Memorandum of Understanding on the Scottish Income Tax Powers

Scottish Government
and
HM Revenue & Customs

Contents

Introduction

In February 2016, the Scottish Parliament passed its first Scottish Rate Resolution to set the Scottish rate of income tax (SRIT), as provided for under the Scotland Act 2012.

The Scotland Act 2016 increases the range of Scottish income tax powers, to allow the Scottish Parliament to vary rates by band, to set rate thresholds and to introduce new bands. The 2016 Act also provides for the Scottish Government (SG) to receive all the tax paid on non-savings, non-dividend income of Scottish taxpayers. As is the case for SRIT, from 2017/18, Scottish income tax rates, bands and the thresholds, will be set each year, through a Resolution passed by the Scottish Parliament on the basis of a proposal made by Scottish Ministers.

SRIT and Scottish income tax (Scottish income tax powers) are not fully devolved taxes. They remain part of the UK income tax system and are administered along with the rest of the income tax system by Her Majesty's Revenue and Customs (HMRC). Interaction with Scottish taxpayers, including the provision of information, notices of coding, collection, compliance and pursuit of tax due, are matters for HMRC. Any issues of dispute about the tax will be matters between Scottish taxpayers and HMRC. Under the Scottish income tax powers, Scottish Ministers will be responsible for the tax rate (and from 2017/18, tax rates and bands) but not for any other element of the tax nor for its administration. However the Scottish Government's budget will bear the agreed costs of setting up and the additional net costs of operating the income tax powers and will benefit from revenue collected. This Memorandum of Understanding sets out arrangements between HMRC and SG for setting up and operating the Scottish income tax powers.

Paragraph 1

1.1 ***Scottish rate of income tax -*** The Scotland Act 1998 ("the 1998 Act"), as amended by the Scotland Act 2012 ("the 2012 Act"), gave the Scottish Parliament the power to set a Scottish rate of income tax to be charged on Scottish taxpayers (as defined in new section 80D of the 1998 Act). SRIT commenced on the 6 April 2016 for tax year 2016/17. It is administered by HMRC as part of the UK-wide income tax system and applied to non-savings and non-dividend income. The Scottish Parliament set a rate of 10p for tax year 2016/17. The 2012 Act repeals the provisions for the Scottish Variable Rate (SVR) with effect from the date SRIT began.

SRIT will cease to operate at the point at which the Scottish income tax powers under the Scotland Act 2016 are applied - confirmed by HM Treasury regulations to be the tax year 2017/18.

Scottish income tax- The Scotland Act 2016 gives the Scottish Parliament the power to set income tax rates and the thresholds (excluding the Personal Allowance) on the non-savings and non-dividend income of Scottish taxpayers. It does this by making further amendments to the Scotland Act 1998. The Fiscal Framework agreement between the Scottish and UK Governments (the Fiscal Framework) sets out that these new powers will be available to the Scottish Parliament from tax year 2017/18[1]. As with SRIT, it will be administered by HMRC as part of the UK-wide income tax system.

1.2 ***Purpose of this document-*** This document has been agreed by the Scottish and UK Governments. It sets out HMRC's and SG's respective on-going responsibilities in relation to establishing and operating Scottish income tax powers in an efficient and effective

[1] http://www.gov.scot/fiscalframework, p. 4

manner. The document provides the framework for inter-Government work at Ministerial and official level to oversee the establishment and operation of the Scottish income tax powers. It has no formal legal force. Nevertheless both Governments expect its terms to be followed. Arrangements for dealing with disputes are set out in the document.

1.3 ***Accounting Officer*[2] *and responsible officers-*** HMRC has appointed an Additional Accounting Officer with overall responsibility for Scottish income tax powers, who is accountable for the performance of HMRC in establishing and operating Scottish income tax powers. The responsibilities of this post are set out at Appendix A of this document. The senior officials with responsibility for the matters covered by this document are the Deputy Director, Fiscal Responsibility for SG and the Deputy Director, Devolution for HMRC. In addition, the Fiscal Framework agreement expanded the remit of the Joint Exchequer Committee (Official) to oversee the implementation and operation of the financial provisions of the Scotland Act 2016, which will include the Scottish income tax powers[3]. The Joint Exchequer Committee (JEC) provides Ministerial oversight of the programme of work.

