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Pàrlamaid na h-Alba

Official Report

FINANCE COMMITTEE

Tuesday 11 January 2011

Session 3

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FINANCE COMMITTEE
1st Meeting 2011, Session 3

CONVENER

*Andrew Welsh (Angus) (SNP)

DEPUTY CONVENER

*Tom McCabe (Hamilton South) (Lab)

COMMITTEE MEMBERS

*Derek Brownlee (South of Scotland) (Con)
*Malcolm Chisholm (Edinburgh North and Leith) (Lab)
*Linda Fabiani (Central Scotland) (SNP)
*Joe FitzPatrick (Dundee West) (SNP)
*Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD)
*David Whitton (Strathkelvin and Bearsden) (Lab)

COMMITTEE SUBSTITUTES

Gavin Brown (Lothians) (Con)
Lewis Macdonald (Aberdeen Central) (Lab)
Stewart Maxwell (West of Scotland) (SNP)
Liam McArthur (Orkney) (LD)

*attended

THE FOLLOWING GAVE EVIDENCE:

Janet Clayton (HM Revenue and Customs)
Sarah Walker (HM Revenue and Customs)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

Committee Room 1

Scottish Parliament

Finance Committee

Tuesday 11 January 2011

[The Convener *opened the meeting at 13:30*]

Decision on Taking Business in Private

The Convener (Andrew Welsh): Good afternoon and welcome to the Finance Committee's first meeting in 2011. Before our first substantive agenda item, I ask the committee to consider whether to take our draft report on the Scottish Government's draft budget in private at this meeting and future meetings. I propose that we do so. Are members agreed?

Members *indicated agreement.*

Scottish Variable Rate Inquiry

13:31

The Convener: Derek Brownlee has a comment.

Derek Brownlee (South of Scotland) (Con): The documentation from the Scottish Government on the Scottish variable rate was made available to the committee electronically late yesterday afternoon. At first glance, the documentation appears to be comprehensive, which is what the committee sought but, given the documentation's significant length, it is a significant discourtesy that the Scottish Government released the information so close to our first evidence session. That might mean that we cannot ask HM Revenue and Customs questions of the level of detail that we would like today. Some of the electronic documentation that was released yesterday was created before Christmas, so the Scottish Government should be invited to reflect on whether it has behaved appropriately in providing the information to the committee in the way that it has.

The Convener: You have put that on the record. I am sure that the Government will note what you have said and respond suitably.

Item 2 is evidence on our inquiry on issues that relate to the Scottish variable rate of income tax. I welcome to the meeting, via videolink, from HM Revenue and Customs Sarah Walker, director, pay as you earn, self-assessment and national insurance contributions; and Janet Clayton, assistant director, PAYE, self-assessment and NI contributions.

Sarah Walker (HM Revenue and Customs): Thank you and good afternoon.

The Convener: I invite you to make an opening statement.

Sarah Walker: Thank you for inviting us to give evidence and for allowing us to do so remotely from London. That is a great advantage for us, although we would have loved to go and see you.

As the convener said, I am the director of PAYE, self-assessment and national insurance contributions in HMRC. My colleague Janet Clayton is the assistant director, who is particularly responsible for dealing with tax and national insurance matters that involve the devolved Administrations or other Government departments. My directorate's responsibilities include developing, maintaining and improving the policy and processes that are used for PAYE and self-assessment. We would use such processes were the Scottish variable rate to be invoked. The SVR's delivery would involve several parts of

HMRC. It is our directorate's job to co-ordinate that and to ensure that the parts work together.

Introducing the Scottish variable rate would require us and employers to operate PAYE differently from how it operates at the moment, so our systems need to be able to cope with those differences. The information technology system aspects of implementing the SVR are significant and often have longer lead times than the other tasks that we need to do to put ourselves in a position to deliver the variable rate. That is why IT development has been the focus of conversations between us and the Scottish Government, to ensure that we would be ready to implement the SVR if we were asked to do so.

It is important to bear it in mind that, once a decision had been made to invoke the power, a considerable amount of other work that does not involve IT change would have to be done, such as identifying and communicating with Scottish taxpayers, dealing with their inquiries and ensuring that employers have the right equipment and the right understanding of the system to be able to operate it. Costs would be involved with that, but they would not arise until the decision had been made to invoke the Scottish variable rate.

