

HMRC’s Administration of Welsh Rates of Income Tax

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1. Introduction

- 1.1 The Wales Act 2014 amended the Government of Wales Act 2006 to enable the Welsh Parliament to set a Welsh basic, higher and additional rate of income tax to apply to the non-savings and non-dividend income of Welsh taxpayers. This power came into effect for the 2019-20 tax year.

- 1.2 HM Revenue and Customs (HMRC) administers Welsh Rates of Income Tax (WRIT) through existing Pay As You Earn and Self Assessment processes. HMRC works closely with the Welsh Government to ensure the successful administration of WRIT, and this document sets out some of the measures that have been taken as part of the implementation and business as usual operation of WRIT.

2. Governance of WRIT

- 2.1 To ensure the smooth administration of WRIT, HMRC agreed a governance approach with the Welsh Government. This is underpinned by the close working relationship between HMRC and the Welsh Government, which ensures that the Welsh Government is kept fully informed, and able to challenge HMRC on its performance in administering WRIT.
- 2.2 HMRC has appointed an Additional Accounting Officer (AAO) with overall responsibility for WRIT, who is accountable for the performance of HMRC in establishing and operating WRIT. The current AAO is Ruth Stanier, Director General of Customer Strategy & Tax Design.
- 2.3 The AAO has responsibility for all matters of governance, decision making and financial management in relation to WRIT, and is available to give evidence to Welsh Parliament committees when required.

Agreements between HMRC and the Welsh Government

- 2.4 Ahead of the implementation of WRIT, HMRC and the Welsh Government agreed a Service Level Agreement (SLA)¹ for the 2019-20 tax year, which sets out the requirements, timescales and performance measures for the day-to-day operation of WRIT. This ensures a consistent quality of service to Welsh taxpayers and allows HMRC and the Welsh Government to meet their respective responsibilities in respect of operating WRIT. The SLA is reviewed annually.
- 2.5 HMRC will produce the first WRIT Annual Report in September 2020, which will report on the requirements set out in the SLA, and give assurance that these have been met. The Committee will be provided with a copy of this report.
- 2.6 The SLA is subsidiary to the Memorandum of Understanding (MoU)², which provides the framework for inter-government work at ministerial and official level to oversee the establishment and operation of WRIT. This document is

¹ HMRC and the Welsh Government's SLA for the operation of WRIT: <https://www.gov.uk/government/publications/service-level-agreement-for-operation-of-welsh-rates-of-income-tax-by-hmrc>

² HMRC and the Welsh Government's MoU for the operation of WRIT: <https://gov.wales/welsh-rate-income-tax-memorandum-understanding-html>

currently being reviewed by HMRC and the Welsh Government to ensure it remains up to date.

The WRIT Project

- 2.7 The implementation of WRIT was managed through HMRC's WRIT Project. WRIT was successfully implemented to operate from the start of the 2019-20 tax year. Some aspects of delivery, for instance changes to Self Assessment systems and the Annual Tax Summary, were not required until later. The Self Assessment changes have since been implemented as scheduled and the Annual Tax Summary is currently in development.
- 2.8 A Programme Board of senior officials provided oversight of all HMRC's Welsh tax devolution work, whilst the WRIT Project Board managed the implementation of WRIT. Both the Project and Programme Boards included representatives from the Welsh Government to ensure they had the opportunity to scrutinise the implementation of WRIT.
- 2.9 A Critical Friend Review was carried out in February 2020 to assess the Project's effectiveness in relation to project governance, delivery capability and planning, readiness for full implementation into business as usual, and value for money. The overall findings of the review were positive. The review also made several recommendations, which were discussed by the Project Board and addressed.

