

Administration of Scottish income tax 2018/19



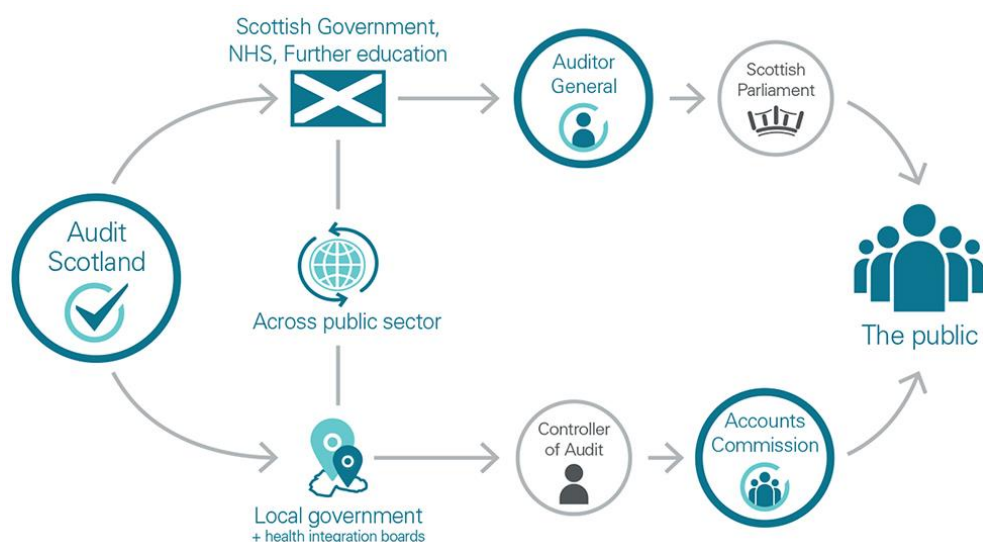
AUDITORGENERAL 

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The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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Introduction

1. The Scotland Act 2016 extended the Scottish Parliament's power to vary all income tax rates and thresholds to the non-savings, non-dividend (NSND) income of Scottish taxpayers. The power to determine any reliefs or exemptions, including the personal allowance. From 2017/18 onwards, the total amount of NSND income tax, now referred to as Scottish income tax, collected by HMRC in Scotland is paid to the Scottish Government.

2. HM Revenue and Customs (HMRC) collects and administers Scottish income tax as part of the UK's overall income tax system. This includes separately identifying the amounts that relate to Scottish taxpayers. The Scottish Government is responsible for:

- reimbursing HMRC for the cost of implementing Scottish income tax
- ensuring that the cost of implementing Scottish income tax represents value for money
- seeking assurances that the new system collects the correct amount of tax.

3. The amount of Scottish income tax collected each year is identified separately in HMRC's annual accounts. The annual accounts for 2018/19 were published in July 2019. This report relates to 2018/19, including the final outturn calculation of Scottish income tax for the 2017/18 tax year.

Audit and assurance

4. HMRC's accounts are audited by the National Audit Office (NAO) and received an unqualified auditor's report from the Comptroller and Auditor General (C&AG). The C&AG is also required to report to the Scottish Parliament on HMRC's administration of Scottish income tax by 31 January of the financial year after the one to which the report relates.¹

5. The predecessor Public Audit Committee of the Scottish Parliament recommended that I should provide additional assurance on the NAO's audit work on Scottish income tax. I make this report to the Public Audit and Post-Legislative Scrutiny Committee in response to that recommendation.

6. Audit Scotland's review was limited to consideration of the NAO's audit work; it did not directly review evidence obtained from HMRC or discuss any matters relating to Scottish income tax directly with HMRC. The judgements and conclusions set out in the report of the C&AG are his alone, based on the audit work undertaken by the NAO on his behalf.

7. The C&AG made his fifth annual report to the Scottish Parliament on 8 January 2020. His report relates to 2018/19 and considers:

- HMRC's calculation of the 2017/18 income tax revenue attributable to Scotland and provides assurance on the correctness of the amounts brought to account
- HMRC's estimation of the 2018/19 income tax revenue attributable to Scotland and his view on the methodology used to estimate the amount
- key controls operated by HMRC to assess and collect Scottish income tax
- HMRC's approach to assessing and mitigating the risk of non-compliance with Scottish rate provisions

¹ Scotland Act 1998, section 80HA as amended by the Finance Act 2014, section 297.

- the cost of administering Scottish income tax and provides assurance on whether the amounts are accurate and fair in the context of the costs incurred by HMRC.

8. Audit Scotland considered:

- the NAO's approach to identifying the key risks to the successful administration of Scottish income tax
- the NAO's audit working files, with focus on the audit evidence underpinning the key findings and conclusions in its report
- the NAO's arrangements for ensuring the quality of the audit work and reporting.

9. Based on Audit Scotland's review, I am satisfied that the NAO's approach was reasonable and that its audit work covered the key audit risks. I am also satisfied that the findings and conclusions in the C&AG's report are reasonably based.

Correctness of the sums brought to account

Impact of tax outturns on the Scottish Budget

10. HMRC's 2018/19 Annual Report and Accounts, included Scottish income tax outturn figures for the first time; these relate to the 2017/18 year. Scottish income tax in 2017/18 was £10.916 billion.

11. 2017/18 budget figures for Scottish income tax were based on independent forecasts prepared by the Scottish Fiscal Commission (SFC) and the Office for Budget Responsibility (OBR). A budget adjustment (or 'reconciliation') is made in later years once outturn data is known. The reconciliation resulting from the 2017/18 outturn figure is a budget reduction of £204 million, made through the 2020/21 budget. Further information on this is included in Audit Scotland's briefing paper, [Scotland's New Financial Powers: Operation of the Fiscal Framework](#).

