OFFICIAL REPORT
AITHISG OIFIGEIL

Public Audit and Post-legislative Scrutiny Committee

Thursday 15 June 2017

Session 5

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PUBLIC AUDIT AND POST-LEGISLATIVE SCRUTINY COMMITTEE
16th Meeting 2017, Session 5

CONVENER

*Jackie Baillie (Dumbarton) (Lab) (Acting Convener)
Jenny Marra (North East Scotland) (Lab)

DEPUTY CONVENER

*Liam Kerr (North East Scotland) (Con)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)
*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)
*Monica Lennon (Central Scotland) (Lab)
*Alex Neil (Airdrie and Shotts) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Jim Harra (Her Majesty's Revenue and Customs)
Derek Mackay (Cabinet Secretary for Finance and the Constitution)
Brian Taylor (Scottish Government)
Sarah Walker (Her Majesty's Revenue and Customs)

CLERK TO THE COMMITTEE

Terry Shevlin

LOCATION

The James Clerk Maxwell Room (CR4)

Scottish Parliament

Public Audit and Post-legislative Scrutiny Committee

Thursday 15 June 2017

[The Acting Convener opened the meeting at 08:50]

Decision on Taking Business in Private

The Acting Convener (Jackie Baillie): Good morning and welcome to the 16th meeting in 2017 of the Public Audit and Post-legislative Scrutiny Committee. I ask everybody to switch off electronic devices, or at least switch them to silent mode so that they do not interfere with the committee's work.

Before I move to today's business, I should mention that our former colleague Ross Thomson has resigned from the committee following his election as a member of Parliament. I place on record our thanks to Ross for his contribution to the committee and wish him well for the future.

Under agenda item 1, we are invited to consider whether to take items 4 and 5 in private. Do we agree to take those items in private?

Members *indicated agreement.*

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

08:51

The Acting Convener: Agenda item 2 is further consideration of the report by the National Audit Office entitled "The Administration of the Scottish Rate of Income Tax 2015-16". In March, we heard from the National Audit Office and the Auditor General for Scotland on the report and agreed to take evidence from Her Majesty's Revenue and Customs. I welcome Jim Harra and Sarah Walker, both of whom are from HMRC. As there is no opening statement, we will move straight to questions.

Colin Beattie (Midlothian North and Musselburgh) (SNP): I have pretty much the same question that I have asked in previous evidence sessions on the issue. It is about the identification of Scottish taxpayers. I believe that there is no definitive record or data set of Scottish residents against which to test your success in identifying Scottish taxpayers. In previous evidence sessions, we have tried to pin down the error margin and find out whether it is 5 or 10 per cent, but nobody has been able to tell us that. What reassurance can you give us that you have identified all the taxpayers?

Jim Harra (Her Majesty's Revenue and Customs): We have three tasks. First, we have to ensure that everyone in our database who has a Scottish address is properly flagged as a Scottish taxpayer. We then have to check the accuracy of our database and make it as accurate and up to date as possible. Then, we have an on-going job of maintaining that and continuously improving on it.

We have taken a number of steps to check our database against third-party databases. Where there is a difference between those, we have looked to see whether we can learn anything about our database management. For Scottish addresses on our database, we have run corroboration exercises with a number of third-party databases, such as the electoral roll and the databases of credit reference agencies and major retailers, and we have been able to corroborate between 98 and 99 per cent of the addresses that we hold. That does not mean that the remaining 1 to 2 per cent are wrong; it just means that they are not corroborated by anyone else.

We have also gained some reassurance that our processes for keeping our database up to date mean that it stands up to scrutiny compared to those other databases. In fact, where we found discrepancies between our database and the electoral roll, in the majority of cases, ours was the more up-to-date and accurate record. It is a question of continuously improving, but you are right that there is no definitive benchmark against which we can judge whether our database is at 100 per cent or 99 per cent completeness.

Colin Beattie: It seems that, mostly, you rely on postcodes. How accurate is that approach?

Jim Harra: We have a set of parameters that identify Scottish addresses in our database. Initially, we relied too much on postcodes and what we call the PAF—the postcode authentication field. We have since extended that scan, and we pick up addresses in lots of different formats. We have also carried out an exercise to identify addresses on our database that are incomplete—for example, those that do not contain a full postcode. We have done a cleansing exercise to bring that up to date.

A small number of postcodes straddle the English-Scottish border, so we cannot rely on postcode alone to determine who is a Scottish taxpayer. In those cases, we have taken further steps to identify which addresses in the postcode area need to be flagged as Scottish addresses.

Colin Beattie: You have mentioned checking against third-party databases—the electoral register, for one. Could you remind me what other databases you check against?

Jim Harra: Sarah Walker will give you some details about that.

Sarah Walker (Her Majesty's Revenue and Customs): We used a commercial firm that specialises in that sort of thing. It has a number of address lists—commercial credit agencies and places where people are registered to take deliveries from mail order companies. There are mobile phone and other commercial providers to which people have to provide an address, and those providers make their address lists available to commercial companies, so they are then available to compare with our lists. If you can identify somebody by name and address, you can see whether the same name and address appear on other lists.

Colin Beattie: Every time we order something by mail order, you guys are checking on that.

Sarah Walker: That is not what I am saying. I am talking about what is made available to commercial companies. We do not get all that information ourselves.

Colin Beattie: You purchase that information.

Jim Harra: You are right, in that your footprint with retailers, mobile phone companies and utilities is building a record in databases, which those commercial organisations all share, and we use that record to verify and validate our database. We do not just take addresses; when our record does not corroborate theirs, it does not mean that theirs is more accurate than ours, but it is something for us to investigate.

Colin Beattie: That is obviously an on-going process. How often do you go through it? Is it one big exercise every year, or is it on-going?

Sarah Walker: We are talking to the Scottish Government now about exactly how regularly we should do that comparison. We expect that we will do it every year. It is quite a major exercise. It costs money and it takes time to do, so I do not think that we would do it more often than that.

Colin Beattie: I was just about to come to the question of cost. Is it included in what you already charge the Scottish Government?

Sarah Walker: Yes.

Colin Beattie: It is not an additional cost.

Sarah Walker: No, it is not an additional cost.

Colin Beattie: I understand that 80,000 employers had problems with tax codes, but that the issue is now fixed. How was it fixed, and what was the real problem?

Jim Harra: As well as identifying people as Scottish taxpayers, we require employers to deduct the correct amount of tax from them. This year, 2017-18, the amount of tax is different from that in the rest of the United Kingdom for the first time. We send a coding notice to both the employer and the employee telling them what code to apply, to ensure that the correct amount of tax is deducted. We then have a programme of employer compliance checks to ensure that employers comply with their pay-as-you-earn obligations, apply the codes correctly in their payrolls and deduct the correct amount of tax.

When we go out on employer compliance visits, we find a very high level of compliance, with the lowest tax gap out of all the taxes that we administer. There are problems, however. Employers sometimes make errors. In the case of the Scottish code, we have found that, in some instances, the software programmes that employers use have not been updated to take account of what we call the S codes—the Scottish taxpayer codes. We have taken action both with employers, where we have found that they were making errors, and with the software providers, to ensure that they have the correct specification and update their products for their customers.

Colin Beattie: How widespread is that error?

09:00

Jim Harra: It has been very small in percentage terms, but it is there. I will explain what its impact would be.

We run a reconciliation exercise at the end of the year for each employee. At that point, we would pick up whether there had been an underdeduction of tax and correct it. There would be no impact on the Scottish Government's finances, but it would be undesirable from the taxpayer's point of view because, at the end of the tax year, they would find that they have an underpayment when, ideally, that would have been taken out of their salary over the year.

Despite the fact that we have a fail-safe reconciliation at the end of the year, the ideal is that the system operates correctly over the year. We have very high compliance rates and we are continuously improving on those. The key is to make sure that software providers keep their products up to date and that employers use the latest versions of those software products.

Monica Lennon (Central Scotland) (Lab): I am interested in the situation whereby 420,000 taxpayers did not receive the information that the other 2.45 million taxpayers received. The Comptroller and Auditor General said in his report that that

"may have created a less informed group of taxpayers".

Do you recognise that concern, and is it well founded?