Business as Usual Governance

- 2.10 A new governance structure was put in place ahead of the transition of WRIT from the project into business as usual. As most of the implementation is complete, the WRIT Project Board was succeeded by the WRIT Board, the first meeting of which was held in February 2020. The Board meets on a quarterly basis to oversee the administration of WRIT and ensure that HMRC is fulfilling the requirements set out in the SLA. The Welsh Government is represented on the Board, and shares chairing responsibilities with HMRC.
- 2.11 HMRC and the Welsh Government have both nominated a Single Point of Contact (SPoC) for WRIT, to oversee its day-to-day management. The SPoCs meet on a regular basis, and regular meetings also take place between the signatories to the SLA and between the chairs of the WRIT Board.
- 2.12 This close working between HMRC and the Welsh Government ensures the smooth operation of WRIT, and that any issues can be identified and dealt with quickly. In the event of any disputes between HMRC and the Welsh Government, there is a disputes resolution process in place to ensure these are escalated appropriately and resolved swiftly.

NAO Audits

- 2.13 As well as our own internal governance process, HMRC also relies on the National Audit Office (NAO) to assess our administration of WRIT.
- 2.14 The most recent audit by the NAO was published in January 2020, and considered HMRC's administration of WRIT in 2018-19³. The NAO made positive findings in a number of areas, including governance, recharging, and identification and assurance. The NAO did not make any recommendations in its report, however HMRC has considered it carefully to ensure we continue to effectively administer WRIT.
- 2.15 The NAO conducts these audits annually, and the audit of HMRC's administration of WRIT in 2019-20 will be published later this financial year.

Looking Ahead

- 2.16 The business as usual governance approach currently in place will continue to operate. HMRC is committed to maintaining its close working relationship with the Welsh Government, to ensure that the governance of WRIT remains effective.

3. Identification and Assurance of Welsh Taxpayers

- 3.1 In order to effectively administer WRIT, HMRC must identify and maintain an accurate and robust record of the Welsh taxpayer population⁴. HMRC therefore conducts a range of activities to identify Welsh taxpayers, and provide assurance that this identification is correct.

Initial Identification

- 3.2 Ahead of the introduction of WRIT in 2019-20, HMRC undertook a third party data clash exercise, which matched HMRC address records with third party data. This included the electoral roll, data held by credit reference agencies, and employer records. It enabled HMRC to test whether our identification of Welsh taxpayers was corroborated by other address records.
- 3.3 The results of this exercise provided evidence to suggest that HMRC's identification of Welsh taxpayers was correct in 98-99% of cases. This gives HMRC confidence that we have correctly identified the vast majority of Welsh taxpayers. The data clash was unable to corroborate the other 1-2% of cases, but these are not necessarily incorrect addresses. There is no reason to believe that the third party data used for this corroboration is more likely to be correct than HMRC's data.

³ The NAO's audit of HMRC's administration of WRIT in 2018-19: <https://www.nao.org.uk/report/the-administration-of-the-welsh-rate-of-income-tax-2018-19/>

⁴ A summary of who is defined as a Welsh taxpayer: <https://www.gov.uk/welsh-income-tax/who-pays-the-Welsh-rates>

- 3.4 HMRC also identified postcodes that straddle the England and Wales border. Using ordnance survey data, we were able to identify whether all properties in these postcodes were in England or Wales.
- 3.5 HMRC communicated with Welsh taxpayers ahead of the introduction of WRIT to inform them of the upcoming changes to the tax system. In November 2018 a bilingual letter was sent to 2.01 million HMRC customers identified as being resident in Wales. As well as providing information about the introduction of WRIT, this letter also informed them of the need to notify HMRC of any address changes.
- 3.6 A range of communications activity supported this letter, targeting employers, software providers, pension providers, tax professionals, and others.
- 3.7 HMRC has extensive guidance in place to establish Welsh taxpayer status, including guidance on cross-border issues.

Ongoing Activity

- 3.8 HMRC carries out a number of scans to support the ongoing identification of Welsh taxpayers. This includes scans of blank and invalid postcodes in records where we identify indicators in the remainder of the address that it is Welsh. Records identified in these scans are updated to ensure they have the correct postcode and residency status.
- 3.9 HMRC also uses data provided by the Office of National Statistics to reflect new properties being built and subdivision of existing properties on our systems.
- 3.10 We continue to use the extensive existing channels of communication with taxpayers to reinforce key WRIT messages, including channels such as online social media and the Personal Tax Account. These communications have focused on the need for customers to update their address details with HMRC when they move.

