National Audit Office

REPORT

Administration of Scottish income tax 2023-24

HM Revenue & Customs

SESSION 2024-25
17 JANUARY 2025
HC 541

SG/2025/6

We are the UK's independent public spending watchdog.

We support Parliament in holding government to account and we help improve public services through our high-quality audits.

The National Audit Office (NAO) scrutinises public spending for Parliament and is independent of government and the civil service. We help Parliament hold government to account and we use our insights to help people who manage and govern public bodies improve public services.

The Comptroller and Auditor General (C&AG), Gareth Davies, is an Officer of the House of Commons and leads the NAO. We audit the financial accounts of departments and other public bodies. We also examine and report on the value for money of how public money has been spent.

In 2023, the NAO's work led to a positive financial impact through reduced costs, improved service delivery, or other benefits to citizens, of £1.59 billion. This represents around £17 for every pound of our net expenditure.

National Audit Office

Administration of Scottish income tax 2023-24

HM Revenue & Customs

Report by the Comptroller and Auditor General

Ordered by the House of Commons
to be printed on 15 January 2024

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act

Presented to the Scottish Parliament pursuant to Section 80HA of the Scotland Act 1998 as amended by the Finance Act 2014

Gareth Davies
Comptroller and Auditor General
National Audit Office

10 January 2024

HC 541 | £10.00

SG/2025/6

Value for money reports

Our value for money reports examine government expenditure in order to form a judgement on whether value for money has been achieved. We also make recommendations to public bodies on how to improve public services.

014065 01/25 NAO

Contents

This report can be found on the National Audit Office website at www.nao.org.uk

If you need a version of this report in an alternative format for accessibility reasons, or any of the figures in a different format, contact the NAO at enquiries@nao.org.uk

The National Audit Office study team consisted of:

Qasim Chaudhry, Lamees Hashim, Natalie Low, Esther Namukasa, Freya Scott and Andy Serlin, under the direction of Darren Stewart.

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157–197 Buckingham Palace Road
Victoria
London
SW1W 9SP

020 7798 7400
www.nao.org.uk
@NAOorguk

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).

Part One

Income tax collected from Scottish taxpayers

1.1 Part One of this report covers HM Revenue & Customs' (HMRC's) calculation of the final revenue outturn for Scottish income tax in 2022-23 and its provisional estimate of Scottish income tax revenue for 2023-24. This includes:

- our assessment of HMRC's Scottish income tax outturn calculation for 2022-23, including data limitations and HMRC's judgements in areas of uncertainty; and
- our views on HMRC's estimate of Scottish income tax revenue for 2023-24 and the features and limitations of HMRC's methodology.

The Scottish income tax 2022-23 final outturn

1.2 HMRC's calculation of the outturn for Scottish income tax revenue for 2022-23 is £15,169 million. HMRC calculates the final outturn figure from several components, which it aggregates to produce the total Scottish 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 11.5% 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 Scottish 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 £15,187 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 Scottish share of uncollectable amounts or tax reliefs. The reduction in Scottish income tax outturn arising from these adjustments was £17 million (net) (**Figure 2** overleaf).[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 Scottish share of these balances by using other available data, such as population and income data, to apportion the balance between Scotland and the rest of the UK. The gross total of all the estimates and adjustments made by HMRC totalled £1,077 million in 2022-23, or 7.1% of the reported outturn, which is similar to the proportion in 2021-22.[2]

1.6 In July 2024, HMRC reported some discrepancies identified in the outturn figures it had previously published in respect of Scottish 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 2016-17 and 2021-22, this led to HMRC overstating the Scottish income tax outturn by an average of £78 million per year, or 0.7% 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** overleaf).[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 Scottish Government have been discussing the historical discrepancies in the outturn calculations but have not yet agreed whether any adjustments are needed to amounts previously paid to the Scottish Government. HM Treasury and the Scottish Government have calculated that the revised outturn figures in Scotland and the rest of the UK between 2016-17 and 2021-22, together with revised population estimates following the Scottish Census in 2022, would have reduced the Scottish budget by £29 million overall.[5]

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 Scottish income tax revenue outturn for 2022-23 is fairly stated. We describe the key components of the outturn calculation in more detail below.

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 £530 million estimated liabilities and £547 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.
3 Given the discrepancies affected the calculation of outturn figures in both Scotland and the rest of the UK, the net effect on the income tax revenue that should have been paid to the Scottish Government does not equal the amounts reported here.
4 HM Revenue & Customs, *Scottish Income Tax Outturn Statistics: 2022 to 2023*, July 2024.
5 HM Treasury and the Scottish Government, *Scottish Income Tax outturn reconciliation for 2022-23,* 3 October 2024.