1.4 ***Context-*** This document reflects:

- the Memorandum of Understanding and Supplementary Agreements between the United Kingdom Government, the Scottish Ministers, the Welsh Ministers, and the Northern Ireland Executive Committee;
- Cabinet Office devolution guidance notes[4];
- HM Treasury's statement of funding policy, "Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly"[5]; and
- the agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's fiscal framework.[6]

The document sets out how the broad approach in these documents will be applied to setting up and operating Scottish income tax.

The principle of openness also underlies this document. Information in relation to the matters within the scope of this MoU will be shared freely between SG and HMRC, subject to relevant legal or contractual conditions including the Data Protection Acts and the Freedom of Information Acts. Information covered by HMRC's obligations to protect taxpayer confidentiality will continue to be so covered.

1.5 ***Dates and timing-*** this document updates the Memorandum previously signed on 14 February 2013 (Version JEC1). This updated MoU, amended to reflect the further Scottish income tax powers devolved by Scotland Act 2016 comes into effect on the date of the signature below. This document has no expiry date, but it will cease to have effect if Scottish income tax powers are repealed. The document may be brought to an end by agreement between SG and HMRC. It will be reviewed at the request of either party. Any changes to its content arising from such a review or from material changes in the documents listed in 1.4 will be marked by the issue of a new, dated, version number.

The SRIT provisions in the Scotland Act 2012 are in force. The Scottish income tax provisions in the Scotland Act 2016 will come into force for the 2017/18 tax year (and

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[2] In Scottish terminology, this is equivalent to "Accountable Officer".
[3] http://www.gov.scot/fiscalframework, p. 16
[4] https://www.gov.uk/government/publications/devolution-guidance-notes
[5]https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/479717/statement_of_funding_206
[6] https://www.gov.scot/fiscalframework

subsequent years) as set by The Scotland Act 2016 (Commencement No.2) Regulations 2016.[7]

1.6 ***Roles and responsibilities of SG and HMRC***

SG and HMRC will each set up governance arrangements for the development of Scottish income tax powers. The JEC(O) (referred to at 1.3 above) has been set up to assure, along with other wider tax and non-tax aspects of devolution, the successful implementation of the income tax provisions in the 2012 and 2016 Act: it will take an inter-governmental approach to monitoring progress towards implementation.

HMRC will develop and test the IT and non-IT systems for the implementation of Scottish income tax powers, as set out in paragraph 2 below.

Following successful conclusion of testing, HMRC will administer Scottish income tax powers, as set out in paragraph 3 below, as part of the UK tax system.

HMRC will invoice SG for agreed items of expenditure relating to both development and operation of Scottish income tax powers within the terms set out in paragraph 4 below.

SG will make payment to HMRC for amounts invoiced for agreed items of expenditure, as set out in paragraph 4 below.

For tax year 2017/18 onwards the SG will prepare a Scottish rate resolution as described in section 80C of the 1998 Act as amended by Scotland Acts 2012 and 2016, and ensure this is placed before the Scottish Parliament (see also paragraph 5 below).

HMRC will pay receipts related to Scottish income tax powers into the UK Consolidated Fund in the same way as for other tax receipts. The arrangements for funding SG in relation to Scottish income tax receipts, and for reconciliation between forecast and actual Scottish income tax receipts, are matters between HMT and SG. For information, these are described separately at paragraph 6 below.

SG and HMRC responsibilities in relation to the exchange of information are set out in paragraph 7 below.

The annual cycle of activities in relation to the Scottish income tax powers (including SG and HMRC actions) is summarised at Appendix B.

