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Ann McKechin MP
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Dear Ann

At the Scotland Bill Committee debate on Monday 14 March you asked a number of detailed questions, in particular relating to the definition of a Scottish taxpayer.

I was not able to respond to all of these questions during the debate. Therefore, I am writing to provide you with responses to these questions.

I hope that you find this helpful. I am copying this letter to the Secretary of State for Scotland, Sheila Gilmore MP, Mark Lazarowicz MP and Stewart Hosie MP, and will be laying a copy in the House library.

Yours
David

David Gauke MP



Definition of a Scottish taxpayer

1. *Do the Government not agree that individual taxpayers deserve a degree of certainty in regard to their tax affairs as the end of a tax year approaches?*

Yes. The Government's view is that the new definition provides that as it is primarily based on where people live.

2. *Paragraph 673 of the Holyrood Committee report asks what "place of residence" means, as defined in clause 26, as it appears to be different from how residence is understood in other areas of tax law such as capital gains tax. Does place of residence imply ownership when juxtaposed against "main place of residence" in new section 80E(a), (b) and (c). Place of residence and main place of residence are not defined in that new section, which I fear could present problems of interpretation. I would be grateful if the Minister clarified his understanding of the interpretation in this case.*

As set out during the debate, the ordinary meaning of the main place of residence is set out in case law. It is not necessarily determined by the number of days one spends at a location.

A 'main place of residence' appears elsewhere in long-established legislation – notably Capital Gains Tax and Council Tax – without being defined in statute. We see no reason for a statutory definition for the purposes of the Scottish rate of income tax.

HMRC will be publishing detailed guidance on this matter to resolve any uncertainty which an individual might have.

There is no stipulation in the legislation which requires that a place of residence needs to be owned by the individual – it could include rented accommodation and a home belonging to a friend or family member.

3. *Take the situation of someone who lives in Dumfriesshire or the borders.... That person may live in Scotland but be a night-shift worker in England—perhaps a delivery worker for a retailer or a regular night-shift worker in a factory. Such a person could be defined as being in England, rather than in Scotland, under one definition even though he clearly lived in Scotland—or vice versa. Will guidance be given to clarify how such a situation should be addressed?*

Where an individual works in Scotland on night shifts but has a home over the border in England (or vice versa), whether they are a Scottish



taxpayer will be determined by the location of their sole or main residence – not by the number of nights which they might spend in each part of the UK. This approach provides for a major simplification compared to the previous Scottish Variable Rate (SVR) definition of a Scottish taxpayer.

So an individual who works overnight shifts in Scotland, but returns to their home in England will not be a Scottish taxpayer because their sole or main place of residence is not in Scotland.

4. *In respect of those who live board ships and other installations. Is the Minister convinced that the description in new section 80E(4), introduced by clause 26, that a place "includes a place on board a vessel or other means of transport" is sufficient?*

Yes. Section 80E(4) puts beyond doubt that a place of residence can include a caravan and houseboat.

5. *It would be preferable if at some point during the passage of the Bill we knew about the position of the impact on the armed forces. Will the Minister ask his colleagues to ensure that we have a definitive response before we reach our final conclusions on the Bill?*

HMRC is currently in consultation with the Ministry of Defence (MOD) to look at this issue and find the best way forward. The issue is under consideration within MOD who have been consulting widely within the department, to ensure that the introduction of these new arrangements do not adversely impact upon our Armed Forces. This is a national force with an enforced mobility obligation with personnel sometimes having frequent changes of location during the course of a military career, including deployments on operations. Given the vital national service which we rely upon them to undertake, I will thus consider any representations from MOD Ministers on this matter most carefully. Any consideration of treating members of the Armed Forces under different arrangements must of course be both practical to administer and without prejudice to the overall principles contained within the Bill, and HMRC officials remain in close contact with their MOD counterparts to ensure that this is the case.

6. *How will the system apply to self-employed people, particularly if they generate earnings in different parts of the United Kingdom.*

The definition of a Scottish taxpayer will apply to self-employed individuals in the same way as it applies to anyone else who is tax resident in the UK. Whether or not they are a Scottish taxpayer will not



be determined by where they earn their profits or trade, but will instead depend upon the location of their sole or main residence.