Figure 2
HM Revenue & Customs' (HMRC's) calculation of the 2022-23 Scottish 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	6,597	(57)	**6,540**	**6,047**
Pay As You Earn (PAYE) liabilities	8,590	19	**8,609**	**7,578**
Estimated further liabilities	–	414	**414**	**372**
Deductions from revenue	–	(394)	**(394)**	**(389)**
Total	**15,187**	**(17)**	**15,169**	**13,607**

Notes

1 Self Assessment and PAYE 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 that 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

Figure 3
Original and revised Scottish income tax revenue outturns, 2016-17 to 2021-22

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

Year	Original outturn	Revised outturn	Percentage difference
	(£mn)	(£mn)	(%)
2016-17	10,706	10,655	0.5
2017-18	10,908	10,845	0.6
2018-19	11.549	11,476	0.6
2019-20	11,825	11,750	0.6
2020-21	11,948	11,859	0.7
2021-22	13,724	13,607	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

Self Assessment liabilities

1.9 The Self Assessment total liability of £6,540 million represents all income tax attributable to Scotland from Scottish Self Assessment taxpayers in 2022-23. HMRC identifies Scottish taxpayers by using its record of Scottish residency status in its Computerised Environment for Self Assessment (CESA) system. The calculation of Self Assessment liabilities is mainly based on the extraction of Scottish taxpayers from CESA. HMRC deducted £57 million to estimate Scotland's share of other relevant Self Assessment balances where specific data are not available.[6]

PAYE liabilities

1.10 The PAYE total liability of £8,609 million represents all income tax attributable to Scotland from Scottish 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 Scottish taxpayers in the NPS using a residency indicator based on taxpayer postcode information. HMRC identifies the total Scottish income tax liabilities by extracting Scottish taxpayer records from the NPS.

1.11 Most PAYE liabilities are based on Scottish taxpayer data extracted from the NPS, but some apportionment of other smaller elements is required. The sum of these adjustments in 2022-23 was an increase in liabilities of £19 million.[7]

Estimated further liabilities

1.12 Most Self Assessment liabilities for 2022-23 were 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 £414 million in the 2022-23 outturn.

6 This includes the following: an estimate of £48 million from manually entered liabilities and assessments, which do not provide a split of the liability between taxes; an adjustment of £21 million to cover sensitive records, which HMRC does not access when calculating Scottish income tax; and a deduction of £126 million for the Scottish share of tax reliefs claimed through Self Assessment, for which HMRC does not collect Scotland-specific data.

7 This includes a deduction of £28 million to cover the Scottish share of tax reliefs given against PAYE liabilities, for which HMRC does not collect Scotland-specific data. HMRC also made an adjustment of £47 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 Scottish proportion of UK-wide settlement agreement revenue.

Deductions from revenue

1.13 HMRC deducted a total of £394 million from the outturn revenue, made up of the following.

- £83 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 Scottish taxpayers.
- £190 million in pension contributions and £121 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 Scottish share of each tax relief claimed across the UK using historical data.

The Scottish income tax estimate for 2023-24

1.14 HMRC estimates it will collect £17,254 million of Scottish income tax revenue relating to the 2023-24 year.[8] This represents an increase of £2,085 million (13.7%) against the 2022-23 outturn. For the UK overall, the increase was 11.9%. 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), increases in the higher and top rates of income tax in Scotland, and the freezing of most other thresholds. 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 Scottish Government receives, which is based on independent forecasts of Scottish income tax from the Scottish Fiscal Commission (SFC) and the Office for Budget Responsibility (OBR). When HMRC confirms the final outturn, an adjustment is then made to the Scottish Government's budget to account for any difference between the forecasts and the final amount.