Jim Harra: It is a possible concern. The 420,000 Scottish taxpayers who were not picked up in the initial scan received a written communication, but it was a different communication from the communication that was received by the other 2.4 million people. We sent letters out to 2.4 million people in December 2015, and the other 420,000 people received a pay-as-you-earn coding notice in early 2016-17, which specified that they had been identified as a Scottish taxpayer. That is our standard means of communicating with people on pay as you earn about the code that we apply to them. Everyone received a communication, but they were different communications for the two population sets. We have not seen any evidence that that has had a practical impact on the taxpayers.

Monica Lennon: Communication is clearly important so I am interested to hear about your wider communication strategy and its cost.

Jim Harra: Good communications are key to maintaining and improving the accuracy of our address database, so we continuously remind taxpayers, employers and tax agents of the need to notify us of changes in addresses. That is the key compliance activity that makes a difference.

There was an initial communication exercise that involved unpaid and paid communications, and that communication continues. For example, we use our regular contact with taxpayers and employers to remind them of the need to update their addresses. We used Twitter just two days ago to tell all our followers of the need to keep their addresses up to date. Sometimes that is specifically about Scottish addresses, but sometimes it is a general message to all taxpayers, which the administration of Scottish income tax benefits from, as does the administration of tax in the rest of the UK.

We can do a lot of effective communication that does not involve additional cost, and we can give advice on the additional benefit from paid communications, so the question is how much money the Scottish Government wishes to spend on paid communications. Most of the paid communication that we did in the early stages was targeted at specific groups of Scottish taxpayers whom we thought we needed to reach to make sure that they heard the message about keeping addresses up to date—they included people who live in areas of the Borders. It might not be good value for money to target groups that are more widespread than that.

Monica Lennon: You mentioned Twitter, which can be a very cost-effective way of getting a message out. How many followers does HMRC have on Twitter? Do you use Facebook and other social media channels?

Jim Harra: I think that we have 28,000 followers on Twitter, many of whom are professional associations and tax agents who spread the message more widely, and we also use other social media.

Monica Lennon: What assessment has been made of the communication strategy and the cost incurred to ensure that it provides value for money?

Sarah Walker: We did an evaluation of the publicity that we conducted at the time of the launch of the Scottish rate of income tax, which was when we sent out the letters. The evaluation suggested that a significant proportion—around 30 to 40 per cent—of the target population, who were people who had recently moved, people who live in the Borders and students, were aware of the campaign that we had conducted.

There was an increase in the number of people updating their address details on our website. We think that the campaign was effective at the time. We continue to use cost-free methods such as Twitter and our contacts with employers and agents, and we are talking with the Scottish Government about whether we should be doing more targeted communications to pick up people who move house.

If we are fairly confident that we have a good picture of what the static population was when we started, we need to make sure that we capture the changes—the people who move into and out of Scotland. We are thinking of using the data that we get from stamp duty, HM Land Registry—where people register the purchase of property—estate agents and other places to prompt people and remind them that if they have just moved into or out of Scotland, they have to tell HMRC. We are looking at what is the most cost-effective way of picking that up.

We also use our own digital services. We are conducting publicity to encourage people to sign up for a personal tax account online, through which they can manage all their tax affairs. That includes making sure that they are aware of the address that we hold for them and making it easy for them to update that information.

Monica Lennon: That is helpful, thank you. I am sure that our witnesses already follow the committee on Twitter, and I am sure that my colleagues will endeavour to follow you back by the end of the meeting.

The Acting Convener: I do not think that I have ever knowingly wanted to follow HMRC on Twitter—forgive me for that.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): Good morning. Is it not a bit disconcerting for the public to hear that, to a degree, HMRC relies on mail order companies and mobile phone companies to compile a definitive list of taxpayers?

Jim Harra: That is not what we do. I am glad that I have an opportunity to clarify the point. We regard ourselves as holding the database of who pays tax, but it is important that we check its accuracy against all other available sources, maintain its quality and learn and take action if any corroborative evidence tells us that we have a problem. Those things are a source of information that helps us to check what we have, but we are not reliant on them to maintain the database.

Sarah Walker: In no case have we replaced an address that we hold with an address that we have taken from that sort of database. The addresses that we hold, which we get primarily from the taxpayer and sometimes from employers, are always our primary source. The comparison with the commercial databases would lead us simply to raise a query, if you like. If they have a different address for someone, we assess whether we need to query that and make more inquiries, but we would not take the address in the commercial database in preference to the address that we hold.

Jim Harra: An outcome of the exercise that we have done is that we have not found any database that we would wish to use to overwrite ours. In the majority of cases, our database proves to be more accurate and up to date than the databases with which we compare it.

Willie Coffey: There are no cases where data that you have got from mail order companies or mobile phone companies has given you additional information to corroborate the information that you have on a Scottish taxpayer—you had the information anyway.

Jim Harra: We looked at whether the evidence from other databases tended to corroborate the address that we had, whether it caused us to raise a query about the address, or whether it did not tell us anything at all, which meant that the address that we had was uncorroborated and we had no evidence either way.

Where the other databases tend to corroborate what we have, we regard that as evidence that our databases are of good quality. Where they say something different from what our database says, that raises a query on our part, as Sarah Walker said, to go back to the taxpayer and check exactly where they live. Where the databases do not corroborate either way—a significant proportion provide no corroboration—we look at other factors to assess our data. For example, if we have an address for someone for whom the other databases do not show anything at all, but we know that they are employed by a chip shop in Aberdeen, the chances are that they are a Scottish taxpayer and our Scottish address for them is correct.

We learn from such comparisons—that is why we spend the money on the exercise—but they have tended to corroborate our Scottish addresses. As we said, between 98 and 99 per cent of them have been corroborated by that exercise and we have yet to identify a database that we think is a much better database than ours.

Willie Coffey: You mentioned addresses with partial postcodes in some of the data. How did you resolve that issue?

Sarah Walker: We work with Royal Mail in such cases and we have teams of people who go through individual addresses. If we have a road and a house number, we will work with Royal Mail to make sure that we have the right postcode on the record.

Willie Coffey: Why would that not have been done as a matter of course, to make sure that the data that you have is always correct? It only seems to have arisen because of the requirement to identify separate Scottish taxpayers.

Sarah Walker: It is a continuous process. We do that work year by year to make sure that we are keeping our addresses accurate but we have millions and millions of addresses; it is a constant process. This is the first time that someone's address has had an effect on their tax, which makes it even more important that those addresses are up to date, so we have put extra effort into making sure that the Scottish addresses are corrected.

Willie Coffey: What is to stop the problem continuing if people move around, as they generally do—particularly in relation to cross-border addresses? What is to stop those anomalies continuing to be part of the system?

Jim Harra: It is a never-ending task to maintain and improve the quality. It is not a static, one-off exercise. We have assessed that there are about 80,000 moves a year across the England-Scotland border—roughly half in each direction. If we did nothing and did not update our databases, they would degrade over time, so it is a continuous exercise.

We get a continuous flow of data—for example, taxpayers contact us all the time to tell us that they have moved house; employers contact us all the time to say that they have taken on a new employee and to give the employee's address; and we periodically run those corroboration exercises against the commercially available databases, which throw up cases for us to query. It is a never-ending process.

Willie Coffey: Lastly, in the dataset that you have, is the solution not as simple as allowing people themselves to identify the country that they live in?

Sarah Walker: That is exactly what we want people to do.

Willie Coffey: Are you doing that now as a matter of course?

Sarah Walker: Yes, we rely on people to give us their address and that is how—

Willie Coffey: Yes, I know that, but do you ask people to give you information about which country they live in—Scotland, England, Wales or Northern Ireland?

Sarah Walker: For self-assessment, we will. Where people are filling in a tax return, there will be a specific question asking, "Are you a Scottish taxpayer?" We need to have people's addresses for all sorts of purposes and that is our main source of information for this. If they are prepared to tell us that they are a Scottish taxpayer, they ought to be prepared to tell us their address because we need it anyway.

Willie Coffey: Yes, I know that—I understand what you are asking there but that is not what I am asking. Are you asking people to give the country that they live in? They may be a Scottish taxpayer or they may think that they are not a Scottish taxpayer, but do you ask them whether they live in Scotland, England or elsewhere? Do you ask them that information so that you can record it? You were talking about S codes—

Jim Harra: It is important to understand that there are only about 9 million taxpayers in the whole of the UK who have to complete a self-assessment return and therefore are under an obligation to tell us that information. They will be asked for that information on their self-assessment return.