It might help if I give a brief history of the relations between HMRC and our predecessor departments, and the Scottish Executive and the Scottish Government over the life of the SVR. Following the decision to devolve taxation powers to the Scottish Parliament, as set out in the Scotland Act 1998, the Inland Revenue set up a cross-departmental project to implement the SVR in 2000-01, which was the first year when the power became available for use. Some initial expenditure was made at that stage to prepare the Inland Revenue's tax systems for that implementation. However, following the 1999 election, the incoming Scottish Executive made it clear that it did not intend to operate the power during the lifetime of that Parliament. Consequently, rather than spend further resources to complete the implementation, the Inland Revenue agreed with the Executive that we would close the project but aim to be able to put the SVR into live running within 10 months of a Scottish election on the normal cycle. That would enable the next Administration to introduce the SVR at the earliest possible opportunity.

All the parties to the project felt that there was a risk that knowledge would dissipate over time if the SVR was not being used. We therefore instigated a memorandum of understanding that was supported by two sequential service level agreements. A key part of the memorandum of understanding was that, at appropriate times, the parties to the memorandum would review their state of readiness for the SVR. Such reviews were undertaken ahead of the 2003 and 2007 elections. We reviewed our operational plans and the capacity of our IT system. In each case, we were confident that the operational planning for the implementation of the SVR was in place and could be activated within the 10-month window.

In 2003, no additional IT work was identified as necessary. However, we concluded in 2007 that further IT development would be required as much had changed in the intervening period and we were in the process of a major upgrade to our IT system. I can talk more about that upgrade if you would like me to; it was a major change to the IT that operates PAYE across the United Kingdom. The overall cost of that was £389 million, which is a significant investment for the Government and HMRC. We identified at that point that the cost of maintaining SVR capacity in the new system would be in the range of £3.3 million to £4.9 million. At that point, in March 2007, the Scottish Executive felt that it could not commit to that money.

For the 2011 election, we similarly formally reviewed the position on our ability to implement the SVR in summer 2010. We concluded that we could deliver the SVR in 2012-13, which is the first tax year after the election, but that the further development work that was discussed in 2007 would still be necessary. The cost last summer was estimated at £7 million, which the Scottish Government felt that it could not agree to. As I explained, IT costs are only one element of the introduction of the SVR, but IT expenditure is necessary before the decision to invoke the SVR is taken in order to ensure that we can meet the agreed timescale.

Our view now is that we could not deliver the SVR for 2012-13 in April 2012. It is too late now for us to start the necessary work on our IT system. However, we could deliver the SVR in 2013-14, provided that we had sufficient notice and the funding was made available. That is all that I want to say by way of introduction. Thank you.

The Convener: Thank you for that explanation. Large computer programmes are notoriously difficult to implement, especially if they involve amalgamation or regular updating. However, after 12 years and almost £25 million, we have nothing to show. Can you now deliver a computer system for the SVR? If not, how much more will it cost to pursue it further? The fundamental question is whether it can be delivered.

Sarah Walker: Yes, we can deliver the functionality to operate the SVR. Last summer, we told the Scottish Government that we could put ourselves in the position that a new Government, following the election this year, could operate it from April 2012 if it was prepared to commit to the payment of the cost at that point. However, at that point, it decided that it could not do that. We can now offer the facility to operate the SVR in April 2013 if the decision is taken to fund the work that we need to do to operate it.

The Convener: Given the history, you will understand why I am asking the question in the hope that it can now be delivered.

Joe FitzPatrick (Dundee West) (SNP): What detail came with the request for a £7 million investment that was made on 28 July 2010? What information did the Scottish Government receive about what that £7 million was for?

Sarah Walker: We sent a breakdown of the costs. The e-mail that was sent is probably included in the material that was released by the Scottish Government last night. We provided a schedule of the changes that would have needed to be made at different points, details of the assumptions on which we were working and an indication of the cost.

Joe FitzPatrick: What guarantee was attached to those assumptions that £7 million would deliver the SVR in a state of readiness?

Sarah Walker: The £7 million is an estimate that is provided by our IT suppliers; it is not an absolutely cast-iron cost. It is the same basis on which we work when we plan our own IT. The cost was our best estimate at the time. We are pretty confident that, if we had had a decision last summer and the time had been available, we would have been able to deliver the SVR.

Joe FitzPatrick: The Scottish Government responded on 20 August, asking for more discussions on the issues. What contact was there thereafter, prior to 18 November, when the secretary of state wrote to the First Minister?

Sarah Walker: The response that we received in August was that they had decided that, at that point, they could not commit to the expenditure and recognised that that would not allow us to fulfil our obligation to implement the SVR within 10 months. They said that they would like to meet and we got back to them in September with an agreement to do that. We eventually met them in November.

Joe FitzPatrick: Prior to the secretary of state's letter?