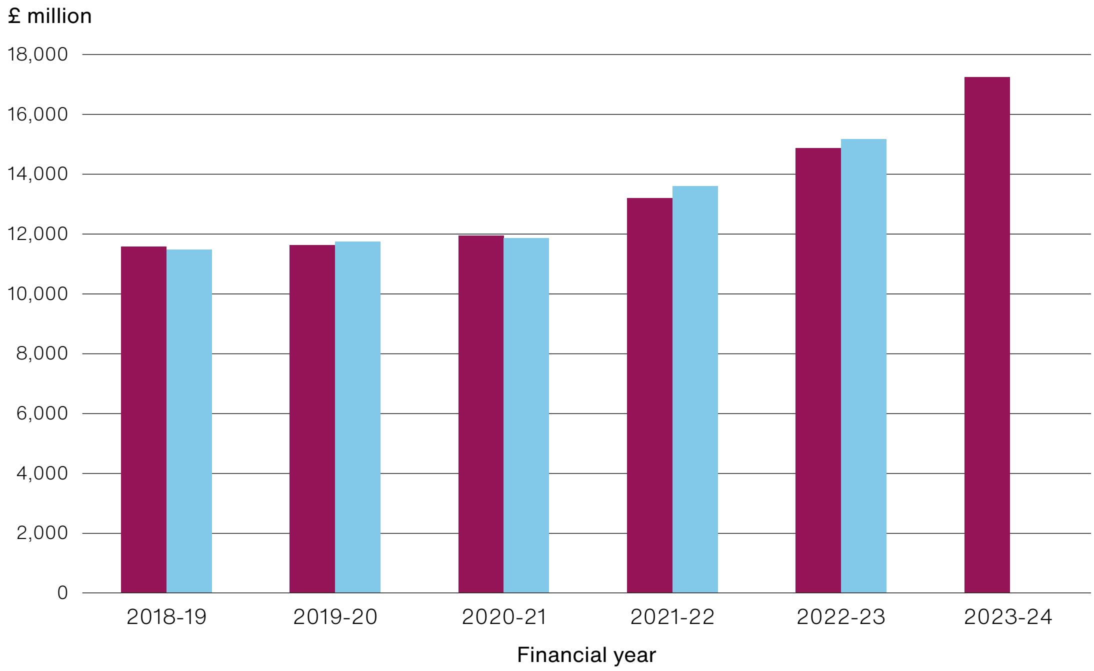
1.16 The Scottish Government uses the SFC and OBR forecasts, as well as regular updates on the amount of income tax paid through PAYE systems, to understand the amount of income tax likely to be collected from Scottish taxpayers, though HMRC's provisional estimate can also provide a useful indicator based on historical experience (**Figure 4**). The outturn in 2022-23 was £300 million (2.0%) higher than HMRC's provisional estimate.

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

Figure 4

Provisional estimate and final outturn for Scottish income tax revenue, 2018-19 to 2023-24

HM Revenue & Customs (HMRC) estimates that Scottish income tax revenue will increase by 13.7% in 2023-24, from £15,169 million to £17,254 million



	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Provisional estimate	11,583	11,623	11,951	13,196	14,869	17,254
Final outturn	11,476	11,750	11,859	13,607	15,169	

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 2018-19 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

1.17 HMRC's methodology to estimate Scottish income tax revenue in 2023-24 is largely unchanged from that 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 Scotland 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.

1.18 Our review of the methodology concluded that HMRC's approach is reasonable.

Part Two

Administering Scottish 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 Scottish 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 Scotland or the rest of the UK. However, HMRC also operates additional rules and procedures for Scotland, and which we assess below. This reflects HMRC's responsibility to administer income tax for Scottish 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 risks and approaches arising from divergences in income tax policy. 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 Scottish income tax estimates. To reach our conclusions, we examined several elements of devolved tax administration, such as HMRC's ongoing maintenance of Scottish 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** overleaf 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.

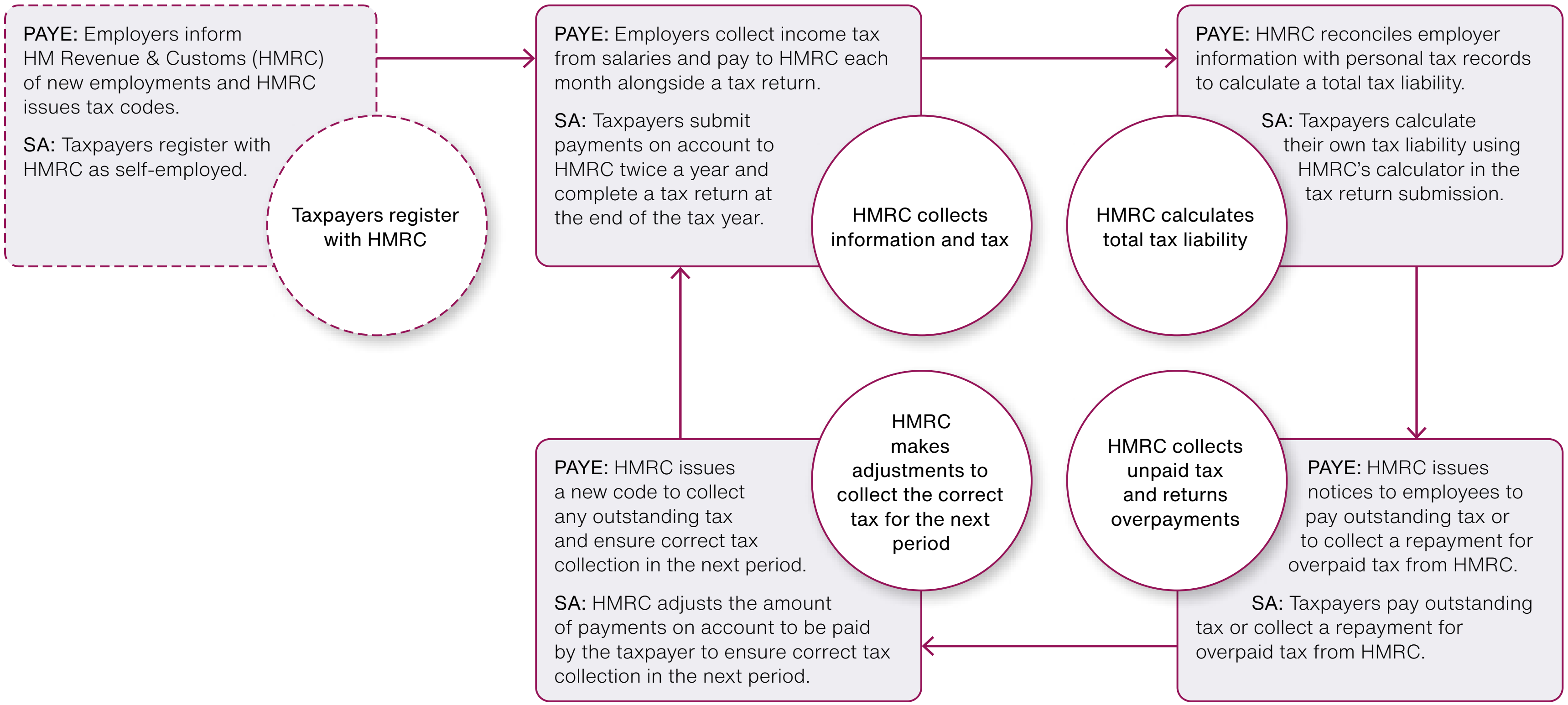
2.9 HMRC applies similar processes to each individual Self Assessment return that it receives. Self Assessment taxpayers make payments on account and at the year-end calculate their own tax liability using HMRC's calculator in their tax return submission.

