National Audit Office

Administration of Scottish income tax 2019-20

HM Revenue & Customs

REPORT

by the Comptroller and Auditor General

SESSION 2019–2021
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Key facts

2.5m	£11,556m	£11,703m
Scottish taxpayers in 2018-19[1]	Scottish income tax revenue in 2018-19	HM Revenue & Custom's estimate of Scottish income tax revenue in 2019-20

£0.6 million project implementation costs in 2019-20

£0.9 million costs of administering Scottish income tax in 2019-20

£24.3 million total lifetime cost of implementing Scottish income tax projects

Note

1 Refers to Scottish taxpayers with non-savings, non-dividend income.

Summary

Introduction

1 The Scotland Act 2016 gave the Scottish Parliament full power to determine the rates and thresholds[1] (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 2018-19, 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. In 2019-20, the Scottish Government chose not to increase the higher rate thresholds in line with the rest of the UK, resulting in further divergence (see **Figure 1** overleaf). The point at which taxpayers pay the higher rate in Scotland was £43,431 in 2019-20 and remained the same as in 2018-19. The threshold for the higher rate tax band for the rest of the UK increased to £50,001 (2018-19: £46,351). The personal tax allowance was £12,500 in both Scotland and the rest of the UK in 2019-20.

Roles and responsibilities

3 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 Scottish income tax to the Scottish Government.

4 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. This report covers the final outturn for 2018-19. The outturn for 2019-20 is due to be published by HMRC in its 2020-21 Annual Report and Accounts.

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

Figure 1
Scottish and rest of UK income tax rates and bands for 2019-20

The introduction of the Scottish starter and intermediate rates in 2018-19 means there are five tax bands in Scotland compared to three in the rest of the UK

	Scottish income tax rates		Rest of UK income tax rates	
Band	Taxable income	Tax rate	Taxable income	Tax rate
		(%)		(%)
Personal Allowance[1]	Up to £12,500	0	Up to £12,500	0
Starter rate	£12,501 to £14,549	19	–	–
Basic rate	£14,500 to £24,944	20	£12,501 to £50,000	20
Intermediate rate	£24,945 to £43,430	21	–	–
Higher rate	£43,431 to £150,000	41	£50,001 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*, www.gov.uk/income-tax-rates/previous-tax-years, accessed November 2020 and HM Revenue & Customs, *Income Tax in Scotland*, www.gov.uk/scottish-income-tax/2019-to-2020-tax-year, accessed November 2020

Remit of the Comptroller and Auditor General

5 Section 80HA of the Scotland Act 1998, as amended by the Finance Act 2014 and the Scotland Act 2016, 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.

6 This report considers:

- HMRC's calculation of the 2018-19 income tax revenue attributable to Scotland, the 'outturn', and provides assurance on the correctness of the amounts brought to account (Part One);
- HMRC's estimate of the 2019-20 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 – we provide 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 and recommendations

Scottish income tax 2018-19 final outturn and 2019-20 estimate

7 HMRC calculated the final outturn for 2018-19 as £11,556 million, representing amounts collected under Scottish income tax policy. HMRC's estimate of 2018-19 Scottish income tax revenue, published in July 2019, was £11,660 million. 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 that audit work, we have concluded that the Scottish income tax revenue outturn for 2018-19 is fairly stated (paragraphs 1.2 to 1.19).

8 HMRC has estimated Scottish income tax revenue for 2019-20 as £11,703 million. The methodology used by HMRC to produce the 2019-20 provisional estimate is largely consistent with the prior year. For 2019-20, the calculation includes a reduction of £25 million to reflect HMRC's estimate of the economic impact of COVID-19 on taxpayer finances, which could result in amounts due to HMRC not being recovered. HMRC expects to calculate the finalised 2019-20 income tax revenue attributable to Scotland in 2021 (paragraphs 1.20 to 1.27).

9 The impact of COVID-19 on future outturns for 2019-20 and 2020-21 is yet to be determined. Tax receipts across the UK have fallen since the onset of the pandemic. HMRC's compliance and debt collection activities have also reduced as a result of the impact of COVID-19 on the Department's capacity, measures taken to allow taxpayers more flexibility in making payments and the ability to physically engage with businesses and individuals. HMRC will need to consider whether further refinements to the calculation of future outturns and estimates are necessary, as more data become available, to better reflect the uncertainties caused by COVID-19 (paragraphs 1.28 to 1.29).