Janet Clayton (HM Revenue and Customs): Are you referring to the letter from Michael Moore, the Secretary of State for Scotland?

Joe FitzPatrick: Yes.

Janet Clayton: I think that we had some telekits with the Scottish Government at the end of November and during December.

Joe FitzPatrick: After the letter was written.

Janet Clayton: I think that that was probably after the letter was written.

Joe FitzPatrick: Did the secretary of state contact you to ascertain what discussions were on-going prior to writing to the First Minister?

Janet Clayton: I am not aware of any direct contact with the secretary of state.

Joe FitzPatrick: The secretary of state made no effort to contact your offices prior to the letter of 18 November.

Janet Clayton: Not directly, no.

Tom McCabe (Hamilton South) (Lab): Good afternoon. Let me take you back to 2007. This is important. The current Scottish Government says that it did not inherit an operational system. You can correct me if I am wrong, but my understanding is that, in the years prior to 2007, the 10-month notice meant that, if an incoming Government had decided that it wished to activate the SVR, on a statutory basis that could not have been done until the following April. Nevertheless, in each year prior to 2007, you were able to accommodate an incoming Government that was elected in May and would have been able to activate the system in the following April. Is that correct?

13:45

Sarah Walker: The memorandum of understanding was based on the normal cycle of elections, so we reviewed it in 2003 and again in 2007. When we did the review before the election in 2007, we knew that we were having a major upgrade of our computers, and we therefore informed the Scottish Executive in March 2007 that additional expenditure would be needed for us to be able to implement the SVR within 10 months following the election.

Tom McCabe: In other words, in 1999, or perhaps more correctly in 2003, it cost £50,000 a year to maintain the 10-month readiness—I understand that the Scottish Executive paid that—but in 2007 it would have cost more. It would have required approximately £3.4 million.

Sarah Walker: It may be helpful to explain the difference between the £50,000 a year and the £3.4 million. The £50,000 a year was an on-going cost to maintain our records of Scottish taxpayers. It was to ensure that we had an up-to-date record of which taxpayers on our records would potentially be liable for the Scottish rate. That is quite separate from the costs of upgrading our computers to ensure that they could operate the SVR. Although the Scottish Executive was paying the £50,000 a year and we were maintaining our database, that had no effect on the cost that would be involved in ensuring that our infrastructure was capable of operating the SVR. Given the changes to our infrastructure that we were planning in 2007, a cost had arisen to ensure that it could operate the SVR, regardless of the £50,000 a year.

Tom McCabe: The £50,000 a year maintained the database and the information that was necessary.

Sarah Walker: Yes.

Tom McCabe: As long as there was an IT set-up sitting beside that, you could have implemented the SVR within 10 months. Is that correct?

Sarah Walker: Yes.

Tom McCabe: In 2007, you required to upgrade your IT systems, which had been in place for a period of time. Had the Scottish Government decided in May 2007 to pay the estimated charge of about £3.4 million—I appreciate that that is an estimate—would you have been ready to implement the SVR in April 2008?

Sarah Walker: We told the Scottish Executive before the 2007 election that, in order to have the full functionality to implement the SVR in April 2008, it would need to commit to the £3.4 million figure before the 2007 election. The option of spending that money after the election did not arise because it was then too late. We said to the Scottish Executive following the 2007 election that we would see what we could do, if you like. We said that, if the new Government wanted to implement the SVR, we would see whether there was some way in which we could implement it from April 2008, but it would be sub-optimal and would not have the full operation that we would expect to be able to provide.

Tom McCabe: That does not entirely concur with the briefing note that was supplied to Scottish ministers in May 2007, which stated that, provided that they committed to the £3.4 million before a date in June, the 10-month state of readiness could be maintained.

Sarah Walker: I think that what that says—[*Interruption*.] I beg your pardon while I read the document. What we were saying at that point was that we could implement something for April 2008 but that it would not have full functionality. In particular, it would not be able to cope with people who move in and out of Scotland throughout the year—we would not be able to keep up with people who become or stop being Scottish taxpayers during the year. That has a significant effect on yield.

Tom McCabe: Yes, but any system that is based on residence has that difficulty. Local councils have that difficulty given that around 10 per cent of people move each year and it is difficult to trace people. Any system that is based on residence will always be sub-optimal to some degree. Is that not the case?

Sarah Walker: I think that we are talking about PAYE, which is a system that takes account of changes in circumstances during the year. Normally, we expect to be able to take account of changes that affect people's tax liability so that we get the collection of tax right during the year. The inability to deal with movements of people would lead to a significantly lower level of service than we would normally deliver through PAYE.

