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not later than

Sunday 20 September 2015

STRICT ADHERENCE TO THIS ARRANGEMENT WILL GREATLY FACILITATE THE PROMPT PUBLICATION OF THE BOUND VOLUMES OF PROCEEDINGS IN GENERAL COMMITTEES

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The Committee consisted of the following Members:

Chair: Mr Adrian Bailey

† Beresford, Sir Paul (Mole Valley) (Con)
† Burns, Conor (Bournemouth West) (Con)
† Chapman, Douglas (Dunfermline and West Fife) (SNP)
† Gauke, Mr David (Financial Secretary to the Treasury)
† Hollinrake, Kevin (Thirsk and Malton) (Con)
† Hurd, Mr Nick (Ruislip, Northwood and Pinner) (Con)
† Jones, Graham (Hyndburn) (Lab)
† Keeley, Barbara (Worsley and Eccles South) (Lab)
† McCartney, Karl (Lincoln) (Con)
† Mactaggart, Fiona (Slough) (Lab)
Mann, John (Bassetlaw) (Lab)

† Marris, Rob (Wolverhampton South West) (Lab)
† Pursglove, Tom (Corby) (Con)
† Robinson, Mr Geoffrey (Coventry North West) (Lab)
† Stride, Mel (Lord Commissioner of Her Majesty’s Treasury)
† Thompson, Owen (Midlothian) (SNP)
† Tomlinson, Michael (Mid Dorset and North Poole) (Con)
† Wragg, William (Hazel Grove) (Con)

Katy Stout, Committee Clerk

† attended the Committee
I hope that it will assist the debate if I briefly outline the aspects of the income tax system to which the order before us relates, and the nature of the amendments that it makes. First, on pension relief at source, the current system will not automatically provide the correct relief for Scottish taxpayers under the new Scottish rate. The order therefore makes amendments to ensure that relief at source will be paid at Scottish rates, meaning that Scottish taxpayers will receive the correct relief into their pension pots.

Additionally, the Government have acknowledged that the pensions industry is working in a challenging environment at present, and have agreed that it can have longer to make the changes. It is planned that the industry should be ready to make relief at source claims at the Scottish basic rate from April 2018. In the meantime, to ensure that pension scheme members who are Scottish taxpayers are not disadvantaged, the Government have agreed that from April 2016 pension scheme administrators will be able to continue to claim relief at source at the UK basic rate of tax for all members. Her Majesty’s Revenue and Customs will identify Scottish taxpayers and, depending on the rate set by the Scottish Government, make any necessary adjustment to the relief directly with the scheme member. That will be done through either the self-assessment process or PAYE coding.

The Finance Act 2004 contains a number of special tax charges. The majority are designed to generate a charge based broadly on current rates, and percentages that are therefore used. In two areas though, there are references to rates. The order amends those two areas to ensure that they operate appropriately under the new Scottish rate. It supplements references to “basic rate”, “higher rate” and “additional rate” with references to the Scottish equivalents applicable to Scottish taxpayers.

Deficiency relief may be available to individuals when their life insurance policy, life annuity contract or capital redemption policy comes to an end. If the tax calculation needed when a policy or contract comes to an end gives a negative result rather than a gain, but taxable gains have arisen earlier in the life of the same policy or contract, individuals may be entitled to the relief. The deficiency relief tax reduction is determined using the amount of any deficiency to reduce the income liable at the highest rates, and then in sequence at each lower rate. The order amends the relevant rules so that they include income liable at various Scottish main rates in that sequence, factoring in the possibility that the Scottish higher rate could differ from the UK higher rate.

The next aspect is the social security pension lump sum. Current rules for the tax treatment of that lump sum stipulates that the rate of tax paid by an individual on their lump sum should be the same as their highest marginal rate, which is determined by reference to their total income, as established in the wider calculation of income tax liabilities. The order makes an amendment to ensure that lump sums will be taxed at the Scottish rates for Scottish taxpayers by amending the references to “basic rate”, “higher rate” and “additional rate” with references to the Scottish equivalent rates if the individual is a Scottish taxpayer.

Finally, the order makes amendments to the Income Tax Act 2007 to ensure that the parts of the Act covering the calculation of total income, entitlement to transferable tax allowance for married couples and civil partners, election to reduce personal allowance and
relief for gifts to charity will continue to operate with a new Scottish rate. It does so by supplementing relevant references to rates of income tax with references to equivalent rates for Scottish taxpayers.

It is important to ensure that the income tax regime continues to operate smoothly once the Scottish rate of tax has been implemented, and the amendments being made in the order will ensure that is the case. Having set out in detail the nature of the amendments, I am now happy to answer questions from members of the Committee.

