Government about how it carries on refining that within the cost envelope that it has.

Ross Thomson: What will you be doing to monitor how it meets those challenges? Will you continue to look at that?

Steven Corbishley: Yes, we will. Statute requires us to report to Westminster and the Scottish Parliament on on-going developments and debate, which we do annually, of course.

Ross Thomson: Although this is a slightly different point, do you know whether any work is being done to look at the wider economic impact of those risks, if there is a significant risk around tax?

Steven Corbishley: I would probably pass on that question. That would be a matter for you to take up with the Scottish Government. I am sure that the answer is yes, but I would not have the evidence on that.

Liam Kerr (North East Scotland) (Con): Good morning. I have a quick follow-up to Ross Thomson's question, the answer to which I hope will help me out. We have a slightly divergent tax system already, and it is not inconceivable that it will continue to diverge. What I read is that the system is based on addresses, which means that where I live determines where I pay tax. If I live within commuting distance of the border, is it not open to me to relocate to a lower-tax jurisdiction if I believe that to be financially beneficial to me?

Steven Corbishley: I am not here to act as your tax adviser. [*Laughter*.] However, that could be a legitimate response if you felt that to be the case.

As we have discussed, the residency test is not necessarily just about an address; it is about where your home is. If your home and your family are based on the English side of the border and you work in Scotland but do not live there, you would be classed as a rest-of-the-UK or an English taxpayer for the purposes of that exercise. Where HMRC can prove, or it is shown, that your home is in Scotland—that that is where your children go to school, for example, and that is where your family live—that test would be one of a whole series of factors that HMRC would apply to such a cross-border issue. At the end of the day, if it comes down to numbers of days, it will exercise that formula as well. However, it is not just a simple matter of the number of days that you spend in a place; it is about where you are deemed to live.

Liam Kerr: I see.

Steven Corbishley: Of course, there is an issue about whether that is avoidance or whether you might be trying to do something that defrauds the tax system.

Liam Kerr: Indeed. Thank you.

I am interested in the fact that, when the system was set up, a significant number of Scottish taxpayers were missed, as Colin Beattie pointed out. That was then notified to HMRC by other stakeholders. I am slightly troubled by that. Would you not have expected that, when such a system was designed, HMRC would have put in some kind of check and balance that said, “The system is now working. Now let us check that it is working”?

Steven Corbishley: Yes.

Liam Kerr: Will you talk to me about that?

Steven Corbishley: I agree. I could not really say any more than that. The problem arose when HMRC did its original interrogation of the system. As we discussed earlier, the parameters that it used to go through its whole record data set missed out an aspect of the information. It assumed that the postcode field was filled in and therefore that the system would take the information based on that field. However, not all the information was input with a postcode involved, and that is why some Scottish taxpayers were missed.

Figure 4 in our report is a little diagram setting out a—dare I say it—back-of-an-envelope assessment that shows that, if those factors had been taken into account, HMRC might have judged that, in reality, the actual number of taxpayers that were being hit was far below its tolerance level, which should have sounded alarm bells in people’s heads.

I have to say that HMRC reacted pretty quickly after the stakeholder conversations over December and January, when it realised that the issue had to be fixed. I guess that you and other colleagues in your offices will have done that straw poll—“Have you had your letter yet?”—and that was part of the debate of which it was the recipient. It then recast the formula to fix the problem.

Liam Kerr: Is it not extremely concerning that it “assumed” that the information was included and that alarm bells “should have” sounded?

Steven Corbishley: Yes.

Liam Kerr: After all, we are talking about vast sums of money—this is the revenue that the state has to spend.

When HMRC found out what had happened, it built an interim solution. Why had the interim solution not been built already, just in case?

Steven Corbishley: HMRC’s IT systems are largely legacy based. It spends an awful lot on refining and augmenting its systems across the whole of its tax base, and it has a schedule of developmental work, of which this will be a part. It is not just a matter of pressing a few buttons to make things right; it needs to have a profile of IT work in place to correct things, and this will be part of that. That is why it had to put in place an interim solution prior to the final strategic solution, which came into effect in October and which we will look at in due course to see how effective it has been. It has taken a long time to get to this point, because of all the other work that HMRC has had to do.