Devolved income tax

2.10 The main differences in administering Scottish 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 to assess and collect income tax



Notes

1 PAYE and Self Assessment do not occur simultaneously. PAYE is processed during the tax year (6 April to 5 March) and reconciled after the tax year ends. 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 Scottish taxpayer is someone with a tax liability whose main place of residence during the tax year is Scotland.[9] The rules that the HMRC system applies for Scottish taxpayers are as follows.

- It checks the individual's residency status and applies the 'S' tax code prefix where they are identified as a Scottish resident. This instructs employers to collect tax under Scottish tax rates. Where an individual is no longer resident in Scotland, the system removes the 'S' prefix.
- Where the system identifies an individual as a Scottish resident, it applies Scottish 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 Scottish resident and is enrolled on a PAYE scheme, the system uses Scottish income tax rates and thresholds 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 Scotland 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** overleaf shows where these divergences occur within the income tax system.

Tax relief on pension contributions

2.13 HMRC must identify Scottish 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. Scottish taxpayers paying a tax rate above 20% can claim the remaining tax relief through a Self Assessment return or by contacting HMRC.

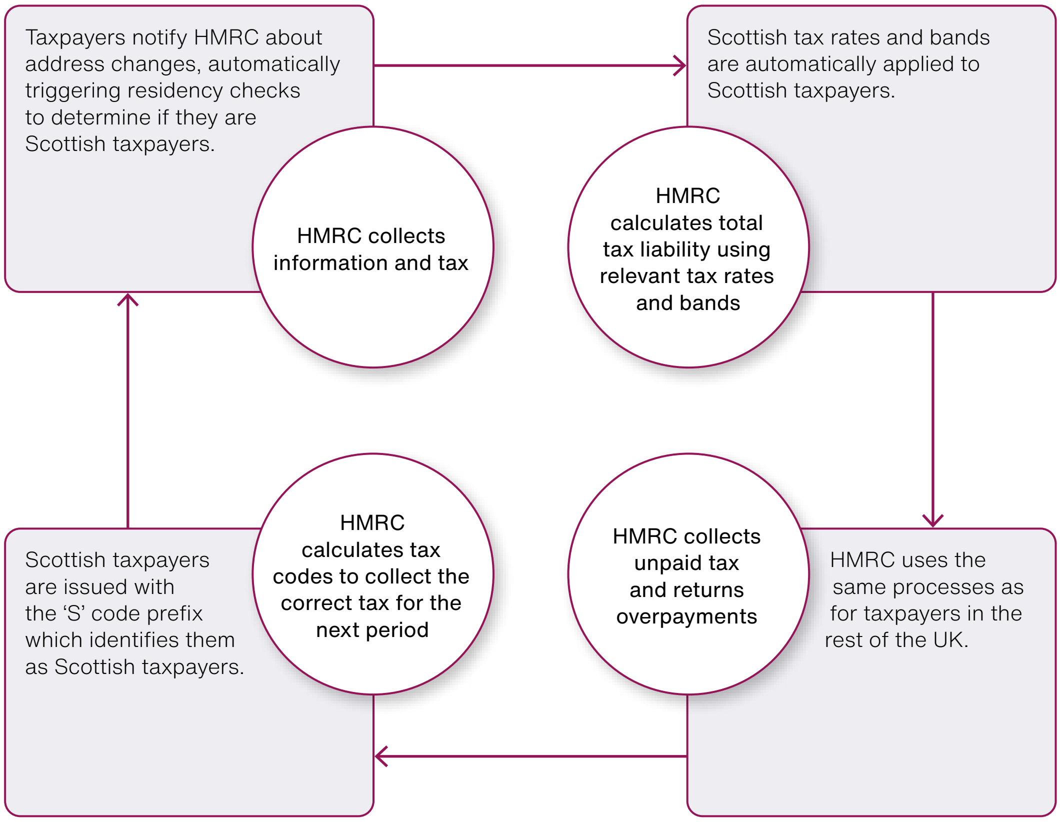
2.14 To administer relief at source, HMRC requires all pension administrators to submit an annual return of information, which provides details of their members and their pension contributions during the previous tax year. HMRC's Relief at Source system then automatically matches scheme members against addresses held by HMRC and confirms the residency status of pension scheme members to identify Scottish 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 six years. A Scotland-specific figure for the proportion of residency statuses confirmed is not available.