Paragraph 2

2.1 ***Development of IT and administrative systems for Scottish income tax powers-*** HMRC will develop and test the IT and administrative systems for Scottish income tax powers within the overall Scotland Act programme managed by the Programme Board, on which SG is represented, with senior oversight provided by the jointly-chaired JEC(O). HMRC will keep SG informed of and will consult SG on, plans, timetables, estimated costs and progress. Where there are options for developing such systems, HMRC will discuss these, together with cost, risk, efficiency, effectiveness or customer impact factors, with SG before an option is selected. Subject to the overall programme agreed between HMRC and the SG as part of the inter-governmental oversight process referred to above, the delivery of IT components will be timed to fit with wider IT system schedules and to ensure that the correct functionality is available to support the timely introduction of Scottish income tax powers.

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[7] http://www.legislation.gov.uk/uksi/2016/1161/contents/made

HMRC is responsible for delivering a working income tax system for Scottish income tax powers that is able to collect the correct amount of tax from Scottish taxpayers as defined in section 80D of the 1998 Act and provides appropriate control and accounting information

2.2 ***IT systems***- HMRC will develop and test the IT systems through its contracted IT suppliers and in accordance with its normal IT development practice. The cost and functionality of each part of the IT systems will be notified to SG in advance and in detail, subject to any confidentiality rules in prevailing HMRC IT contracts. SG and HMRC will scrutinise the cost of each item with a view to keeping this as low as possible. Where any concerns remain about the cost of a particular item, SG - or HMRC on behalf of SG and after discussion with them - may request an independent assessment of the estimated costs at additional cost. This assessment will provide a breakdown of activity required to deliver the functionality necessary and the associated costs and will provide an opinion on whether the cost estimate appears to be reasonable in the circumstances.

HMRC's plans for testing IT system changes required to deliver Scottish income tax will be informed by best practice learnt from the implementation of SRIT. Plans for testing and appropriate key requirement decisions will be brought to the Project Board for review by all stakeholders, including the Scottish Government. The results of the tests of IT system changes will also be reported to the Project Board. To provide maximum assurance, SG may ask for additional audit work to be undertaken on systems testing and testing results. Where evidence arises that suggests that further assurance is needed about the accurate and reliable operation of the system, the necessary additional testing and related work will be carried out by HMRC and its IT contractor.

2.3 ***Administrative (non-IT) systems***- HMRC will develop and test the administrative systems for Scottish income tax powers in accordance with its normal practice. A breakdown of the expected costs and activities will be shared with SG before such costs are incurred. SG and HMRC will scrutinise the cost of each item with a view to keeping this as low as possible.

Paragraph 3

3.1 ***Continuing operations***- After IT changes have been made to deliver Scottish income tax, HMRC will maintain its IT and administrative systems from year to year so that systems supporting Scottish income tax continue to operate effectively and efficiently.

3.2 ***Scottish Taxpayers***- As part of the work to implement SRIT HMRC have introduced a Scottish taxpayer identifier in their systems for each individual potentially liable to be a Scottish taxpayer as defined in new section 80D of the 1998 Act.

Within Pay As You Earn (PAYE), 'S' codes have been applied to all Scottish taxpayers recorded at a Scottish postcode on HMRC systems. HMRC will send revised coding notices to taxpayers and/or employers, as appropriate, as taxpayers move in or out of the Scottish taxpayer population, either in-year or as part of the annual coding exercise that normally starts at the beginning of each calendar year.

HMRC will maintain an accurate record of Scottish taxpayers by updating a taxpayer's identifier as addresses are changed and by interaction with the taxpayers themselves.

HMRC may, subject to its obligations about taxpayer confidentiality, inform appropriate third parties, such as pension providers, whether a person is a Scottish taxpayer.

The Self-Assessment (SA) system has been adapted so that Scottish taxpayers within SA will declare their status as part of their annual return.

3.3 ***Service Standards***- SG and HMRC will agree a set of standards for the operation of Scottish income tax powers, including levels of service to Scottish taxpayers.

3.4 ***Compliance -*** HMRC will conduct risk analysis/assessment compliance and anti-avoidance activity on Scottish taxpayers in accordance with its normal targeting priorities in relation to income tax. HMRC's risk processes will take into account any changes in the Scottish rates and/or bands, which may affect the distribution of risk and will make no distinction, pound for pound, between income tax levied by the UK Parliament and that levied by the Scottish Parliament.