12. HMRC will publish the final Scottish income tax outturn for 2018/19 in its 2019/20 accounts, which should be available in July 2020. Any reconciliations will be made through the 2021/22 Scottish Budget. The HMRC 2018/19 accounts give a provisional estimate of £11.660 billion.²

2017/18 final outturn

13. The C&AG concluded that 'The outturn of income tax revenue for the Scottish rate of income tax for 2017/18 is fairly stated'.

14. The majority of the outturn, £10.844 billion of the overall £10.916 billion (99.4%) is based upon established tax liabilities, after the tax owed has been finalised and the taxpayer records have been reconciled. The remainder is based on estimated liabilities. Estimation is required in some areas of the calculation because the income tax liability data is not available to specifically identify the Scottish share of individual income tax liabilities, reliefs or other adjustments at the point the outturn is calculated.

15. The C&AG's audit identified £111 million of unreconciled PAYE cases, which were then included in the HMRC's calculation of estimates. This arose from system upgrades relating to the introduction of Simple Assessment. While this increased the Scottish income tax outturn figure, the same issue also applied to the overall UK position, which offsets the impact on the Scottish budget.

2018/19 Provisional estimate

16. The way the provisional estimate is constructed means it remains of limited value in assessing the potential size of future budget reconciliations. Further

² This is rounded in the HMRC accounts (note 13) but disclosed as £11.660 billion in the Comptroller and Auditor General's report – para 1.21.

improvements in methodology would improve the estimation and better inform Parliamentary scrutiny as well as the Scottish Government's ongoing financial management.

17. The C&AG continues to recommend that HMRC should consider whether a revised estimation methodology based on actual outturn data could be developed. In my view, it is important that the Scottish Government and HMRC keep the estimation methodologies under review as more data becomes available to ensure they are as accurate as possible.

Adequacy of HMRC's rules and procedures and compliance with these

18. The C&AG concluded that 'HMRC has adequate rules and procedures to ensure the proper assessment and collection of Scottish income tax and that they are being complied with'.

Scottish Tax Base

19. Accurate identification of Scottish taxpayers remains fundamental to the effective operation of the Fiscal Framework, to the size of the Scottish budget and in ensuring that the right amount of tax is collected from individuals.

20. The C&AG reports that HMRC has implemented processes to maintain the completeness and accuracy of the Scottish taxpayer population. This includes a series of checks on the overall taxpayer population. The NAO has also undertaken specific procedures around address cleansing and tax compliance to inform its assessment of the completeness.

21. The C&AG provides an update on two specific concerns about the Scottish tax base previously raised by the Scottish Parliament:

- Where Scottish taxpayers had failed to tick the appropriate box on their 2017/18 self-assessment form, their tax was initially calculated using UK tax rates rather than Scottish tax rates. HMRC noted that as a result of this corrections were made for around 30,000 customers. HMRC now use the taxpayers' address held on their records to calculate their tax liability rather than the tick box on the self-assessment return.
- 45 MSPs had not initially been provided with 'S' tax codes in respect of the 2019/20 tax year. HMRC confirmed that it has undertaken a review of tax records for parliamentarians for 2017/18 and 2018/19 to confirm the correct tax was paid. HMRC now checks the residency status, tax codes issued, and tax codes being operated by employers of Scottish parliamentarians on a weekly basis. HMRC will again conduct manual processes to identify all Scottish parliamentarians prior to annual coding for 2020-21 tax codes. HMRC also intends to implement further manual processes to review paper 2018-19 self-assessment calculations for Scottish parliamentarians to ensure that these have used Scottish tax rates and bands.

Compliance Risks

22. HMRC continues to address compliance risk for Scottish taxpayers in the same manner as it does for the entire UK taxpayer population. HMRC undertakes an assessment of compliance risk specific to Scottish income tax based on its Strategic Picture of Risk (SPR).

23. The divergence of Scottish and UK tax policies presents the risk that taxpayers will manipulate their place of residence to reduce their tax liability. HMRC considers this risk to be very low risk compared to the overall risk of non-compliance affecting taxpayers across the UK, such as efforts to avoid or reduce liabilities altogether. HMRC has not identified any significant or widespread instances of taxpayers changing their address to obtain a tax advantage.

24. Third-party data checks against taxpayer addresses identify cases for further investigation against this risk. If an inconsistency is identified, it does not necessarily follow that manipulation of residency has occurred; for example, a taxpayer may legitimately live in England but work in the Scottish Borders. HMRC is conducting a third-party data check in November 2019. The C&AG notes that before this, the exercise had not been performed since November 2017.

25. The C&AG recommends that HMRC should consider whether the third-party data check should be completed annually, and the timing of this assurance work. Given further tax policy divergences in 2019/20 and potentially beyond this, the Scottish Government and HMRC should keep the consideration of the regularity of these checks under review.

The accuracy and fairness of the administrative expenses

26. The C&AG noted that 'based on our procedures, we have concluded that the amount repaid by the Scottish Government for the year ended 31 March 2019 is accurate and fair'.

27. HMRC initially estimated that total implementation costs associated with the introduction on SRIT would be between £25 million and £30 million. This was revised down to between £20 million and £25 million in April 2017, and to between £20 million and £23 million in April 2018.

28. As noted in the C&AG's report, £23.7 million had been spent up until April 2019 on implementing the Scottish rate of income tax and the two associated HMRC projects: further Scottish income tax powers and relief at source. HMRC estimates that a further £1.1 million will be spent on the remaining lifecycle of the project, largely to deliver the relief at source pensions system, meaning it anticipates a total cost of around £24.8 million.

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