Liam Kerr: This will be my final question for now, although I might seek to come back in later, convener, if you do not mind. Given all that you have said, the sums involved and the importance of what we are talking about—after all, this money funds what we do all day—can HMRC guarantee that the same thing will not happen again?

Steven Corbishley: My glib answer would be that that is a question that you would need to put to HMRC. However, as I have said, HMRC has told us—and we will test this over the next few months—about how it is refining its database of information. It has picked up on the missing 400,000 whom it did not initially identify, and it is continually revising that database to the point that it is now funnelling things down to having an acceptable number of people—if there is such a thing—who are never really captured because of all sorts of other dynamics. The question, though, is how successful it is being with all those refinements and that on-going maintenance of its database.

HMRC has told us, “Well, we’ve done an awful lot of work since then, and we’re learning the lessons from all that.” It says that it is continually checking its database and its records alongside information that is held by significant employers in Scotland and is ensuring that, for example, someone who it knows works in the Scottish Government has a Scottish flag on its database to ensure that the tax implications are picked up. It is that continual data cleansing that will make this right—or rather, that is what the success of the project will rest on.

Monica Lennon (Central Scotland) (Lab): Good morning. Going back to the 420,000 taxpayers who did not receive the initial letter that 2.45 million individuals received in December 2015, I would say that that potentially creates a less informed group of taxpayers. What are the practical implications of that?

Steven Corbishley: Forgive me—the practical implications of what?

Monica Lennon: The practical implications for the 420,000 people who did not receive the letter in December 2015. I appreciate that they received a P2 coding notice later on, but what are the issues for those people?

Steven Corbishley: Part of the fix by HMRC is that those individuals have now been identified as Scottish taxpayers, so the rates that they will be subject to will kick in automatically in their tax calculations. I know that they have been captured, and they now fall into the normal tax assessment processes.

Figure 6 on page 19 of our report sets out what the purposes of those letters were in the first place. It is clear that all of us as individual taxpayers have a responsibility to keep our records with our respective tax authorities up to date. There is a duty on us all to ensure that information is held.

10:00

The red bars in figure 6 show when the letters were issued, but the yellow line in the figure shows that the spikes in the number of people updating their records on HMRC's database did not necessarily follow their receiving a letter informing them that they were Scottish taxpayers. You can see that a number of hits follow way after people received a letter.

HMRC has a continuing communication campaign through means other than the issuing of a letter to ensure that people do the right thing and keep their information up to date. That is the same throughout the UK, of course. It is good that HMRC has told people the consequences of what is happening and the importance that it attaches to individuals ensuring that their records are up to date with the tax authority, but the letter is not the only means by which it has communicated the impact or will continue to communicate it.

Monica Lennon: Can the committee be confident that no one has been disadvantaged by being less informed than other people?

Steven Corbishley: We have pointed to the fact that the people who did not get the same information in the coding letters and the process from the interim solution as the other 2.45 million people might be at a disadvantage in not getting those letters.

The Convener: One of the key facts on page 4 of the report is that the Scottish Government has reimbursed HMRC £8.4 million for implementing the Scottish rate of income tax. Is that correct?

Steven Corbishley: In the 2015-16 financial year.

The Convener: So the Scottish Government has paid £8.4 million for the implementation of SRIT. Is that correct?

Steven Corbishley: It is correct.

The Convener: I am looking at the cost of that compared with what we raise in tax. The Government in Holyrood has set tax rates at the same level as the British Government with the exception of the threshold for the 40p rate. Can either of the witnesses tell me how much the Scottish Government will raise in the next financial year by not raising that threshold?

Steven Corbishley: I cannot.

Caroline Gardner: We can tell you. I do not have the figure before me at the moment, convener, so I will come back to you after the meeting.

The Convener: I know that you are not in the business of giving rough estimates, Auditor General, but would it be more than £8.4 million?