7. *What about those who are neither UK resident nor employed by non-UK employers?*

An individual who is not tax resident in the UK will not be a Scottish taxpayer and therefore will not pay the Scottish rate. Whether a UK resident individual's employer is not UK resident has no bearing on whether they will be a Scottish taxpayer.

8. *Does the Government agree that if a non-UK resident is working in Scotland and liable to pay tax, it should be paid at the Scottish rate? The Bill currently provides for company directors, sports people and entertainers undertaking duties wholly in Scotland to pay UK income tax on income earned entirely in Scotland, but not to pay Scottish income tax.*

It is the case that non-resident individuals will not be a Scottish taxpayer and therefore will not pay the Scottish rate. It is also true that some non-residents, including foreign sportsmen and entertainers, can be liable to UK tax when they perform in the UK. To introduce special rules to make such individuals liable to the Scottish rate would introduce significant complexity for a relatively small number of people.

9. *The current definition of UK residency lies in 86 pages of guidance that are the subject of frequent revision by HMRC. How, then, can the Government be confident that this definition is going to work?*

The potential complexity of the current rules for determining UK tax residence will have no effect on the application of the definition of a Scottish taxpayer in the vast majority of cases.

Whilst it might be difficult for an individual in some circumstances to decide whether they are tax resident in the UK, the definition of a Scottish taxpayer has no bearing on the way those rules are applied. For the vast majority of people, it will be a straightforward matter to determine whether they are UK resident.

10. *Will the Minister tell us whether they are likely to attempt to provide a better definition of a UK resident taxpayer in the Finance Bill that will follow next week's Budget statement?*



The Coalition Agreement included a commitment that the Government would review the current tax rules affecting non domiciled individuals. A more detailed announcement on this review – including whether it should encompass a statutory residence test – will be made by Treasury Ministers at the appropriate time

Impact on benefits entitlement

11. Most benefits are calculated on after-tax income. If the Scottish rate income tax is higher than the basic rate, Scottish taxpayers on benefits will be entitled to claim more benefit. Will the Government ensure that the extra benefit is paid automatically, or will they issue public information on how full entitlement can be claimed? How will the new proposals on universal credit be implemented in respect of these tax changes? The Government have stated that their general rule on the tax base is one of no detriment, but I ask the Minister to reflect and give any assurance he can about whether there might be a possible conflict. Conversely, if the Scottish tax rate is lower than that of the rest of the UK, Scottish taxpayers on benefits will be entitled to fewer benefits in some cases. What mechanism will the Government put in place to ensure that adjustments are made to their payments? who may already have many concerns about what is being proposed in the Welfare Reform Bill. I hope the Minister can reassure us that he will not be adding to that burden.

Any potential impact that arises on benefits is being considered by the Department for Work and Pensions (DWP). There are many factors that influence an individual's entitlement. The amount of income tax they pay is just one of them. Where an individual lives can already influence the amount of Council Tax they are liable for, for example. Currently if two people have the same gross salary but different tax liabilities they will be have slightly different levels of entitlement to means-tested benefits where those benefits are calculated on net income. So this is nothing new.

Design of income tax powers

12. What consideration have the Government given to the recommendation that while a flat-rate structure [of income tax] should be adopted initially, this decision must be carefully evaluated as experience is gained of operating it?

The Government will consider any future changes to the operation of the system once it is in place and operating successfully. This approach



is wholly consistent with the recommendations of the Scottish Parliament.

13. *Will the taxpayer be able to choose the order of deductions against various sources of income?*

The Government has no plans to alter the well established rules around the order of deductions.

14. *What consideration have the Government given to the Holyrood Committee's recommendation that the transition period for the income tax powers and the calculation of the block grant reduction be reduced or done away with in its entirety if, for example, the measures on the tax base are implemented?*

The Government believes that there is significant risk in moving straight to a permanent adjustment to the block grant, without an opportunity to test the system through the transitional arrangements. Our approach is based on the UK Government, bearing that initial administrative risk rather than exposing the Scottish Parliament to unanticipated variations in revenue. Furthermore, the Command Paper, "*Strengthening Scotland's Future*", is not prescriptive about the duration of these transitional arrangements. However, the Government has committed to consider the recommendations of the Scottish Parliament Committee, and is happy to discuss transitional arrangements with the Scottish Government in the Joint Exchequer Committee.