HMRC will also conduct risk analysis/assessment, compliance and anti-avoidance activity on individuals in relation to Scottish taxpayer status and on employers to ensure that PAYE systems are being operated properly in accounting for Scottish income tax.

The nature of this risk and compliance activity will be discussed with SG. Where SG proposes that further activity should be carried out in respect of Scottish income tax and it is agreed that this is feasible and would reduce revenue risk and improve compliance, HMRC will carry out such activity. This would be charged for on the basis set out at 4.2.

Paragraph 4

4.1 ***Funding-*** Where HMRC charges for its services, it does so (following HM Treasury policy) at the full economic cost of providing the service, seeking to make clear the breakdown of the calculation. Full economic cost is based on the average salary cost for the relevant grade plus per capita overheads such as HR, accommodation and finance costs. Where costs are incurred under contract by third parties including HMRC's IT supplier, these will be charged at-cost. These costs may be subject to external review and assessment as described in paragraph 2.2 above.

The Fiscal Framework agreement sets out that, in line with the approach taken for the Scottish Rate of Income Tax (agreed between Ministers of the UK and Scottish Governments in the exchange of correspondence on 21 March 2012) the Scottish Government will reimburse the UK government for net additional costs wholly and necessarily incurred as a result of the implementation and administration of the [Scottish] Income Tax powers[8]. With the exception of spend on establishing Scottish taxpayer status, continuation of the compliance and collection activity that HMRC already currently undertake for income tax in Scotland will not constitute a net additional costs chargeable to SG.

Costs will be borne by SG and HMRC as set out at paras 4.2 and 4.3 below.

4.2 ***Costs borne by SG-*** the Fiscal Framework agreement sets down that subject to the arrangements detailed in paragraphs 2 and 3 above, HMRC will invoice and SG will pay for:

- Capital costs of IT changes to identify Scottish taxpayers and calculate and account for Scottish income tax powers;

- Cost of any independent assessment of IT costs requested by, or after consultation with, SG;

[8] http://www.gov.scot/fiscalframework, p. 5/6

- Maintenance costs of IT systems where specific provision is needed for Scottish income tax powers;

- Cost of the Scottish income tax powers element of improvements and upgrades to systems, where specific provision is needed ;

- Non-IT capital costs relating specifically to Scottish income tax powers;

- Project costs of preparation for the introduction of Scottish income tax powers;

- Resource cost of activities specifically relating to the administration of Scottish income tax powers;

- Resource costs relating to additional risk analysis, risk assessment, compliance, customer contact and anti-avoidance activity relating to Scottish taxpayer status (whether involving - or targeted at - claimed Scottish taxpayers who may be other UK taxpayers, or claimed other UK taxpayers who may be Scottish taxpayers) over and above the compliance efforts that HMRC currently practise for income tax in Scotland

4.3 ***Costs borne by HMRC -*** HMRC will not charge SG for:

- Cost of changes to IT systems where no specific provision needs to be made for Scottish income tax powers (even if the systems are involved in accounting for Scottish income tax powers or identifying Scottish taxpayers);

- Cost of changes to IT systems where the aspects relating to Scottish income tax powers cannot reasonably be costed separately;

- Cost of changes to IT systems arising from UK Government policy initiatives, even where specific provision is needed for Scottish income tax powers;

- Cost of compliance cases relating to Scottish taxpayers where Scottish taxpayer status is not the main factor;

- Cost of compliance cases relating to other UK taxpayers where Scottish taxpayer status is considered, but is not the main factor in the case; and

- Cost of general employer compliance on Scottish employers or relating to Scottish taxpayers.

Where a dispute arises in relation to whether any costs set out in paragraphs 4.2 or 4.3 above are net additional costs both wholly and necessarily incurred as a result of the implementation and/or administration of Scottish income tax, it will be dealt with under the dispute resolution process as laid out in paragraph 8.

4.4 ***Invoicing -*** HMRC will invoice SG for costs incurred on a quarterly basis. SG will make payment to HMRC within 30 days of the invoice date, or within 30 days of receipt of the invoice if there is a delay of more than 5 days between invoice date and date of receipt.