2.37 pm

Barbara Keeley (Worsley and Eccles South) (Lab): It is a great pleasure to serve on the Committee with you as Chair, Mr Bailey. The order makes a number of consequential amendments to specific references to tax rates in existing legislation, which the Minister talked us through, so that Scottish rates can be used when it is appropriate to do so.

Labour believes that Scotland should have more autonomy over its taxation decisions. In the general election, we promised to make the Scottish Parliament “the most powerful devolved Parliament in the world.”

Although the order will simply adapt legislation to take account of any changes to income tax, the Scottish Parliament may undertake no tax changes in the future without this complication. A number of concerns remain about how the changes will be implemented.

The Institute for Fiscal Studies report on the Smith commission made it clear that in many ways, the most difficult work lies ahead, and that the details of how taxes and benefits are devolved will be crucial. We must also consider the practical implications of tax devolution for businesses such as insurers and pension funds. Concerns have been raised about how to identify who is liable to pay the Scottish rate of income tax. What measures has the Minister taken to ensure that Scottish taxpayers will be identified without significant additional costs?

Concerns have been raised by the pensions industry about how to implement pension relief at source in light of the change, which follows the implementation of a range of other pension measures introduced in 2014. The purpose of those measures was to provide customers with greater pension freedom, but there is clearly already a significant amount of strain on the pensions industry, causing difficulties for many pensioners. Last year, Scottish Widows admitted that it had reached breaking point because of the reforms, which have had a significant negative impact on its ability to provide its customers with a quality service.

Pension providers have stated that they will struggle to implement the new round of reforms. Many pension scheme providers have pointed out that the new arrangements will have significant administrative implications. The National Association of Pension Funds has said that the higher operational costs are likely to be passed on to scheme members. I do not know whether the Minister agrees with the NAPF that those changes will lead to higher costs. If he does, can he give the Committee a figure of what the costs might amount to for scheme providers and individual members who will end up having the costs passed on to them? That raises the question of who will bear the impact of higher operational costs. Will those additional costs be borne solely by scheme members in Scotland or by members across the UK?

As the Minister mentioned, because of the pressures and strains on the industry, HMRC has given it more time to implement the changes. Between April 2016 and April 2018, relief will be given at main UK rates, with an adjustment being applied later. Given the delay, does the Minister think the planning for the arrangements has been adequate? Have the cost and administrative implications for pension scheme providers and their members in Scotland been sufficiently taken into account? What steps is he taking to ensure that the reforms do not impact negatively on the service that customers receive from their pension providers?

The future implementation of the Scottish rate of income tax remains unclear. The explanatory memorandum states that after April 2018 Scottish taxpayers will “as far as possible…receive the correct amount of relief into their pension pot.”

Will the Minister clarify to the Committee what is meant by “as far as possible”? It implies that the implementation of the changes may not be completed even within the grace period given to pension providers. It raises concerns that, even by 2018, there will still be cases in which individuals are not receiving the correct amount into their pension scheme. Will the Minister explain to the Committee what will happen in those cases?

It is clear that there are lessons to be learned from the implementation of the Scottish rate of income tax. The Scotland Bill outlines devolution plans that include the devolution of far more substantial income tax powers to the Scottish Parliament. Will the lessons learned from the introduction of this tax change inform the Government’s approach to the management of the reforms that are yet to come? HMRC has published draft guidance on how it will interpret the definition of “Scottish taxpayer”, but concerns have been raised about the helpfulness of that guidance for more complex cases. At the moment it is unclear whether that guidance will be amended to take account of the feedback. Will the Minister provide further information on that?

Overall, there is still very little guidance for taxpayers about this important matter. Employers and taxpayers need to be in possession of clear guidance, and they need to be given enough time to plan for changes that they may need to implement. Will the Minister tell us what plans have been made to ensure that information is provided to taxpayers and employers in a timely manner?

We must bear in mind the wider changes that may result from this tax change. The Association of British Insurers has warned in its response to the Smith commission:

“Over an extended period any adjustment to the value of tax relief would affect the…value of an individual’s pension fund and their income in retirement. As a result, employees in Scotland could receive different levels of pension income (lower or higher) than colleagues in other parts of the UK, even if they are making the same contributions into the same scheme over the same period of time.”

Clearly, that seems totally wrong.

What assessment have the Government made of the impact on financial services currently based on the UK income tax regime if the Scottish income tax regime...
were to differ? The UK Government are currently undertaking a comprehensive review of pension tax relief in the UK. The review will consider potential reforms to how pensions are taxed, which could have a significant impact on pension policyholders. Does the Minister anticipate that the UK Government’s review and any changes arising from it will have an impact on the operation of pension tax relief in Scotland?