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

Figure 6

Divergences in the income tax system for Scottish 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 review of HM Revenue & Customs processes

Tax relief on Gift Aid contributions

2.15 HMRC provides tax relief on Gift Aid contributions in Scotland 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 Scottish 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.

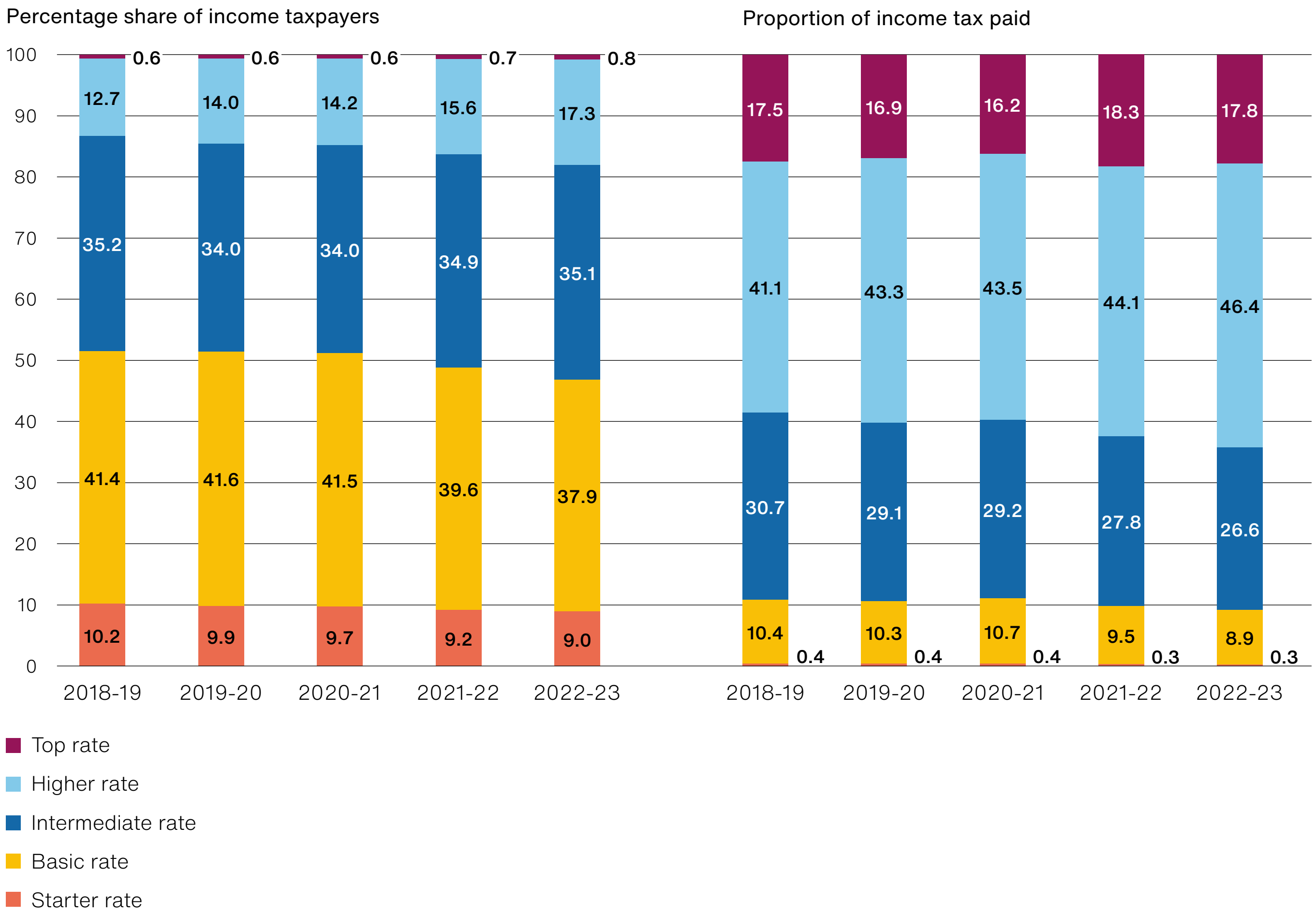
Scottish taxpayer population

2.16 HMRC has calculated that there were 2.8 million Scottish taxpayers in 2022-23, which is a 4.4% increase from 2021-22. Higher rate and top rate taxpayers accounted for 18.1% of the Scottish income tax population in 2022-23 (up from 16.3% in 2021-22) and contributed 64.2% of tax paid (up from 62.4% in 2021-22). These increases reflect the freezing of tax rates and the movement of taxpayers into higher tax brackets. Starter rate and basic rate taxpayers accounted for just under half of the population (46.9%) and provided 9.2% of tax paid. This has fallen from 51.5% of taxpayers and 10.8% of tax paid in 2018-19 (**Figure 7**).

Figure 7

Proportion of income taxpayers by band and income tax paid by band in Scotland, 2018-19 to 2022-23

The proportion of Scottish income taxpayers who are starter rate or basic rate taxpayers fell from 51.5% in 2018-19 to 46.9% in 2022-23, and the proportion of income tax paid by these taxpayers fell from 10.8% to 9.2%



Note

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

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

2.17 The Scottish Parliament has set income tax bands and rates in Scotland that are different from the rest of the UK since 2018-19. From 2018-19 to 2023-24, there were five tax bands in Scotland, compared with three in the rest of the UK. The net effect is that some taxpayers with lower incomes pay less tax in Scotland than a taxpayer elsewhere in the UK, while some taxpayers with higher incomes pay more. For 2023-24, Scottish income tax policy diverged further from the rest of the UK, with the top rate of income tax in Scotland increasing from 46% to 47% and the higher rate of income tax increasing from 41% to 42%. Where taxpayers are subject to higher Scottish tax rates, they may seek to manipulate their residency status to reduce their tax liability. This could include failing to notify HMRC of address changes or deliberately falsifying address information. HMRC considers that the risk of these behaviours is very low compared with the overall risk of non-compliance across the UK, such as efforts to avoid or reduce liabilities altogether.

Address assurance

2.18 Maintaining accurate and complete records of the Scottish taxpayer population continues to be the main challenge for HMRC in administering Scottish 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.