Accrual arrangements will be agreed between HMRC and the SG for Quarter 4 payments to ensure that payments are made in the appropriate financial year.

4.5 ***Financial Management Guidance -*** UK Government policy about financial management is set out in Treasury documents "Consolidated[9] Budgeting Guidance" and "Managing Public Money", which are available on the Treasury website[10]

Paragraph 5

5.1 ***Setting the Rate-*** New section 80C of the 1998 Act requires that, for the Scottish rate to be set, the Scottish Parliament must pass a Resolution before the start of the tax year to which it relates, that is by 5 April in any year. The SG and the Scottish Parliament will make arrangements for including in the annual budget cycle the setting of the rate by Resolution. This is a matter for the SG and the Scottish Parliament. As far as administration is concerned, HMRC will make orderly preparations for the next tax year, providing all UK taxpayers (including Scottish taxpayers) and employers with correct coding information in a timely way. SG and HMRC will work together to ensure that these administrative steps are planned and carried out efficiently and in a timely way to minimise cost and burden for both employers and taxpayers. This includes agreeing an approach to be taken with regard to the main issue of tax codes, if the rate has not been determined by the end of November.

5.2 ***Notification of Rate -*** Scottish rate resolutions passed by the Scottish Parliament will be a matter of public record.

Paragraph 6

6.1 ***Forecasting and payment of tax receipts –*** For tax year 2016/17 forecasting of SRIT receipts was carried out by the Office for Budget Responsibility (OBR). As part of a transitional arrangement agreed under the Fiscal Framework, for 2017/18, forecasting of Scottish income tax receipts will be done by SG and scrutinised by the Scottish Fiscal Commission. Commencing from the 2018/19 tax year, the Scottish Fiscal Commission are to take on the role of forecasting Scottish income tax receipts. The mechanism for making funds available to SG, are matters for agreement between SG and HMT,

6.2 ***Accounting, Audit and Assurance -*** Expenditure and receipts relating to Scottish income tax powers will be identified separately in HMRC annual accounts, which are audited by the National Audit Office (NAO).

Following audit of the HMRC accounts, the AAO (see para 1.3 above) will provide an extract, covering all matters relating to Scottish income tax powers, to the Scottish Parliament. He will be available to give evidence to Scottish Parliamentary Committees when required.

In addition, section 33 of the 2012 Act lays a duty on the Secretary of State for Scotland to make a report each year, until 2020 at the earliest, on the implementation and operation of Part 3 of the 2012 Act (Finance). Scottish Ministers must make and lay a similar report each year. The Fiscal Framework sets out that both Governments will separately prepare and publish a similar type of report for the functions and duties being devolved under the Scotland Act 2016. These reports will also be provided to both the UK and Scottish Parliaments.

These reports include sections on the implementation and operation of the Scottish income tax powers.

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[9] https://www.gov.uk/government/publications/consolidated-budgeting-guidance-2016-to-2017
[10] https://www.gov.uk/government/publications/managing-public-money

6.3 ***In-year reporting to Scottish Ministers -*** HMRC will provide information to SG in a form and at a frequency to be agreed throughout the tax year reporting on actual tax receipts and on any issues arising relating to compliance or other matters that are relevant to the collection of receipts arising from Scottish income tax powers.

Paragraph 7

7.1 ***Information Sharing-*** HMRC must provide information to SG that will enable Scottish Ministers and officials to discharge their duties in respect of Parliamentary accountability, scrutiny, rate setting and forecasting in relation to Scottish income tax powers. This includes information in relation to the reporting requirements of section 33 of the 2012 Act and the Fiscal Framework agreement. Where the provision of information would involve significant analysis time, HMRC will notify SG of the likely cost and time period involved. If SG authorises the work and agrees to pay, HMRC will undertake this work.

7.2 ***Limitations****-* As mentioned at para 1.4 above, HMRC operates within legal constraints about taxpayer confidentiality. The Commissioners for Revenue & Customs Act 2005 (CRCA) prohibits the disclosure of information held by HMRC, but in the list of exceptions to this, section 18(2)(a) allows HMRC to disclose information for the purpose of a function of HMRC (which income tax is). HMRC cannot though provide any analysis that identifies individual taxpayers, or that would allow amounts of tax relating to individual taxpayers to be inferred.

