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I am writing to you further to the latest meeting of the Joint Exchequer Committee (JEC) in Edinburgh on 14 February, and further also to the Committee's helpful comments on the Memorandum of Understanding (MoU) between the the Scottish Government and HMRC on the Scottish Rate of Income Tax (SRIT) which you wrote to me about on 12 December.

This was the third meeting of the JEC and the second since the Scotland Act 2012 received Royal Assent. The Committee discussed implementation of the financial provisions of the Act and noted that substantial progress has been made by both the Scottish and UK Governments to prepare for the successful delivery of these new functions. Ministers also agreed that the MoU should be finalised.

I am therefore enclosing a signed copy of the MoU which had been adjusted in light of comments from your committee and the Public Audit Committee. I am also writing similarly to the Convenor of the Public Audit Committee enclosing a copy of the signed MoU. A copy is being sent by HMRC to the Chair of the Scottish Affairs Committee at Westminster.

**JOHN SWINNEY**

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Memorandum of Understanding on the Scottish Rate of Income Tax

**Scottish Government  
and  
HM Revenue & Customs**

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## ***Introduction***

The Scottish rate of income tax (SRIT) will be set, each year, through a Resolution passed by the Scottish Parliament on the basis of a proposal made by Scottish Ministers. SRIT is not a devolved tax. It forms part of the UK income tax system and will be administered along with the rest of the income tax system by Her Majesty's Revenue and Customs (HMRC). Interaction with those taxpayers who are liable to pay SRIT, including the provision of information, notices of coding, collection, compliance and pursuit of tax due, will be matters for HMRC. Any issues of dispute about the tax will be matters between Scottish taxpayers and HMRC. Scottish Ministers will be responsible for the tax rate but not for any other element of the tax nor for its administration. However the Scottish Government's (SG's) budget will bear the agreed costs of setting up and operating SRIT and will benefit from revenue collected. This Memorandum of Understanding sets out arrangements between HMRC and SG for setting up and operating SRIT.

### *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”), gives 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 will commence from a date to be set by the UK Government. This is expected to be April 2016. It will be administered by HMRC as part of the UK-wide income tax system and applied to non-savings income. The Scottish Parliament will be able to set a rate of SRIT from zero to any number of pence or half-pence in the pound. This rate will be added to each of the main UK rate bands after ten pence in the pound has been deducted from each rate.

The 2012 Act repeals the provisions for the Scottish Variable Rate (SVR) with effect from the date SRIT begins.

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 responsibilities in relation to establishing and operating SRIT efficiently and effectively. The document provides the framework for inter-Government work at Ministerial and official level to oversee the establishment and operation of SRIT. 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<sup>1</sup> and responsible officers*** – HMRC has appointed an Additional Accounting Officer with overall responsibility for SRIT who is accountable for the performance of HMRC in establishing and operating SRIT. 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

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<sup>1</sup> In Scottish terminology, this is equivalent to “Accountable Officer”.

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Director, Fiscal Responsibility for the Scottish Government and the Deputy Director, Devolution for HMRC. In addition, an inter-Governmental Assurance Board (IAB) has been established, jointly chaired by the Director General Finance, Scottish Government (SG) and the Director, Public Services, HM Treasury (HMT) with senior official representation from HMT, SG, Scotland Office, and HMRC to oversee the planning and implementation of the financial provisions of the 2012 Act, notably SRIT. 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; and
- HM Treasury's statement of funding policy, "Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly"<sup>2</sup>.

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

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 came into effect on the date of signature below, following Royal Assent to the 2012 Act. This document has no expiry date, but it will cease to have effect if SRIT is 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 and at the end of the two- or three-year transitional period referred to in the Command Paper (April 2018 or 2019). 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 came into force on 1 July 2012. HMRC will liaise with SG about:

- the commencement of the consequential amendments relating to SRIT in Schedule 2 to the 2012 Act (which by virtue of

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<sup>2</sup> <http://www.official-documents.gov.uk/document/cm78/7864/7864.pdf>  
<http://www.cabinetoffice.gov.uk/resource-library/devolution-guidance-notes>  
[http://www.hm-treasury.gov.uk/spend\\_sr2010\\_fundingpolicy.htm](http://www.hm-treasury.gov.uk/spend_sr2010_fundingpolicy.htm)

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section 44(4)(a) come into force on a day to be appointed by the Treasury); and

- the timing and making of the Treasury Order under section 25(5) of the 2012 Act to appoint the first tax year to which a Scottish rate resolution can apply.