Although Labour does not intend to oppose the order and we support the move to devolve further tax powers to the Scottish Parliament as outlined in the Scotland Bill, we have concerns about the practical applications of the changes. I look forward to hearing the Minister’s reply and any assurances he can give about the issues I have raised.

2.44 pm

Owen Thompson (Midlothian) (SNP): I will be very brief. We certainly do not object to any of the proposals outlined in the order. I would like to make the point, however, that while the additional powers granted to the Scottish Parliament are welcome, they are limited. We feel they need to go much further. Even with this additional power, Scottish Ministers will still not be able to vary the individual rates to make any progressive changes to the tax regime. They will only be able to make block changes. We wish to see that taken much further.

Much of the content of the order will be largely superseded by what is in the Scotland Bill, so it should be seen very much as a tidying-up exercise. I would make the case that it would be far more beneficial for the taxpayers of Scotland if all tax-varying powers were to be devolved to the Scottish Parliament.

2.46 pm

Mr Gauke: It is a pleasure to respond to the two speeches we have heard. First, on HMRC’s ability to identify Scottish taxpayers, which will be fundamental to the introduction of a Scottish rate of income tax, HMRC will use its own data to determine a person’s status. To give individuals an opportunity to respond, HMRC will encourage them to make it aware of changes to their address. HMRC is also looking at the best ways to check the information against other sources, and at the costs associated with the activity. Scottish Government officials have been involved in that process for some time and are consulted about key decisions.

It is worth pointing out that the latest risk register reflects a growing confidence in the effectiveness of HMRC’s plans to identify Scottish taxpayers. As Scottish taxpayer status is determined by main place of residence in the UK, HMRC will use the addresses it holds in its records to identify taxpayers who live in Scotland.

Rob Marris (Wolverhampton South West) (Lab): It is a pleasure to appear before you for the first time, Mr Bailey, and to have the opportunity to ask a question of the Minister. It was probably 2006 when we last crossed swords on a Treasury matter in Committee, with the Finance Bill of that year.

With regard to Scottish residence, I am not accountant, as the Minister knows, but there used to be a withholding tax for money earned in Scotland by certain foreign residents, such as pop stars or sportspeople. Would the order affect the withholding tax for money earned in Scotland by such a foreign resident?

Mr Gauke: First, it is a great pleasure once again to cross swords with the hon. Gentleman in Committee. I think there were subsequent Finance Bills that we debated: 2007, 2008 and 2009 possibly.


Mr Gauke: Let us not detain the Committee too long on that ancient history. However, it is great pleasure to respond once again to an intervention from the hon. Gentleman.

The Scottish rate of income will apply to Scottish residents. In the circumstances that the hon. Gentleman sets out, where somebody is not a Scottish resident, the UK rate of income tax will apply. I hope that provides clarity.

I should point out that there is no definitive list of Scottish residents, but HMRC has been and will continue checking its address data against third-party information, for example the Scottish electoral register; to check accuracy. HMRC expects to contact Scottish taxpayers later in 2015, well in advance of the introduction of the Scottish rate in April 2016.

Work on making changes ready for the Scottish rate of income tax is well advanced. It is on schedule and will support further devolution. While it is clearly vital that the public have all the information necessary to understand the Scottish rate of income tax before it comes into force, all the customer research that HMRC has commissioned shows that the timing of information is equally important. If guidance or information highlighting the changes is provided too early, it will not be at the forefront of busy people’s minds.

UK employers and pension providers are amending payroll software to take into account the introduction of the Scottish rate of income tax from next April. Technical guidance on Scottish taxpayer status was published for consultation in June and will be published in its final form, along with a raft of more general support and guidance, later this year. HMRC will write to those whose records show that they are a Scottish taxpayer later this year and tell employers and pension providers which of their employees or pensioners are Scottish taxpayers. I reassure the Committee that progress towards the introduction of the SRIT appears to be well in hand.

Barbara Keeley: We have talked in other debates about such things as insurance premium tax. There are considerable pressures and strains on the pension industry, and one of the serious concerns we came across was the higher cost to pension scheme providers. As I said earlier, Scottish Widows said that its systems were at breaking point. This change comes on top of others, and we are even changing insurance premium tax. I do not know whether he was going to respond to that point, but will he do so? Given that even insurance premium tax is being put up, there is concern that pension scheme providers will be suffering from extra administrative cost. What might that cost be?
Mr Gauke: On the process for pension funds, we are mindful of the specific challenges. The hon. Lady asks for the cost of administration for pension providers, but we do not have a specific number. We are happy to confirm that HMRC continues to work extremely closely with the pensions industry and is extremely mindful of minimising the burden. There are technical groups involving the industry, which continue. End-of-year adjustments for pension taxation often occur for changes of circumstances in-year. Any required adjustment that relates to the interim treatment of Scottish taxpayers will occur in the same manner, usually through coding adjustments.

