National Audit Office

Report
by the Comptroller
and Auditor General

HM Revenue & Customs

Administration of Scottish Income Tax 2017-18

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Key facts

2.53m
Scottish taxpayers in 2016-17

£4,347m
Scottish rate of income tax revenue in 2016-17, under the 2012 powers

£11,896m
HMRC's estimate of Scottish income tax revenue in 2017-18, under the 2016 powers

£4.5 million	Project implementation costs in 2017-18
£0.3 million	Costs of administering Scottish income tax in 2017-18
£3.2 million	HM Revenue & Customs' (HMRC's) forecast of the remaining project implementation costs

Summary

Introduction

Scottish rate of income tax 2016-17

1 The Scotland Act 2012 reduced UK income tax rates in Scotland by 10 percentage points and gave the Scottish Parliament the power to apply a Scottish rate of income tax. In 2016-17, the Scottish Parliament set the Scottish rate of income tax at 10% of all non-savings, non-dividend income of Scottish taxpayers. The Scottish Government received the income tax revenue generated from the Scottish rate based on a forecast produced by the Office for Budget Responsibility (OBR) in autumn 2015.

2 The 2016-17 tax year was a standalone year before the introduction of the full Scottish income tax powers in April 2017 and there will be no reconciliation or adjustment for any difference between the original forecast and the final outturn, regardless of the actual tax collected by HM Revenue & Customs (HMRC).

3 In our 2016-17 report, we assessed HMRC's latest estimate of the revenue collected from the Scottish rate of income tax. The revenue had to be estimated as the total income tax liabilities could not be known until all of the Pay As You Earn (PAYE) taxpayer accounts were reconciled and the income tax liability data were collected from Self-Assessment taxpayers, which can take up to 10 months after the end of the tax year.

4 HMRC has calculated the final outturn for the 2016-17 Scottish rate of income tax and the calculation is disclosed in the 2017-18 annual report and accounts published in July 2018. As part of this report we provide assurance over HMRC's calculation of this figure from the records of Scottish taxpayers and the impact of estimation for some elements, such as collection rates.

Scottish income tax from 2017-18

5 The Scotland Act 2016 gave the Scottish Parliament full power to determine the rates and thresholds (excluding the personal allowance) paid by Scottish taxpayers on all non-savings, non-dividend income in 2017-18.[1] This represents a significant change from 2016-17, where a Scottish rate of tax was applied to all non-savings and non-dividend income. Under these new powers, in 2017-18 income tax rules in Scotland differed from the rest of the UK for the first time: Scottish taxpayers paid the higher rate of tax (40%) as soon as they earned £43,000 – as opposed to £45,000 in the rest of the UK. There were no other areas where the UK and Scottish income tax regimes diverged.

1 The point at which a taxpayer starts to pay a different rate of tax..

6 HMRC has estimated the revenue collected from Scottish income tax in 2017-18 under the new powers using the same methodology as the previous year. This report provides our view on the calculation of this estimate and highlights potential areas for improvement in future years as Scottish-specific taxpayer data develops.

7 The final outturn for Scottish income tax collected in 2017-18 will be disclosed by HMRC in its 2018-19 annual report and accounts expected to be published in July 2019.

8 For the 2018-19 tax year, the UK and Scottish income tax rules have diverged further. The Scottish Government has introduced two new income tax bands and has varied the rates of the existing higher rate and additional rate income bands. The higher rate threshold will also continue to differ from the UK income tax regime. These changes will only apply to non-savings, non-dividend income. We will report on these changes in more detail in our 2018-19 report.

9 HMRC continues to administer and collect Scottish income tax as part of the UK tax system. Taxpayer records with Scottish addresses are identified in HMRC's systems by a flag which indicates that they are subject to Scottish income tax rates and thresholds. Income tax collected from Scottish taxpayers is paid over to HM Treasury. HM Treasury is responsible for the payment of the Scottish income tax to the Scottish Government.