2.19 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 ofthe address data it uses to identify Scottish taxpayers (**Figure 8**).

Postcode scans

2.20 HMRC scans taxpayer records to identify missing or invalid postcodes which would result in an incorrect residency status being applied. The 2023-24 scan, performed in August 2023, identified 52,170 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 1,766 postcodes, a similar level to 2022-23 (1,567) and considerably less than in 2021-22 or 2020-21 (3,031 and 9,429, respectively). Cases that HMRC has not updated are identified as dormant because they have no current taxable income and therefore no income tax attributable to Scotland in 2023-24.

Figure 8

Assurance over the Scottish taxpayer population

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

Assurance activity	Description and purpose	Results
Controls ensuring Scottish residency is correctly determined using the address held by HMRC		
New postcodes	Comparison of HMRC's list of Scottish 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 1,129 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 52,170 missing or invalid postcodes. HMRC updated 1,766 of these postcodes because they had 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–Scotland border. HMRC reviews these cases to ensure it determines the correct residency.	In 2023-24, HMRC reviewed 34 cross-border cases, of which it amended eight following investigation. HMRC amended all eight to Scottish residency.
Missing residency flags	Scans to identify Scottish taxpayer records that are not flagged as such in the system.	HMRC's scans during 2023-24 identified 2,618 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 45,809 cases where 'S' 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.	The exercise performed in August 2023 compared 5.3 million Scottish address records. HMRC identified 8,540 records where the residency determined from the address held by HMRC did not match the residency suggested by the third-party data. Data from the exercise in August 2024 were not available at the time of publication.
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

1 Invalid postcodes identified are corrected or manually set as Scottish where the correct postcode cannot be determined from the address.

2 Figures are from HMRC's analysis of monthly tax code scans and show the number of tax codes where the Scottish 'S' prefix was not correctly applied, and where the tax code would have otherwise been correct.

3 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

The administration of Scottish tax codes

2.21 Where an employer does not apply the 'S' 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 the tax liability each taxpayer should pay. The outturn for Scotland is, therefore, unaffected where the 'S' prefix in an individual's tax code is not correctly applied by an employer.

