



National Audit Office

Report

by the Comptroller
and Auditor General

HM Revenue & Customs

Administration of Scottish income tax 2018-19

Key facts

2.5m

Scottish taxpayers in 2017-18¹

£10,916m

Scottish income tax revenue
in 2017-18²

£11,660m

HMRC's estimate of Scottish
income tax revenue in 2018-19³

£2.0 million project implementation costs in 2018-19

£0.8 million costs of administering Scottish income tax in 2018-19

£1.1 million HM Revenue & Customs' forecast of the remaining project
implementation costs in 2019-20

Notes

1 Source: HMRC, *Scottish Income Tax: Experimental Statistics 2016-17 & 2017-18*, 18 July 2019. The number of Scottish taxpayers includes those recorded through the PAYE (2.0 million) and Self Assessment (0.4 million) systems along with an estimate for taxpayer records yet to be finalised.

2 HM Revenue & Customs, *Annual Report and Accounts 2018-19*, HC 2394, July 2019.

3 HM Revenue & Customs, *Annual Report and Accounts 2018-19*, HC 2394, July 2019.

Summary

Introduction

Scottish income tax in 2017-18

1 The Scotland Act 2016 gave the Scottish Parliament full power to determine the rates and thresholds¹ (excluding the personal allowance) paid by Scottish taxpayers on all non-savings, non-dividend income from 6 April 2017. The Scottish Government receives all income tax revenue generated from non-savings, non-dividend income under Scottish income tax policy.

2 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. Apart from this difference in thresholds, the rate of tax applied to each band remained the same.

3 These powers represent a significant change from 2016-17, where the Scotland Act 2012 first introduced a Scottish rate of income tax by reducing UK income tax rates by 10% and giving the Scottish Parliament the power to apply its own additional rate. In 2016-17, the Scottish Parliament had set the Scottish rate of income tax at 10% of all non-savings, non-dividend income of Scottish taxpayers, so there was no difference to individual taxpayers' liabilities compared with those of taxpayers in the rest of the UK.

Scottish income tax from 2018-19

4 For the 2018-19 tax year, the Scottish income tax rules diverged further from those in the rest of the UK. The Scottish Government introduced two new income tax bands for non-savings, non-dividend income, the starter rate and intermediate rate bands. The rates for the existing higher rate and top rate income tax bands were also increased. The higher rate threshold continues to differ from the UK income tax regime (see **Figure 1** overleaf).

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

Figure 1 2018-19 Scottish income tax rates and bands

The income tax bands and tax rates set out under Scottish income tax policy are shown below

Band	Scottish income tax rates		Rest of UK income tax rates	
	Taxable income	Tax rate (%)	Taxable income	Tax rate (%)
Personal Allowance ¹	Up to £11,850	0	Up to £11,850	0
Starter rate	£11,851 to £13,850	19	–	–
Basic rate	£13,851 to £24,000	20	£11,851 to £46,350	20
Intermediate rate	£24,001 to £43,430	21	–	–
Higher rate	£43,431 to £150,000	41	£46,351 to £150,000	40
Top rate ²	over £150,000	46	over £150,000	45

Notes

- 1 A taxpayer's Personal Allowance is reduced by £1 for every £2 of net income above £100,000.
- 2 This is known as the Additional Rate in the Rest of the UK.

Source: HM Revenue & Customs, Income Tax rates and Personal Allowances, available at: www.gov.uk/income-tax-rates/previous-tax-years, accessed October 2019 and HM Revenue & Customs, *Income Tax in Scotland*, available at: www.gov.uk/scottish-income-tax/previous-tax-year, accessed October 2019.

Roles and responsibilities

5 HM Revenue & Customs (HMRC) administers and collects 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. HM Treasury is responsible for the payment of the Scottish income tax to the Scottish Government.

6 Following the end of each tax year, HMRC produces a provisional estimate of the Scottish income tax revenue for that year. The final outturn is calculated in the following year once HMRC has received further information from taxpayers and employers. HMRC's Annual Report and Accounts 2018-19 reported the outturn for 2017-18 and an estimate of revenue collected for 2018-19. The final outturn for Scottish income tax collected in 2018-19 will be disclosed in HMRC's Annual Report and Accounts 2019-20, expected to be published in July 2020.