15. *Will the Government consider the Holyrood Committee's proposals that the reduction in grant might be indexed to changes in the income tax base for the rest of the UK? Will they consider also the principle of a formal review of the grant reduction mechanism after 10 years, as the report recommends?*

The Holtham Commission recommended an indexed-based approach to adjusting the block grant which was acknowledged in the Command Paper. As set out in the Government's Command Paper, there are practical restraints, in particular availability of data, that mean that the Government believes that this approach could not be introduced at present. However, the Government has committed to further analysing alternatives, including the Holtham approach, and will engage with the Scottish Government and the Office of Budget Responsibility to ensure that the optimal and most equitable model is the one ultimately adopted.

16. *Does the Government agree that the retrospective application of an order could adversely affect the budget of the Scottish Parliament?*



For example, if the Budget is set in March and the Treasury lays an order in October to apply a relief clause retrospectively, that could have grave implications for the Scottish Government's budget.

One Order is unlikely to have a large impact on the Scottish Government. The Command paper makes clear that the UK Government will adopt a principle of 'no detriment', meaning that any policy changes to the UK tax base that impact (either positively or negatively) upon the Scottish budget will be compensated by an appropriate adjustment to the block grant.

17. Does the Government agree with the Chartered Institute of Taxation that a mechanism might be required to ensure that any future Scottish provisions do not conflict, and to consider how future UK treaties and EU rules might affect the powers that we provide to Scotland in the Bill?

The Chartered Institute of Taxation intended for Scotland to have a mechanism to monitor whether their new taxes conflict with EU rules. As the Scottish Parliament is responsible for devolved taxes the mechanism they choose to ensure compatibility is a matter for them, not the UK Government.

Avoidance

18. What provisions will be put in place to deal with tax avoidance in the future?

HMRC monitor tax avoidance closely and will discuss these issues with the Scottish Government. On the Scottish rate of income tax HMRC will identify who is and who is not a Scottish taxpayer. Scottish taxpayers will then be given a Scottish tax code by HMRC and employers will use this code in the PAYE system just as they would with their other employees. For those who self-assess, it will use its usual risk based approach, comparing data it holds and that of third party suppliers.

19. How do the Government propose to deal with avoidance of the Scottish tax rate? Unlike other jurisdictions that have devolved taxes, and where there are different forms of collection and reporting, many people self-assess or are in pay-as-you-earn schemes, and they are not currently specifically called on to declare their residence to the tax authorities in the way required by the Bill. The Bill's provisions only apply to income; they do not apply to dividends or to interest on savings. What measures will be taken to ensure that people do not end



up transferring income into another route, to try to avoid the income tax provisions made by the Scottish Parliament?

HMRC will identify who is and who is not a Scottish taxpayer. Scottish taxpayers will then be given a Scottish tax code by HMRC and employers will use this code in the PAYE system just as they would with their other employees. For those who self-assess, it will use its usual risk based approach, comparing data it holds and that of third party suppliers.

There is nothing new in some people trying to disguise employment income as dividend income. HMRC always monitors this closely.

20. The definition of "Scottish residence" is so loose that wealthy individuals can arrange their affairs in such a way as to avoid a higher rate of tax. How do the Government plan to avoid such a scenario?

There is no reason why the definition of a Scottish taxpayer should significantly impact evasion or avoidance. The definition is perfectly clear and straightforward to apply in the majority of cases.

HMRC operations

21. Is it likely that the introduction of the Scottish income tax rate will create additional HMRC jobs and, if so, are they likely to be based in Scotland?

It is too soon to say. HMRC has a substantial presence in Scotland but it will depend upon the best way of organising the work.

22. The Chartered Institute of Taxation has suggested that HMRC will need to "staff up properly in anticipation of a considerable extra flow of questions when the Scottish income tax goes live." What are the Government doing to achieve that, given that in recent months HMRC has been closing offices across Scotland and the rest of the UK and reducing its capabilities?

The Scottish rate of income tax is planned to take effect from 2016-17. HMRC is confident that it can deliver this and any additional staffing required will be funded by the Scottish Government.

23. How does the Government intend to control those costs?



HMRC has an excellent record in delivering projects and programmes on behalf of other organisations and Government Departments. This includes taking a rigorous approach to all aspects of project management, including financial control. As the Scottish Government will be paying for this they too will take a close interest and scrutinise the costs thoroughly. Progress on the project including costs will also be monitored by the Joint Exchequer Committee.