For the vast majority of taxpayers, their affairs are administered between HMRC and their employer and there is no obligation for them to get in touch with us. Therefore we have to look for data that tells us where they live. The address is the key thing. We have not gone down a route of asking all taxpayers to declare the country in which they live for tax purposes; we have asked them to keep us up to date on the address where they live and then we apply that information to determining their taxpayer status.

If, for any reason, people feel that the process comes out with the wrong answer for them, they have the right either to update the data if they think it is wrong or to challenge the decision if they think the data is right but they do not think they pass the test.

Willie Coffey: Would it not be easier just to ask them the country they live in and gather that data?

Jim Harra: There is a test for determining whether someone is a Scottish taxpayer and it applies over the whole of the tax year, so it is a slightly complex thing to ask some people, particularly if they are mobile. We feel that, if we know the address where you live, that will enable us to determine it accurately.

09:15

Willie Coffey: The test that you have applied so far missed 420,000 of them.

Jim Harra: Yes, there was an error in our original scan. Although we had a Scottish address on our database for those people, the technical parameters of the computer scan did not pick those addresses up, and that was an unfortunate error, for which I am very sorry. I am glad to say that it was identified and fixed very quickly, but it does not go to the accuracy of our data about where people live. It went to the accuracy of that one-off job of running the scan against our system.

Willie Coffey: If you do not mind me pressing you on that, what does it mean when you say "running the scan" and that the scan did not pick up the fact that they were Scottish? Do you mean that it missed a field where there should have been a postcode, or it was in the wrong field, or there was only a partial postcode, or there was no country name? How did it miss it?

Jim Harra: We had all that address data on our systems, but we had not in the past flagged people as Scottish taxpayers, because there had been nothing in the tax system that required us to do that. When the Scottish rate of income tax came in, we had to identify all of those addresses that we held on our database and flag that record as a Scottish taxpayer record. There was a technical specification of the scan that ran across our whole address database to pick that up, and some of the parameters of that scan did not pick up some of the input methods that had been used for our addresses. In particular, it overrelied on postcodes and the way in which the addresses had been input from postcodes. In fact, there are other means by which addresses can be input, which that initial scan did not pick up.

Two things should have happened. First of all, the people who designed the scan should have had a deeper understanding of how addresses are input into our system and should have got the scan right. Secondly, there should have been more testing of the results of the scan to identify the error, and unfortunately that mistake got through. When it was picked up we fixed it, but if I was doing that exercise again—which we will be doing shortly for Wales—I would be looking at the lessons to be learned to improve the quality and testing.

Willie Coffey: Is not the solution simply to have the word "Scotland" or "Wales" or "England" in a column in the data attached to every address? That way you will not miss any—if the software works, that is.

Jim Harra: Until now, because the country in the UK in which you live has not been relevant to your tax affairs, that has not been a field that we have required people to capture. With the exception of a small number of postcodes that straddle the border—about six, I think—the postcode tells you which country the address is in, and the postcode is what we have always had on our address list because that is what is relevant for mailing. We feel that that is the best way, from the data we have, of identifying Scottish taxpayers. With hindsight, if we had known when we were starting to collect addresses from people 30, 40 or 50 years ago that there might have been a differential, we might have asked people for the country, but that is not where we are and I do not think it is necessary to do it in order to get at the identification we need, because the address data and the postcode data pretty much do it.

Willie Coffey: So there will be no errors next time round.

Jim Harra: I hope that, after the equivalent scan in Wales, I will be able to say that there were not. We have certainly learned lessons from that exercise, which Scotland will not gain from, because it was a one-off exercise, but Wales will. We have also learned lessons about the on-going need for assurance, which have strengthened our assurance activity, and you will benefit from that.

Liam Kerr (North East Scotland) (Con): The estimated costs of implementing the Scottish income tax powers keep reducing, which on one analysis sounds quite good, but how can a £5 million saving—I think that that is the latest figure—be made?

Sarah Walker: The story is that the initial estimate, which I think was £40 million, was given back in 2010. That was a long way ahead of implementation. We were doing a lot of new things that we had never done before, and I think that we were cautious in the estimates that we gave.

Over time a number of things have happened. We have been able to get a better idea of how to do the information technology changes, and the costs of those changes are coming down. However, the big reason that the estimates have come down is that we thought that there would be a lot more costs for contact with the public—the mail-shot that we did and staff and operational costs in our business from dealing with changes and correspondence.

As it happens, because we had good time to plan for it, we managed our communications. We did work at database level to check our addresses. We did not need to make as much contact with customers as we expected and we had a lot fewer contacts and queries from them than we thought we would have to deal with. A lot of the cost reduction is because of less contact with the public and less administrative work than we thought that we would have to do.

The recent reduction is, again, largely because there is less administrative and operational work. We also have a clearer idea of the IT requirements for working with pensions relief at source; we have had to put in a separate system to make sure that pension schemes that are claiming relief at basic rate from HMRC are able to identify Scottish taxpayers, so that if the basic rate is different, they will claim a different amount of relief. That work is on-going. It is the last big chunk of work that we have to do.

Liam Kerr: This committee often sees estimates going the other way. By one analysis, the reduction is all quite encouraging, but there is a concern in my mind that significant overbudgeting has consequences as well for how one makes provision for it. Are you aware of how the Scottish Government made provision for the £40 million in terms of its own funding, and whether in effect it said, “We haven’t got £40 million to play with, so let’s put it over here”? If so, what impact has that had on day-to-day running?

Sarah Walker: I cannot comment on how the Scottish Government manages its budget. We have been keeping in touch with the Scottish Government on our reassessment of the costs, but we have also been working closely with it on the short-term forecasting. Each year we have given it an estimate, which is the best estimate that we can give. It has been involved in our programme governance, so it has the same access to cost forecasts that we do and it sees all our programme and project papers. It has as good an understanding as we have.

I agree that the estimate of £40 million in 2010 was pretty speculative. I think that it was done well before we had done a lot of work on it—we were asked to give an estimate and we did. We erred on the side of caution because we thought that this was a big, novel project and the cost was difficult to predict at the time.

Liam Kerr: We have looked at an error on the number of Scottish taxpayers. There is an impact on the tax taken and there is a rectification cost.

I understand that this time around HMRC has borne that cost. If there were to be a further error, there would be a rectification cost, but presumably there would also be potential for rectification of the opportunity cost of not having taken all the tax that should have been taken. Is it reasonable to assume that HMRC would pick up that cost again, if there were a further error?

Sarah Walker: That is hypothetical.

We have in our memorandum of understanding with the Scottish Government a presumption that it will bear all our implementation costs, which follows Treasury rules for public expenditure. In the case of the error that led to 420,000 people being left off the database, there was no effect on tax take, partly because the error was rectified quickly and partly because there was no difference between the Scottish and UK tax rates at the time. For that particular issue, we agreed that we would bear the costs because it was clearly our error, but we would want to look at future instances according to the circumstances at the time.

Liam Kerr: To be clear, if HMRC was to make an error in the future for which there was a cost, one could not automatically assume that HMRC would pick up the cost of rectification. Is that fair to say?

Jim Harra: It is fair to say that you cannot automatically assume that. I would expect us to follow the approach that we followed in the instance of the 420,000 taxpayers—we would approach it in a reasonable manner. In that instance it was clearly our mistake and we took it on the chin financially. However, as Sarah Walker said, we would have to look at each instance. We hope that there will not be any, but if there are we will have to look at them individually and assess what we want to do, and we will have to enter into a dialogue with the Scottish Government—I can pretty much understand where it will come from in that debate.

Liam Kerr: I would like to explore a final issue. The Scottish rate resolution needs to be agreed by the end of March. This committee’s predecessor committee heard that if the Scottish rate resolution is agreed right at the end of that period it could give rise to extra costs, because you guys have to change people’s tax codes at the start of the financial year. Do you have any idea what those extra costs will be and whose costs they are?

Sarah Walker: The costs are borne by the Scottish Government. The extra costs will depend on the nature of the change. The change this year to the higher rate threshold was relatively small; it affected only a minority of tax codes. A change to, say, the basic rate later on in the process would affect a large number of tax codes, so there would be a much greater cost.

Liam Kerr: Are you able to give me a ballpark figure?

Sarah Walker: I cannot off the top of my head, but we may be able to write and let you know.

Liam Kerr: That might be useful. Thinking aloud, I presume that the Scottish Government has to factor that into its consideration: if we change the tax rate, there will be a cost.

