



National Audit Office



REPORT

Administration of Scottish income tax 2022-23

HM Revenue & Customs

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Key facts

2.7mn

Scottish taxpayers
in 2021-22

£13.7bn

Scottish income tax
revenue in 2021-22

£15.0bn

HM Revenue & Customs'
estimate of Scottish income
tax revenue in 2022-23

£0.6 million costs of administering Scottish income tax in 2022-23

Summary

Introduction

1 The Scotland Act 2016 gave the Scottish Parliament power to determine the tax bands and rates (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 has set income tax rates differently in Scotland to the rest of the UK. It uses the five-band system first introduced in 2018-19. There are three tax bands in the rest of the UK (**Figure 1** overleaf). Scottish taxpayers pay a marginally lower rate of tax for those in the lowest band and a marginally higher rate for taxpayers earning more than £25,688. In 2022-23 rates between Scotland and the rest of the UK typically varied by a single percentage point, but the threshold at which the higher rate was payable in Scotland was lower than in the rest of the UK. For 2022-23, the amount of income subject to the starter and basic rates increased by 3.1% for Scottish taxpayers in line with CPI (Consumer Prices Index) inflation as at September 2021, while the thresholds for the higher and top rates were frozen. In the rest of the UK, all income tax rates and thresholds were frozen.

3 HM Treasury is responsible for paying Scottish income tax to the Scottish Government. HM Revenue & Customs (HMRC) administers and collects Scottish income tax as part of the UK tax system. It identifies taxpayers living in Scotland by applying a 'flag' in its systems that indicates they are subject to Scottish income tax rates and thresholds. HMRC has calculated that there were 2.7 million Scottish taxpayers in 2021-22.

4 Following the end of each tax year, HMRC produces a provisional estimate of Scottish income tax revenue for that year. It calculates the final outturn the following year once it has received further information from taxpayers and employers. This report covers the final outturn for 2021-22 and the provisional estimate for 2022-23. HMRC expects to publish the outturn for 2022-23 in its 2023-24 Annual Report and Accounts.

Figure 1

Income tax rates and bands in Scotland and the rest of the UK for 2022-23

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

Band	Income tax rates in Scotland		Income tax rates in the rest of the UK	
	Taxable income	Tax rate	Taxable income	Tax rate
	(£)	(%)	(£)	(%)
Personal allowance ¹	Up to 12,570	0	Up to 12,570	0
Starter rate	12,571 to 14,732	19	–	–
Basic rate	14,733 to 25,688	20	12,571 to 50,270	20
Intermediate rate	25,689 to 43,662	21	–	–
Higher rate	43,663 to 150,000	41	50,271 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 The top rate 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 August 2023; and HM Revenue & Customs, *Income Tax in Scotland*, available at: www.gov.uk/scottish-income-tax, accessed August 2023

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 HMRC is complying with these rules and procedures;
- the correctness of the sums brought to account by HMRC which relate to income tax that is attributable to a Scottish rate resolution; and
- the accuracy and fairness of amounts reimbursed to HMRC as administrative expenses.

6 This report assesses:

- HMRC's calculation of the 2021-22 income tax revenue for Scotland (the 'outturn') and assurance on the correctness of amounts brought to account (Part One);
- HMRC's estimate of the 2022-23 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 the agreement between HMRC and the Scottish Government (Part Three).

7 For the 2023-24 tax year, the top rate of income tax in Scotland increased from 46% to 47% and the higher rate of income tax increased from 41% to 42%. The level at which taxpayers pay the top rate of income tax reduced from £150,000 to £125,140 for taxpayers in both Scotland and the rest of the UK. For the 2024-25 tax year, the top rate of income tax will increase further to 48%, and a new advanced rate of income tax, at 45%, will apply to incomes between £75,000 and £125,140.

