



National Audit Office



Administration of Welsh income tax 2019-20

HM Revenue & Customs

REPORT

**by the Comptroller
and Auditor General**

**SESSION 2019–2021
21 JANUARY 2021
HC 1073**

Key facts

1.4m

Welsh taxpayers in 2019-20

£2,008m

HM Revenue & Customs'
(HMRC's) estimate of
Welsh income tax revenue
in 2019-20.

£1.4 million project implementation costs in 2019-20

£0.6 million costs of administering the Welsh rates of income tax in 2019-20

Summary

Introduction

Welsh income tax

1 The Wales Act 2014 amended the Government of Wales Act 2006 to give the Welsh Parliament the power to set the Welsh rates of income tax that will apply to the non-savings, non-dividend income of Welsh taxpayers from the 2019-20 tax year onwards.

2 From April 2019, the United Kingdom (UK) basic, higher and additional income tax rates were reduced by 10 percentage points and the Welsh Parliament had the power to apply Welsh rates. The sum of the reduced UK rates and the new Welsh rates determines the overall rate of tax paid by Welsh taxpayers (**Figure 1** overleaf). The Welsh Parliament set the Welsh rates of income tax at 10% across all bands, effectively matching the UK rates at 20% (basic rate), 40% (higher rate) and 45% (additional rate).

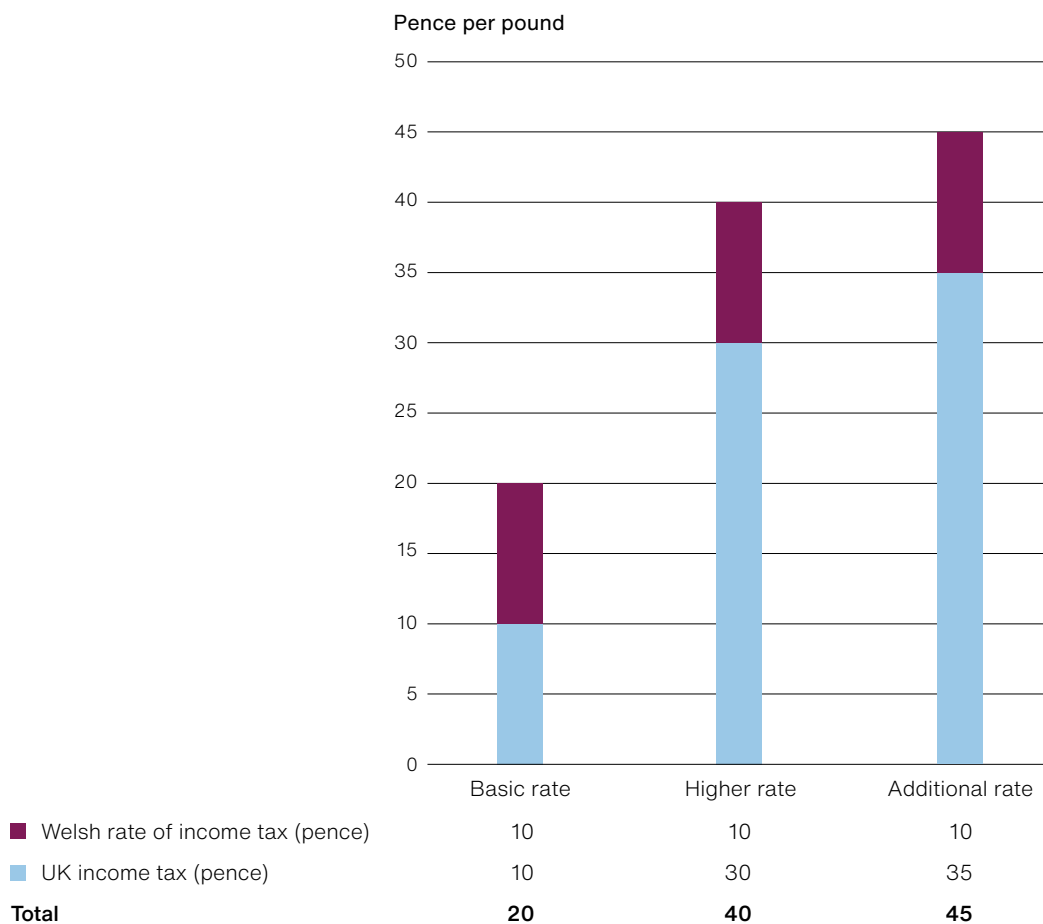
Roles and responsibilities

3 HM Revenue & Customs (HMRC) is responsible for the administration of the Welsh rates of income tax and continues to collect Welsh income tax as part of the UK tax system. HMRC will pay revenues collected in relation to the Welsh rates of income tax to HM Treasury in the same way as it does for all other tax receipts. HM Treasury is responsible for the payment of the Welsh income tax collected to the Welsh Government.

4 Following the end of each tax year, HMRC produces a provisional estimate of the Welsh 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 first estimate of Welsh income tax for 2019-20, following the implementation of the Welsh rates of income tax in April 2019. The outturn for 2019-20 is due to be published by HMRC in its 2020-21 Annual Report and Accounts.

