



National Audit Office



REPORT

Administration of Welsh rates of income tax 2023-24

HM Revenue & Customs

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HC 542



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HM Revenue & Customs

Report by the Comptroller and Auditor General

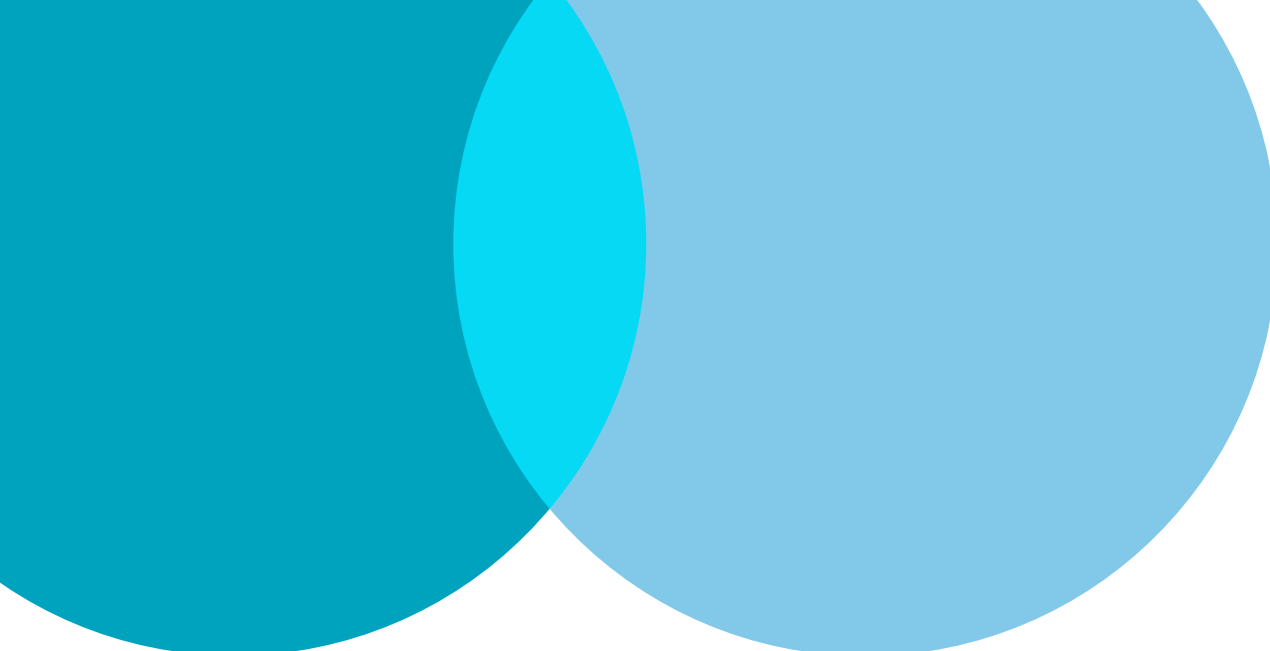
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Gareth Davies
Comptroller and Auditor General
National Audit Office

10 January 2025



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Summary

Introduction

1 The Wales Act 2014 gave the Senedd (Welsh Parliament) power to determine the rates (excluding the personal allowance) paid by Welsh taxpayers on all non-savings, non-dividend income, from 6 April 2017.

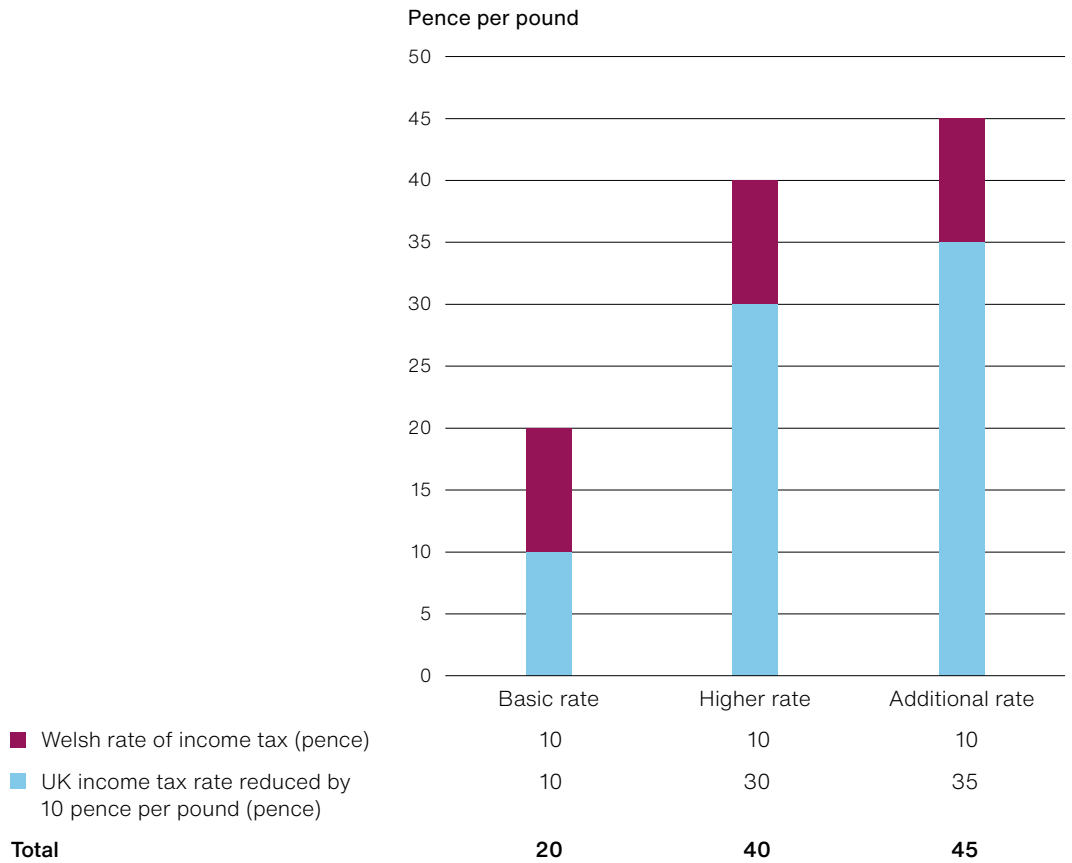
2 Since April 2019, the UK government has reduced the UK basic, higher and additional income tax rates by 10 percentage points for Welsh taxpayers, and the Senedd has had the power to apply Welsh rates in addition. For each tax band, the rate of income tax paid is the sum of the reduced UK rate and the Welsh rate set for the year (**Figure 1**). As in previous years, for 2023-24 the Senedd set the Welsh rates of income tax at 10% across all bands, which meant that the total rates for taxpayers in Wales matched the UK rates at 20% (basic rate), 40% (higher rate) and 45% (additional rate).

3 In this report, we describe the amount collected under the Welsh rates of income tax, which represents approximately 43% of the total income tax collected from Welsh taxpayers. The Welsh Government's resource block grant from the UK government is reduced by this amount and HM Treasury is responsible for paying these amounts to the Welsh Government. The balance of remaining income tax contributions is paid to the UK Government.