8 Appendix One sets out our audit evidence base.

Key findings

Scottish income tax 2021-22 final outturn and 2022-23 estimate

9 HMRC calculated the final outturn for 2021-22 as £13,724 million, representing amounts collected under Scottish income tax policy. HMRC's estimate of 2021-22 Scottish income tax revenue, published in July 2022, was £13,295 million, meaning the actual outturn was £429 million (3.2%) higher than HMRC had originally estimated. We examined HMRC's methodology for calculating the actual outturn, which necessarily includes some remaining areas of estimation, for instance where HMRC had not yet received returns from taxpayers. In these areas, we have evaluated the basis of HMRC's estimates, including the relevant assumptions and available data. Based on that audit work, we have concluded that the Scottish income tax revenue outturn for 2021-22 is fairly stated (paragraphs 1.2 to 1.16).

10 HMRC has estimated Scottish income tax revenue for 2022-23 as £14,996 million. This represents an increase of £1,272 million (9.3%) compared with the 2021-22 outturn. Income tax for the whole of the UK increased by 8.9% in 2022-23. These increases reflect inflationary rises in earnings, together with the freezing of the thresholds for the higher and top rates of income tax in Scotland and all income tax bands and thresholds in the rest of the UK, moving some taxpayers into higher tax brackets. HMRC expects to calculate the finalised 2022-23 income tax outturn attributable to Scotland in 2024. The estimate HMRC produces is solely for financial reporting purposes in its annual accounts and does not affect the amount of revenue that the Scottish Government ultimately receives, which is based on independent forecasts from the Scottish Fiscal Commission and the Office for Budget Responsibility (paragraphs 1.17 to 1.21).

11 External factors have increased the level of uncertainty in HMRC's estimate of Scottish income tax revenue in the past two years. HMRC identifies the key source of uncertainty as the accuracy with which it can estimate Scotland's share of UK income tax liabilities, particularly since its estimate for 2022-23 relies on survey data from 2019-20. The outturn for 2021-22 was 3.2% higher than HMRC had originally estimated, compared with the years between 2018-19 and 2020-21 where the outturn was within approximately 1% of HMRC's estimates. HMRC said there was stronger growth than it expected in Self Assessment liabilities in 2021-22, and the COVID-19 pandemic created additional uncertainty in the amount of tax accrued and collected. HMRC has highlighted high interest rates and inflation, wage growth and high and volatile energy prices as external factors causing increased uncertainty in 2022-23. We consider the approach adopted by HMRC to estimating the impact of these areas of uncertainty on Scottish income tax revenue in 2022-23 to be reasonable (paragraph 1.22).

Administration of Scottish income tax

12 HMRC has adequate rules and procedures in place to ensure the proper assessment and collection of Scottish income tax and it is complying with those rules. 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 had framed adequate regulations and procedures to secure an effective check on the assessment, collection and proper allocation of revenue, and that these regulations and procedures are being duly carried out (paragraphs 2.2 to 2.14).

13 Maintaining an accurate and complete record of the addresses of Scottish taxpayers remains HMRC's 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 Scottish postcodes identified by HMRC's address-cleansing work as either missing or invalid, with 1.6% (41,923) of the overall taxpayer population identified as either missing or invalid in its 2022-23 annual scan in November 2022. This had increased from 1.0% (25,488) in the 2021-22 scan in June 2021. HMRC has investigated and updated those cases with taxable income during the year (paragraphs 2.18 to 2.20 and Figure 9).

14 The divergence between the tax regimes in Scotland and the rest of the UK in 2022-23 remained broadly the same as in 2021-22. As in previous years, the amount of income tax paid in Scotland diverges the most in percentage terms from the rest of the UK for those earning around £50,000, where taxpayers in Scotland pay £1,489 more than in the rest of the UK. HMRC continues to assess the risk of a Scottish taxpayer manipulating their address to minimise their tax liability and monitors data on taxpayers changing their address or migrating out of Scotland. HMRC has not identified any significant or widespread instances of taxpayers changing their address to obtain a tax advantage (paragraphs 2.16 and 2.17 and Figure 8).