Looking Ahead

- 3.11 The identification of Welsh taxpayers, and assurance that this identification is correct, is an ongoing process. HMRC will continue to carry out a range of activities to support this, and we will work closely with the Welsh Government to further refine our approach. We are currently discussing with the Welsh Government when the next third party data clash should be carried out.

4. Compliance Approach

- 4.1 HMRC continues to assess risk and undertake compliance activity into the tax affairs of Welsh taxpayers in the same manner we have always done, as part

of the administration of the UK income tax system as a whole. HMRC applies risk-based compliance activity to the collection of WRIT in the same way as is applied to the collection of income tax from taxpayers in the rest of the UK. The cost of this activity is not recharged to the Welsh Government.

- 4.2 HMRC also considers any compliance risk specific to WRIT. Risk attributable to Welsh taxpayers is dependent on the divergence of WRIT from the rest of the UK. This risk, and any activity carried out by HMRC as a result, is summarised in the WRIT Compliance Plan, which is produced annually. The first WRIT Compliance Plan was provided to the Welsh Government in July 2020.

Current Risk and Activity

- 4.3 WRIT remains level with UK rates, so there is currently no risk of behavioural change in Welsh taxpayers. However, for all individuals, whether in Self Assessment or Pay As You Earn, HMRC monitors cross-border migration trends and validates the accuracy of reported moves and the completeness of its address data.
- 4.4 For wealthy individuals, HMRC uses the existing Customer Compliance Manager model and other interactions with wealthy customers to raise awareness, educate customers of their WRIT obligations and assess compliance risk related to misrepresentation of Welsh taxpayer status or understatement of income liable to WRIT.

Employer Compliance

- 4.5 HMRC has also worked to ensure that employers fulfil their responsibilities. In June 2019, we identified that 10.4% of employers were not correctly applying the 'C' codes issued to them by HMRC, which denote customers as Welsh taxpayers.
- 4.6 This was in part due to issues with the payroll software used by some employers, and HMRC worked with employers and software providers to resolve these.
- 4.7 HMRC continues to monitor this, conducting regular scans and re-issuing codes to employers. We also communicate with employers, highlighting the importance of correctly applying the codes issued by HMRC.
- 4.8 The most recent scan, carried out in June 2020, showed that the percentage of employers failing to correctly apply the 'C' codes had reduced to 2.9%. This demonstrates continued improvement, and shows that the vast majority of employers are correctly applying the 'C' codes issued to them by HMRC.

- 4.9 The failure of employers to correctly apply the ‘C’ codes issued by HMRC does not impact the identification of Welsh taxpayers by HMRC. Where tax codes are not applied correctly by employers, end of year reconciliation ensures that customers pay the right amount of tax and that this is allocated to the correct government.

Looking Ahead

- 4.10 HMRC will continue to monitor the risk of non-compliant behaviour by Welsh taxpayers, and to support employers in applying ‘C’ codes correctly.
- 4.11 The compliance activity undertaken for Welsh taxpayers as part of the broader administration of the UK tax system will also be used to inform HMRC’s approach for future years. If this activity shows any trends in behavioural change, this will be considered in future periods.

5. Management of Costs and Recharging

- 5.1 The Fiscal Framework agreed between the UK and Welsh Governments in 2016 sets out the funding arrangements for the implementation of the Wales Act 2014⁵. Under this agreement, the Welsh Government is required to reimburse the UK government for net additional costs wholly and necessarily incurred as a result of the administration of Welsh income tax powers.

The Principles of Recharging

- 5.2 It is HMRC’s responsibility to ensure that the recharge to the Welsh Government is fair and accurate, and we have agreed an approach with the Welsh Government to ensure they have the opportunity to scrutinise this. The Operation of Welsh Rates of Income Tax Rechargeable Costs Framework, annexed to the SLA, describes this process.
- 5.3 HMRC recharges the Welsh Government using the net additional costs principle. This means we recharge costs of elements that relate specifically to the administration of WRIT, and not every cost related to the administration of the income tax system for Welsh taxpayers. This ensures that the costs recharged are all additional costs incurred by HMRC as a result of WRIT, and there is no cost benefit to HMRC.