Figure 1
Welsh rates of income tax for 2019-20

The UK rates of income tax are effectively reduced by 10p per £1 and replaced with the Welsh rates of income tax



Notes

- 1 For each tax band (basic, higher and additional), the UK government reduces the amount of tax it will collect by 10 pence per £1 and the Welsh Government sets the Welsh rate of income tax to be added to the UK rates of tax.
- 2 For 2019-20, the Welsh Government set each Welsh rate of income tax at 10 pence, meaning that Welsh taxpayers pay an amount of tax equivalent to the UK rate for each tax band.

Source: The Welsh Government

Remit of the Comptroller and Auditor General

5 The Government of Wales Act 2006, as amended by the Wales 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 Welsh 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 that is attributable to a Welsh rate resolution; and
- the accuracy and fairness of the amounts that are reimbursed by the Welsh Government to HMRC as administrative expenses.

6 This is our third report prepared under these responsibilities. It considers:

- HMRC's estimate of the 2019-20 income tax revenue attributable to Wales and our view on the methodology used (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 Welsh tax requirements (Part Two); and
- the cost of administering Welsh income tax – we provide assurance on whether the amounts are accurate and fair in the context of the costs incurred by HMRC (Part Three).

7 Appendix One sets out our audit approach and methodology.

Key findings and recommendations

Welsh income tax estimate 2019-20

8 **HMRC has estimated Welsh income tax revenue for 2019-20 as £2,008 million.** The methodology used to calculate the estimate is consistent with the methodology used by HMRC in estimating Scottish income tax revenue. For 2019-20, the calculation includes a reduction of £4 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 Wales, the 'outturn', in 2021 (paragraphs 1.2 to 1.9).

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 1.10 and 1.11).

Administering Welsh income tax

10 HMRC has adequate rules and procedures in place to ensure the proper assessment and collection of Welsh 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 2.1 to 2.11).

11 HMRC has not undertaken a comparison between its record of Welsh taxpayer residency status and third-party data since November 2018. Maintaining an accurate and complete record of the home addresses of Welsh 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 2018, HMRC undertook a comparison between its record of addresses and third-party data. This is HMRC's main source of assurance that the information it holds is accurate and complete, although the exercise was not undertaken in 2019-20. HMRC is currently in discussions with the Welsh Government about how frequently this work should be carried out, with the next exercise expected in 2020-21 (paragraph 2.22).

12 As at April 2020, there were 43,000 Welsh taxpayers who had an incorrect tax code applied by employers and pension providers. In May 2019, HMRC identified 198,000 Welsh taxpayers where the incorrect tax code was applied by employers and pension providers. The number of cases in May 2019 was higher than April 2020 due to issues with the software some employers use to process their payroll, as well as employer error. HMRC has worked with employers to resolve these issues, although work is continuing to target those employers and pension providers who continue to apply the 'C' prefix incorrectly. At the end of the tax year HMRC reconciles what each taxpayer has paid in tax against what it thinks they should have paid. HMRC uses this information to calculate the tax liability that each Welsh taxpayer should pay. The revenue outturn for Wales is, therefore, unaffected where the 'C' prefix in an individual's tax code is not correctly operated by an employer (paragraphs 2.23 to 2.28).

13 HMRC continues to assess the risk of non-compliance in relation to the Welsh rates of income tax as very low. In 2019-20, HMRC produced a Welsh Strategic Picture of Risk (SPR) for the first time. HMRC considers the main areas of risk to Welsh 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 Welsh SPR specific to Wales. HMRC continues to assess compliance risks arising from Wales-specific elements as very low because tax rates remain the same as the UK rate. If there is divergence in the future, then this approach may need to change (paragraphs 2.31 and 2.32).

14 HMRC calculated a compliance yield of £90 million relating to Wales 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 as a whole, rather than using Welsh-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 Wales compared with the rest of the UK (paragraph 2.33).

15 The Committee of Public Accounts (the Committee) recommended that HMRC should consider the benefits and challenges of estimating a Welsh-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 Welsh income tax. HMRC is due to respond to the Committee's recommendation by January 2021 (paragraph 2.34).

16 HMRC has put in place appropriate governance arrangements to oversee the implementation and administration of the Welsh rates of income tax. To manage the implementation of the Welsh rates of income tax, HMRC established a project governance structure within its wider devolution and change programme. In February 2020, the governance structure was adapted to reflect the fact that the Welsh rates of income tax project had been implemented and that the administration of the system had become part of HMRC's business-as-usual activities. The project to implement the Welsh rates of income tax project is due to be formally closed in 2021 (paragraphs 2.37 to 2.40).

Costs

17 In 2019-20 HMRC incurred and recharged £2 million to the Welsh Government for the cost of administering the Welsh rates of income tax. We examined HMRC's method for estimating the costs of collecting and administering the Welsh rates of income tax for the year ended 31 March 2020. Based on our audit work, we have concluded that the amount paid by the Welsh Government was accurate and fair in the context of the agreement between HMRC and the Welsh Government (paragraphs 3.1 to 3.7).

Recommendation

18 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.