Paragraph 8

Dispute Resolution - where a dispute arises in relation to any of the matters set out in this Memorandum of Understanding, or about other aspects of the implementation of Scottish income tax powers, it will be discussed at the Programme Board on which SG is represented. If agreement is not reached between HMRC and SG at the programme board, the matter will be passed to the JEC(O) for resolution. If, exceptionally, the matter cannot be resolved there it will be brought to the Joint Exchequer Committee for discussion and agreement by Ministers, as laid out in the Fiscal Framework agreement.

Signed on behalf of their relevant organisations:

Aidan Grisewood
Deputy Director, Fiscal Responsibility
for Scottish Government
Date: 1st December 2016

Sarah Walker
Deputy Director, Devolution
for HM Revenue & Customs
Date: 1st December 2016

Appendix A

HMRC Additional Accounting Officer Responsibilities

The legal basis for Accounting Officers is found in:

- Government Resources and Accounts Act (GRAA) 2000
- Government Trading Funds Act (GFTA) 1973, (as amended in the Government Trading Act 1990 and the Finance Acts 1991 and 1993)

The administration of SRIT and Scottish income tax is a function of HMRC and so lies within the overall responsibility of HMRC's Principal Accounting Officer, its Chief Executive, Jon Thompson.

The Command Paper, "Strengthening Scotland's Future"[11], published alongside The Scotland Bill when it was introduced to Parliament on 30 November 2010, announced that an Additional Accounting Officer (AAO) will be appointed who will be specifically accountable for the collection of SRIT, including the associated assets, liabilities and cash flows. This appointment will not detract from the Principal Accounting Officer's overall responsibility for HMRC's departmental accounts.

The AAO will have responsibility for all matters of governance, decision making and financial management in relation to SRIT. This includes promoting and safeguarding regularity, propriety, affordability, sustainability, risk, and value for money for SRIT; and accounting accurately, and transparently for all matters relating to it. The AAO will provide an SRIT extract from the audited HMRC accounts to the Scottish Parliament (see Para 6.2).

Whilst not specifically addressed in the Fiscal Framework agreement, HMRC intends that the AAO's role will extend also to Scottish income tax, in keeping with the spirit of the Command Paper

Scottish Parliamentary Committees will be able to request HMRC Accounting Officers to give evidence. The Accounting Officers will be available to give evidence when required.

Full details of the responsibilities of Accounting Officers are shown at Chapter 3 of the HM Treasury document, Managing Public Money. This may be found at:

http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/454191/Managing_Public_Money_AA_v2_-jan15.pdf

[11] http://www.scotlandoffice.gov.uk/scotlandoffice/files/Scotland Bill Command Paper.pdf

Appendix B

Operation of Scottish income tax
Indicative Annual Cycle of Activities

Timing	Activity
By 30 November before tax year	SG provides information to HMRC about the proposed Scottish rates and bands for the coming tax year when the draft Scottish budget is published. If information is not available by this date, alternative arrangements will be made.
Before tax year	HMRC issues PAYE coding notices to Scottish taxpayers based on Scottish Taxpayer (S) indicator
Before tax year	SG lodges Scottish rate motion before the Scottish Parliament, in time for Scottish rate resolution, to be passed by 5 April.
During the tax year	Employers make PAYE returns and payments in respect of Scottish taxpayers
	HMRC updates systems with data from employers
	Scottish block is based on OBR forecast of Scottish income tax; SG draws down funding from block
	HMRC employer compliance
	HMRC updates “S” indicator as appropriate
At the end of the tax year	HMRC issues Self-Assessment (SA) returns
31 October after tax year	Taxpayer deadline for manual SA returns
31 January after tax year	Taxpayer deadline for online SA returns
February onwards after tax year	HMRC taxpayer compliance
Till 12 months after tax year	Administrative reconciliation of SRIT element in Scottish block by reference to actual income tax liability declared for tax year 2016/17. Reconciliation of Scottish income tax element in Scottish block by reference to actual income tax liability declared from 2017/18.