Figure 1

Welsh rates of income tax for 2023-24

The UK income tax rate is reduced by 10 pence per pound in Wales, with the Welsh government determining an additional amount to be paid as the Welsh rate 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 pound and the Senedd (Welsh Parliament) sets the Welsh rate of income tax to be added to the UK rates of tax.
- 2 For 2023-24, the Senedd 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: National Audit Office analysis of data from the Welsh Government

Roles and responsibilities

4 HM Revenue & Customs (HMRC) administers and collects the Welsh rates of income tax as part of the UK tax system. HMRC identifies taxpayers living in Wales by applying a 'flag' in its systems that indicates they are subject to Welsh income tax rates. HMRC has calculated that there were 1.5 million Welsh taxpayers in 2022-23 (2021-22: 1.4 million).

5 Following the end of each tax year, HMRC produces a provisional estimate of tax revenue for that year from the Welsh rates of income tax. 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 2022-23 and the provisional estimate for 2023-24. HMRC expects to publish the outturn for 2023-24 in its 2024-25 Annual Report and Accounts.

6 The Government of Wales Act 2006, as amended by the Wales Act 2014, requires the Comptroller and Auditor General to prepare a report for each financial year on:

- the adequacy of HMRC's rules and procedures, in consequence of the Welsh 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 Welsh rate resolution; and
- the accuracy and fairness of amounts reimbursed to HMRC as administrative expenses.

7 This report assesses:

- HMRC's calculation of the 2022-23 Welsh rates of income tax revenue (the 'outturn') and assurance on the correctness of amounts brought to account (Part One);
- HMRC's estimate of the 2023-24 Welsh rates of income tax revenue 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 Welsh tax requirements (Part Two); and
- the cost of administering Welsh income tax. We provide assurance on the accuracy and fairness of these amounts in the context of costs incurred by HMRC (Part Three).

8 Appendix One sets out our audit evidence base.

Key findings

Welsh rates of income tax 2022-23 final outturn and 2023-24 estimate

9 HMRC calculated the final outturn for the Welsh rates of income tax in 2022-23 as £2,618 million, representing amounts collected under Welsh income tax policy. This represents an increase of 10.8% compared with the outturn for 2021-22. HMRC largely based the outturn calculation on established tax liabilities where HMRC has finalised the tax owed and fully reconciled the taxpayer records. The calculation includes some areas of estimation and adjustments, for instance where HMRC had not yet received returns from taxpayers or where HMRC does not have Wales-specific data. In these areas, we have evaluated the basis of HMRC's estimates, including the relevant assumptions and available data. The gross total of the estimates and adjustments made by HMRC constituted 7.6% of the reported outturn in 2022-23, a proportion which was similar in 2021-22. Based on our audit work, we have concluded that the outturn for the Welsh rates of income tax for 2022-23 is fairly stated (paragraphs 1.2 to 1.13 and Figure 2).

10 HMRC has estimated revenue from the Welsh rates of income tax for 2023-24 as £2,938 million. This represents an increase of £320 million (12.2%) compared with the 2022-23 outturn. Income tax for the whole of the UK increased by 11.9% in 2023-24. These increases reflect rises in earnings, the reduction of the threshold at which taxpayers pay the top rate of income tax (from £150,000 to £125,140) and the freezing of most other thresholds. This increased the size of the taxpayer population and moved some taxpayers into higher tax brackets. HMRC expects to calculate the finalised 2023-24 income tax outturn attributable to the Welsh rates of income tax by July 2025. The estimate HMRC produces is solely for financial reporting purposes in its annual accounts. Based on the performance of the estimate in recent years, it has proved to be a reasonable indicator of the amount of income tax likely to be collected from Welsh taxpayers. The outturn in 2022-23 was £51 million (1.9%) higher than HMRC's provisional estimate. The estimate does not affect the amount of revenue that the Welsh Government ultimately receives (paragraphs 1.14 to 1.17 and Figure 4).

Administration of the Welsh rates of income tax

11 HMRC has adequate rules and procedures in place to ensure the proper assessment and collection of the Welsh rates of income tax and it is complying with those rules. Our work on Welsh income tax 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 2.15).

12 Maintaining an accurate and complete record of the addresses of Welsh 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. The number of Welsh residents with taxable income in 2023-24 found to have a missing or invalid postcode through HMRC's address-cleansing work remained relatively low at 807 (2022-23: 770). As part of its assurance work, HMRC updated all these records. HMRC last compared the Welsh address records it holds with third-party data in August 2023, when it successfully matched 75.8% of address records (paragraphs 2.17 to 2.22 and Figure 8).

13 HMRC continues to assess the risk of non-compliance in relation to the Welsh rates of income tax as low because there is no divergence between Welsh tax rates and the rest of the UK.

HMRC produces an annual Strategic Picture of Risk (SPR) for the Welsh rates of income tax. In 2023-24, it considered the main areas of risk to Welsh income tax to be the same as those compliance risks which it assesses at the whole-of-UK level. In this SPR, HMRC identifies no risks as specific to Wales as HMRC assesses that compliance risk in Wales is consistent with the rest of the UK (paragraphs 2.23 and 2.24).

14 HMRC calculated a compliance yield of £110 million relating to Wales for 2022-23, 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, and the revenue losses it has prevented. HMRC estimated that the Welsh share of net losses from compliance risks for 2021-22, the most recent data available, was £390 million. HMRC calculates these figures as a proportion of the equivalent UK figure, rather than using Wales-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 Wales compared with the rest of the UK (paragraph 2.27).

Costs

15 In 2023-24 HMRC incurred £0.43 million for the cost of administering the Welsh rates of income tax, and re-charged this to the Welsh Government.

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 2024. 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 3.4 and 3.5).

Part One

Income tax collected from Welsh taxpayers

1.1 Part One of this report covers HM Revenue & Customs' (HMRC's) calculation of the final revenue outturn in 2022-23 and its provisional estimate of the revenue for 2023-24 from the Welsh rates of income tax. This includes data limitations and HMRC's judgements in areas of uncertainty in its calculation of the outturn, and the features and limitations of HMRC's methodology in calculating its provisional estimate.

The Welsh rates of income tax 2022-23 final outturn

1.2 HMRC's calculation of the outturn for the Welsh rates of income tax for 2022-23 is £2,618 million. HMRC calculates the final outturn figure from several components, which it aggregates to produce the total Welsh rates of income tax liability. HMRC calculates each component using one or more sources of data.

1.3 The outturn for 2022-23 represents an increase of 10.8% compared with 2021-22. The outturn for non-savings, non-dividend income tax for the whole of the UK increased by 10.5% in 2022-23. HMRC attributes the growth in revenue from the Welsh rates of income tax in 2022-23 to higher nominal earnings growth, likely due to economic recovery following the pandemic and tight labour market conditions during a period of increasing inflation.

Components of the outturn

1.4 HMRC largely based the outturn calculation on established tax liabilities, some £2,668 million, where HMRC has finalised the tax owed and fully reconciled the taxpayer records. HMRC calculates the established liabilities from the final tax liability data extracted from the Pay As You Earn (PAYE) and Self Assessment income tax systems.