Caroline Gardner: Absolutely—the estimate for what the Scottish rate of income tax was likely to raise in 2015-16 was £4.9 billion. The reconciliation has not yet been done. It is important to note that the preparations put in place for the Scottish rate of income tax are the same arrangements that will support the full devolution of non-savings, non-dividend income tax from this April, when the amount involved is forecast to rise significantly to more than £10 billion. That is the scale of comparison.

The Convener: Correct me if I have not understood this correctly, but that £10 billion is the whole of the Scottish rate of income tax. I was looking for a rough estimate of the figure that will be raised by not raising the threshold for the 40p rate. We will pay that rate at £43,430 and taxpayers in England will pay it at £45,000, which is quite a small divergence. How much will be raised by not raising the threshold in Scotland?

Caroline Gardner: We have a figure for that, but I do not want to mislead the committee by taking a stab at it here, so I will come back to you shortly after the meeting with what the estimate is.

The Convener: Is it likely to be more than £8.4 million?

Caroline Gardner: My recollection is that it is larger than that, but it would be more sensible to give you an accurate figure than it would be to take a stab at it.

The Convener: As you probably understand, the point that I am getting at is whether the decisions that the Scottish Government has taken on tax this year raise the budget in any way. I understand that the cost of implementing SRIT is probably in a different budget line from the tax income, but is that cost just offset by what the Government has done on the threshold for the 40p rate?

Caroline Gardner: That is the reason for the answer that I gave you initially, because the arrangements that have been put in place will cover the collection of most tax in Scotland from April this year. I guess that there will be decisions in the future about rates and bands up and down the scale that will have an impact, but I am not sure that it is particularly relevant to pick out that one shift in the threshold for 2017-18 in comparison with the £8.5 million. Steven Corbishley is looking to add to that.

Steven Corbishley: To be clear, the costs that we are talking about—which cover a longer period of time than just a year and which could be approximately £30 million—are for implementing the Scottish rate of income tax; they do not relate only to the marginal changes in thresholds.

The Convener: No, indeed.

Steven Corbishley: For example, as we point out in figure 1, the 10 per cent—the £4.9 billion that Caroline Gardner has already mentioned—would feed into that cost calculation.

The Convener: Okay. Thank you. My next question might be for Mr Corbishley. HMRC has centres around the UK and has several here in Scotland. Do you know where most of the work on Scottish tax is being done?

Steven Corbishley: I might be corrected on this, but a lot of the work is done in the Newcastle office, because that is where the payroll systems are monitored. The easy answer to your question is that the work is done in England.

The Convener: You will be aware that there has been a proposal by HMRC to close several of its centres across Scotland. I realise that this is a question for HMRC as well. However, from your point of view, Mr Corbishley, do the closures mean that we will lose essential skills in Scotland as the tax powers come in?

Steven Corbishley: You are right in saying that that question is more for HMRC. However, HMRC might argue, as it moves to a more regional tax office structure, that it has been able to maximise and improve the skills that people have to deal with the taxpayer community. In due course, we will assess how effective HMRC is in that regard. In January 2017, we published a report in which we looked at HMRC's plans for the regional office structure. Scotland clearly plays its part in that. However, the report looked at the high-level costing analysis and the impact on the skills base that you just referred to.

The Convener: Can you give us a brief indication of the conclusions that the report reached? What was the National Audit Office's take on HMRC's move to regionalisation and closures?

Steven Corbishley: In particular, we pointed to the fact that there are savings that can be realised and that it would be important for HMRC to secure those savings but not at the cost of the effectiveness of the service that HMRC provides to all taxpayers—both individuals and across the whole taxpayer base. We did not focus on any one nation or any particular group of regions but looked conceptually at the whole piece. It is about HMRC keeping an eye on the cost base and making sure that it can deliver the savings that are part of its business case. However, HMRC must also ensure that there is support to hand for the skills that people have to ensure that they can deliver the services that are expected of them.