Implementation Costs

- 5.4 The WRIT Project Board, with oversight from the Welsh Programme Board, was responsible for approving the costs of implementing WRIT, and the project team also scrutinised and challenged these costs. Implementation

⁵ Fiscal Framework between the UK and Welsh Governments:
<https://gov.wales/sites/default/files/publications/2018-11/agreement-on-welsh-government-fiscal-framework.pdf>

costs include the IT, business and staff costs relating to the introduction of WRIT.

- 5.5 HMRC's current estimate of the cost of implementing WRIT is £8-9 million, which covers the initial implementation of WRIT and not the implementation of any future changes to WRIT. Our initial estimate was £5-10 million, and we subsequently revised this to reflect our improved assessment of this cost. In October 2018, we provided a revised estimate to the Cabinet Secretary for Finance of £7.5-9.5 million, and in December 2019 we further revised this to the current estimate. The costs will be finalised following the delivery of the Annual Tax Summary.

Forecasting

- 5.6 An initial forecast of the annual cost of administering WRIT is provided to the Welsh Government at the end of quarter 3. This is an indication only as it does not include any bespoke requests, subsequent tasks identified, or cessation of existing tasks during the course of the following year. Changes that will affect future years will be reflected in the next annual forecast. This forecast is then iterated as plans for the next year become clearer.
- 5.7 This forecast is then compared to the actuals in each month and quarter, and revised as necessary.

Recharging of Ongoing BAU Costs

- 5.8 HMRC produces a report for the Welsh Government each month, detailing the previous month's costs and comparing these to the forecast. Any discrepancies between the forecast and the actuals is explained, and HMRC and the Welsh Government hold monthly meetings to discuss these reports. This enables the Welsh Government to scrutinise and challenge the recharge.
- 5.9 These monthly reports feed into a quarterly report, which is presented to the WRIT Board. The quarterly invoices are raised only once the WRIT Board has confirmed it is content that the recharge is fair and accurate.
- 5.10 Additional governance is in place to provide assurance over larger costs before they are incurred. One-off costs up to £50k require approval by the HMRC SPoC for WRIT, whilst costs over this amount require approval by a Change Control Board and a Deputy Director.
- 5.11 Change Control Boards provide the Welsh Government with the opportunity to challenge HMRC on proposed expenditure and the amounts requested. Restricting this process to amounts over £50k ensures that the process is not unnecessarily onerous for smaller amounts. Amounts under £50k are still subject to scrutiny in the monthly meetings and by the WRIT Board.

Looking Ahead

- 5.12 HMRC will continue to recharge the Welsh Government for costs wholly and necessarily incurred as a result of WRIT. We will work closely with them to ensure they have the information they need to approve the costs, and will provide estimates and forecasts of future costs.
- 5.13 We recently provided the Welsh Government with a high-level estimate of the costs for 2021-22, and will soon provide an initial forecast.

6. The WRIT Outturn

- 6.1 The first WRIT outturn, covering the 2019-20 tax year, is due to be published in summer 2021. HMRC's first provisional estimate of this figure is due to be published this year⁶.
- 6.2 The proposed methodology for calculating the outturn was approved by the WRIT Board in August 2020. HMRC worked closely with Welsh Government analysts during the development of this methodology to ensure it was fully explained.
- 6.3 The WRIT outturn will be audited by the NAO and published in HMRC's Annual Reports and Accounts, alongside the provisional estimate of the 2020-21 figure. We also expect to release a separate statistical publication. An extract of the accounts, including the outturn figure, will be provided to the Committee.

7. Summary

- 7.1 HMRC is committed to the successful administration of WRIT, and we are confident that the approach set out above enables us to work effectively towards this. The successful implementation of WRIT demonstrates this, and we are committed to ensuring that this success continues throughout the business as usual running.
- 7.2 We will prioritise working collaboratively and constructively with the Welsh Government, and ensure they remain able to scrutinise and challenge HMRC's administration of WRIT.

⁶ The forecast of the WRIT outturn is the responsibility of the Office for Budget Responsibility.