1.5 HMRC makes adjustments or estimates where it has not yet finalised the tax due, or where it must estimate the Welsh share of uncollectable amounts or tax reliefs. The reduction in outturn arising from these adjustments was £49 million (net) (**Figure 2**).¹ In some areas of the calculation, HMRC does not have data in sufficient detail to identify income tax liabilities, reliefs or other adjustments relating to individual taxpayers. HMRC estimated the Welsh share of these balances by using other available data, such as population and income data, to apportion the balance between Wales and the rest of the UK. The gross total of all the estimates and adjustments made by HMRC totalled £199 million in 2022-23, or 7.6% of the reported outturn, which is similar to the proportion in 2021-22.²

Figure 2

HM Revenue & Customs' (HMRC's) calculation of the 2022-23 Welsh rates of income tax revenue outturn

The majority of the outturn is based on established liabilities with a small proportion estimated by HMRC

	2022-23 outturn			2021-22 outturn
	Established amounts	Estimates and adjustments	Total	Total
	(£mn)	(£mn)	(£mn)	(£mn)
Self Assessment liabilities	799	(8)	792	749
Pay As You Earn (PAYE) liabilities	1,868	(5)	1,864	1,654
Estimated further liabilities	-	58	58	54
Deductions from revenue	-	(95)	(95)	(93)
Total	2,668	(49)	2,618	2,363

Notes

- 1 Self Assessment and PAYE established tax liabilities are based primarily on the tax liability data held by HMRC, although some amounts are based on estimates as well.
- 2 Estimated further liabilities are HMRC's estimate of PAYE tax liabilities that have not yet been finalised and where tax liabilities are expected from future Self Assessment returns or compliance activity.
- 3 Deductions from revenue include tax relief on pension contributions and Gift Aid and an estimate for the share of tax liabilities after either employers or taxpayers fail to pay.
- 4 Numbers shown in brackets are negative numbers.
- 5 Totals may not sum due to rounding.

Source: National Audit Office analysis of HM Revenue & Customs data

- 1 The sum of the established tax liabilities and the net adjustments does not equal the reported outturn due to rounding.
- 2 This gross total is made up of £75 million estimated liabilities and £124 million deductions. Estimates and adjustments for Self Assessment and PAYE liabilities include both amounts that are added as estimates and those deducted from revenue, so this gross total is higher than the sum of the individual components presented in Figure 2.

1.6 In July 2024, HMRC reported some discrepancies identified in the outturn figures it had previously published in respect of Welsh income tax and the equivalent taxes elsewhere in the UK. The discrepancies occurred due to double-counting of certain taxpayer records where the taxpayer had elected to submit a Self Assessment tax return when one was not needed. Between 2019-20 and 2021-22, this led to HMRC overstating the outturn for the Welsh rates of income tax by an average of £17 million per year, or 0.8% of the previously reported outturn.³ HMRC has since revised its outturn calculations to remove the duplicate records for each of the affected years (**Figure 3**).⁴ These revised calculations do not affect individual taxpayer circumstances or suggest that any taxpayers paid the wrong amount of income tax. We have reviewed calculations and are satisfied that the adjustments determined are reasonable.

1.7 HM Treasury and the Welsh Government have discussed the historical discrepancies in the outturn calculations and agreed that no adjustments are needed to amounts previously paid to the Welsh Government.

1.8 The other components of HMRC's methodology for calculating the outturn have remained broadly the same since the prior year. The methodology includes areas of estimation, for instance where HMRC had not yet received returns from taxpayers. In these areas, we evaluated the basis for HMRC's estimate including relevant assumptions and available data. We concluded that the outturn for the Welsh rates of income tax for 2022-23 is fairly stated. We describe the key components of the calculation of outturn in more detail below.

Figure 3

Original and revised outturn for the Welsh rates of income tax, 2019-20 to 2021-22

HM Revenue & Customs has revised its calculation of outturn from the Welsh rates of income tax to correct historical discrepancies arising from double-counted taxpayer records

Year	Original outturn (£mn)	Revised outturn (£mn)	Percentage difference (%)
2019-20	2,040	2,026	0.7
2020-21	2,140	2,123	0.8
2021-22	2,384	2,364	0.9

Note

1 Stated figures may not equate to percentage differences due to rounding.

Source: National Audit Office analysis of HM Revenue & Customs data

3 Given the discrepancies affected the calculation of outturn figures in both Wales and the rest of the UK, the net effect on the income tax revenue that should have been paid to the Welsh Government does not equal the amounts reported here.

4 HM Revenue & Customs, *Welsh Income Tax Outturn Statistics: 2022 to 2023*, July 2024.

Self Assessment liabilities

1.9 The Self Assessment total liability of £792 million represents all Welsh rates of income tax attributable from Welsh Self Assessment taxpayers in 2022-23. HMRC identifies Welsh taxpayers by using its record of Welsh residency status in its Computerised Environment for Self Assessment (CESA) system. The calculation of Self Assessment liabilities is mainly based on the extraction of Welsh taxpayer records from CESA. HMRC deducted £8 million to estimate Wales's share of other relevant Self Assessment balances where specific data are not available.⁵

PAYE liabilities

1.10 The PAYE total liability of £1,864 million represents all Welsh rates of income tax attributable from Welsh PAYE taxpayers in 2022-23. Under PAYE, employers submit data monthly to HMRC on the earnings and tax deductions made for their employees and HMRC records this information in its National Insurance and PAYE Service (NPS) system. HMRC identifies Welsh taxpayers in the NPS using a residency indicator based on taxpayer postcode information. HMRC identifies total Welsh income tax liabilities by extracting Welsh taxpayer records from the NPS.

1.11 Most PAYE liabilities are based on Welsh taxpayer data extracted from HMRC's systems but some apportionment of other smaller elements is required. The sum of these adjustments in 2022-23 resulted in a reduction in liabilities of £5 million.⁶

Estimated further liabilities

1.12 Most Self Assessment liabilities for 2022-23 are established prior to calculating the outturn. Nevertheless, HMRC knows from past years that Self Assessment tax liabilities will continue to be established and collected for up to six years afterwards. This is because HMRC continues to receive additional information from taxpayers and through its compliance activity. HMRC calculates the estimated additional liability for these elements based on past performance and estimated it at £58 million in the 2022-23 outturn.

5 This includes the following: an estimate of £4 million from manually entered liabilities and assessments, which do not provide a split of the liability between taxes; an adjustment of £7 million to cover sensitive records, which HMRC does not access when calculating the Welsh rates of income tax; and a deduction of £19 million for the share of tax reliefs claimed through Self Assessment attributable to the Welsh rates of income tax, for which HMRC does not collect Wales-specific data.

6 This includes a deduction of £11 million to cover the share of tax reliefs given against PAYE liabilities attributable to the Welsh rates of income tax, for which HMRC does not collect Wales-specific data. HMRC also made an adjustment of £6 million to apportion the tax it collects from employers under PAYE settlement agreements. These agreements allow employers to make one annual payment to cover all tax due on minor, irregular or impracticable expenses or benefits for employers in the scheme. As tax liabilities are settled through one payment for the employer, the identity of individual taxpayers is not recorded and, therefore, HMRC analyses employer submissions to determine the Welsh proportion of UK-wide settlement agreement revenue.

Deductions from revenue

1.13 HMRC deducted a total of £95 million from the outturn revenue, made up of the following.

- £17 million for liabilities HMRC does not expect to collect. Some PAYE and Self Assessment income tax liabilities are never settled because either employers or taxpayers fail to pay the full amounts due. HMRC analyses historical data for the UK as a whole to determine patterns of uncollected liabilities and then apportions an amount relating to the Welsh rates of income tax.
- £47 million in pension contributions and £31 million in Gift Aid, both of which attract income tax relief at the taxpayer's marginal rate of income tax. Pension scheme administrators claim tax relief at the basic rate from HMRC on behalf of their scheme members, while charities claim tax relief at the basic rate from HMRC on behalf of their donors. HMRC calculates both deductions by estimating the Welsh share of each tax relief claimed across the UK using historical data.