2.22 Using a tax code without the 'S' prefix could result in Scottish taxpayers either under- or overpaying tax during the tax year. In this situation, taxpayers may have to pay additional amounts in future years to offset an underpayment or await a refund from HMRC for any overpayments. HMRC does not collate the number of reconciliations for Scottish taxpayers where the amount of tax collected was different from the amount HMRC calculated should have been paid.

2.23 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 45,809 cases (1.4% of cases) where employers were not operating a tax code with an 'S' prefix. This number varies across the year but has remained below 1.5% since April 2020. 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.

2.24 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.

Third-party data exercise

2.25 HMRC periodically compares the Scottish taxpayer address records it holds with third-party data to identify differences. This comparison is HMRC's main source of assurance over its address information. Between 2019 and 2023 HMRC ran this exercise every two years. We have previously suggested that HMRC consider more frequent checks if it struck a better balance between timeliness and cost. HMRC has agreed with the Scottish Government to run an additional third-party data exercise in 2024, one year after the previous exercise, and for the next two years to more closely track any impact from increasing divergence in tax policy.

2.26 The results of the 2024 third-party data assurance exercise were not available at the time of publication. In the previous year's exercise, carried out in August 2023, 5.3 million records held by HMRC were compared with third-party data, showing that:

- 3.9 million records (72.9% of records analysed) held by HMRC were successfully matched to third-party data with a Scottish address. This is an increase from 72.2% in the previous third-party data exercise in 2021;
- 8,540 records (0.2% of records analysed) were identified where the residency determined from the address held by HMRC did not match the residency suggested by third-party data; and
- the residency status of taxpayers for 1.4 million records (27.0% of records analysed) could not be corroborated by comparison with the third-party data. HMRC reviewed these records against other internal data sources to gain assurance over the accuracy of the addresses held.[10]

2.27 HMRC and the Scottish Government have agreed that they will return to undertaking the third-party data assurance exercise every two years if, in the 2026 exercise, there are fewer than 15,000 address records where the residency does not match the residency suggested by third-party data.

Compliance risk assessment and planning

2.28 HMRC applies the same risk-based compliance approach to collect income tax in Scotland 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.

10 Approximately 71,000 records were discounted from any analysis as the individuals concerned were under the age of 18, deceased, or indicated as living abroad, or the records were duplicate.

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

2.30 HMRC told us that it monitors risks specific to Scottish income tax and would include these in future SPRs if it deemed appropriate. Its current assessment is that this risk is still very low despite the level of divergence between Scottish income tax policy and the rest of the UK. Through the data it monitors it has not identified any significant or widespread instances of taxpayers changing their address to obtain a tax advantage. There is typically a lag in HMRC's compliance procedures and the reporting or analysing the data that HMRC monitors, and so HMRC does not have any direct evidence of whether this compliance risk has increased in 2023-24.

2.31 HMRC is now carrying out work to assess whether its current compliance approach in Scotland remains sufficient and to ensure it is prepared if the further divergence in tax policy from 2023-24 increases compliance risks. HMRC and the Scottish Government set up a compliance working group, which met for the first time in May 2024 and has been directed by the Scottish Income Tax Board to evaluate HMRC's approach to compliance in Scotland. This evaluation will cover how the current approach is working; the limitations in the approach and how these can be addressed; and how the scope of compliance activity could be increased, to what impact and at what cost. Options being evaluated include carrying out additional compliance checks and calculating a Scottish-specific tax gap. HMRC expects to report to the Board on the first phase of the evaluation in January 2025.

2.32 HMRC has several sources of information to monitor the risk of address manipulation, including the following.

- The number of compliance cases it has identified as relating to the residency status as a Scottish taxpayer: Given when HMRC requires taxpayers to submit tax returns, compliance activity typically applies to tax liabilities from two years previously, therefore any compliance risk from the further divergence in tax policy between Scotland and the rest of the UK from 2023-24 is unlikely to be apparent through compliance cases until at least 2025-26.
- The number of discrepancies from its third-party data exercise and the number of incorrect ‘S’ codes applied by employers for Scottish residents: As part of its evaluation, HMRC is seeking agreement from the Scottish Government on what is an appropriate response to these discrepancies, with options including opening a selected number of compliance cases to investigate further, sending letters to taxpayers to nudge their behaviour or doing further work to understand the reliability of third-party datasets.
- Cross-border migration trends to identify potential instances of taxpayers changing their address to obtain a tax advantage: HMRC has been seeking to establish a baseline up until 2022-23 against which it can monitor cross-border migration from 2023-24 in the context of increasing divergence in tax policy. However, for the last two years HMRC has encountered difficulties with importing into its system its main data source to check against – land and property transaction data. It is instead reliant on other sources of information, which are not as reliable.