Administration of Scottish income tax

10 HMRC has adequate rules and procedures in place to ensure the proper assessment and collection of Scottish income tax and that those rules are being complied with. Our work on devolved tax matters builds on our wider assessment of HMRC's rules and procedures, completed as part of our annual audit of HMRC. 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 (paragraphs 2.6 to 2.15).

11 Maintaining an accurate and complete record of the addresses of Scottish taxpayers to correctly determine residency remains the key challenge in administering the system. HMRC relies on taxpayers notifying it of a change of address, although there is no legal requirement for them to do so. In November 2019, HMRC undertook a data comparison between its address records for Scottish taxpayers and third-party data to provide assurance over the accuracy and completeness of the address information it holds. Matching records could not be identified for 21.2% of Scottish taxpayers (1.1 million records) and the residency of these taxpayers could not be corroborated by comparison to third-party data. HMRC reviewed these records against other internal data sources to gain assurance over the accuracy of the addresses held. After the exercise was completed, HMRC wrote to 8,600 Scottish taxpayers (0.2% of records matched to third-party data) where its records did not match third-party data asking them to confirm their address. HMRC sent each letter to the address it held in its records, rather than that suggested by the third-party, for data-protection reasons. No other direct form of communication was undertaken with the taxpayers in question to confirm residency (paragraphs 2.16 to 2.31).

12 **HMRC continues to assess the risk of non-compliance in relation to Scottish income tax as low, although there is increasing divergence between Scottish income tax rates and the rest of the United Kingdom.** In 2019-20, HMRC produced a Scottish Strategic Picture of Risk (SPR). HMRC considers the main areas of risk to Scottish income tax to be the same as those compliance risks which are tackled at the whole-of-UK level. There are no risks identified in the Scotland SPR specific to Scotland. HMRC continues to assess the risk of a Scottish taxpayer manipulating their address to minimise their tax liability to be low. HMRC has not identified any significant or widespread instances of taxpayers changing their address to obtain a tax advantage. Behavioural analysis may become increasingly important to support HMRC's assessment of compliance risk if tax rates and bands continue to diverge (paragraphs 2.32 to 2.39).

13 **HMRC calculated a compliance yield of £210 million relating to Scotland for 2017-18, the most recent data available.** HMRC measures the effectiveness of its enforcement and compliance activities through compliance yield: its estimate of the additional revenues that HMRC considers it has generated, and the revenue losses it has prevented. These figures are calculated based on a proportion of the UK figure, rather than using Scotland-specific data to quantify the risks. HMRC does not consider geographical variations in the level of compliance risk, or the relative success of compliance activity in Scotland compared with the rest of the UK (paragraph 2.34).

14 **The Committee of Public Accounts (the Committee) recommended that HMRC should consider the benefits and challenges of estimating a Scotland-specific tax gap,** the difference between the amount of tax that should be paid and what is actually paid. This would be a useful measure to understand how successful HMRC is in administering Scottish income tax. HMRC is due to respond to the Committee's recommendation by January 2021 (paragraph 2.35).

Costs

15 **In 2019-20 HMRC incurred and recharged £1.5 million of costs to the Scottish Government for the cost of administering Scottish income tax.** We examined HMRC's method for estimating the costs of collecting and administering Scottish income tax for the year ended 31 March 2020. Based on our audit work, we have concluded that the amount paid by the Scottish Government was accurate and fair in the context of the agreement between HMRC and the Scottish Government. (paragraphs 3.4 to 3.6).

Recommendations

a **HMRC should consider how it reflects the impact of COVID-19 in its calculation of the revenue outturn and estimate for future years,** including consideration of what additional data might be available to refine the calculation and better reflect the uncertainties caused by the pandemic.

b **HMRC should review, by March 2022, how it can enhance the effectiveness of its third-party data comparison exercise in providing assurance over the accuracy of its address records,** and in doing so should consider:

- what additional action can be taken to reduce the proportion of records that cannot be matched to third-party data and the most appropriate time in the data-matching cycle to do so; and
- whether there are additional ways HMRC can communicate with taxpayers to confirm an address where its records do not match third-party sources, including the possibility of the use of email or communication via employers.