The Welsh rates of income tax estimate for 2023-24

1.14 HMRC estimates it will collect £2,938 million of revenue through the Welsh rates relating to the 2023-24 year (**Figure 4** overleaf).⁷ This represents an increase of £320 million (12.2%) against the 2022-23 outturn. For the UK overall, the increase was 11.9%. These increases reflect inflationary rises in earnings, together with the freezing of tax bands and thresholds. This increased the size of the taxpayer population and caused some taxpayers to move into a higher tax bracket. HMRC expects to publish the final outturn for the 2023-24 year in its 2024-25 Annual Report and Accounts by July 2025.

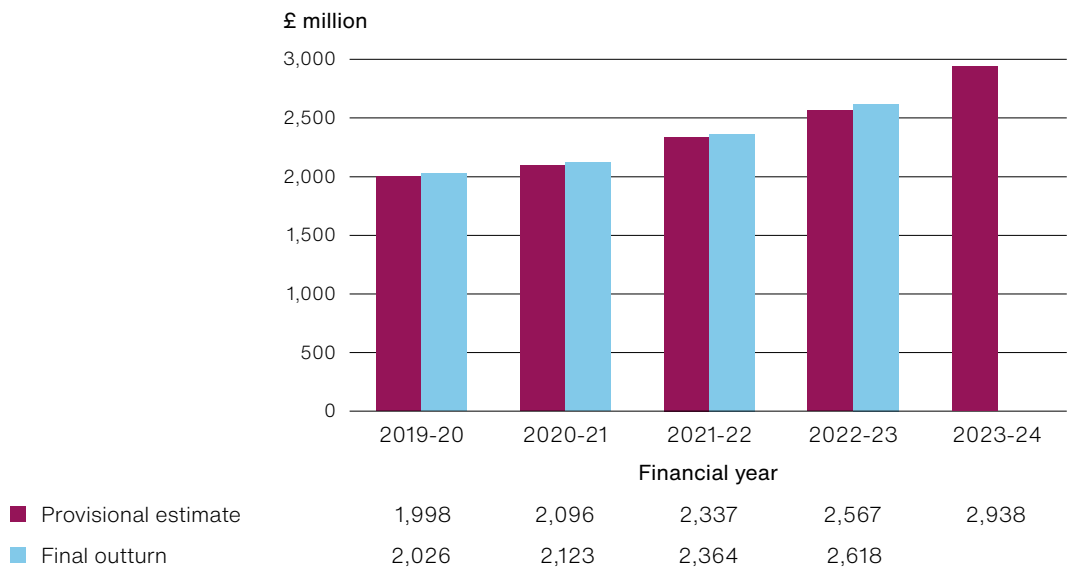
1.15 HMRC's estimate is solely for financial reporting purposes in its annual accounts. It does not affect the amount of revenue that the Welsh Government receives. It does though provide a useful indicator, based on historical experience, of the amount of income tax likely to be collected from Welsh taxpayers (Figure 4). The outturn in 2022-23 was £51 million (1.9%) higher than HMRC's provisional estimate.

⁷ HM Revenue & Customs, *Annual Report and Accounts 2023 to 2024*, HC 47, July 2024.

Figure 4

Provisional estimate and final outturn for the Welsh rates of income tax, 2019-20 to 2023-24

HM Revenue & Customs (HMRC) estimates that revenue from the Welsh rates of income tax will increase by 12.2% in 2023-24, from £2,618 million to £2,938 million



Notes

- 1 All data are nominal amounts, meaning they have not been adjusted for inflation.
- 2 In July 2024, HMRC published revised outturn figures for the years prior to 2022-23 after it discovered some duplication of income tax revenue in its calculations. HMRC has also revised the provisional estimates for years 2019-20 to 2022-23 to account for the duplication.
- 3 HMRC expects to publish the final outturn for the 2023-24 year in its 2024-25 Annual Report and Accounts by July 2025.

Source: National Audit Office analysis of HM Revenue & Customs data

1.16 HMRC’s methodology to estimate revenue from the Welsh rates of income tax in 2023-24 is largely unchanged from that which it used to calculate the 2022-23 estimate. The methodology relies on taxpayer data from HMRC’s Survey of Personal Incomes (SPI). The latest SPI data available to HMRC at the time it produced the estimate were from 2021-22. HMRC then adjusted the data to reflect demographic and policy changes that it expects or knows have taken place between 2021-22 and 2023-24. The SPI is a sample of 1.5% of UK taxpayers, which introduces sampling uncertainty into the revenue estimate. It also combines the calculation of PAYE and Self Assessment liabilities so does not reflect the differing proportions of each type of taxpayer between Wales and the rest of the UK. There is also an inherent risk that data from 2021-22 will not accurately reflect the taxpayer base for 2023-24.

1.17 Our review of the methodology concluded that HMRC’s approach is reasonable.

Part Two

Administering Welsh income tax

2.1 This part of the report covers:

- HM Revenue & Customs' (HMRC's) key processes to administer the income tax system and how we have obtained assurance on them;
- HMRC's procedures to identify and maintain a complete and accurate record of the Welsh taxpayer population; and
- how HMRC identifies and responds to compliance risks.

2.2 HMRC uses the same systems to administer income tax whether it comes from a taxpayer in Wales or the rest of the UK. However, HMRC also operates additional rules and procedures for Wales, and which we assess below. This reflects HMRC's responsibility to administer income tax for Welsh taxpayers in the same way as the service provided elsewhere in the UK.

2.3 Under Section 2 of the Exchequer and Audit Departments Act 1921, the Comptroller and Auditor General (C&AG) must consider the adequacy of HMRC's systems to assess and collect tax in the UK, including income tax. Each year we publish a report (the Standard Report) alongside HMRC's Annual Report and Accounts setting out the C&AG's conclusions in this respect. Our 2023-24 Standard Report 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 they are duly carried out.

2.4 To support the conclusions of this report, we extended our UK-wide testing to address the risks and approaches relevant to the administration of the Welsh rates of income tax. We also undertook specific procedures looking at HMRC's address-cleansing and wider tax compliance activities. These informed our assessment of the completeness and accuracy of HMRC's Welsh income tax estimates. To reach our conclusions, we examined several elements of devolved tax administration, such as HMRC's ongoing maintenance of Welsh taxpayer records, and how it identified and responded to devolved tax compliance risks.

The income tax system

2.5 HMRC's system to collect income tax is consistent across the UK. Depending on the type of income an individual receives, income tax is assessed and collected by employers deducting earnings through Pay As You Earn (PAYE), by the taxpayer submitting a Self Assessment return, or both.

2.6 The PAYE and Self Assessment processes share common principles, despite HMRC using different IT systems and data sources to assess and collect tax. **Figure 5** identifies these principles and describes the main processes for each income tax stream.

Assurance of income tax processing

2.7 Our annual audit work programme on HMRC includes procedures providing assurance over key tax processing controls. These controls are broadly divided into two categories:

- automated system controls around handling, storing and processing data; and
- complex key business controls that have a high level of automation.

