National Audit Office

Administration of Scottish income tax 2020-21

HM Revenue & Customs

REPORT

by the Comptroller and Auditor General

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Key facts

2.5m	£11,833m	£12,035m
Scottish taxpayers in 2019-20	Scottish income tax revenue in 2019-20	HM Revenue & Customs' estimate of Scottish income tax revenue in 2020-21

£0.7 million costs of administering Scottish income tax in 2020-21

Summary

Introduction

1 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 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 The Scottish Parliament sets income tax rates in Scotland using the five-band system first introduced in 2018-19. For 2020-21, the tax bands for higher and top rate taxpayers were frozen, with the starting thresholds for basic and intermediate rate taxpayers increasing in line with inflation. The rest of the UK opted to freeze tax rates for all taxpayers, resulting in further divergence between the two tax regimes (see **Figure 1**). The personal tax allowance was £12,500 in both Scotland and the rest of the UK in 2019-20.

Figure 1
Income tax rates and bands in Scotland and the rest of the UK for 2020-21

There are five tax bands in Scotland compared with three in the rest of the UK

	Income tax rates in Scotland		Income tax rates in the rest of the UK	
Band	**Taxable income**	**Tax rate**	**Taxable income**	**Tax rate**
	(£)	(%)	(£)	(%)
Personal allowance	Up to 12,500	0	Up to 12,500	0
Starter rate	12,501 to 14,585	19	–	–
Basic rate	14,586 to 25,158	20	12,501 to 50,000	20
Intermediate rate	25,159 to 43,430	21	–	–
Higher rate	43,431 to 150,000	41	50,001 to 150,000	40
Top rate[2]	More than 150,000	46	More than 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 November 2021; and HM Revenue & Customs, *Income Tax in Scotland*, www.gov.uk/scottish-income-tax/2020-to-2021-tax-year, accessed November 2021

3 HM Revenue & Customs (HMRC) administers and collects Scottish income tax as part of the UK tax system. HMRC identifies taxpayers resident in Scotland by applying a 'flag' in its systems that indicates they are subject to Scottish income tax rates and thresholds. HM Treasury is responsible for paying Scottish income tax to the Scottish Government.

4 Following the end of each tax year, HMRC produces a provisional estimate of Scottish income tax revenue for that year. The final outturn is calculated the following year once HMRC receives further information from taxpayers and employers. This report covers the final outturn for 2019-20 and the provisional outturn for 2020-21. HMRC expects to publish the outturn for 2020-21 in its 2021-22 Annual Report and Accounts.

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 HMRC's rules and procedures, in consequence of the Scottish rate provisions, to ensure the proper assessment and collection of income tax charged at rates determined by those provisions;
- whether these rules and procedures are being complied with;
- the correctness of sums brought to account by HMRC relating to income tax attributable to a Scottish rate resolution; and
- the accuracy and fairness of amounts reimbursed to HMRC as administrative expenses.

6 This report considers:

- HMRC's calculation of the 2019-20 income tax revenue for Scotland, the 'outturn', and assurance on the correctness of amounts brought to account (Part One);
- HMRC's estimate of the 2020-21 income tax revenue for Scotland and our view on the estimate methodology (Part One);
- key controls operated by HMRC to assess and collect 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 the accuracy and fairness of these amounts in the context of costs incurred by HMRC (Part Three).

7 Appendix One sets out our audit approach and methodology.

Key findings

Scottish income tax 2019-20 final outturn and 2020-21 estimate

8 **HMRC calculated the final outturn for 2019-20 as £11,833 million, representing amounts collected under Scottish income tax policy.** HMRC's estimate of 2019-20 Scottish income tax revenue, published in September 2020, was £11,703 million, meaning the actual outturn was £130 million higher than HMRC had originally estimated. 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 2019-20 is fairly stated (paragraphs 1.2 to 1.17).