Remit of the Comptroller and Auditor General

10 Section 80HA of the Scotland Act 1998, as amended by the Finance Act 2014, requires the Comptroller and Auditor General (C&AG) to prepare a report for each financial year on:

- the adequacy of any of HMRC's rules and procedures put in place, in consequence of the Scottish rate provisions, for the purpose of ensuring the proper assessment and collection of income tax charged at rates determined under those provisions;
- whether these rules and procedures are being complied with;
- the correctness of the sums brought to account by HMRC which relate to income tax which is attributable to a Scottish rate resolution; and
- the accuracy and fairness of the amounts which are reimbursed to HMRC as administrative expenses.

11 This report considers:

- HMRC's calculation of the 2016-17 income tax revenue attributable to Scotland and provides assurance on the correctness of the amounts brought to account (Part One);
- HMRC's estimation of the 2017-18 income tax revenue attributable to Scotland and our view on the methodology used to estimate the amount (Part One);
- key controls operated by HMRC in the assessment and collection of Scottish income tax (Part Two);
- HMRC's approach to assessing and mitigating the risk of non-compliance with Scottish rate provisions (Part Two); and
- the cost of administering Scottish income tax and provides assurance on whether the amounts are accurate and fair in the context of the costs incurred by HMRC (Part Three).

Appendix One sets out our audit approach and methodology.

Key findings

Scottish rate of income tax 2016-17 final outturn

12 HMRC calculated the final revenue outturn for 2016-17 as £4,347 million, representing amounts collected under the Scottish rate. We examined the methodology for the calculation of the final outturn, which necessarily includes some remaining areas of estimation. In these areas, we have evaluated the basis of HMRC's estimate including the relevant assumptions and the available data. Based on our procedures, we have concluded that the outturn of income tax revenue for the Scottish rate of income tax for 2016-17 is fairly stated (paragraphs 1.5 to 1.20).

Scottish income tax 2017-18 estimate

13 From 2017-18 onwards, the Scottish Government receives all income tax revenue generated from non-savings, non-dividend income under Scottish income tax policy. HMRC's estimate, published in July 2018, calculated Scottish income tax revenue of £11,896 million for 2017-18. The methodology that HMRC has used for this estimate is consistent with the estimate for the Scottish rate of income tax in 2016-17. The limitations of this methodology remain the same as we reported last year and HMRC plans to refine its estimation methodology now it has a full year of Scottish income tax data for 2016-17 (paragraphs 1.25 to 1.28).

Administering Scottish income tax

14 Under Section 2 of the Exchequer and Audit Departments Act 1921 the C&AG is already responsible for considering the adequacy of the systems HMRC has in place for the assessment and collection of tax in the UK, including income tax. In this year's Standard Report, which accompanies HMRC's annual report and accounts, we concluded that HMRC framed adequate regulations and procedures to secure an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out.

15 Having completed our additional work on devolved tax matters, we are satisfied that HMRC has adequate rules and procedures to ensure the proper assessment and collection of Scottish income tax and that they are being complied with (paragraphs 2.15 to 2.19).

Costs

16 In 2017-18 HMRC incurred and recharged £4.8 million of costs on the three Scottish income tax projects, of which £0.3 million was running costs.

17 We examined HMRC's method for estimating the costs of collecting and administering the Scottish income tax for the year to ensure this was reasonable in the context of the agreement with the Scottish Government. Based on our procedures, we have concluded that the amount repaid by the Scottish Government for the year ended 31 March 2018 is fairly stated (paragraphs 3.2 to 3.5).

Recommendations

a The complete and accurate calculation of the outturn of Scottish income tax revenue is a central responsibility of HMRC's role in devolved taxes. We are content that both parties have a good understanding of the methodology, which has been agreed. We recommend that the methodology is formalised by consolidating it into a single agreed document that forms a baseline position from which future refinements can be made. This will support understanding of the process in the event of changing personnel on either side and reduce the risk that unagreed changes are made to the methodology in the future as better data become available.

b As part of its compliance strategy for Scottish income tax HMRC set out its intention to complete an annual review of its Strategic Picture of Risk (SPR) for Scotland. An updated SPR was not available for review as part of this report. We recommend that HMRC completes this review, incorporating a detailed analysis of the available Scottish taxpayer data for 2016-17, to inform its ongoing compliance work.