2.8 Following annual updates to business rules to reflect changing tax rates, thresholds and allowances for the UK and devolved administrations, HMRC completes several phases of assurance testing on key business controls to confirm system functionality. We evaluate the scope of this testing and re-perform elements to confirm HMRC's conclusions as part of our audit. The key processes for PAYE include annual:

- reconciling of employer information with personal tax records to confirm tax due on earnings and calculate any over- or underpayments of tax based on country of residence; and
- issuing of tax codes to PAYE taxpayers which incorporate residency information to ensure employers deduct tax under the tax rules of the correct country.

2.9 HMRC applies similar processes to each individual Self Assessment return that it receives. Self Assessment taxpayers make payments on account and at the year-end calculate their own tax liability using HMRC's calculator in their tax return submission.

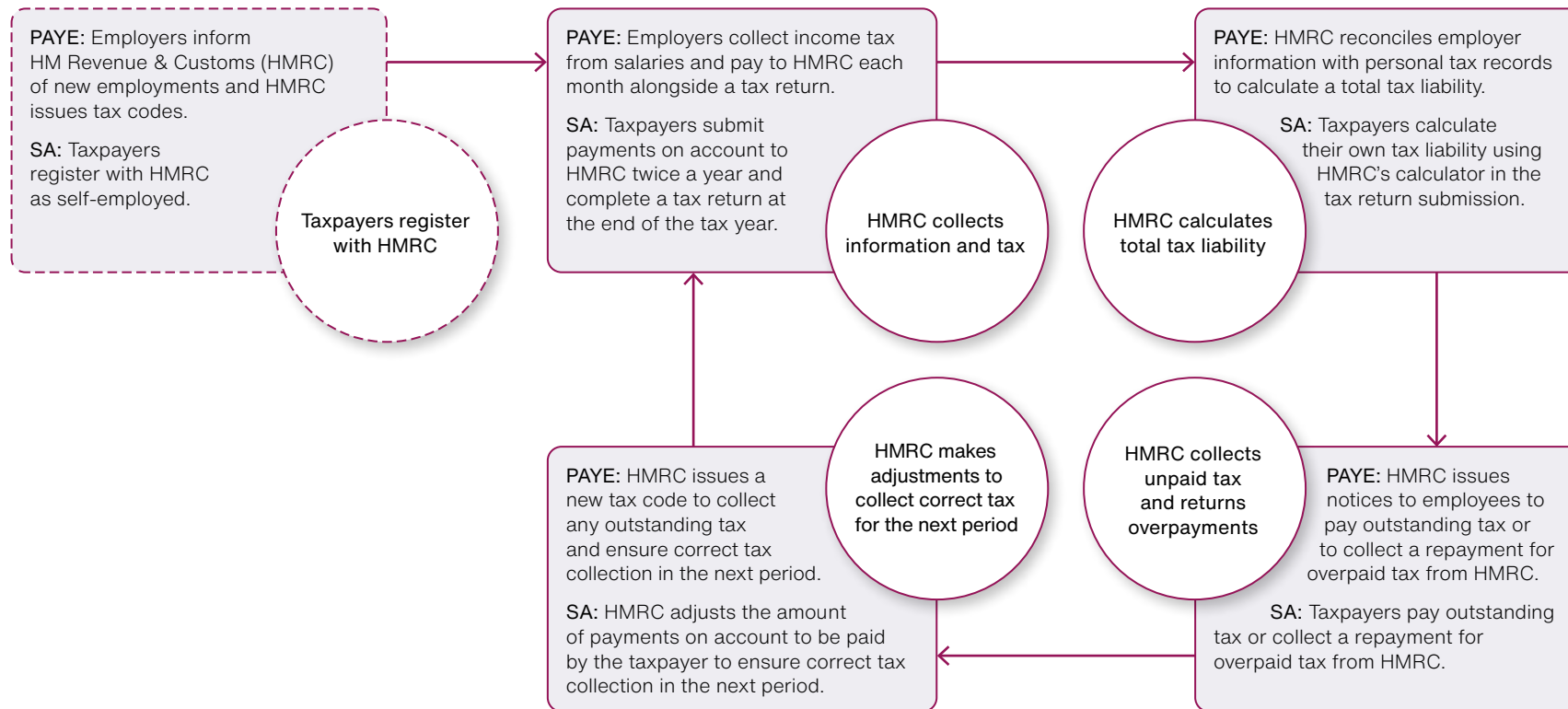
Devolved income tax

2.10 The main differences in administering Welsh income tax, when compared with UK processes, are the business rules that the HMRC system applies when completing tax liability and tax code calculations. There have been no significant changes to system rules since our last report covering 2022-23.

Figure 5

The UK income tax system

The Pay As You Earn (PAYE) and Self Assessment (SA) processes share common principles in the assessment and collection of income tax



Notes

- 1 PAYE and Self Assessment processes do not occur simultaneously. PAYE is processed during the tax year (6 April to 5 March) and reconciled after the end of the tax year. Self Assessment returns are not submitted until the January following the end of the tax year.
- 2 After the tax year ends, HMRC's PAYE reconciliation process calculates the income tax liability for each taxpayer using all available data. The calculated liability is compared with amounts deducted at source or collected from taxpayers directly to determine whether the correct tax has been collected.

Source: National Audit Office analysis of HM Revenue & Customs processes

2.11 A Welsh taxpayer is someone with a tax liability whose main place of residence during the tax year is Wales.⁸ The rules that the HMRC system applies for Welsh taxpayers are as follows.

- It checks the individual's residency status and applies the 'C' tax code prefix where they are identified as a Welsh resident. This instructs employers to collect tax under Welsh tax rates. Where an individual is no longer resident in Wales, the system removes the 'C' prefix.
- Where the system identifies an individual as a Welsh resident, it applies Welsh tax rates and bands to the reported income when calculating the liability for the current tax year.
- If an individual has been identified as a Welsh resident and is enrolled on a PAYE scheme, the system uses Welsh income tax rates to calculate a new tax code for the following year.

2.12 Self Assessment returns include a check box for the taxpayer to state whether they resided in Wales during the tax year. If this contradicts HMRC's records, HMRC uses the address it holds to calculate the taxpayer's tax liability. HMRC notifies taxpayers of the discrepancy and asks them to update their address if required. **Figure 6** shows where these divergences occur within the income tax system.