Sarah Walker: It is a very small proportion compared with the yield from the tax change, obviously.

Liam Kerr: The analysis is predicated on the Scottish rate resolution not being agreed until right before the end of March. That could incur additional cost. How far before the end of March would the rate resolution need to be agreed to avoid incurring the additional cost?

Sarah Walker: We do an annual tax code update for the whole of the UK, which runs around the end of the year—December and January. The agreement that we have in our memorandum of understanding with the Scottish Government is that by the end of November we need an assumption, if you like, to use in the codes that we issue in the main coding exercise. We will have to review that, because potentially the UK budget and the Scottish budget will be announced later in the year, so getting an assumption by the end of November may not be realistic.

We have been able to accommodate the Scottish budget announcement in December and reflect that in our main coding exercise. However, if a change comes after January, as it did this year, that means that we have to do an additional exercise to redo some of those tax codes, and that is where the extra cost arises.

Even if it happened right at the end of March, we would still do an additional tax-coding exercise. However, that would probably happen after the start of the new tax year, and it would have a bit of knock-on effect on employers, who would have to update codes at that time. However, it is possible to do, and there are precedents for our changing tax codes after the start of the tax year. A whole range of different things can happen, and it is always possible for us to accommodate late decisions, but a range of costs might be incurred.

09:30

Liam Kerr: I would not mind having more clarity on those costs. At some point, the Parliament will debate the rate resolution, and it might want to know that there could be a cost implication of not getting something agreed by a certain time.

Jim Harra: We can certainly go away and look at what we can come back to you with. As Sarah Walker has explained, there is a whole range of different scenarios, each of which would have to be looked at individually. In any case, we would expect to liaise closely with the Scottish Government on any particular instance or issue. We will see what in general we can give the committee, but there is obviously a wide range of scenarios, each with its own separate impact.

Liam Kerr: Thank you.

Alex Neil (Airdrie and Shotts) (SNP): I want to pursue three supplementary questions on who is and who is not liable to pay the Scottish rate of income tax. First, what if I had a house in Scotland and a house in England and I told you that my main house was in England but I had a house in Scotland? Would I pay the Scottish rate of income tax?

Jim Harra: It would depend on which address was your main home, and we have a set of criteria that we apply to determine that. For example, we have identified just over 2,000 cases of the nature that you have just described, in which people with an address in Scotland and an address elsewhere have told us that the address elsewhere is their main address, despite the fact that the Scottish address is a correspondence address for us. We have done some compliance work to understand the accuracy of what we are being told.

The wealthier you are, the more likely you are to have two homes and, indeed, to have scrutiny by us. Affluent and high-net-worth people are basically man-marked by a relationship manager in the United Kingdom who tracks their residence status, but Sarah Walker can probably give you more details of the test that is applied.

Sarah Walker: We are looking at, say, where your children go to school, where your family is, where you are registered with a general practitioner and that kind of thing. We would expect people to have a main home with those characteristics.

Alex Neil: If Scotland were to introduce a 50p rate of tax, and I were to say to you, "My main home's no longer in Scotland—it's south of the border," would you automatically accept that or would you apply these tests and say, "No, we don't accept that"?

Jim Harra: Although this is a new scenario for us in the UK context, we are very used to it in the international context. We have lots of taxpayers who tell us that, for tax purposes, they are resident in France or wherever while appearing to have a presence in the UK, and we are very used to policing that sort of thing.

We take a risk-based approach to compliance. In other words, we assess the risk of someone misleading us, and the level of intervention that we take is based on that risk. Relevant factors include the tax differential between Scotland and the rest of the UK; in the current tax year, that differential will be a maximum of about £300, and our assessment, therefore, is that the risk of people deliberately not complying will be pretty low. Obviously, though, if that differential grew in future, we would have to reassess that risk, and we intend to do that exercise annually and share the results with the Scottish Government.

In the circumstances that you have described, we would probably have assessed the risk to have grown significantly and therefore it would be something that we would have to actively police. That is exactly the type of case that we might well decide to investigate.

It depends on the taxpayer and their level of income, and what we know about their tax behaviours generally. For example, we will keep a close eye on a high-net-worth individual who we know has actively engaged in avoidance schemes in the past. On the other hand, if we see evidence that someone appears to have moved house, we may decide that, in that particular case, an intervention is not required. We would certainly be constantly assessing risk.

Alex Neil: So you will monitor it.

Jim Harra: The level of compliance intervention that we would expect to take would, subject to discussion with the Scottish Government, be relative to the risk assessment.

Alex Neil: As part of the compliance assessment, do you look at people who are getting free tuition because they are allegedly staying in Scotland?

Jim Harra: Factors like that would all pour into the risk that someone would actively mislead us. We would look at all the factors that might cause someone to mislead us about their address and which would have a tax consequence. Clearly, a range of factors can drive people's behaviour—it is not just about the tax benefit, but that may be part of it.

Alex Neil: Let us say that I have a son who is 19, and I am living in England and a taxpayer there, but he has told the authorities up here that he is resident in Scotland, and he is getting free tuition and not having to pay fees. Would you pick that up?

Jim Harra: Obviously we are not directly accountable for administrating the risk of fraudulent access to tuition fees—

Alex Neil: Who is?

Jim Harra: I assume that it will be someone in the Scottish Government, in the department for education or whatever. We have ways to share data with other agencies that are investigating potential fraud. For example, if the police in Scotland are investigating fraud, there are gateways through which they can share HMRC information. We collaborate closely with other agencies on tackling fraud, because if someone commits fraud in one area, they are quite likely to do so in another area, including ours, so it is in our interests to do that.

Alex Neil: And you would share the necessary information with Scottish Government enforcement or compliance officials.

Jim Harra: Provided that there is a legal gateway for us to do so. We have to comply with data protection rules and the rules that say that we have to keep taxpayer information confidential, but there is an extensive range of gateways that allow us to collaborate with other law enforcement agencies. For example, in Scotland, we have HMRC staff embedded in Gartcosh who are both working on joint operations and arranging to share information. We always check that we have the right gateway.

If there is a risk in an area where there is no gateway to enable us to share information, we and our administrators have a very good record of acting quickly to create the necessary gateway.

Alex Neil: I want to ask about another scenario, which is quite common, not necessarily just among high-net-worth individuals. This is not about someone who is trying to defraud the system; I am asking about how we define a Scottish taxpayer for the purposes of income tax. Let us say that I live in Scotland, but I work in London. I go down on a Sunday evening or Monday morning, I work in the City and I stay in London five days a week, and I come back up to Scotland on a Friday night. For all intents and purposes, I live in Scotland. Does my employer in London deduct the Scottish rate of income tax?

Jim Harra: I believe that those people are known as WILLIEs—

Alex Neil: WILLIEs?

The Acting Convener: WILLIEs?

Jim Harra: Someone who works in London, lives in Edinburgh—is that right?

Alex Neil: I never knew that.

Jim Harra: I am glad that I got an opportunity to explain what I was saying there. [*Laughter*.]

The answer to your question is yes. We would have that person flagged on our system as a Scottish taxpayer, and the fact that they were working for an employer in London would not alter that fact. Their employer would be given an S code to operate.

Alex Neil: That clarifies that matter—thank you.

I will go on to an area that has nothing to do with fraud or people trying to avoid or evade tax. As you probably know, there has been a big debate in Scotland about whether we should increase the 45p rate to 50p, and what the behavioural impact of doing so would be. I know that there are many other scenarios that you could paint not just for the top rate of income tax but for the standard and low rates. However, for the purposes of this discussion, can you tell us how much work HMRC has done on the behavioural impact of tax changes such as increasing the 45p rate to 50p in Scotland?

Jim Harra: There was a 50p additional rate in the UK in 2010-11, but it was in place for only a year. In March 2012, the department published an analysis of the behavioural impact of the measure, and you can find that online or, if necessary, I can send you the link to it.

Obviously it was quite a difficult analytical exercise to carry out, because the rate was in place for only one year, and having a series of data might give you a better understanding of the on-going behavioural impact. However, the broad outcome was that there was a very significant behavioural impact on the tax take in 2010-11 that we had underestimated in our forecast of the yield from the 50p rate. In particular, we saw significant forestalling, with people who had the option to do so bringing income into the previous tax year when the rate was lower. That had a consequential impact on the yield in the following tax year.