Tom McCabe: But it was possible to implement the system in 2008—you could have done it.

Sarah Walker: Yes, but not with full functionality.

David Whitton (Strathkelvin and Bearsden) (Lab): Good afternoon. I suppose that I should put on record that, in looking back through material for the meeting, I came across a note from Mr Batho of which I was a recipient. I had not recollected that until I saw the note again. The note dates back to the beginning of the process, when the tax-varying power was being introduced. In his paper, Mr Batho refers to the various options that were put in front of Mr McConnell, who was Minister for Finance at the time, for consideration. One option—option 2—would involve

> "maintaining a reasonably high level of IT readiness and an up to date (but internal to Inland Revenue) register of Scottish taxpayers. This would allow implementation of the tax 10 months after a decision to use the power. In other words, it would allow an incoming administration elected in May to introduce the power the following April—the first point at which, statutorily, this would be possible."

Mr Batho goes on to talk through the other options. The recommendation was that option 2 become the preferred option; indeed, Mr McConnell and the Government of the time adopted it. That being the case, and from what you said earlier, surely that has always been the position, up until the present time.

Sarah Walker: That has always been the basis of the memorandum of understanding between us and the Scottish Government. We went through a major change to our IT systems, which meant that our ability to maintain the 10-month lead time was dependent on further IT expenditure as part of the upgrade of our systems. At each stage and before each election, we were very keen to work to understand what was needed to maintain that ability. At each stage, we discussed with the Scottish Executive and the Scottish Government what would be involved. I need to make it clear that we are not funded to make those changes to the system. Under the existing conventions, charges that are directly attributable to the

Scottish variable rate are payable by the Scottish Government.

David Whitton: You said to my colleague Mr McCabe that in March 2007 HMRC was in discussions with the Scottish Government about the following-up date. When exactly in March 2007 did those discussions take place—before or after the purdah period started?

Sarah Walker: I can find you the dates, if you will give me a second. A series of meetings were held, which is why I am flicking through the papers. There was a meeting on 23 February and a subsequent meeting on 23 March.

David Whitton: I assume that those were meetings with officials rather than with ministers.

Sarah Walker: Oh yes. They were meetings between officials.

David Whitton: Okey-dokes.

Let us move on to 20 August. You say that there had been some more communication between HMRC and the Scottish Government and that the Scottish Government decided in August that it could not commit to the expenditure.

Sarah Walker: Do you mean August 2010?

David Whitton: Yes, sorry—we are talking about 2010. In August 2010, there was a meeting, or perhaps it was done by letter—

Sarah Walker: It was done by e-mail.

David Whitton: Okay. There was an exchange of e-mails and officials told you that the Scottish Government would not commit to the extra expenditure. You said that they realised then that they could not meet the 10-month commitment. Who is "they"? Does that refer to the officials you were dealing with?

Sarah Walker: We had the message from the officials we were dealing with.

David Whitton: Who were those officials?

Sarah Walker: They were officials in the Scottish Government finance department.

Janet Clayton: Yes.

Sarah Walker: So in August of last year, officials in the Scottish Government finance department knew that an incoming Government in 2011 would not be able to introduce the SVR within the 10-month period.

Sarah Walker: Yes.

David Whitton: That is fine. Thank you very much.

Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD): I want to continue along the lines of Mr Whitton's question, but before I do so, I want to go back to Mr McCabe's question about previous Administrations. Is it correct that the official relationship that HMRC has with the Scottish Government operates through the memorandum of understanding and a service level agreement?

Sarah Walker: Yes.

Jeremy Purvis: Currently, are you operating under a service level agreement with the Scottish Government?

Sarah Walker: No. That has lapsed, I believe.

Jeremy Purvis: When did that happen?

Janet Clayton: In 2007, when the £50,000 payments came to an end.

Jeremy Purvis: Is it correct that that happened at the end of July 2007?

Janet Clayton: Yes, I think so.

Jeremy Purvis: So since July 2007, HMRC has not been operating under a service level agreement with the Scottish Government.

Sarah Walker: That is right.

Jeremy Purvis: At any time, did HMRC make a request to the Scottish Government for a third service level agreement as a successor to the service level agreement that came to an end in July 2007?

Sarah Walker: I am not aware of any discussions about that following the Scottish Government's decision in 2007 not to maintain the service level agreement.

Jeremy Purvis: Could you check back to the e-mails of early 2008, in which HMRC asked specifically what the view of Scottish ministers was? In the information that we have, there is an e-mail from Ron Powell to Sandra Stewart in the Scottish Government of 31 January 2008, in which he asked—

Sarah Walker: Yes, you are right. He asked whether they wished to renew the service level agreement. I am not aware of our having received a reply to that.

