National Audit Office

REPORT

Administration of Scottish income tax 2023-24

HM Revenue & Customs

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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 different income tax bands and rates in Scotland from the rest of the UK. In 2018-19 it introduced a five-band system, which continued until 2023-24. There are three tax bands in the rest of the UK (**Figure 1**). In 2023-24, Scottish taxpayers paid a lower marginal rate of tax for those in the lowest band and a higher marginal rate for taxpayers earning more than £25,688. The threshold at which the higher rate was payable in Scotland was lower than in the rest of the UK. For 2023-24, 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. All other 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 2.8 million Scottish taxpayers in 2022-23 (2021-22: 2.7 million).

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 2022-23 and HMRC’s provisional estimate for 2023-24. HMRC expects to publish the outturn for 2023-24 in its 2024-25 Annual Report and Accounts.

Figure 1
Income tax rates and bands in Scotland and the rest of the UK for 2023-24

For 2023-24 there were five tax bands above the personal allowance 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 12,570	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 125,140	42	50,271 to 125,140	40
Top rate	More than 125,140	47	More than 125,140	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 October 2024; and HM Revenue & Customs, Income Tax in Scotland, available at: www.gov.uk/scottish-income-tax, accessed October 2024

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 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 2022-23 income tax revenue for Scotland (the 'outturn') and assurance on the correctness of amounts brought to account (Part One);
- HMRC's estimate of the 2023-24 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 For the 2024-25 tax year, the top rate of income tax increased further to 48%, and a new advanced rate of income tax, of 45%, applies to incomes between £75,001 and £125,140. For the 2025-26 tax year, the Scottish Government proposes to increase by 3.5% the threshold at which Scottish taxpayers will pay the basic and intermediate rates of income tax.

8 Appendix One sets out our audit evidence base.

Key findings

Scottish income tax 2022-23 final outturn and 2023-24 estimate

9 **HMRC calculated the final outturn for 2022-23 as £15,169 million, representing amounts collected under Scottish income tax policy.** This represents an increase of 11.5% 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 Scotland-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 7.1% 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 Scottish income tax revenue outturn for 2022-23 is fairly stated (paragraphs 1.2 to 1.13 and Figure 2).

10 **HMRC has estimated Scottish income tax revenue for 2023-24 as £17,254 million.** This represents an increase of £2,085 million (13.7%) 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), the increase in the higher and top rates of income tax in Scotland and the freezing of most other thresholds. HMRC expects to calculate the finalised 2023-24 income tax outturn attributable to Scotland 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 Scottish taxpayers. The outturn in 2022-23 was £300 million (2.0%) higher than HMRC's provisional estimate. The estimate 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 1.14 to 1.18 and Figure 4).

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 it is complying with those rules.** Our work on Scottish 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 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. The number of Scottish 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 1,766 (2022-23: 1,567). As part of its assurance work, HMRC updated all these records. In its 2023 exercise to compare the Scottish address records it holds with third-party data, the latest available, HMRC was able to successfully match 72.9% of address records, up from 72.2% in August 2021 (paragraphs 2.20 to 2.27 and Figure 8).

13 **HMRC's latest assessment is that the risk of address manipulation by Scottish taxpayers remains very low, though this relies on compliance information gathered up to two years in arrears.** HMRC produces an annual Strategic Picture of Risk (SPR) for Scottish income tax. In 2023-24, it considered 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. In this SPR, HMRC identifies no risks as specific to Scotland as HMRC assesses that compliance risk in Scotland is consistent with the rest of the UK. This assessment draws on insights gathered through compliance investigations which, given when HMRC requires taxpayers to submit tax returns, typically apply to tax liabilities from two years previous. Through these investigations, HMRC has not identified any significant or widespread instances of taxpayers changing their address to obtain a tax advantage. However, this means that any increased risk from diverging tax policy may not be apparent through these investigations until at least 2025-26. HMRC monitors trends in various data to give a more timely indication of whether compliance risk is increasing, including the number of discrepancies from its third-party data exercise and the number of cross-border movements. The data on cross-border movements are also subject to a time lag in its availability, and HMRC has encountered difficulties for the last two years with importing relevant land and property transaction data into its system. HMRC instead has had to use other sources of information on cross-border movements which are not as reliable (paragraphs 2.17 and 2.29 to 2.32).

14 **HMRC is reviewing its compliance strategy in the face of increasing divergence in tax policy in Scotland, but it has not yet assessed the options available, or their costs.** Where taxpayers are subject to higher Scottish tax rates, there is a risk that they may seek to manipulate their residency status to reduce their tax liability, although HMRC considers that the risk of these behaviours is relatively low. While HMRC waits to see whether increased compliance risk from further divergence in tax policy features in compliance investigations in 2025-26, it is using 2024-25 to evaluate whether its current compliance approach in Scotland will remain sufficient and identify what more it could do, such as carrying out additional compliance checks or calculating a Scotland-specific tax gap. In reviewing its compliance strategy, HMRC and the Scottish Government must ensure they evaluate the costs and benefits of each option and implement timely changes to identify any increased compliance risks. They have set up a compliance working group to oversee this work. It expects to report to the Scottish Income Tax Board on the first phase of this evaluation in January 2025, including the likely costs of additional compliance work, after which the Scottish Government must decide on the merits of funding any additional activity (paragraphs 2.17, 2.30 and 2.31).

15 HMRC calculated a compliance yield of £350 million relating to Scotland for 2022-23, the most recent data available. Compliance yield is HMRC's estimate of the additional revenues it has generated through its compliance work, and the revenue losses it has prevented. It is how HMRC measures the effectiveness of its enforcement and compliance activities. HMRC estimated that Scotland's share of net losses from compliance risks in 2021-22, 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 (paragraphs 2.36 and 2.37).

Costs

16 In 2023-24 HMRC incurred £1.0 million for the cost of administering Scottish income tax, and re-charged this to the Scottish Government. Of this amount, £0.6 million related to running costs, which is similar to that for 2022-23. The remaining £0.4 million related to the implementation of the advanced rate of Scottish income tax, in particular ensuring Pay As You Earn systems were updated ahead of the new tax band becoming operational in 2024-25. We examined HMRC's method for estimating the costs of collecting and administering Scottish income tax for the year ended 31 March 2024. 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).