Tax relief on pension contributions

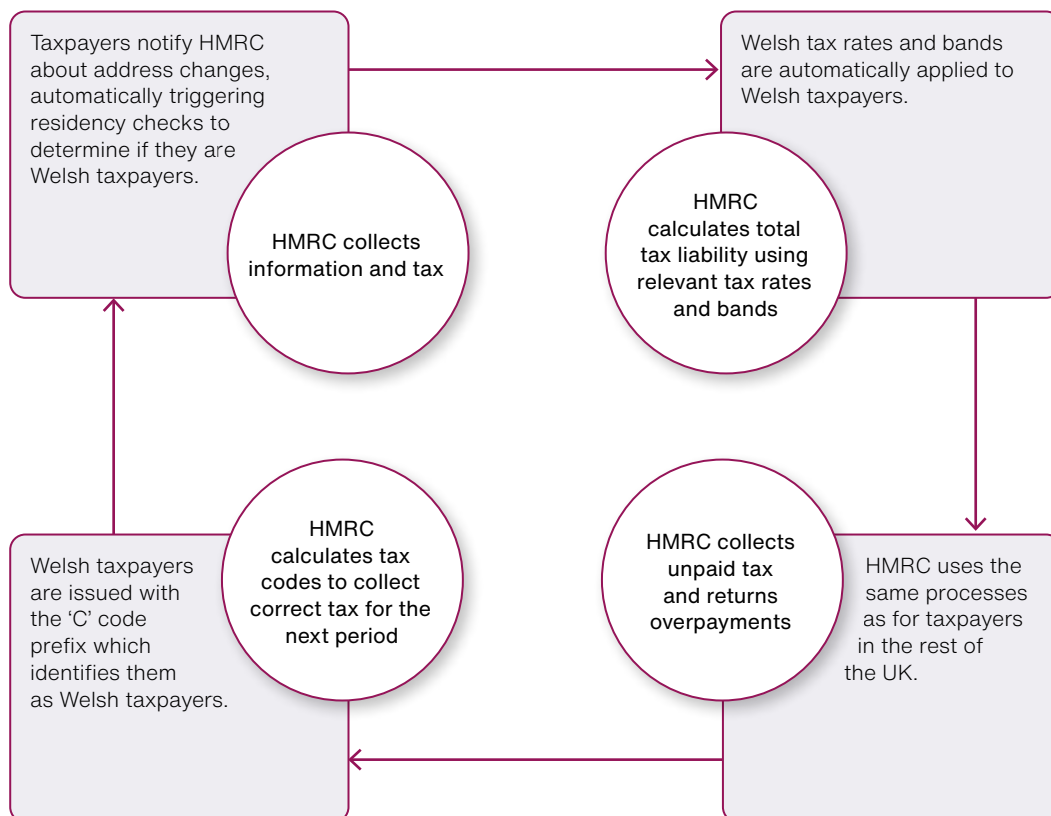
2.13 HMRC must identify Welsh taxpayers so that tax relief is correctly allocated. Pension administrators claim tax relief at source on behalf of their members and add this to their members' contributions. HMRC applies tax relief on pension contributions at the basic rate of 20% for all taxpayers. Welsh taxpayers paying a tax rate above 20% can claim the remaining tax relief through a Self Assessment return or by contacting HMRC.

⁸ Welsh parliamentarians are automatically deemed as Welsh taxpayers in any tax year they are in office, regardless of where they reside. This applies to the elected members of the Senedd and those members of Parliament in Westminster representing Welsh constituencies. Once HMRC records a Welsh parliamentarian as a Welsh taxpayer, its system automatically overrides its normal business rules, and always records them as Welsh taxpayers until HMRC manually resets the override for each parliamentarian. HMRC told us that it did not identify any issues in relation to Welsh parliamentarians being recorded as Welsh taxpayers during 2023-24.

Figure 6

Divergences in the income tax system for Welsh taxpayers

HM Revenue & Customs' (HMRC's) business rules are configured to process income tax using the rates and thresholds applicable to a taxpayer's residency status



Source: National Audit Office analysis of HM Revenue & Customs processes

2.14 To administer relief at source, HMRC requires all pension administrators to submit an annual return of information, which provides details of their members and their pension contributions during the previous tax year. HMRC's Relief at Source system then automatically matches scheme members against addresses held by HMRC and confirms the residency status of pension scheme members to identify Welsh taxpayers and ensure the correct relief is applied at source. HMRC then issues a report to all pension administrators confirming the residency of their members. HMRC confirmed the residency status for 93% of Scottish and Welsh pension scheme members following the 2022-23 tax year, which is a similar proportion to that of the past five years. A Wales-specific figure for the proportion of residency statuses confirmed is not available.

Tax relief on Gift Aid contributions

2.15 HMRC provides tax relief on Gift Aid contributions in Wales at the UK basic rate of 20%. This is because HMRC does not have systems in place to establish the residency of taxpayers donating to charity. All taxpayers paying tax above the basic rate can claim back the difference between their tax rate and the basic rate on their donation. Where donations are made by Welsh taxpayers, HMRC applies the correct rate of relief when it is notified of the donated amount either through a request to amend a tax code or via a Self Assessment return.

Welsh taxpayer population

2.16 HMRC has calculated that there were 1.5 million Welsh taxpayers in 2022-23 which is a 4.4% increase from 2021-22.⁹ Higher rate and additional rate taxpayers accounted for 9.4% of the Welsh income tax population in 2022-23 (up from 8.4% in 2021-22) and contributed 44.0% of income tax paid by Welsh taxpayers (up from 42.7% in 2021-22). These increases reflect the freezing of tax thresholds and the movement of taxpayers into higher tax brackets. Basic rate taxpayers accounted for 90.6% of the population and provided 56.0% of income tax paid by Welsh taxpayers overall (**Figure 7**). This has fallen from 92.8% of taxpayers and 60.2% of tax paid in 2019-20.

Address assurance

2.17 Maintaining accurate and complete records of the Welsh taxpayer population continues to be the main challenge for HMRC in administering the Welsh rates of income tax. HMRC considers a number of information sources for changes of address, but relies primarily on taxpayers informing it of such changes in a timely manner, although taxpayers are not legally required to do this. HMRC has been exploring in 2024-25 how it can better remind taxpayers about their responsibility to inform HMRC of a change of address, including through messaging in the online Personal Tax Account. HMRC also obtains address information from other sources, such as employers, although it is not mandatory for employers to provide updates when their employees' addresses change.

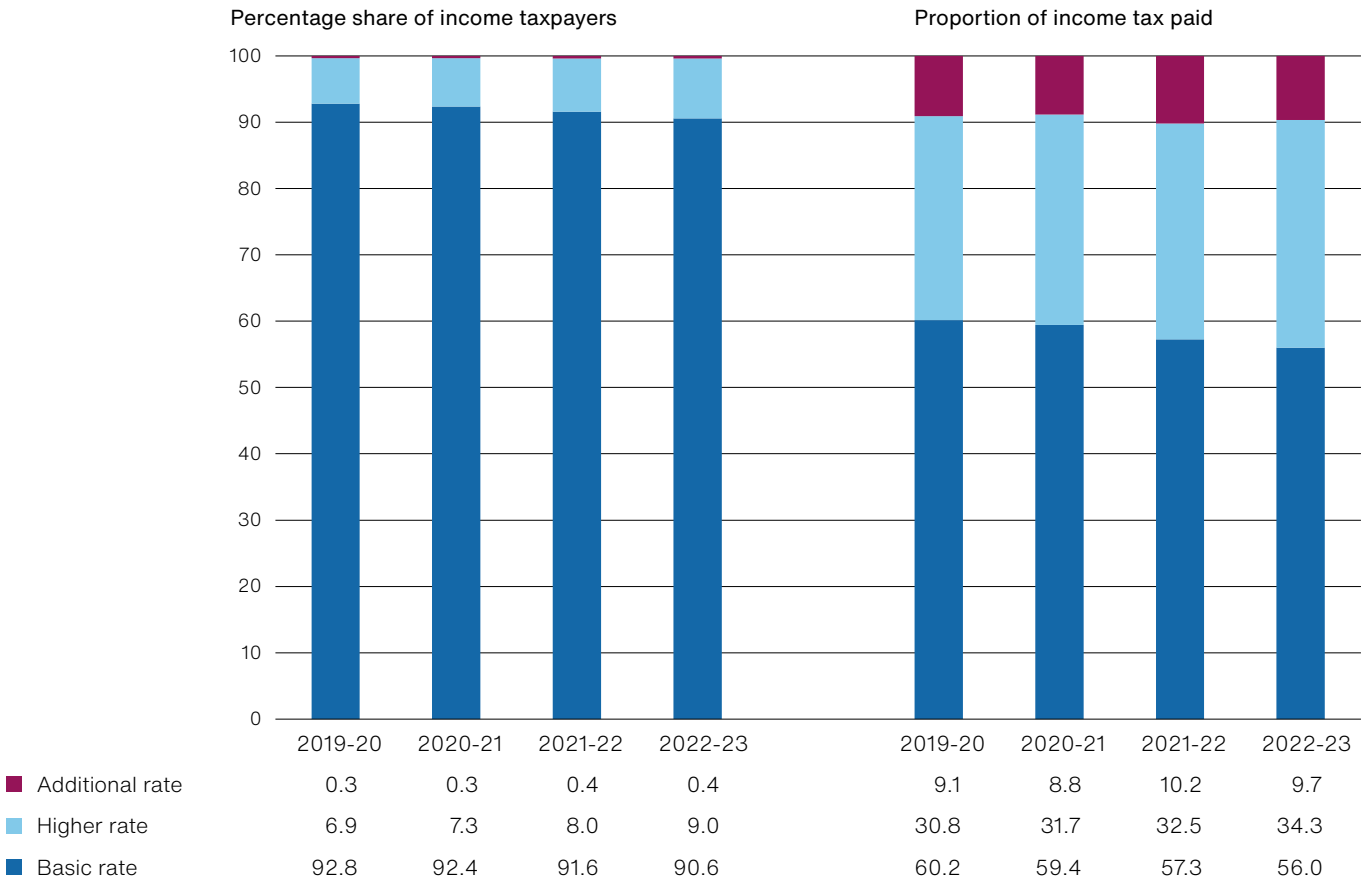
2.18 Address information must be correct to ensure the right amount of tax is collected from individuals and allocated to the appropriate government. HMRC has several assurance processes in place to maintain the completeness and accuracy of the address data it uses to identify Welsh taxpayers (**Figure 8** on page 22).