9 **HMRC has estimated Scottish income tax revenue for 2020-21 as £12,035 million.** This represents an increase of £202 million (1.7%) against the 2019-20 outturn. Despite the impact of public health restrictions arising from the COVID-19 pandemic on the economy and HMRC compliance activity, income tax revenues remained stable because growth in wages and salaries was stronger than anticipated. HMRC expects to calculate the finalised 2020-21 income tax outturn attributable to Scotland in 2022. The estimate HMRC produces is solely for financial reporting purposes in its annual accounts and does not affect the amount of revenue ultimately received by the Scottish Government (paragraphs 1.18 to 1.23).

10 **The impact of COVID-19 on both the economy and individual taxpayers increases the level of uncertainty in HMRC's estimate of Scottish income tax revenue in 2020-21.** HMRC identified the collectability of tax revenues as the key source of uncertainty and took account of this as part of its normal calibration to outturn adjustment. We consider the approach adopted by HMRC to estimating the impact of COVID-19 on Scottish income tax revenue in 2020-21 to be reasonable (paragraph 1.24).

Administration of Scottish income tax

11 **HMRC has adequate rules and procedures in place to ensure the proper assessment and collection of Scottish income tax and those rules are being complied with.** Our work on Scottish income tax matters builds on our wider assessment of HMRC's rules and procedures, completed as part of our annual audit of HMRC. As part of that audit, 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 2.2 to 2.14).

12 **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. We found that there had been an increase in the number of missing Scottish postcodes identified by HMRC's address-cleansing work, with 23,351 identified compared with 13,708 when we last reported. This continues to represent less than 1% of the overall taxpayer population, with HMRC having investigated and updated all identified cases where individuals were either employed or receiving a pension (paragraphs 2.15 to 2.24).

13 **HMRC continues to assess as 'low' the risk of non-compliance as a result of divergence between Scottish income tax and the rest of the UK.** In 2020-21, HMRC produced a Scottish Strategic Picture of Risk (SPR). It 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 (paragraphs 2.25 and 2.37).

14 **The tax regimes in Scotland and the rest of the UK diverged further in 2020-21.** The most significant change in income tax paid by Scottish taxpayers is for those earning around £150,000, which now differs from the UK by 6.3% compared with 5.1% the previous year. As in previous years, Scottish income tax diverges the most from the rest of the UK for those earning around £50,000. HMRC continues to assess the risk of a Scottish taxpayer manipulating their address to minimise their tax liability. HMRC has not identified any significant or widespread instances of taxpayers changing their address to obtain a tax advantage (paragraphs 2.34 to 2.38).

15 **HMRC calculated a compliance yield of £270 million relating to Scotland for 2019-20, 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. HMRC also estimates Scotland's share of net losses was £800 million. 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 (paragraphs 2.26 to 2.28).

16 **HMRC has limited performance data available about its compliance activities in Scotland.** Unlike its income tax system which flags residents as Scottish, HMRC's compliance system cannot readily identify people living in Scotland. HMRC therefore cannot easily track and monitor compliance activity in Scotland and this affects its ability to collect performance data about the extent of Scottish non-compliance (paragraph 2.29).

17 COVID-19 has continued to have an impact on HMRC's compliance and debt management activities. Across the UK, there were 29% fewer civil compliance cases opened and 26% fewer cases closed in 2020-21 than in 2019-20, which reduces the level of tax receipts that HMRC has collected through its compliance activities. Our recent report *Managing tax debt through the pandemic* found that the debt balance for income tax across the UK increased from £11 billion at the end of 2019-20 to more than £16 billion at the end of 2020-21. An analysis of income tax debt attributable to Scotland is not currently available (paragraphs 2.30 to 2.33).

Costs

18 In 2020-21 HMRC incurred and recharged £0.7 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 2021. 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. The 2020-21 costs were lower than in previous years, largely because 2020-21 is the first year since income tax powers were devolved to Scotland that expenditure relates exclusively to operating costs with no costs for implementing the Scottish Income Tax Project being incurred. In 2019-20 HMRC recharged costs of £1.5 million, comprising £0.9 million of operating costs and £0.6 million of implementation costs (paragraphs 3.3 to 3.5 and Figure 10).