The analysis drew what conclusions we could from having that rate in place for a year but, nevertheless, it indicated a significant behavioural impact, and you would have to look at whether and how you could constrain that impact if you decided to introduce higher rates in future.

Alex Neil: Based on your analysis, then, is it fair to say that a 50p rate might result in our receiving less revenue because of likely behavioural impacts?

Jim Harra: I am not sure that it is safe to draw conclusions for what would happen in Scotland; after all, this was a UK-wide rate and, as I have said, we had only very limited data, because the rate was in place for only a year. However, in that instance, we saw a large behavioural impact that we had underestimated at the outset and which meant that in the year in which the rate was in place less revenue was raised than had been forecast. The analysis says very little about what the on-going effect would have been, because obviously we were not able to test that.

Alex Neil: It was also not a permanent rise. Had it not been announced that it was going to be abolished at some point?

Jim Harra: No. From recollection, it was introduced as a final act of the Labour Government before the coalition Government came in in 2010 and repealed it. It was not announced as a one-year measure, but in practice it was in place for only a year.

Alex Neil: But had it been place for longer, would the behavioural impacts have been greater, smaller or neutralised?

Jim Harra: We do not have the data to test that but, to the extent that people took income early or delayed taking it, there might have been a different impact over time. People might be able to do that kind of thing for a period of time, but they might have less of an ability to do so after a while. The analysis does not get into that issue because, as I have said, there was data for only one year.

Alex Neil: Have you done any more general work on behavioural impacts?

Jim Harra: We do it all the time with regard to policy costings for our ministers, but I cannot share with the committee what policies they ask us to cost.

Alex Neil: Would you do that kind of exercise for the Scottish Government, if asked?

Jim Harra: It would be for the Scottish Government and the Scottish Fiscal Commission to carry that out.

Alex Neil: But you would co-operate with them.

Jim Harra: We would certainly provide them with the data sets to enable them to do policy costings and forecasts. In the UK, the Office for Budget Responsibility uses the survey of personal incomes as a key data set, and we have essentially given the Scottish subset of that data to Scotland so that the Scottish Government and the Scottish Fiscal Commission can make their own forecasts. We do not have an agreement to provide an analytical service, but we certainly provide data.

Alex Neil: Thank you.

The Acting Convener: I want to pursue this a little bit further, because you are absolutely right to point out that it will be the Scottish Fiscal Commission that will provide us with some of the modelling of behavioural impacts for our budget discussions. We saw forestalling when the land and buildings transaction tax was introduced, as you might have noted, but I wonder just how much of this work you can do in advance when planning a tax system. If the Scottish Government indicated that it was considering a 50p top rate of tax and it or the Scottish Fiscal Commission asked you to do some modelling in advance, is it not conceivable that some anti-avoidance measures could be put in place before that measure was brought in?

09:45

Jim Harra: If, as a policy maker, you knew that a policy measure under consideration was likely to have a big behavioural impact, you would look at whether other measures could be put in place to manage people's ability to make such an impact. You might be able to close off certain avenues, but there might be other avenues where you felt the options for closing off were more limited. That is certainly the kind of thing that you could look at.

The Acting Convener: So in effect it would be possible to minimise the bulk of the impact in advance.

Jim Harra: Undoubtedly there might be some behavioural choices available to taxpayers that you would have options to close off, but there might be others that you would have fewer options to do anything about. People with wealth and high incomes can plan their affairs, including whether and when to take income or whether and when to sell an asset and realise a gain. You might be able to legislate to constrain some of those behaviours, but there might be others that you decide you cannot.

The Acting Convener: That is helpful. I recall as a member of the Finance Committee when we were discussing this very subject one of your senior colleagues telling us that anti-avoidance measures had improved over the piece and that he did not necessarily foresee any problems in that respect. Is that your feel for what is going on on the ground?

Jim Harra: The large raft of anti-avoidance measures that has been put in place in recent years has significantly stamped out tax avoidance as an activity. It has not been stamped out completely—and probably never will be—but we have seen a very significant reduction in the use of tax avoidance schemes.

Moreover—and I should point out that this is not tax avoidance—the ability for people to put their money into something that is subject to relief has in some instances been capped in recent years. As I have said, a lot of work has been done to close off some avenues that we would regard as mischiefs, because they are about tax avoidance.

As far as tax planning is concerned, a key pressure on the tax system at the moment is what we call tax-motivated incorporation, where there is differential tax treatment of employed and self-employed people or companies. We are certainly seeing a behavioural impact where people incorporate, because one of the reasons for their incorporating is to take advantage of that differential. Whether you call that tax avoidance or taking sensible and legitimate steps, we are nevertheless seeing that kind of behaviour, and if those differentials were to increase, people would have greater incentive to do that kind of thing. There are still areas of tax planning where certain opportunities are available, and not all of them have been closed off by any means.

The Acting Convener: Finally, I am aware that you have had a series of mergers or consolidations—call them what you will—that have affected tax offices in Glasgow and Edinburgh. Has that had any impact on your work on the SRIT?

Jim Harra: No. We have a programme of reducing the number of small offices that we have over the coming years and concentrating our resources into 13 regional centres plus, I think, six specialist offices and a head office. We think that that will enable us to deliver a better service more efficiently. Not all of that has been implemented—it is in train over the next few years—but there has been no impact on our implementation of the Scottish rate of income tax.

The Acting Convener: As there are no more questions from colleagues, I thank our witnesses very much for appearing before the committee. I suspend briefly to allow a changeover of witnesses.

09:49

Meeting suspended.

09:52

On resuming—

National Fraud Initiative

The Acting Convener: Under agenda item 3, we will take evidence as part of our post-legislative scrutiny of the national fraud initiative. I welcome Derek Mackay, Cabinet Secretary for Finance and the Constitution, and Brian Taylor, senior risk manager at the Scottish Government. I understand that the cabinet secretary would like to make an opening statement before we move to questions.

The Cabinet Secretary for Finance and the Constitution (Derek Mackay): The good news is that it is a very brief opening statement. I appreciate the opportunity to contribute to the committee's first piece of post-legislative scrutiny and I appreciate its interest in the effectiveness of the national fraud initiative, which is just one tool that the public sector uses to combat the risk of fraud.

The Scottish Government takes the prevention, detection and investigation of fraud seriously. As well as ensuring that our key financial controls are robust, we work with all public bodies to share fraud prevention information and good practice. All that is underpinned by effective audit arrangements.

For the national fraud initiative, ministers, through legislation, enabled Audit Scotland to carry out data-matching exercises to assist in the prevention and detection of fraud in Scotland. The Cabinet Office oversees the exercise across the UK and is responsible for the effectiveness of the data-matching processes. It is important to review the NFI's effectiveness and make improvements where possible, to maximise the value of participation.

If, as a result of its scrutiny, the committee makes recommendations that would require statutory amendments, they will be for Scottish ministers to consider and take forward, which we will be happy to do. Other recommendations to improve the effectiveness of the exercise may be for the Cabinet Office, as owners of the data-matching service, or for Audit Scotland, as the facilitator of the process in Scotland. Scottish Government officials will be happy to support the considerations.

The Acting Convener: I understand that you are willing to take questions on the subject of our earlier evidence session with HMRC, but I ask members to hold them back and start with questions on the national fraud initiative.

Colin Beattie: In our most recent evidence session on the NFI, I was interested to discover that there is a possibility of real-time pre-transaction checking, which I had no idea was available. There must be advantages to that. If I remember correctly, the NFI is a three-yearly exercise, and it is big. Surely real-time checking could have a huge advantage in eliminating fraud that could otherwise go on for a lengthy period. If I remember correctly, such an approach would cost each local authority less than £2,000. Part of the benefit would be for the Department for Work and Pensions, but part of it would be for councils. Is there a way of introducing real-time checking, sponsored by the Scottish Government?

Derek Mackay: We support Audit Scotland and local authorities through the general financing, and it is up to those organisations to contribute financially. If there were further recommendations on financing, I would be interested in them. That is an operational matter that we could consider.

Brian Taylor (Scottish Government): Absolutely. The AppCheck service has some restrictions because some of the data that is in it is quite old, but some of it is refreshed every two months and is quite valuable. The Cabinet Office has promoted AppCheck and given it reduced rates. If we were to try to roll something out across Scotland, we would want first to talk to the Cabinet Office about how best to do it, and cost would be part of that. I hope that we could overcome any barrier.