Remit of the Comptroller and Auditor General

7 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.

8 This report considers:

- HMRC's calculation of the 2017-18 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 2018-19 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 income tax (Part Two);
- HMRC's approach to assessing and mitigating the risk of non-compliance with Scottish tax requirements (Part Two); and
- the cost of administering Scottish income tax, and we provide assurance on whether the amounts are accurate and fair in the context of the costs incurred by HMRC (Part Three).

9 Appendix One sets out our audit approach and methodology.

Key findings

Scottish income tax 2017-18 final outturn

10 HMRC calculated the final revenue outturn for 2017-18 as £10,916 million representing amounts collected under Scottish income tax policy. We examined the methodology for the calculation of the actual 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 Scottish income tax revenue outturn for 2017-18 is fairly stated.

11 The complete and accurate calculation of the outturn of Scottish income tax revenue is a central responsibility of HMRC's role in devolved taxes. The calculation of the 2017-18 outturn included a new adjustment to the methodology. The methodology is agreed annually with the Scottish Government and HMRC has also published a summary in its statistical publication.² **We consider that the governance arrangements could be enhanced by formalising the full detail of the methodology in a single document that is ratified by all parties with any subsequent changes subject to approval by the Scottish Income Tax Board.** This will support understanding of the process, strengthen the governance around changes to the methodology and form a baseline position from which future refinements can be made (paragraphs 1.2 to 1.20).

Scottish income tax 2018-19 estimate

12 HMRC has estimated Scottish income tax revenue for 2018-19 as £11,660 million.³ The methodology used by HMRC to produce the 2018-19 provisional estimate is largely consistent with the prior year; however, it includes an adjustment to reflect potential overestimation in the underlying methodology. This was calculated through comparison of the 2017-18 outturn with a revised estimate of 2017-18 revenue based on the same methodology with the latest assumptions and data. The 2018-19 provisional estimate has been scaled down by the percentage difference observed (3.6%) on the assumption that the same level of forecast error will be present in the 2018-19 estimate. We have set out the limitations of HMRC's modelling approach in our past reports and summarise these in Part One.

13 **HMRC should continue to improve the accuracy of the revenue estimate by incorporating more of the outturn data for Scottish income tax as it becomes available in future years.** HMRC now has access to actual tax liability data for Scottish taxpayers, which has been used to calibrate the estimate to reflect previous over-estimation in 2016-17 and 2017-18. The current methodology for estimating the revenue is consistent with the methodology used by the Office for Budget Responsibility (OBR) to forecast income tax receipts for both Scotland and at the whole-of-UK level (paragraphs 1.21 to 1.30).

² HM Revenue & Customs, *Scottish Income Tax: Experimental Statistics 2016-17 & 2017-18*, July 2019.

³ HM Revenue & Customs, *Annual Report and Accounts 2018-19*, HC 2394, July 2019.

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 2018-19,⁴ 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 2.5 to 2.20).

16 HMRC obtains assurance over the accuracy of its address records from a comparison with third-party data. Although HMRC has not identified any significant or widespread instances of taxpayers changing their address to obtain a tax advantage, the comparison with third-party data has not been undertaken since November 2017. The timetable for completing this exercise has been agreed between HMRC and the Scottish Government in accordance with the Service Level Agreement. Scottish and UK income tax will diverge further in 2019-20 and HMRC is repeating the exercise in November 2019, the findings of which we will consider as part of our next report. **HMRC should consider whether the third-party data clash exercise should be undertaken annually, and the most appropriate point in the reporting cycle to do this, in providing more regular assurance over the taxpayer data used to calculate the revenue outturn** (paragraphs 2.27 to 2.28 and 2.38 to 2.39).

Costs

17 In 2018-19 HMRC incurred and recharged £2.8 million of costs, of which £0.8 million was running costs and £2.0 million was implementation costs.

18 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 2019 is fairly stated (paragraphs 3.4 to 3.5).

⁴ HM Revenue & Customs, *Annual Report and Accounts 2018-19*, HC 2394, July 2019.