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

SG and HMRC will each set up governance arrangements for the development of SRIT. The IAB (referred to at 1.3 above) has been set up to assure the successful implementation of the financial provisions of the 2012 Act: it will take an inter-governmental approach to quality assurance of the implementation process and agree and review how progress towards implementation milestones should be driven and measured.

HMRC will develop and test the IT and non-IT systems for the administration of SRIT, in consultation with SG, as set out in paragraph 2 below.

Following successful conclusion of testing, HMRC will administer SRIT, 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 SRIT 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.

SG will prepare a Scottish rate resolution as described in new section 80C of the 1998 Act, and ensure this is placed before the Scottish Parliament (see also paragraph 5 below).

HMRC will pay SRIT receipts into the UK Consolidated Fund in the same way as for other tax receipts. The arrangements for funding SG in relation to SRIT receipts, and for reconciliation between forecast and actual SRIT 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 SRIT (including SG and HMRC actions) is summarised at Appendix B.

#### *Paragraph 2*

##### 2.1 ***Development of IT and administrative systems for SRIT –***

HMRC will develop and test the IT and administrative systems for SRIT within the overall Scotland Act programme managed by the Programme Board on which SG is represented, with senior oversight provided by the jointly-chaired IAB. HMRC will keep SG informed of, and will consult SG on, plans, timetables, estimated costs and

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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 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 timely introduction of SRIT. HMRC will remain responsible for delivering a working SRIT system that, by the date appointed by HMT under section 25(5) of the 2012 Act, is able to collect the correct amount of tax from Scottish taxpayers as defined in new 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 will review with SG plans for testing the IT systems, and SG will have the opportunity through the Programme Board to review testing material and the results of the tests. 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 SRIT 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 SRIT, HMRC will maintain its IT and administrative systems from year to year so that SRIT continues to operate effectively.
- 3.2 ***Scottish Taxpayers*** – HMRC will identify Scottish taxpayers, as defined in new section 80D of the 1998 Act, from information on its systems and by interaction with the taxpayers themselves. This will be

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recorded on HMRC systems by a Scottish taxpayer identifier for each individual.

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

Before the start of the first year that SRIT will apply (expected to be 2016-17) HMRC will issue Scottish tax codes (S codes) to all Scottish taxpayers within Pay as you Earn (PAYE) and their employers. In subsequent years, HMRC will send revised coding notices as appropriate, either in-year or as part of the annual coding exercise that normally starts at the beginning of each calendar year.

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 will be adapted so that Scottish taxpayers within SA will declare their status as part of their annual return.

- 3.3 **Service Standards** – SG and HMRC may agree a set of standards for the operation of SRIT including levels of service to Scottish taxpayers in relation to SRIT.
- 3.4 **Compliance** – HMRC will conduct risk analysis and assessment, and 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 changes in the Scottish rate, which will 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 and assessment, and 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 SRIT.

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 SRIT 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 below.

### *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 superannuation, HR, accommodation and finance costs. Where costs are incurred under contract by third parties

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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.

On the basis of the agreement reached between Ministers of the UK and Scottish Governments in the exchange of correspondence on 21 March 2012, 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** – Subject to the arrangements set out 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 SRIT;
  - Cost of any independent assessment of IT costs requested by, or after consultation with, SG;
  - Maintenance costs of IT systems, where specific provision is needed for SRIT;
  - cost of the SRIT element of improvements and upgrades to systems, where specific provision is needed for SRIT;
  - Non-IT capital costs relating specifically to SRIT;
  - Project costs of preparation for the introduction of SRIT;
  - Resource cost of activities specifically relating to the administration of SRIT;
  - Resource costs relating to risk analysis, risk assessment, compliance 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);
  - Resource costs of employer compliance where specifically related to the administration of SRIT; and
  - Resource costs of any additional compliance requested by SG.
- 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 SRIT (even if the systems are involved in accounting for SRIT or identifying Scottish taxpayers);
  - Cost of changes to IT systems where the aspects relating to SRIT cannot reasonably be costed separately;
  - Cost of changes to IT systems arising from UK Government policy initiatives, even where specific provision is needed for SRIT;
  - Cost of compliance cases relating to Scottish taxpayers where Scottish taxpayer status is not the main factor;

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- 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.
- 4.4 **Invoicing** – HMRC will invoice SG for costs incurred no more frequently than monthly and no less frequently than quarterly. 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.
- 4.5 **Financial Management Guidance** – UK Government policy about financial management is set out in the HM Treasury documents “Consolidated Budgeting Guidance” and “Managing Public Money”, which are available on the Treasury website.<sup>3</sup>
- 4.6 **Dispute Resolution** – where a dispute arises over a payment in relation to the matters set out in this section, or about other aspects of the implementation of SRIT, 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 IAB 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, whose joint decision will be final.