To finish the point I was making on guidance being published to identify taxpayers, which the hon. Lady raised, HMRC received 20 responses to its consultation on the guidance and is amending it to reflect that. Final technical guidance and supporting information for taxpayers will be published later this year.

Picking up on the point that the hon. Member for Midlothian made about the powers being devolved to Scotland, the Smith commission—it is important to remember that all parties present in the Scottish Parliament signed up to it—specifically decided after careful consideration not to devolve income tax fully but to leave it as a shared UK tax, albeit with significant powers to set rates and thresholds being made available to the Scottish Parliament. That is why the whole of income tax has not been devolved. The UK Government will continue to set the personal allowance, other allowances, income tax on savings and dividend income, and reliefs. Going further than the powers set out in the Scotland Bill would break the concept of a shared tax and would be complicated for individuals and employers with activity on both sides of the border, who would have to understand and comply with two potentially entirely different systems.

As the Prime Minister pointed out today, we can keep on debating the processes, but very substantial powers have been devolved to the Scottish Government and the Scottish Parliament. Perhaps debate should now focus on how those powers are used rather than necessarily continuing to be about which additional powers should be provided, given where we got to with the Smith commission.

Mr Gauke: I do not accept that point. In the course of a year, the establishment of the Smith commission and the bringing forward of legislation to devolve income tax much more fully to Scotland has been remarkably fast-paced. Indeed, the point that the hon. Member for Worsley and Eccles South raised was that it involves, in some cases, really quite complicated changes. Institutions such as insurance companies need to be able to make changes to ensure that it works effectively. Yes, there are times when we need a run-in period to introduce measures, but in reaching a consensus and making progress towards a very substantial transfer of power, I am pleased to say that the Government are delivering on the promises made before the Scottish referendum.

Rob Marris: Perhaps the Minister could confirm whether I have misunderstood, which I may have done, that since the Scottish Parliament was set up, the devolved Administration have had the option of a 3p in the pound income tax change. As far as I am aware—the Minister can correct me on this—successive Administrations of different political colours have not exercised that choice. Does he agree that chomping at the bit to deal with income tax now therefore seems a little strange?

Mr Gauke: I do agree with the hon. Gentleman. Powers have been in place with the Scottish variable rate for many years and have not been used. We now have the additional powers of the Scottish rate of income tax. If the Scottish National party is so keen to make use of those powers, I look forward to hearing what it will do with the Scottish rate of income tax. We have gone even further in providing devolution consistent with the Smith commission, and maybe it is time that the debate moved on from which powers are devolved to how those powers will be used.

Owen Thompson: Does the Minister accept that the current powers are only to vary upwards by 3p across the board? Individual levels cannot be varied, and the rate of income tax cannot be reduced below what it currently is.

Mr Gauke: If the SNP is suggesting that it has a plan to reduce taxes and reduce spending accordingly, I look forward to hearing it. In the absence of that, let me make the point that what is set out in the Scotland Bill—I appreciate that we are not debating the Scotland Bill today—will give the Scottish Government a huge amount of flexibility. I am sure the people of Scotland are looking forward to hearing, at some point, what the Scottish Government intend to do with it. I note that we hear no further information at the moment on that point.

Barbara Keeley: The Minister has not really answered all my questions, so I would like to make some key points again. Given that much more is to be done in future years—there is to be more devolution—the issues I have raised and the questions I have asked are important. If the Minister does not have the details of the higher costs that will hit pension scheme providers, he needs to write to me about them.

I really do take on board the point about the potential impact on individuals. The ABI believes that, because of all the difficulties and the time it is taking, “employees in Scotland could receive different levels of pension income” from others “making the same contributions into the same scheme over the same period of time.”
[Barbara Keeley]

I feel strongly that that is not acceptable. There is much more work to be done. We cannot have individuals losing out on their pension funds because the pension schemes are on their knees trying to cope with the changes that are being thrown at them. It is clearly not acceptable that individuals will be affected in that way. If the Minister is not able to assess that and tell us what he thinks the impact will be, perhaps he could write to me. He will have the note with all my questions.

Mr Gauke: As I said, we do not have the specific numbers for the costs of administration by pension providers, but I reassure the hon. Lady that individuals will not lose out. HMRC will ensure that all pensioners pay the correct tax—that is what the system is designed to do. There is an interim arrangement, so to speak, but there is also a reconciliation process, and the correct tax will be paid. I hope that the Committee will take note of those points and support the order.

Question put and agreed to.

Resolved,

That the Committee has considered the draft Scottish Rate of Income Tax (Consequential Amendments) Order 2015.

3.2 pm

Committee rose.