The Convener: You say that there is a need to strike a balance between getting value for money and keeping the skills base. Is it the National Audit Office's opinion that HMRC has struck that balance?

Steven Corbishley: From our perspective, as we see the strategy being developed, that is yet to be determined.

The Convener: Okay. Thank you.

Liam Kerr: I have a couple of quick questions. You suggest in the report that, by its error, HMRC might have created a less-informed group of taxpayers. Can you explain what that means?

Steven Corbishley: If letters to 4 million taxpayers say that they are Scottish taxpayers, that means that, in due course, there might a different threshold for, or a different rate paid by, a small population that does not have the same information to hand to make its own decisions. As I mentioned, the impact of those letters might not yield that risk, but there is that particular risk.

Liam Kerr: A risk of what? What are the practical implications of creating a less-informed group of taxpayers?

Steven Corbishley: As a taxpayer, I need to tell HMRC of any change in my circumstances. If I move address within Scotland, for example, I must tell HMRC that I have changed my address. If I move into Scotland, I need to tell the tax authorities that I am now a Scottish taxpayer or that I live in Scotland, according to the definitions that we have just talked about. That is the kind of practical circumstance that I am talking about, and that helps HMRC with the on-going maintenance of its database.

Liam Kerr: I see. Let us move on to the fiscal framework. You will appreciate that I am no accountant, so this might take some time. From April 2017, the Scottish Fiscal Commission will have the responsibility to project ahead the income tax revenues for Scotland. In the light of our earlier conversation, is there a risk that it will say, “We can’t accurately predict our tax base, and therefore our tax take,” and that it will not be able to do its job properly?

Steven Corbishley: I will stumble through an answer—I hope that Caroline Gardner will help me. For any fiscal projection, you need a good basis of data, and in that respect the Scottish framework will be no different from any Treasury projections governed by the Office for Budget Responsibility. The SFC will need to know the veracity of that data in order to project, and there is a bit of a risk, as you point out, in trying to ensure that that is the case.

The block grant calculations are part of this, and they will continue to be refined and adjusted over a two-year period as part of the settlement that you will have as the new information on the taxpayer database that I have just talked about becomes available. The figure will not be just a one-year estimate; it will be refined for the following year, taking into account new information about how much taxpayers are paid, which will adjust the previous block grant calculation.

Caroline Gardner: Liam Kerr’s question takes us, understandably, into the territory of the report that I have published today on the next stage of implementing the new financial powers. I will give you a brief answer. I suggest that we come back to the detail a bit later on.

As you say, from April this year, the Scottish Government will have control of all non-savings, non-dividend income tax, and we have seen the prelude to that in the agreement of the 2017-18 budget in the Scottish Parliament over the past few weeks and months. Roles and responsibilities are shifting as those new powers come into place. The Office for Budget Responsibility is still making forecasts of the likely proceeds from Scottish income tax at this stage. As it becomes a statutory body, the Scottish Fiscal Commission is gearing up to take on responsibility for producing a wider range of forecasts, including Scottish gross domestic product forecasts, and there will be an estimate of the proceeds for income tax in there as well. However, under the fiscal framework, it is the OBR estimates that will be the basis for the block grant adjustment estimates that come through, and there will then be a reconciliation 18 months or so after the end of the financial year to look at the actual proceeds against the forecasts and to make the reconciliation to the block grant that is needed. It is complex, and the relationships, roles and responsibilities involve the OBR as well as the Scottish Government and the Scottish Fiscal Commission as things develop.

Liam Kerr: I was going to ask about the reconciliation. I hope that Caroline Gardner will forgive me if that is something that we should address at another time.

The reconciliation of the projected receipts and the adjustment to the block grant will happen 18 months hence. HMRC will say that there are X number of taxpayers in Scotland and the Scottish Government will then, I presume, budget against a particular take, and the block grant will be set against that level. What will happen if HMRC gets that wrong and says that there is more tax revenue coming in than actually comes in? For 18 months, the Scottish Government will have less money from the block grant and less money from its tax base, and it will be 18 months at least before there is some kind of reconciliation to make that right. Is that correct?