### 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 Scottish Government 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 Scottish Government and the Parliament. As far as administration is concerned, HMRC will make orderly preparations for the next tax year, including providing all UK taxpayers (including Scottish taxpayers) and employers with correct coding information in a timely way. The Scottish Government and HMRC will work together to ensure that, in preparation for 2016-17 and beyond, these administrative steps are planned and carried out efficiently and in a timely way to minimise costs, including costs to employers. This will include agreeing an assumption to be used in the main issue of tax codes, if the rate has not been determined by the end of November.

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<sup>3</sup> (Ctrl + click to view):

[http://www.hm-treasury.gov.uk/psr\\_bc\\_consolidated\\_budgeting.htm](http://www.hm-treasury.gov.uk/psr_bc_consolidated_budgeting.htm)  
[http://www.hm-treasury.gov.uk/psr\\_mpm\\_index.htm](http://www.hm-treasury.gov.uk/psr_mpm_index.htm)

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- 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** – Arrangements for forecasting of SRIT receipts by the Office for Budget Responsibility (OBR), which will be incorporated into the calculation of SG’s total budget for each year, and the mechanism for making funds available to SG<sup>4</sup>, are matters for agreement between SG and HMT, and will be set out in a separate document. The methodology used by OBR in forecasting SRIT is set out in their document, “Forecasting Scottish Taxes”<sup>5</sup>.
- 6.2 **Accounting, Audit and Assurance** – Expenditure and receipts relating to SRIT 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 SRIT, 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) – which will include a report on the implementation and operation of SRIT – and to send a copy of the report to Scottish Ministers who are in turn to lay a copy before the Scottish Parliament. Scottish Ministers must make and lay a similar report each year. These reports must include a report on progress with implementing and subsequently operating the financial provisions in the 2012 Act.

- 6.3 **In-year reporting to Scottish Ministers** – Once SRIT becomes operational, 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 SRIT.

### *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 SRIT. This includes information in relation to the reporting requirements of section 33 of the 2012 Act. Where the provision of information would involve significant analysis time, HMRC

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<sup>4</sup> See also “How the Scottish income tax receipts will be managed” at p27 of the Command Paper (link at footnote 1 above).

<sup>5</sup> <http://budgetresponsibility.independent.gov.uk/wordpress/docs/Forecasting-Scottish-taxes.pdf>

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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.

***Signed on behalf of their relevant organisations:***

**Alistair Brown**

Deputy Director, Fiscal Responsibility  
for Scottish Government

*Date:*

**Sarah Walker**

Deputy Director, Devolution  
for HM Revenue & Customs

*Date:*

**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 is a function of HMRC and so lies within the overall responsibility of HMRC's Principal Accounting Officer, its Chief Executive, Lin Homer.

The Command Paper, "Strengthening Scotland's Future"<sup>6</sup>, 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).

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.hm-treasury.gov.uk/d/mpm\\_ch3.pdf](http://www.hm-treasury.gov.uk/d/mpm_ch3.pdf)

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<sup>6</sup> [http://www.scotlandoffice.gov.uk/scotlandoffice/files/Scotland\\_Bill\\_Command\\_Paper.pdf](http://www.scotlandoffice.gov.uk/scotlandoffice/files/Scotland_Bill_Command_Paper.pdf)

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***Appendix B***

**Operation of SRIT  
Annual Cycle of Activities<sup>7</sup>**

<b>Timing</b>	<b>Activity</b>
By 30 November before tax year	Scottish Government provides information to HMRC about the proposed Scottish rate for the coming tax year
January before tax year	HMRC issues PAYE coding notices to Scottish taxpayers based on Scottish Taxpayer (ST) 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 ST 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	Reconciliation of SRIT element in Scottish block by reference to actual income tax liability declared

<sup>7</sup> Non SRIT specific items in this appendix reflect the general timetable for income tax.