We have made initial arrangements for the Cabinet Office to come to Scotland and help to roll out AppCheck, as it is quite new. We would be absolutely willing to talk to the Cabinet Office about how best to do that. We would consider that in terms of central funding.

Colin Beattie: Are you saying that discussions are under way and that that is in course?

Brian Taylor: Yes.

Colin Beattie: When do you expect that work to be completed?

Brian Taylor: It is part of the NFI steering group discussions. We last met in October and the next meeting is yet to be scheduled but, on the back of the committee's evidence sessions, we have been in touch with the Cabinet Office. The Cabinet Office is doing the scheduling, but I cannot say when the next meeting will be.

Colin Beattie: One thing that arose in the previous evidence session on the NFI is that significant bodies such as housing associations are excluded from it. Are there any thoughts about bringing them on board? I do not know whether that would need legislation or other encouragement.

Derek Mackay: If the committee thought that that was required, I would be interested in considering it. Current data-matching powers can be used voluntarily. If the sense was that there should be compulsion, I would be interested in that.

A range of measures can be used to prevent fraud, and the Scottish Housing Regulator and others are doing work in which housing associations can already participate. However, the committee might think that compulsion is required to widen the scope.

Colin Beattie: The difficulty that the committee picked up is that a significant number of housing associations seem almost by default not to participate. Should they be compelled to do so, given that they are such a significant part of the opportunity to eliminate fraud?

Derek Mackay: There has not been evidence about identified fraud that indicates that such a measure is required. If the committee produces a recommendation on compulsion, I will look at it, but other checks and balances are in place.

Colin Beattie: The current legislation does not allow for enforcing follow-ups from the NFI. Some of the councils that appeared before us made the point that, when the amount involved is trivial, following up a line of investigation would cost more than would be recouped, so they use their discretion to drop the case. Could there be a benefit in legislating to enforce follow-ups while still giving councils a bit of wriggle room?

Derek Mackay: The operation is for the organisations and the audit agencies to take forward, but that suggestion is worthy of further consideration.

Brian Taylor: Down south, the Cabinet Office works on an encouragement basis, and that is Audit Scotland's approach, too. Audit Scotland tries to get organisations properly engaged, rather than take away organisational flexibility. Resources might be required if follow-ups were enforced.

10:00

Alex Neil: I have two questions, the first of which is on the national fraud initiative. From the evidence that we have taken, the national fraud initiative appears to have been quite effective in reducing instances of fraud, but we can always go further and there is always more to do. As Colin Beattie said, there may be a need to consider compelling organisations such as housing associations to participate. Given the initiative's success, has the time come to consider widening the remit?

I will give an example. Tuition fees take up a large amount of money every year, as is right. People who are resident in Scotland qualify for getting their tuition fees paid, while people in the rest of the UK do not, but people who live in the European Union do, although some of that will change, policy-wise, after Brexit.

In picking that example, my fundamental point is to ask whether there is a case for employing the national fraud initiative with an extended remit to weed out fraud in other areas, such as tuition fees—if there is fraud there, which we do not know.

Derek Mackay: That point is helpful. It is hard to quantify the preventative effect of the national fraud initiative or other initiatives. We cannot quantify what fraud has not happened because of the measures. The impact on the Scottish Government so far has been that we have been alerted to a very small amount of fraud risk, which has been investigated and resolved.

We could respond to demands because of risk or potential threat. A huge issue that will be coming our way is social security, and careful consideration will have to be given to whether the data for social security can play into the initiative. It is right to look at risks and ask what is appropriate. Tuition fees have not been identified to us as an issue, but they are worthy of consideration in relation to the remit and the scope of the exercise.

Brian Taylor may be able to say more about risk analysis.

Brian Taylor: Mr Neil is absolutely right to say that extension of the scope should be considered, although any extension would be not just about adding more and more data but about adding data that will bring about good value and high-risk matches that will be of use to the organisations that participate. Mr Neil is right to say that we should always review what extra data sets should be brought on board, particularly for things such as social security. Tuition fees have not come up, but they might be something that could be included.

Alex Neil: We always seem to spend a lot of resources on chasing people at the lower end of the income scale, who rely particularly on social security benefits. I am not justifying fraud, which should be weeded out no matter where it is. However, we criticise the UK Government for spending four or five times as much on identifying and dealing with fraud among alleged social security benefit fraudsters as it spends on tackling tax avoiders and evaders, and maybe we are in danger of making the same mistake.

Maybe we, too, should ensure that there is no fraud of any scale in the programmes that tend to benefit better-off people and middle-class people. I am not suggesting that such fraud is taking place, but I would have thought that, given the amount of money that we are spending not only on tuition fees but on other programmes that dish out a lot of public money to people, we should take as robust an approach to those people as we take to people who are on lower incomes.

Brian Taylor: You raise an important point. The approach needs to be risk based, but it also needs to be proportionate.

Alex Neil: Absolutely, but my point is that it could be time to look at what is proportionate and whether we need to extend the remit to cover other programmes.

Brian Taylor: In any consideration of extending the remit, proportionality should absolutely be a factor.

Alex Neil: I have two questions for the cabinet secretary that arise from the previous evidence session this morning. First, one thing that is clear about the Scottish rate of income tax—or any rate of income tax—is that the level of allowances and reliefs is an important element in deciding the tax take and the economic and behavioural impacts. Is the Scottish Government pressing the UK Government to extend our powers over income tax to cover all aspects of income tax, including reliefs and allowances, which would give us much more power to be innovative in the application of income tax policy north of the border?

The Acting Convener: That is a substantial reach from the evidence session this morning, but I will allow the cabinet secretary to answer.

Derek Mackay: Convener, it would be unlike you and Mr Neil to spring any surprises on me that come from earlier evidence.

Alex Neil: I am sure that you are fast enough on your feet to deal with that.

Derek Mackay: That bought me a few seconds to think about how to answer the question.

The simple answer is yes—of course the Scottish Government takes a maximalist position on the devolution of powers and the functions within them. In relation to revenue and debt generation, tax avoidance issues and so on, we have repeatedly made the point that we would welcome more levers and more opportunities to tackle such issues. We have made that point—I have certainly made it to Treasury ministers.

Alex Neil: Do we need to step that up a wee bit?

Derek Mackay: Yes—it is fair to say that on income tax, we will have an opportunity with a new UK Government to set out immediate asks. There is the continuation of the argument on tax collection in Scotland and the decisions that we can take to address some of the anomalies that now exist because of partial control of income tax, for the reasons that you have given. If the committee wished to collectively add to those asks, I would certainly welcome that intervention.

Alex Neil: My second question that arises from the previous evidence session relates to the debate about the behavioural impact of any tax changes. There has been a debate about whether to increase the top rate from 45p to 50p. You may or may not have listened to the evidence earlier from the HMRC witnesses, who mentioned their analysis of the one recent year—2010-11—when there was a 50p tax rate. Their analysis clearly showed that there was a substantial behavioural impact for the duration of the extra 5p on the top rate of income tax. What work has the Scottish Government commissioned on the behavioural impacts of any rate changes and in particular on whether the top rate should be raised from 45p to 50p?

Derek Mackay: Without getting into the political argument on that and the Scottish Government's position on a Scotland-only change compared with a UK-wide change, I will say that we have commissioned the Council of Economic Advisers to look at the issue and report back in good time for the next budget process. Such a change would be a budget consideration for the Government and therefore the Parliament. The First Minister has asked the Council of Economic Advisers to report back.

Alex Neil: Will the report be published?

Derek Mackay: I have not been asked that before. First, the council will advise ministers. I would want to double-check this, but I think that the evidence was published previously, so I will try to stick with the precedent and do that. While keeping within the parameters of guidance and advice to ministers, I would be happy to share the evidence.

Alex Neil: I am not suggesting that the report should be published before the budget—

Derek Mackay: Exactly.

Alex Neil: However, I presume that it would be published with the budget.

Derek Mackay: I am not sure when the analysis was published last time round but, in the interests of transparency, I would want to publish, while keeping within the protocols for advice to ministers. I think that people would want to see that evidence, would they not?

Alex Neil: Is the remit of the Council of Economic Advisers limited to looking at the behavioural impact of increasing the 45p rate? Will a wider piece of work be done that includes any variation in the lower rates?

Derek Mackay: The remit is specifically to look at the additional rate.