10:15

Caroline Gardner: You are absolutely right in saying that the identification of Scottish taxpayers is at the heart of all of this—not just for the Scottish rate of income tax that we are reporting on today but for the devolution of income tax as it comes into full effect next month. That is why the report is so important.

The assurance that we all have is that 2015-16 was the year before the 10p Scottish rate of income tax came into effect, and the problem was identified at that stage. That has been a useful wake-up call for HMRC and the Scottish Government about the importance of getting this right. You have heard from Steve Corbishley about the action that has been taken to correct that, but there is continuing concern about the fact that all of us, as taxpayers, have to understand our responsibility to keep our tax records up to date. That now matters much more for Scottish taxpayers than for taxpayers across the rest of the United Kingdom. Employers that have Scottish employees as the whole or a part of their workforce also have to understand their responsibility to keep their real-time information up to date.

All of that, which we are reporting on now, is happening at least 12 months before the full devolution of income tax and any divergence between the rates and bands that would have an impact on the amount that is collected for Scotland in that direct way. However, it has been a useful learning process for everyone to ensure that everything possible is being done to get the initial database right and to ensure that arrangements are in place for keeping it up to date thereafter. There is a separate set of complications around the forecast and the reconciliation of the block grant adjustments that will come into play from the new tax year, and that is a big part of the deliberations of the budget process review group that the Finance Committee, in particular, is interested in.

That is an indication of how important and complex the issue is. It is important that the Scottish Government, the UK Government and HMRC get it right.

Alex Neil (Airdrie and Shotts) (SNP): I want to ask a broader question, which might be more appropriate for HMRC but which concerns an issue that, I would have thought, impacts on the work of auditors.

Particularly in relation to higher-rate taxpayers, we are often told that increasing the rate of taxation or the point at which higher rates are paid leads to a loss of talent through those people moving abroad or, in this case, south of the border. I am told that three out of seven—or 43 per cent—of the taxpayers in Scotland who pay the 45 per cent rate, which kicks in at £150,000, are in the public sector. A lot of those people are doctors, and they would have little difficulty in getting good jobs elsewhere, either in the UK or abroad. I am not trying to argue that the alleged disincentive is confined to the private sector, because it could operate in the public sector.

From an auditor's point of view, is there any evidence that, if we increase the rate of income tax—I am talking about effective levels of income tax, whether that involves freezing allowances or increasing the rate—that will lead to an exporting of talent through people leaving the country? If so, is there any estimate of the elasticity that is involved? At what point do people decide that staying here is not worth the candle?

Part of the debate in Scotland at the moment is that, even though someone might pay a bit more tax than people south of the border, there are benefits to living here such as the fact that, if their residence were south of the border, their children would need to pay the full tuition fee if they came to a Scottish university, the fact that they would not get free prescriptions and so on. All those things together mean that the net impact—taking into account all the pros and cons—is positive. Obviously, the higher revenue take funds those services. However, I am specifically interested in whether there is evidence that higher effective rates impact on the export of talent abroad.

Caroline Gardner: I will have a first bash at answering that question, and Steve Corbishley can follow up.

There is an awful lot in that question—as you know—starting with the famous Laffer curve and economic theory, and that is contested. If we look at the issues in more practical terms instead of getting engaged in macroeconomic debates, we can say that we know that the shape of the taxpayer population in Scotland is different from that of the UK as a whole, particularly because of the south-east and London.

There are fewer higher-rate and additional-rate taxpayers in Scotland than there are in England. It is fair to say that we do not yet know enough about the behaviour of those people, in terms of either their ability genuinely to demonstrate that they are not Scottish taxpayers if they have a foot in both countries—as many higher-rate taxpayers do—or their willingness to genuinely make a move and their likelihood to do so. As you say, doctors and other professionals will be able to do that, given the demand for their skills elsewhere and—I am guessing—the pressures on public services if we reduce European Union migration following the result of the EU referendum. However, we do not know whether that will happen. It is an issue that both the OBR and, in particular, the Scottish Fiscal Commission are thinking about as they start to develop their ability to forecast and to refine their forecasts of the figures that will come from Scottish income tax in the future.