Jeremy Purvis: That is more a question for the Scottish Government.

That e-mail refers to a number of phases associated with keeping the SVR in a state of readiness. Convener, I am not sure whether the note on the Scottish variable rate history was provided by the clerks or the Government. I think that it was from the Government—is that correct?

The Convener: It was from Government officials.

14:00

Jeremy Purvis: The note that we had from Government officials refers to what happened in March 2007, which you referred to in your opening remarks, Ms Walker. The note states:

"HMRC report IT suppliers' view that £3.4m investment needed immediately to ensure readiness."

The e-mail from Ron Powell discusses a number of phases. It then states:

"Alternatively, do you wish to go down the route outlined at para 12g. of the briefing"—

by Scottish Government officials—

"that was to go to incoming Ministers vis 'If the decision is not to invoke SVR during the life of the Scottish Parliament it is recommended that the work associated with 2 phases, at a total cost of £1.2m, should be undertaken to maintain the current 10 month state of readiness.'"

Is that correct from HMRC's point of view?

Sarah Walker: That is what the e-mail says, yes.

Jeremy Purvis: We have been told by the Scottish Government that the cost was £3.4 million, so there is a difference.

Sarah Walker: The £1.2 million is part of the £3.4 million, which is the total cost. In his e-mail, Ron was offering a minimum expenditure that was part of the total cost and which related only to the PAYE elements and not to the other tax elements on which money would need to be spent. That was the minimum that needed to be done to ensure that we could keep the 10-month implementation in play.

Jeremy Purvis: I want to be clear on the record. Was the £1.2 million for the lifetime of the Scottish Parliament session?

Sarah Walker: The £1.2 million would have been a capital cost. It is the cost of a particular upgrade rather than a cost over a period of time. The proposition was that it could be spent in order to ensure that the first part of the upgrade was done in time so that a decision could be taken at the subsequent election on whether to invoke the SVR within 10 months.

Jeremy Purvis: When was HMRC informed that the view of the Scottish ministers was not to take forward a state of readiness?

Sarah Walker: In the exchange of e-mails, Ron asked whether the Scottish Government was interested in the limited option. We had a response from it in February, in which it asked more questions about what was involved in the expenditure. Between early 2008 and last year, we were into the process of a major computer project—our major upgrade. It then became difficult for us to isolate the cost of the SVR aspects from the overall HMRC PAYE project.

The programme was called MPPC—Modernising PAYE Processes for Customers—and the overall modification was a major project. As I said, it cost £389 million and involved reorganising the entire United Kingdom database of PAYE payers from a regional structure into a single centralised structure. It involved a lot of new computer support for our operations. The project was rescheduled more than once, and it caused us quite a lot of difficulty in the implementation, which I am sure that you will be aware of.

By the time we got to February 2008 and the Scottish Government was asking us for more detail on how the SVR aspects of that implementation could be done, we were in a process whereby we were aiming at a moving target. The SVR aspects got swept up in the overall project. We continued to keep in touch with the Scottish Government. We told it that we would reassess the costs involved. I think that on two occasions we offered to meet to update it but, in practice, until last summer it was difficult for us to give it the details of the phases of the project that we were talking about in that February e-mail, what the work would cost and what it would involve. That accounts for some of the time that was taken between the start of that conversation and the results being produced last summer.

Jeremy Purvis: So, from an HMRC perspective, were you working on the expectation that Scottish ministers would wish to carry on a state of readiness?

Sarah Walker: We were working on the basis of the memorandum of understanding, which included an assumption that we would maintain that state of readiness, but we would be able to do so only if the Scottish Government was prepared to meet the cost.

Jeremy Purvis: When did HMRC first tell the Scottish Government that there would be a deadline in 2010, which would be the last point at which SVR readiness would be available to an incoming Government after the 2011 elections?

Sarah Walker: I think that we sent it an e-mail early in 2010, by which time we had implemented the new IT system, although it was still going through some transitional issues. We told the Scottish Government early in 2010 that we were going to have to do another costing exercise to get another estimate from our IT suppliers, that that would be available in the summer and that we would need fairly quick decisions from the Scottish Government to be able to implement it. I think that at that point we also gave it to understand that the cost was likely to be significantly higher than the £1.2 million that we had been discussing previously.

Jeremy Purvis: It would be helpful if you knew when in early 2010 you informed the Scottish Government of that, just for our reference.

Sarah Walker: The e-mail was sent on 6 April 2010.