24. Are the costs of implementation still as estimated in the Command Paper?

The provisional estimates published in the Regulatory Impact assessment last November are still current.

25. Is the Government aware of any potential problems, and what measures they intend to put in place to avoid them, so that the maximum level of tax that is due is collected and returned to the Scottish Government, and so that administration is kept to a minimum?

HMRC is confident that it can deliver a Scottish rate of income tax in 2016-17. The basic design of the income tax is based on the Scottish variable rate and HMRC will be building on that. SVR is already built into payroll software. The start-date is 5 years from now so there is time to carry out the work.

26. What kind of public awareness campaign will the Government conduct to make companies aware of the proposed changes and their impact on payrolls?

The Scottish rate of income tax is planned to take effect from 2016-17 which gives 5 years for HMRC to discuss the detailed implementation with the representative bodies, employers, payroll providers and complete the design work and the remaining development.

27. What discussions has the Minister held with the high-level expert group about the definition of Scottish residence and what issues have arisen as a result of those discussions?

These discussions are on-going. Professional representatives are keen that the definition of a Scottish taxpayer is clear and easy to use as is the Government. The Group has established three technical groups to look at the practical implementation issues in some detail. For example, the income tax technical group has already been discussing the definition of a Scottish Taxpayer in some detail and working with HMRC



to ensure that the impacts of its application are understood and any potential burdens minimised.

Impact on employers

28. When the Federation of Small Businesses surveyed its members, it found that 18% of them did not use PAYE software to administer their payrolls by means of computer systems, but undertook the task manually. Is it not unhelpful of the Government to suggest that many small businesses should be forced to take on the burden of identifying and administering the new tax rates? What specific measures will the Government introduce to help small businesses with 10 or fewer employees to cope with the changes?

HMRC will identify who is and who is not a Scottish taxpayer. Scottish taxpayers will then be given a Scottish tax code by HMRC and employers will use this code in the PAYE system just as they would with their other employees. HMRC would recommend that all employers should use computer software to administer PAYE as it makes the task much easier. Indeed to be of help to small employers it has launched a new product called Basic PAYE Tools. This new product is available to download from the Business Link website and provides basic tools and calculators needed to run payroll throughout the year.

Stamp duty land tax and Landfill tax

29. Is it possible for different rates of Stamp duty land tax (SDLT) and landfill tax to apply to different parts of Scotland? Could they be delegated to local authorities for example?

As explained in the debate, the Scottish Government will have complete control over the design and administration of the taxes devolved to them. Of course, in designing their tax, the Scottish Government will need to ensure that it complies with EU law.

30. Where the Scottish rate and English rate of landfill tax vary, what measures can be taken to stop the flow of waste towards the part of the country that has the lower rate of landfill tax?

The rate of landfill tax is only one factor which affects the costs of disposal of waste to a landfill site. The cost of transportation of waste is another factor and this limits the extent to which operators could exploit differences in gate prices caused by lower rates of landfill tax in different areas of the UK. The Command paper makes clear that landfill tax is a key lever for the UK Government to achieve its 2020 landfill reduction



target under the Landfill Directive. If changes to the devolved Scottish landfill tax were solely responsible for the UK missing its target, the Scottish Government would be liable to pay the fines imposed on the UK

Spending and borrowing framework

31. *What is the rationale for requiring the Scottish Government to fund the first £120 million of any tax shortfall?*

The UK Government believes this creates the right incentive for prudent financial management – holding a small amount of cash reserve will enable the Government to deal with differences in forecast as opposed to relying on borrowing up to the maximum limit. In the period 2004-05 to 2009-10 the Scottish budget had average annual underspends of £195m¹.

32. *When did the UK Government communicate to the Scottish Government that the End Year Flexibility Scheme would be ended? When was the issue raised with the Joint Ministerial Committee and the Scottish Government? Why was no mention made of this when the Exchequer Secretary and the Chief Secretary were giving evidence to the LCM Committee?*

The UK Government announced that it is reforming the EYF system in the Spending Review. The UK Government is meeting commitments to drawdown of EYF in the current year and exceptionally has allowed the Scottish Government to carry forward planned underspends from 2010-2011 to 2011-2012. The UK Government has discussed these matters with the Scottish Government. This issue is however separate from the Scotland Bill.

¹ Based on an analysis of published PESA data