15 HMRC continues to assess as 'low' the risk of non-compliance as a result of divergence between Scottish income tax and rest of the UK, although this assessment relies on information with a significant time-lag. In 2022-23, HMRC produced a Strategic Picture of Risk (SPR) for Scottish income tax. It considers the main areas of risk to Scottish income tax to be the same as those compliance risks which it assesses at the whole-of-UK level. There are no risks that HMRC identifies in this SPR which are specific to Scotland as HMRC assesses that compliance risk in Scotland is consistent with the rest of the UK. There is a risk that this current position may not be sustainable in the longer term, particularly from 2023-24 when income tax rates in Scotland will diverge further from the rest of the UK. However, HMRC told us that compliance activity typically applies to tax liabilities from two years previous and so any increased risk is unlikely to be apparent through compliance cases until at least 2025-26. For 2023-24, the Scottish Government has commissioned HMRC to establish a more reliable baseline of cross-border migration and to better understand whether this risk is materialising (paragraphs 2.30 to 2.35).

16 HMRC calculated a compliance yield of £380 million relating to Scotland for 2021-22, the most recent data available. HMRC measures the effectiveness of its enforcement and compliance activities through compliance yield: its estimate of the additional revenues it has generated through its compliance work, and the revenue losses it has prevented. HMRC estimated that Scotland's share of net losses from compliance risks in 2020-21, the most recent data available, was £1.1 billion. HMRC calculates these figures as a proportion of the equivalent UK figure, rather than using Scotland-specific data to quantify the risks. HMRC does not consider or report on 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 2.39).

17 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 2.37).

18 HMRC's compliance activities increased in 2022-23 but it failed to meet its target for compliance yield. Across the UK, the number of compliance cases that HMRC opened in 2022-23 was higher than in 2021-22 but 17% lower than in 2019-20 before the COVID-19 pandemic. It closed 20% fewer cases than in 2019-20. HMRC says this partly reflects its strategy to focus increasingly on upstream efforts to ensure taxpayers comply in the first place, and to prioritise larger and higher-impact cases. HMRC's yield from its tax compliance activities for the whole of the UK was £34.0 billion in 2022-23, up 10% compared with 2021-22 and higher than the average over the past five years (2018-19 to 2022-23) of £33.2 billion. Compliance yield in 2022-23 was, however, below HMRC's target of £36 billion. As a proportion of total revenue, compliance yield remained unchanged at 4.2% (paragraphs 2.36 to 2.38).

19 UK tax debt has increased since 2022 and remains higher than pre-pandemic levels. HMRC's debt balance is affected by external factors that have an impact on taxpayers' ability to pay their tax liabilities, including current inflationary pressures and increases in the cost of living. At 31 March 2023, total tax debt for the UK was £43.9 billion, 11.9% (£4.7 billion) higher than the level of debt that HMRC reported at 31 March 2022. Tax debt more than trebled in the first six months of 2020-21 due to the wider economic impact of the COVID-19 pandemic and HMRC's decision to suspend most debt collection. It remains higher than the five years leading up to the pandemic when tax debt was typically around £14 billion. HMRC has a new strategy to bring down tax debt in the long term but expects it to remain high throughout 2023-24. HMRC last estimated Scottish taxpayers' total tax debt to be £2.0 billion as at 31 December 2021, 5.7% of UK tax debt at that time.¹ By comparison, Scotland receives 6.6% of income tax revenue. HMRC attributed some £0.9 billion of this to debts from Pay As You Earn (PAYE) and Self Assessment income tax. HMRC calculated this estimate in June 2022 in response to a question from the Scottish Public Audit Committee. It has provided no update since (paragraphs 2.41 to 2.43).

Costs

20 In 2022-23 HMRC incurred and recharged £0.6 million 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 2023. 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 and 3.5).

¹ Figures provided by HMRC to the Convener of the Scottish Public Audit Committee in June 2022. Figures do not sum to the total debt balance of £39.5 billion at that time because they exclude non-UK debts where the country cannot be identified. We have not audited these figures.