Jeremy Purvis: Okay. At that stage there was no concern from HMRC's point of view about the accuracy or otherwise of the amount of investment that would be needed to ensure that the state of readiness was on the same basis as it had been before the 2003 and 2007 elections.

Sarah Walker: I am not sure what you mean by "concern".

Jeremy Purvis: You said that in 2008 there had been e-mails to and fro between HMRC and the Scottish Government with regard to clarifying the costs of the SVR element of the reforms to the HMRC computer system and that, after the viability report was produced, HMRC made clear to the Scottish Government the level of investment that would be needed.

Sarah Walker: We got the viability report last July, at which point we had the same level of certainty about those costs that we had about the costs that we gave in 2007.

Jeremy Purvis: Okay. What happened after you told the Scottish Government that there would be a deadline if SVR readiness was to be available after the 2011 elections?

Sarah Walker: We had a response to the e-mail that we sent in April saying that this was going to have to be done. The response was:

> "I have consulted my colleagues and we are happy to meet in Edinburgh mid June to discuss the results of the Viability Report and next steps."

We assumed that the Scottish Government was happy to operate on that basis.

Jeremy Purvis: Was there a meeting in June 2010?

Sarah Walker: It turned out to be July. We sent an e-mail in July and offered to have a meeting.

Jeremy Purvis: Did that meeting take place?

Sarah Walker: No it did not.

Jeremy Purvis: Under the relationship that HMRC has had with the Scottish Government since devolution, what has been the understanding in "Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy" about who would pay for maintaining SVR readiness?

Sarah Walker: Our understanding of the basis on which we are funded is that the costs of maintaining and upgrading the capacity to operate the SVR are to be paid by the Scottish Government.

Jeremy Purvis: Has that been challenged by the Scottish Government or the Scottish Executive?

Sarah Walker: I am sorry. I do not understand the question.

Jeremy Purvis: Has that ever been questioned? Has the Scottish Executive or the Scottish Government since 2007 ever stated to HMRC that the funding policy is wrong?

Sarah Walker: It has not done so at official level.

Jeremy Purvis: The Scottish Government is saying that the statement of funding policy states that the Scottish Government would not have to cover the increased costs because of actions that were taken by HMRC. Was that ever communicated to you?

Sarah Walker: It was not communicated at official level, although I have seen the ministerial letters that have been published. That is all that I have seen.

Jeremy Purvis: So, HMRC was never informed about the Scottish Government's view of the funding policy.

Sarah Walker: I am not aware that we were. As I said, on each occasion on which we went formally to the Scottish Executive, or the Scottish Government, with an estimate of the costs that would be involved in the upgrade, it simply said that it is not prepared to commit to that expenditure at this time. It has not raised any issue of principle about the funding.

Jeremy Purvis: I just want to be clear, because the funding policy is mentioned in the service level agreements. From your point of view, was there no change to the Scottish Government's view about the statement of funding policy.

Sarah Walker: I do not think that there is anything else that I can say.

Jeremy Purvis: I have a final question, convener. I see that within some of the e-mails, although not—I stress—e-mails from HMRC, the Scottish Government refers to meetings and there are references to the use of the SVR mechanism for local income tax. There is a note from an official stating that, in advance of a meeting with the Treasury to discuss local income tax, the Scottish Government wanted an update on SVR readiness. Did HMRC have any discussions or meetings with the Treasury or the Scottish Government about using the SVR mechanism for a local income tax in Scotland?

Sarah Walker: No.

Jeremy Purvis: Thank you.

The Convener: You mentioned a moving target of costs. Is that not built into what HMRC is doing? Is the target still moving?

Sarah Walker: During the period in which we were implementing the major PAYE upgrade, there was an issue that made it particularly difficult to estimate the cost of the project as a whole, and it was under review. That project is now over and we are back to being much more certain about what is involved in costing and implementing. However, the way in which we get estimates for IT changes has not changed. We have to go through a process that we call viability to get our IT suppliers to give us an estimate of the cost of a change, and that costing is then refined through the subsequent design phases of the project. As with any major IT change, we cannot have absolute certainty about what it will cost until we are a long way through the process.

However, we can give the Scottish Government the same certainty and the same prediction for an IT change associated with the Scottish variable rate that we have given ourselves about upgrades to our IT systems. That would be on the basis of a fairly firm estimate, which would then be refined as the change is implemented.

14:15

The Convener: We wish you well in cost containment.

Linda Fabiani (Central Scotland) (SNP): Ladies, please excuse my not using your names; I am finding it difficult to see your names on the screen.