9 HM Revenue & Customs, *Welsh Income Tax Outturn Statistics: 2022 to 2023*, July 2024.

Figure 7

Proportions of income taxpayers by band and income tax paid by band in Wales, 2019-20 to 2022-23

Basic tax income taxpayers accounted for over 90% of the population in 2022-23 and contributed 56% of the income tax paid



Note

1 2022-23 is the latest year for which data is available.

Source: National Audit Office analysis of HM Revenue & Customs data

Figure 8

Assurance over the Welsh taxpayer population

HM Revenue & Customs (HMRC) carries out several assurance activities to maintain the completeness and accuracy of the Welsh tax base

Assurance activity	Description and purpose	Results
Controls ensuring Welsh residency is correctly determined using the address held by HMRC		
New postcodes	Comparison of HMRC's list of Welsh postcodes with Office for National Statistics (ONS) data to ensure postcodes are up to date.	HMRC receives postcode data quarterly from the ONS. HMRC added 402 new postcodes in 2023-24.
Address cleansing	Scans of taxpayer records held by HMRC to identify missing or invalid postcodes which would result in an incorrect residency status being applied.	Scans undertaken in August 2023 identified 65,200 missing and invalid postcodes. HMRC updated 807 of these postcodes because they have a record of current employment or pension. ¹
Cross-border postcodes	HMRC's systems flag address changes where new addresses lie in a postcode that crosses the England-Wales border. HMRC reviews these cases to ensure it determines the correct residency.	In 2023-24, HMRC reviewed 434 cross-border cases, and amended 89 of these following investigation.
Missing residency flags	Scans to identify Welsh taxpayer records that are not flagged as such in the system.	HMRC's scans during 2023-24 identified 388 cases, all of which it updated.
Controls monitoring the operation of Pay As You Earn (PAYE) by employers		
Tax code comparison scans	A comparison between tax codes in PAYE submissions with HMRC's taxpayer record to identify cases where the employer is applying a different tax code to HMRC.	In January 2024 HMRC identified 45,955 cases where 'C' prefixes were not correctly applied to tax codes. ² It wrote to employers to ask them to update the incorrect tax codes.
Controls to identify incorrect addresses held by HMRC		
Third-party data assurance exercise	A comparison of taxpayer address records held by HMRC with third-party data sources to identify cases where HMRC records are inconsistent with third-party data. The exercise is HMRC's main source of assurance over the accuracy of its address records.	HMRC and the Welsh Government have agreed to run this exercise every two years. The most recent one was performed in August 2023 and compared 3 million Welsh address records. For 75.8% of these records, it successfully matched the residency to that suggested by the third-party data. It identified 10,745 records where the residency determined by HMRC data did not match the residency suggested by third-party data and wrote to most of these taxpayers.
Wealthy individuals	HMRC performs checks and procedures to review the movements of wealthy individuals and ensure their addresses are up to date. ³ Specialist teams develop an in-depth understanding of the finances, behaviours and compliance risks of these taxpayers.	

Notes

- Invalid postcodes identified are corrected or manually set as Welsh where the correct postcode cannot be determined from the address.
- Figures are from HMRC's analysis of monthly tax code scans and show the number of tax codes where the Welsh 'C' prefix was not correctly applied, and where the tax code would have otherwise been correct.
- HMRC defines wealthy individuals as those with incomes of £200,000 or more, or with assets equal to or above £2 million in any of the last three years.

Source: National Audit Office analysis of HM Revenue & Customs activities

Postcode scans

2.19 HMRC scans taxpayer records to identify missing or invalid postcodes that would result in an incorrect residency status being applied. The 2023-24 scan, performed in August 2023, identified 65,200 postcodes as either missing or invalid. HMRC investigates and updates all cases where individuals were either employed or receiving a pension. In 2023-24, HMRC updated 807 records, compared with 770 in 2022-23. Cases that HMRC has not updated are identified as dormant because they have no current taxable income and therefore no income tax attributable to Wales in 2023-24.

Administration of Welsh tax codes

2.20 Where an employer does not apply the 'C' prefix to an employee's tax code, they will deduct tax at the UK rate. 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 then uses this finalised information, and the residency status held on its systems, to calculate each taxpayer's tax liability. The outturn for Wales is, therefore, unaffected where the 'C' prefix in an individual's tax code is not correctly applied by an employer.

2.21 Each month, HMRC compares tax codes in PAYE submissions with its own taxpayer record to identify cases where employers are using a different tax code. In January 2024, there were 45,955 cases (2.5% of cases) where employers were not operating a tax code with a 'C' prefix. This number varies across the year but has remained below 3% since March 2021. We have previously encouraged HMRC to follow up with employers applying incorrect tax codes, particularly those making persistent errors. In November 2024, HMRC expanded its reporting to include the characteristics of employers using incorrect tax codes, including the sector they operate in, number of employees, and the payroll system used.

2.22 When HMRC identifies that an employer is not using the correct tax code, it issues a P6 notification to the employer asking them to update the employee's tax code. HMRC told us that from January 2025 it will begin contacting employers who make large numbers of errors to understand the reasons and to provide support.

Compliance risk assessment and planning

2.23 HMRC applies the same risk-based compliance approach to collect income tax in Wales as it does in the rest of the UK. This approach involves:

- **promoting** compliance by designing processes to encourage and help customers get things right first time;
- **preventing** non-compliance through process design and customer insight, and providing an opportunity to correct mistakes; and
- **responding** to, investigating and correcting compliance risks using tailored activity when intervention is needed.