None of this has mattered before. As a result of the block grant, it has not mattered how much tax is raised in Scotland or what the behaviour of Scottish taxpayers looks like. That will now become very important as part of the overall performance of the Scottish economy relative to that of the UK economy. Some of the data sources are available but some will not be. When the committee has taken evidence on my report on the next stage of income tax, it may want to consider taking evidence from the Scottish Fiscal Commission, the Government and, potentially, others about what work they are doing to get a better understanding of those dynamics, which will be very important if they are to make good and effective decisions about taxation in Scotland for the first time.

Alex Neil: The reverse side of the coin is the assertion that—according to the Laffer curve—if we reduce tax rates, we increase the number of taxpayers and increase the revenue. If I were the minister for finance in Scotland, those are some of the initial questions that I would be asking to inform my strategy. If there was evidence that lowering rates increased revenue and that higher rates resulted in fewer people paying tax because they moved down south to avoid the tax, that would inform my decisions about what my strategy would be.

Convener, I think that we should consider commissioning our own independent research on the matter, because there is an important point about the future long-term security of tax income in Scotland. Given that the committee has the power to commission its own independent research, we should ask the clerks to prepare a draft paper on that. We would seek not to duplicate the work that has been done but to build upon it, because it is fairly fundamental to our role in looking at the revenue side. We tend to look more at the expenditure side, but, in looking at the revenue side, the answers to the questions that we are discussing are pretty fundamental to deciding what the right policy is.

The Convener: That argument has certainly been deployed by a couple of parties in the Parliament recently, Mr Neil, so it would be interesting to look at the issue. Do the witnesses want to add anything?

Caroline Gardner: SRIT is the central part of the powers that are being devolved to Scotland from April this year. I published a report today that looks at the roles and responsibilities and at the preparations that are taking place. It is clearly a matter of discussion in the Finance and Constitution Committee and other places, and we would be happy to help the committee with whatever work it decides to take forward.

The Convener: Thank you. We will consider that and pursue the matter. Do members have any further questions for the witnesses? Does Mr Neil have anything further to say?

Alex Neil: I just want a guarantee that Liam Kerr will not flit south of the border to dodge the tax.

Liam Kerr: I will stay here.

Monica Lennon: I have a brief question. Caroline Gardner mentioned people who have a foot in both camps—I assume that she means in Scotland and in other parts of the UK. How much of an administrative challenge will it be when people become more aware of some of the differences and the loopholes, if you like? How much of an administrative issue will that be for HMRC, for example?

Steven Corbishley: From paragraph 2.17 onwards, our report points to the compliance activity that HMRC will develop in respect of the issue that you raise. It comes back to the assessment of who is a Scottish resident for paying tax, which I have talked about. HMRC will develop its current strategy in earnest from now on, particularly because of the threshold. HMRC is well aware that it needs to keep on top of the issue, because of the risk that we talked about earlier.

The Convener: I want to ask about an issue that a few members have touched on. It is clear from your report that the key issues are the notification letter, communication and the identification of potential taxpayers in Scotland. Will there be a loss to the public purse because the communications have not been as good as we would have liked them to be?

Steven Corbishley: It is not just about the letters that have been issued. There are already other ways of informing taxpayers of what they need to do—HMRC certainly has other mechanisms for doing that.

The Convener: Indeed.

Steven Corbishley: If the database is not kept up to date or people are not aware of their responsibility to inform the tax authority of a change in their circumstances, the details will be misaligned to the taxpayer community, which is what we have just been talking about in relation to the block grant calculations. As we have discussed, the risk is that, if the information in the database is not correct, the Scottish rate of income tax calculations will not be correct. How much and by what degree that would lead to national economic calculations being adrift is what we have been talking about today.