2.33 Since 2022 HMRC has been working with the Scottish and Welsh governments to analyse cross-border migration and taxpayer characteristics over time. HMRC has two key research projects to explore these trends. Firstly, HMRC has built a new data set covering the incomes and location of UK taxpayers over a 12-year period. In April 2024, HMRC published its first findings based on analysing this dataset.[11] The analysis showed a gradual increase in net migration to Scotland and Wales from the rest of the UK from 2016-17 onwards, with this increase accelerating in 2020-21 and 2021-22, the years of the COVID-19 pandemic. The analysis indicates net migration to Scotland, including higher rate taxpayers, was not affected in the years following the introduction of the five-band Scottish income tax system in 2018-19. However, HMRC says it cannot draw conclusions about whether migration trends were affected by income tax policy as it does not know what level of migration would have been expected without any divergence in those policies. HMRC published findings on trends up to 2021-22 two years after this period, so it may not be until 2027 that HMRC can assess how migration has been affected by the recent changes in tax rates in Scotland in 2023-24 and 2024-25.

11 HM Revenue & Customs, *Intra-UK migration of individuals: movements in numbers and income*, April 2024.

2.34 HMRC's second key research project, launched in 2020, focuses on how Scottish taxpayer liabilities and behaviour responded to the Scottish income tax changes introduced in 2018-19. Its latest analysis published in April 2024 showed no evidence of a change in labour market participation but some evidence of a decrease in net migration to Scotland from the rest of the UK in the first year of the policy change for Scottish taxpayers above the higher rate income tax threshold.[12] HMRC told us that this analysis is helpful for understanding general behavioural trends and cannot be used to assess the extent to which, if any, a reported decline in migration is indicative of a rise in address manipulation.

HMRC's compliance activity and debt management

Compliance activity

2.35 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 Scotland. 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 Scottish taxpayers for reasons not related to their status as a Scottish taxpayer requires interrogation of separate information systems. Unlike the income tax system, which can flag Scottish residents, HMRC's compliance management information system cannot readily identify people living in Scotland, and information must be compared with other data to provide numbers on the total extent of Scottish non-compliance.

2.36 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 has 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.

2.37 HMRC estimates a compliance yield of £350 million in 2022-23 for Scotland's share of the risks in the SPR. HMRC also estimates that Scotland's share of net losses from the risks in the SPR was £1.1 billion 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 Scotland-specific data to quantify the risks. HMRC does not consider or report on geographical variation between Scotland and the rest of the UK when assessing compliance risk or the relative success of compliance activity.

12 HM Revenue & Customs, *Impacts of 2018 to 2019 Scottish Income Tax changes on intra-UK migration and labour market participation*, April 2024.

Tax gap

2.38 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 Scotland-specific tax gap. HMRC's view remains that calculating a Scotland-specific tax gap would be difficult for methodological reasons, including the increased burden on taxpayers who would be selected for further enquiry, the additional HMRC resource which would need to be deployed, and the loss of Exchequer revenue associated with redeployment of compliance staff away from yield-bearing work.

Debt management

2.39 HMRC's management of tax debt affects how much income tax that is initially unpaid is subsequently collected across the UK, including in Scotland. 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 Scotland-specific estimate of tax debt. It last estimated total tax debt in respect of Scottish taxpayers to be £2.0 billion as at 31 December 2021, 5.7% of UK tax debt at that time. By comparison, Scotland received around 6.6% of UK income tax revenue in 2021-22.

2.40 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 Scottish income tax, and that these are being complied with.

Part Three

Costs

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

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

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

Costs incurred in 2023-24

3.4 HMRC invoiced the Scottish Government for £1.0 million of costs relating to the implementation and administration of Scottish income tax in 2023-24. Of this amount, £0.6 million related to running costs, which is similar to 2022-23. The remaining £0.4 million related to the implementation of the advanced rate of Scottish income tax, in particular ensuring that systems such as its National Insurance and Pay As You Earn system, and the Annual Tax Summary were updated ahead of the new tax band becoming operational in 2024-25. These changes were supported by a project board. HMRC expects to re-charge the Scottish Government a similar amount of £0.6 million in 2024-25 to finish implementing the advanced rate, this time for HMRC's Self Assessment systems. 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 Scottish income tax for the year ended 31 March 2024. Based on our audit work, we 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.

Appendix One

Our evidence base

1 Section 80HA of the Scotland 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 Scottish 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 Scottish 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 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 Scottish 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 Scottish 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 Scottish Government and Audit Scotland 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 Scottish income tax revenue, HMRC's estimate of Scottish income tax revenue and the administrative costs of Scottish income tax.

This report has been printed on Pro Digital Silk and contains material sourced from responsibly managed and sustainable forests certified in accordance with the FSC (Forest Stewardship Council).

The wood pulp is totally recyclable and acid-free. Our printers also have full ISO 14001 environmental accreditation, which ensures that they have effective procedures in place to manage waste and practices that may affect the environment.

National Audit Office

Design and Production by NAO Communications Team
DP Ref: 014065-001

£10.00
ISBN: 978-1-78604-590-4