2.24 As part of its Service Level Agreement with the Welsh Government, HMRC produces an annual Strategic Picture of Risk (SPR) for the Welsh rates of income tax, to assess and plan for compliance risks applicable to Wales. For this SPR, HMRC considers key compliance risks at the overall UK level and applies a value to represent the Welsh proportion of these risks. It calculates each risk in line with Wales's share of UK income tax in the Welsh Income Tax Outturn Statistics. HMRC does not vary the size of this proportion for each risk and has not tested its assumption that non-compliance in Wales is the same as in the rest of the UK. It said that doing so would involve considerable methodological challenges and costs. As in previous years, HMRC has not identified any significant risks specific to Wales and considers the main risks to Welsh income tax to be the same as for the whole of the UK. These risks include:

- evasion, where individuals or businesses deliberately omit, conceal or misrepresent information to reduce their tax liabilities;
- the hidden economy, where taxable income is not declared or where declared income is deliberately understated; and
- tax avoidance, where tax rules are exploited to gain a tax advantage that Parliament never intended.

HMRC's compliance activity and debt management

Compliance activity

2.25 Across the UK, HMRC opened 311,000 compliance cases in 2023-24 (2022-23: 299,000) and closed 320,000 (2022-23: 280,000). HMRC has limited information on how much of this compliance activity is undertaken in Wales. Its compliance system enables HMRC to raise a flag where potential manipulation of residency status has been identified. We understand that there are currently no such flags on the compliance system. HMRC told us that information about numbers of active compliance cases relating to Welsh taxpayers for reasons not related to their status as a Welsh taxpayer requires interrogation of separate information systems. Unlike the income tax system, which can flag Welsh residents, HMRC's compliance management information system cannot readily identify people living in Wales, and information must be compared with other data to provide numbers on the total extent of Welsh non-compliance.

2.26 HMRC measures the effectiveness of its enforcement and compliance activities through compliance yield, its estimate of the additional revenues it considers it has generated, and the losses it had prevented. HMRC's yield from its tax compliance activities for the whole of the UK was £41.8 billion in 2023-24, up 23% compared with 2022-23 (in cash terms). Compliance yield in 2023-24 exceeded HMRC's target of £40.5 billion.

2.27 HMRC estimates a compliance yield of £110 million in 2022-23 for Wales's share of the risks in the SPR. HMRC also estimates that Wales's share of net losses from the risks in the SPR was £390 million in 2021-22. These data are the most recent available. HMRC calculates these figures as a proportion of the equivalent UK figure, rather than using Wales-specific data to quantify the risks. HMRC does not consider or report on geographical variation between Wales and the rest of the UK when assessing compliance risk or the relative success of compliance activity.

Tax gap

2.28 The tax gap is the difference between the amount of tax that should be paid and what is actually paid. HMRC does not currently produce a Wales-specific tax gap. In response to a report by the Committee of Public Accounts, HMRC noted that calculating a Wales-specific tax gap would be difficult for methodological reasons and the high degree of uncertainty of such an analysis.

Debt management

2.29 HMRC's management of tax debt affects how much income tax that is initially unpaid is subsequently collected across the UK, including in Wales. 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 2024, total tax debt for the UK was £43.0 billion, 1.9% (£0.9 billion) lower than the debt reported at 31 March 2023. Despite the decrease, tax debt remains higher than in the five years leading up to the pandemic, when tax debt was typically around £15 billion. HMRC does not currently produce a Wales-specific estimate of tax debt.

2.30 Having completed our additional work on devolved tax issues, we are satisfied that HMRC has adequate rules and procedures in place to assess and collect Welsh income tax, and that these are being complied with.

Part Three

Costs

3.1 This part considers the administrative costs invoiced to the Welsh Government from HM Revenue & Customs (HMRC) for the Welsh rates of income tax, and whether they are reasonable.

3.2 Under the Service Level Agreement between HMRC and the Welsh Government, the Welsh Government must reimburse HMRC for net additional costs incurred through administering Welsh income tax powers.

3.3 A supporting framework sets out the principles for identifying net additional costs. HMRC re-charges the Welsh Government only for costs that specifically relate to administering devolved Welsh income tax powers, not for the costs of administering the overall income tax system in Wales.

Costs incurred in 2023-24

3.4 HMRC invoiced the Welsh Government for £0.43 million of costs relating to the administration of the Welsh rates of income tax in 2023-24, similar to the amount HMRC re-charged in 2022-23. All of the spending related to operating costs. Costs incurred in 2023-24 were below the budget of £0.51 million. The underspend relates substantially to HMRC staff spending less time on the Welsh rates of income tax than planned. There have been no significant changes to the re-charging process in 2023-24.

3.5 We examined HMRC's method for estimating the costs to collect and administer the Welsh rates of income tax for the year ended 31 March 2024. Based on our audit work, we 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.

Appendix One

Our evidence base

1 Section 80HA of the Wales 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 HM Revenue & Customs' (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 attributable to a Welsh rate resolution; and
- the accuracy and fairness of the amounts that are reimbursed to HMRC as administrative expenses.

2 To reach the conclusions of this report relating to the rules and procedures operated by HMRC, we drew directly from our statutory audit work on HMRC's Annual Report and Accounts, including the C&AG's report on HMRC's controls for the proper assessment, collection and allocation of tax under Section 2 of the Exchequer and Audit Departments Act 1921. We also completed specific audit procedures over controls relevant to administering devolved taxes.

Financial audit

3 We audited the data, methodologies, assumptions and mechanics of the calculation for the revenue outturn for 2022-23 and the revenue estimate for 2023-24, which are described in this report. For the estimate, and where appropriate for the outturn, we applied the principles set out in the International Standards on Auditing (UK) 540 Auditing Accounting Estimates and Related Disclosures, to design audit procedures relevant to the nature of the estimates and to a sufficient level of precision.

4 In relation to administration costs, we based our conclusion on the accuracy and fairness of the costs HMRC charged to the Welsh Government upon evaluating costs against the details of the Service Level Agreement and supporting framework for costs agreed between both parties. HMRC estimated some of the incurred costs from available data on customer contacts and staff time. During the audit, we saw evidence that both parties regularly discuss and review cost budgets and forecasts, and agree any amounts to be invoiced and paid.

5 All of these audit procedures were planned, performed and reviewed in accordance with our internal quality control procedures for financial audit.

6 We completed our financial audit fieldwork between April 2024 and July 2024.

Document review

7 To evaluate HMRC's approach to compliance risk, we reviewed published and unpublished HMRC documents about the Welsh rates of income tax, including project documentation, risk and compliance documentation and details of key assurance work performed by HMRC.

8 We carried out our review between September 2024 and December 2024.

Interviews with departmental officials

9 We carried out two interviews with officials from HMRC, selected to participate because of their job role and their relevance to the audit. This included staff responsible for (or involved in) devolved tax policy and compliance.

10 We also spoke to the Welsh Government to inform our risk assessment and planning for this report.

11 Fieldwork took place between October 2024 and November 2024. We carried out interviews online. They typically lasted one hour, and we took notes.

Quantitative analysis

12 We analysed financial data from HMRC on Welsh income tax revenue, HMRC's estimate of Welsh income tax revenue and the administrative costs of the Welsh rates of income tax.

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