The Convener: As one of my colleague has said, a lot of the responsibility falls on the taxpayers themselves, as they have to ensure that they provide up-to-date addresses. Does the process for income tax operate in the same way across the UK or is that a new requirement?

Steven Corbishley: Whichever side of the border we are on, we all have a duty to inform the tax authority of a change in our circumstances.

Caroline Gardner: That is right—every UK taxpayer has a duty to do that. In Scotland, it did not matter in the same way until income tax powers were devolved to the Scottish Parliament, because we all paid the same amount of tax wherever in the UK we lived. However, that position is changing, and the identification and maintenance of the taxpayer base and HMRC's compliance activity are central to ensuring that people pay the right amount of tax and that the Scottish Government receives the right level of revenue.

The Convener: Is it possible that someone who had a house in England and a house in Scotland could register to be a taxpayer in England? I understand that the criterion is residency for most of the year—that is referred to in your report. How would that be checked?

Steven Corbishley: That takes us back to some of my earlier answers. The reasonableness of how someone determines where their home is is tested. If a person's family lives in England but that person works in Scotland, they can prove to HMRC that they are an English resident and therefore an English taxpayer. If the case was the reverse, the taxpayer would be proved to be a Scottish resident. If HMRC needs further evidence, the number of days that a person physically lives in one country or another will determine whether they are a Scottish or a rest-of-the-UK taxpayer.

Caroline Gardner: Paragraph 2.29 of the C and AG's report talks about HMRC's compliance strategy for the Scottish rate of income tax, which is a key part of the issue. Given current tax policy, with the higher rate threshold being frozen in Scotland while it rises in England, I suspect that HMRC's compliance activity will focus on the people who fall into that band, particularly higher-net-worth individuals. Committee members may have heard of a group of people referred to as WILLIES—people who work in London and live in Edinburgh. Those are the people who will perhaps have the greatest opportunity to manipulate their tax status as tax policy diverges, and it is groups such as those that HMRC would be expected to focus on to make sure that the residency test is being applied rigorously and consistently.

Steven Corbishley: We point to that category of people—the very high earners—in paragraph 2.30. Regardless of where they live, they have an allocated relationship manager who deals with their personal tax affairs to make sure that they report the correct tax in the first place. Residency will, of course, be part of that assessment.

The Convener: Are you both satisfied with the HMRC's communication policy and that we will be able to identify taxpayers in Scotland properly?

Steven Corbishley: We will test that and see the outcome of all that in our work on the 2016-17 financial year. We have seen—and reported on—the line of travel, and we will see how HMRC continues to refine the database. I will respond to your question with a cautious "Yes", but we must test that against the outcome of the first year.

The Convener: A cautious "Yes".

10:30

Caroline Gardner: I have confirmed that I agree with and can provide assurance to the committee about the C and AG's findings. In paragraph 20 of my December 2016 report to the committee, I make the point that the Scottish Government needs assurance that, having gone through the initial phase, HMRC's taxpayer identification strategy is fit for the future, given its importance in making the overall devolution of income tax work in the longer term.

The Convener: Indeed—that is the page that I am looking at. I take it from your answer that you think that HMRC is going in the right direction but that the taxpayer identification strategy might need to be tightened up in order to assure the Scottish Government.

Caroline Gardner: Yes. You have seen in the C and AG's report the difficulties that were encountered in 2015-16. We are assured by HMRC that those difficulties have been addressed. We will be looking for that assurance and that the Scottish Government has in place the controls to ensure that it knows that its taxpayers have been identified and that tax is being collected as planned.

Colin Beattie: A question comes to mind, and I am not sure that it has come up in times past. Where are people who work in the oil industry deemed to be resident for tax purposes?

Steven Corbishley: It depends on where their home is, which takes us back to the residency test. They will have a home, and that is where they will be assessed to be resident. When the assessment is made, people must pass the first hurdle of being a UK taxpayer before we start to think about whether they are an English or a Scottish taxpayer. That might be relevant to the question as well.

The Convener: As there are no further questions from members, I thank both panellists for their evidence this morning.

10:31

Meeting continued in private until 10:54.

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