I, too, am interested in costs. We have clarified that the decision that was taken in March 2007 meant that we did not have that 10-month state of readiness. We were talking at that point about a figure of £3.4 million. We then got to July 2010, by which point the figure had more than doubled to £7 million. We have an extract from an e-mail from Ron Powell, dated 2 May 2007, in which he makes a "guesstimate"—as he calls it—of around £10 million. Why is there such a big variation in estimates? Has your project gone over cost?

Sarah Walker: There have been increases in costs. The quote that was given in 2007 was of up to £4.9 million. There was a central figure of £3.4 million, but £4.9 million was the upper bound of the likely cost. That has now gone up to around £7 million.

The costs are quite confusing. The reason why the figure increased from something like £5 million in 2007 to something like £7 million in the summer of 2010 was partly the change in the costs of our major PAYE programme upgrade. Other things also happened, such as the loss of child benefit data disks in late 2008, which led us to increase significantly the data security requirements of a number of our programmes. That added to the cost of all our programmes and would have had some effect on the cost of SVR implementation. I need to point out that SVR implementation is a small aspect of a large programme—the overall cost of £7 million is a fairly small part of a programme that is worth over £380 million. Perhaps the variability is, therefore, not so surprising.

Linda Fabiani: I was interested to read among the papers that have been posted online about the £12 million that was originally spent. Will you outline for me what was done for that £12 million? Some £2 million was spent on a call centre in East Kilbride to deal with the SVR, which was then mothballed. What benefits has Scotland had from that initial £14 million expenditure?

Sarah Walker: I am not aware of a mothballed contact centre, so I do not recognise the overall cost of £14 million. If it would help Ms Fabiani, we would be happy to provide a note of all the details of the £12 million.

Linda Fabiani: Thank you. Convener, it would be extremely useful if we could find out more information about the call centre in East Kilbride.

Back in May 2007, Ron Powell talked about the £10 million, which he said was for the non-IT costs of introducing the SVR.

Sarah Walker: That is the cost of checking and updating the database, to ensure that the right people are identified; of contacting them and informing them that they are liable for the Scottish variable rate; of dealing with any queries and appeals by people who argue about whether they are liable for the Scottish variable rate; and of dealing with employers to ensure that they are ready to operate the Scottish variable rate and that their systems are able to do that. It is not the direct computer costs, but the implementation costs that we would have to take on to ensure that we could deliver the Scottish variable rate.

Linda Fabiani: For the record, can you confirm that that cost is separate from the IT upgrade costs?

Sarah Walker: Yes.

Linda Fabiani: Who would meet it?

Sarah Walker: The Scottish Government. The cost would arise after a decision to invoke the SVR had been made. It is estimated that it would be £10 million in the first year, because of the additional need to set up the system. There would be an on-going cost of £4 million a year to maintain all of that capacity, to deal with inquiries, disputes about whether people were liable and so on.

Linda Fabiani: So we would have spent nearly £30 million without raising an extra penny of tax. That is interesting.

Derek Brownlee: I would like you to clarify a number of issues for me. The first mention of a discussion of a change in IT systems that I can find in the chain of correspondence that the Scottish Government has released is in an internal Scottish Government note of 22 August, which refers to the fact that HMRC would like to talk to the Scottish Government about system changes and the impact that they may have on the SVR. Are you able to indicate in more detail when HMRC first approached the Scottish Government at the highest level?

Sarah Walker: To which year are you referring?

Derek Brownlee: The note that I have is dated 22 August 2006 and is in document 2 of 2006. It is an internal Scottish Government note that refers to the fact that HMRC hopes to talk to the Scottish Government about system changes, so it is obvious that there was prior communication in some form. Are you able to provide clarification of when and in what form that discussion took place?

Sarah Walker: I do not have details of the specific communications at that point in 2006, but I am happy to check them and to let you know, if you would like me to do so. The first formal notification was part of the project board discussions that took place in early 2007, as part of the formal preparations for the 2007 election.

Derek Brownlee: According to the note, the fact that system changes were in prospect was part of the informal discourse that took place the previous year.

Sarah Walker: I am sure that that is right.

Derek Brownlee: My next question concerns the service level agreement for the second session of the Scottish Parliament—2003 to 2007. A note from the Scottish Government to the Inland Revenue, dated 11 July 2003, requested a four-year service level agreement running to 31 July 2007. Why did it take until 5 March 2007 to get a signed SLA in place?

Sarah Walker: I am afraid that I do not know.

Derek Brownlee: It seems rather odd that an SLA was signed only in the last breath of that four-year period.