The Acting Convener: Okay. If we can perhaps stick to looking at the national fraud initiative first, we can come back to this topic—of course, once Alex Neil gets going, it is very difficult to stop him.

Liam Kerr: I am interested in the cost benefit of the national fraud initiative. We heard in a previous committee meeting about diminishing financial returns from the NFI. Various witnesses have expressed their views about that. Do you have a view, cabinet secretary?

Derek Mackay: I take you back to my point about it being difficult to quantify the preventative element—the fraud that is not happening and what we have done to discourage fraud. However, if we consider just what we have been able to run through the system and identify as an issue for the Scottish Government, we see amounts ranging from a substantial figure of over £1 billion-worth of transactions down to a payment of just over £10,000 that was identified and successfully recovered. That is the context.

I still believe that the exercise is very worth while. I do not want to overstate our role in it—as legislative enablers of it and participants in it—but we all, I think, see value in its continuation, hence the discussion about extending its scope. It appears to continue to be worth while.

Liam Kerr: Is there any way to quantify the deterrent effect? The witnesses all gave similar answers, saying that there clearly is a deterrent effect, and I suspect that that is the case, but there must be a way of going at least some way towards quantifying that. Should resource be spent on a more proactive and comprehensive marketing campaign to increase the deterrent value?

Derek Mackay: That feels more like an operational issue for Audit Scotland and other agencies. I think that there would be concern if we removed the initiative. Of course, many other tools are in place to tackle fraud, but my sense is that removing the NFI would cause more concern than would attempting to promote it. There are other public agencies that could play into it, and more data that could be considered. Brian Taylor can perhaps say more about how he sees risk playing within that. Would that be helpful?

Liam Kerr: Yes, of course.

Brian Taylor: Another point about being part of the NFI is that it gives us good assurance on our financial systems. Having our data run through it and having small returns confirms and gives us assurance that our controls are working well.

There is also the deterrent factor that has been mentioned. The difficulty with measuring fraud in the way in which that has been undertaken in the past, such as with the annual fraud indicator, is that an awful lot is based on estimates of fraud. We could do crude comparisons and consider identified fraud against the average figures for organisations, which vary between 5 and 10 per cent. However, I think that the answer is to continue to improve the value of the transactions, so that we get more results for fewer matches wherever that is possible, and, at the same time, to do the promotion work that you talked about, because that is important as well.

Liam Kerr: Cabinet secretary, you said in your opening remarks that we need to maximise participation—I think that those are the words that you used. One way of doing that, which we discussed at our previous meeting, would be to ensure that when members of the public flag up an issue, they can see the outcome and what happens as a result. I will throw in a question. Could that be considered under current data protection restrictions?

Derek Mackay: It could be considered. I suppose that anything could be considered, although there are parameters that we have to work within. We could look further at that. Ultimately, each organisation, together with Audit Scotland, which facilitates the initiative, and the Cabinet Office, which oversees it, could produce reports on how they believe it to be working. At the same time, however, do we really want to produce a report every time there is a complaint, and then action and an understanding? As I said, the initiative is one of many tools to tackle fraud.

It could be considered, but I am not sure about the value of publishing too much, particularly bearing in mind the difficulties that you rightly mention around data protection.

Liam Kerr: I have a final question to pull together the cost benefit piece. In its evidence, Moray Council mentioned 2,800 matches, from which there were 20 positive outcomes. I presume that the cost of getting those outcomes is borne by the local council—or a Scottish agency, if I can put it in that way—but the benefit accrues to the Department for Work and Pensions, as it did in that example. Do you have a view on that? Should we be looking to review that aspect of the NFI?

10:15

Derek Mackay: I do not have a strong view. It is in the public interest that all parts of the public sector work together to identify fraud, look at value for money and so on. The figure that I was able to give you for Scottish Government transactions shows that there is still value in having reassurance around our systems and in identifying and addressing not necessarily fraud but duplication. I believe that there is value to the public purse in that work, irrespective of who contributes to it.

Monica Lennon: Good morning, cabinet secretary. We have heard oral evidence from a number of local authorities, and it surprises me that the exercises are very much set up as standalone exercises. There does not appear to be a way to track and identify repeat offenders.

Earlier this morning, Jim Harra from HMRC said in his evidence that if a person commits fraud in one area, they are likely to commit fraud in another. Do you recognise the limitations in the current system, given the current statutory powers? Could that be addressed through legislative change?

Derek Mackay: Repeat offending has been identified as an issue. The Cabinet Office is working on that area and I will be interested to see its conclusions. As I said, it is the lead organisation across the UK. If we require legislative change, I am open to that, but the Cabinet Office is leading on that piece of work.

Monica Lennon: It strikes me from hearing the evidence that we have a really static picture. Obviously we are looking at the data matches retrospectively, but if there is good intelligence in there, it seems that there could be a missed opportunity if people are not proactively using that information.

Derek Mackay: As I said, I am happy to consider that matter based on your recommendations and the Cabinet Office's conclusions.

Monica Lennon: Another issue that came out of the evidence from local authority officers, who are very much at the coalface, is that they appear to be drowning in data, given the sheer volume of data matches and all the other sources of intelligence that they get. They are trying to take a risk-based approach and prioritise. However, when you hear about the number of data matches, are you concerned that there is not enough resource in the system to drill down properly into all that data and try to detect fraud?

Derek Mackay: Again, we are looking at our specific role in the NFI as a legal enabler and participant. A resource issue in following up on work or engaging with the data has not been identified to me.

As I said, there are a range of ways in which public sector organisations deal with the issue. If you have further evidence around resourcing, I would be interested to hear it, bearing in mind how the audit agencies and other public sector agencies do their jobs and how we fit in with the Cabinet Office and Audit Scotland as a legal enabler.

Monica Lennon: From the evidence that we have heard, it seems that the teams in local authorities that are dedicated to this work are very small. There are also concerns that there can be delays with other public bodies providing information. That is maybe worth a closer look.

Liam Kerr touched on the data protection aspect of this work. The officer from Aberdeen City Council raised concerns about the public getting frustrated when they provide information and no one can get back to them. Again, that is partly about the volume of work in the system, but it is also about data protection. We understand that data protection laws are in place for very good reasons, not least to protect people's privacy. However, it seems that there is very little awareness of the national fraud initiative.

I know that you have worked in local government as a councillor. Can you see any simple ways in which, without generating a lot of reports and paperwork, we could keep the public informed, so that they at least feel encouraged to co-operate?

Derek Mackay: Resource is a matter for each organisation. In local authorities specifically, the size of their internal audit facility or audit function is a matter for them. It is not as if there is central co-ordination of that resource—it is for each organisation to determine. There are specific funding arrangements for Audit Scotland as well, so the resource matter is for it.

I am interested in any recommendations around awareness of the initiative but, again, I respect the Scottish Government's role in it. We are a legal enabler and a participant. If there is a recommendation that either it or we as a partner should promote it to the public, so be it, but it should be done without raising unnecessary alarm and should give—as you have described—appropriate and proportionate feedback, without creating new bureaucracy and while protecting people's position in terms of data protection.

Monica Lennon: My last question is more directly aimed at the Scottish Government. What work is the Government doing to ensure that the new social security powers fit well with the national fraud initiative?

Derek Mackay: I can go into more detail on the forward planning, but I would also make the point that I touched on earlier about the scale of the data—the number of transactions and of people involved. It will be part of our risk analysis. We know that as a consequence of the social security powers and functions, the Government, through the social security agency, will be doing more transactions in a week than we currently do in a year. We are planning how it might play in and working it into the programme over the next few years. Brian Taylor might have more to say about the operational side.

Brian Taylor: In forming the social security agency, counter-fraud is being made a key aspect of its programme of work. Comprehensive data matching will be built in, in consideration of the NFI, but the data matching that will be required to make sure that the agency counters fraud effectively will go beyond the NFI.

Monica Lennon: Will you say something about the anticipated costs? As the cabinet secretary said, there will be a huge additional volume of data. Do you have any figures for the costs of NFI in relation to the social security powers?

Brian Taylor: I would need to talk to the Cabinet Office and Audit Scotland to see whether there are significant cost implications. From what I am aware of, there should not be, because the system is fast as it is, with 300 million pieces of data in the data pool. I do not think that it would be significantly affected, but I would need to check.