The minutes of a project board meeting from February suggest that there was confidence about maintaining 10-month readiness but that the whole of the work had not been done. The position seems to be updated in the March minutes, which refer to the viability proposal.

Sarah Walker: To which year are you referring?

Derek Brownlee: I am referring to 2007. The minutes for February of that year refer to a degree of confidence about maintaining 10-month readiness, but the minutes for the meeting of 23 March provide detail of the viability proposal, which has already been discussed. Is the first indication that the viability proposal had been superseded the e-mail dated 17 July 2008 from Mr Powell, which refers to the decision that was taken about wider PAYE movement and suggests that the SVR was in a "state of limbo" at that point? Is that the first formal confirmation from HMRC to the Scottish Government that, subsequent to that viability proposal from March 2007, there was an inability to do anything until the new system was in place?

Sarah Walker: That is not quite right. At every time since the beginning of 2007, and probably before then, there has been a recognition that expenditure on an upgrade would be necessary to ensure that we had the 10-month readiness. We had a viability proposal, which just involves getting a quote from our suppliers for what would be involved in doing that. We did that before the 2007 election, but such quotes expire, because other things change. If other changes occur in the system, the cost of making the specific SVR changes are likely to be more or less because other things have moved on. Every time we consider the need to make upgrades, we have to go back and get a new quote, so each time we got a new viability proposal, we did so because we needed to update the quote from our suppliers and ask, "Given the other changes that have been made on the system since we last asked, how much would it now cost?"

Derek Brownlee: The e-mail to which I referred is from 17 July 2008. It is in document 6 for 2008, which was issued by the Government yesterday. It refers to an announcement that was made, I presume, on 16 July by the HMRC executive committee, on deferring the implementation of the migration of the entire PAYE population on to a new IT platform. The second paragraph states:

> "As the Viability Proposal was based on the assumption that the new platform would be in place it is no longer relevant. And until such time as a new date is identified we are in a state of limbo."

It then refers to the fact that, as ministers had indicated no plans to use the SVR in the Parliament, that was perhaps less of an issue. My reading of that is that, from the announcement of 16 July 2008 until such date as the population was moved over to the new system, the SVR could not have been implemented, even had a decision been taken to do so. Is that a correct reading of that e-mail?

Sarah Walker: I do not think that we ever made a judgment about that. The terms of the memorandum of understanding are that we should be able to introduce the SVR following each Scottish election. We were not looking at maintaining that capacity continuously every year between elections, partly because that was the basis of the memorandum of understanding and also, obviously, because the Scottish Government had made a commitment that it would not introduce the SVR.

Derek Brownlee: I understood that the memorandum of understanding had been superseded by the service level agreement, which then lapsed in July—

Sarah Walker: No. The memorandum of understanding is an on-going document. The SLAs are subsidiary to the memorandum of understanding. The SLAs have lapsed, but the MOU has not.

Derek Brownlee: Fine.

A note from 2009 that was internal to the Scottish Government states:

> "Not paying maintenance charges after July 2007 does not seem to have made any difference to the position with HMRC on SVR readiness. The reason for this is that HMRC have frankly not been in a position where they could make any undertakings about their readiness to implement SVR because of their big software changeover project. The agreement between HMRC and the Scottish Government is not a contractual one and HMRC appear to be flexible about its terms—just as we have had to be when it became clear that they were not in a position to deliver on their obligations to us."

Would HMRC agree that that statement is accurate?

Sarah Walker: I do not think that I can comment on that. I have pointed out the difference between the payments under the SLA, which were required to maintain a database, and the costs of upgrading the computer system, which are completely separate.

The Convener: Joe FitzPatrick has the final questions.

Joe FitzPatrick: Most of my questions have been asked but, looking forward, can you say what work is on-going or has been started to consider the implementation of the Scotland Bill?

Sarah Walker: We were not expecting to talk about that today.

Joe FitzPatrick: So you are not aware of any on-going calculations.

Sarah Walker: We cannot undertake any expenditure to implement the Scotland Bill until it has been passed by Parliament.

The Convener: We are asking only the possible of you, not the impossible.

Do our witnesses have any final comments?

Sarah Walker: I do not think so. We have promised to give you a note on the make-up of the £12 million that was initially spent to set up the SVR arrangements and we are happy to do that. Otherwise, I thank the committee for having us.

The Convener: I thank Sarah Walker and Janet Clayton for their detailed contributions and expertise, which are of great assistance to the committee.

As previously agreed under agenda item 1, we will move into private session to consider our draft report on the Government's draft budget for 2011-12.

14:30

Meeting continued in private until 15:26.

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