Willie Coffey: I would like to stick with the issue of repeat offenders, which I raised a couple of weeks ago, cabinet secretary. Like my colleagues around the table, I was surprised to learn that there is no automatic fraud investigation in a second year if fraud was perpetrated in the first year—it is all down to the data sets that are presented for analysis. If someone has attempted to commit a fraud in year 1, why do we not check them in year 2? Are we permitted to do that? I presume that we are—I do not think that we need legislation to do so. Will you clarify the issue?

Brian Taylor: There are some restrictions on what can be done in terms of profiling. I am not an expert on it, but there are restrictions with regard to what can and cannot be done.

The important point, which has been raised already in the discussions that we have had, will be the extension of UK legislation that will allow the sharing of information with third parties, which would include credit reference agencies as well as agencies that would have information on known fraudsters. That is the way in which we would get to the repeat offending issue that you are talking about and would be able to check the data again. I am not aware of the exact details of the roll-out, but I can get that information and feed it back to the committee.

Derek Mackay: To be fair, we are waiting for the Cabinet Office's work on that area to conclude.

Brian Taylor: Yes, it is doing a pilot exercise.

Willie Coffey: That is very helpful.

Some councils have said that there is no legal gateway for them to use to request information from HMRC to help with the national fraud initiative and fraud detection. Quite a number of councils said that they would like for there to be one. What would be the mechanism for us to achieve that? Would we have to get agreement from HMRC? Could we compel or require it? How would that work if we wanted to do it?

Brian Taylor: The restrictions relate to fair and lawful use of the data. With regard to working with HMRC, we would work with the Cabinet Office, which already does a great deal of work with HMRC and the DWP in matching data. We would have to work with Audit Scotland and the Cabinet Office if we wanted to include more HMRC data in the NFI exercise. From those discussions, we would find out whether any additional legislation would be required or whether improvements could be made simply through more effective communication and engagement.

Willie Coffey: The issue is more that there is no legal mechanism to enable councils to get information if they think that they need it. Even if they made a request, the information would not be forthcoming because there is no legal framework for that. The local authority officers all said that if the model that I mentioned was used, it would be very helpful and would add to the initiative's success rate.

Brian Taylor: Yes—I think that the same would be true for the legal gateway issue. We would engage with the Cabinet Office and HMRC. I am not aware of the barriers that have been highlighted. We would absolutely want to understand what those barriers are and what would be required to get over them. For example, we would want to know whether they involve a disagreement on the legal position or whether further legislation would be required.

Willie Coffey: On data protection—

Derek Mackay: Sorry—I just want to be clear on that. We are willing to be open. If what Willie Coffey describes is identified as an issue between local authorities and HMRC and it requires a legal remedy, we are open to helping to enable that. However, based on evidence to the committee, there seems to be a dispute around whether there is a legal issue or an issue with implementation.

Willie Coffey: On wider data protection issues, you will be aware that the European Union regulation on data protection comes into force next May. It will introduce even more stringent arrangements for data sharing and data security. My understanding is that the UK Government, whether or not it leaves the European Union, will sign up to that regulation.

Will the tightening of data security when the regulation comes into force make it harder for us to detect fraud in tax, benefits and social security across the range of agencies that have been mentioned today?

Brian Taylor: I am not aware of the full implications of those new arrangements. We currently have very stringent controls around data protection and use, so I would not expect the changes to be significant. However, in order to provide a detailed response, we would have to look into the matter further and report back to you.

Willie Coffey: My last question relates to evidence that we heard earlier this morning. With regard to the accuracy of the data that HMRC holds on the Scottish rate of income tax, are you assured—and what form does the assurance from HMRC to the Scottish Government take—that we have correct and accurate data that enables us to identify Scottish taxpayers?

Derek Mackay: I am pretty sure that Mr Coffey has asked me that question in the Finance and Constitution Committee as well. We have a range of assurances. There is the political-level agreement; there are arrangements around the fiscal framework and its implementation; and there is engagement between officials. There was a previous issue with not all Scottish income tax payers being identified, but they have all been identified now. HMRC is now doing various checks that it can answer for to assure the Scottish Government and the Parliament that it has identified everyone who should be paying tax in Scotland.

I am as assured as I can be, based on all the information that I have, that HMRC has undertaken a range of exercises to identify everyone, and that there have been further exercises to ensure that that is the case. A substantial number of people were identified further on in the system, but that did not cost any money and it did not lead to us losing any revenue. If I was not assured, I would be raising the matter with the secretary of state, the Chancellor of the Exchequer and other ministers. There is on-going work with officials.

10:30

The Acting Convener: The temptation for committee members to move on to consider this morning's evidence session could not be contained but, as we have now reached the end of those who have indicated that they wanted to ask questions on the national fraud initiative, we will officially move on to consider the evidence that we received this morning from HMRC.

Monica Lennon: Can I just go back to the national fraud initiative, as I am such a fan? [*Laughter*.]

The Acting Convener: I give up.

Derek Mackay: Monica Lennon can be our champion.

Monica Lennon: I know that there was some discussion about voluntary participation so I apologise if this question was asked earlier. Should all bodies that spend public money participate and should it be a condition of procurement bids for public projects?

Derek Mackay: All organisations have fraud and procurement policies and comply with the "Scottish Public Finance Manual", so there is already a range of checks and balances in place. I am not sure that the data-matching exercise should be compulsory and essential for everyone or for all procurement bids; the approach should be proportionate.

Monica Lennon: Thank you. I will let go of the NFI now.

The Acting Convener: Are you sure? This is your last chance. To round off the MFI bit—[*Laughter*.] Dearie me, it has clearly been a long day.

I very much welcome the fact that the cabinet secretary has been so open to the committee's recommendations even before we make them. That is a refreshing approach that I commend to other ministers. We will produce a report on our work on the NFI in due course and I look forward to receiving the bits and pieces of information that the cabinet secretary has said that he will provide to the committee.

As committee members have no further questions on this morning's evidence session with HMRC, I have a couple. We had some interesting discussions about liability for errors that are made and, in relation to the late identification of the 240,000 Scottish taxpayers, the cabinet secretary just said that there was no cost to the Government and no impact on the ultimate tax take. I am curious to know, if there should be an error in the future, what your understanding is of how that would play out with HMRC, particularly if it was HMRC's error.

Derek Mackay: I want to come back to the committee on the specific issue of administrative or identification error. There are very detailed and complex arrangements around the block grant adjustment and the reconciliation of the tax that is forecast to be collected from the BGA and the actual outturn of tax, and that is quite different from an administrative error where there has been a fault. We are paying for a function and we want that to be exercised. I will respond in writing on the question of administrative error by our delivery agent and who pays the consequential impact.

The Acting Convener: That would be very helpful.

I have a set of questions on the issues that Alex Neil touched on. If you are able to publish the

Council of Economic Advisers' work on behavioural impacts, that would be welcome. The Scottish Fiscal Commission will be charged with doing all of that, will it not?

Derek Mackay: Yes, it will do the forecasts.

The Acting Convener: Is it true that there was no consideration of behavioural impacts in relation to the Land and Buildings Transaction Tax (Scotland) Act 2013, in which there has been a lot of forestalling?

Derek Mackay: In terms of its first implementation and creation?

The Acting Convener: Yes.

Derek Mackay: That was before my time, so I would need to double-check what was provided to Mr Swinney at the time.

The Acting Convener: As a member of the then Finance Committee, perhaps I can help you. No behavioural impact assessment was done, which was pointed out by the Scottish Fiscal Commission at that point. We have subsequently seen quite substantial forestalling.

HMRC said that if it knew about a tax coming, it could work proactively to stop unintended consequences and could put in anti-tax avoidance measures—for want of a better phrase—in advance of the tax's implementation. Is that something that you would want to see as a result of the studies that the Scottish Fiscal Commission will do on behavioural impacts and behavioural changes?

Derek Mackay: Yes.

The Acting Convener: So you could anticipate taking out a lot of the potential difficulties by being proactive and putting anti-tax avoidance measures in place in advance.

Derek Mackay: Yes. The Council of Economic Advisers has been asked to look at whether there is any way of mitigating those issues to be able to change the tax positions. Looking at mitigation measures is part of that consideration.

The Acting Convener: That is excellent.

As there are no further questions, I thank the cabinet secretary and Mr Taylor for coming to give evidence this morning. We now move into private session.

10:34

Meeting continued in private until 10:54.

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