PUBLIC AUDIT AND POST-LEGISLATIVE SCRUTINY COMMITTEE

AGENDA

12th Meeting, 2019 (Session 5)

Thursday 9 May 2019

The Committee will meet at 10.00 am in the Mary Fairfax Somerville Room (CR2).

1. **Decision on taking business in private**: The Committee will decide whether to take items 4 and 5 in private.

2. **Decision on taking business in private**: The Committee will decide whether its consideration of a draft report on post-legislative scrutiny of the Control of Dogs (Scotland) Act 2010 should be taken in private at future meetings.

3. The **Administration of Scottish income tax 2017/18**: The Committee will take evidence from—

   Jim Harra, Deputy Chief Executive and Second Permanent Secretary, and Jackie McGeehan, Deputy Director for Income Tax Policy, HM Revenue and Customs.

4. The **Administration of Scottish income tax 2017/18**: The Committee will take evidence from—

   Caroline Gardner, Auditor General for Scotland;

   Mark Taylor, Audit Director, Audit Scotland.

5. **Work programme**: The Committee will consider its work programme.

Lucy Scharbert
Clerk to the Public Audit and Post-legislative Scrutiny Committee
Room T3.60
The Scottish Parliament
Edinburgh
Tel: 0131 348 5390
Email: papls.committee@parliament.scot
The papers for this meeting are as follows—

**Agenda Item 3**

Note by the Clerk PAPLS/S5/19/12/1
PRIVATE PAPER PAPLS/S5/19/12/2 (P)

**Agenda Item 5**

PRIVATE PAPER PAPLS/S5/19/12/3 (P)
Public Audit and Post-legislative Scrutiny Committee

12th Meeting, 2019 (Session 5), Thursday 9 May 2019

Administration of Scottish income tax 2017/18

Introduction

1. At its meeting today, the Public Audit and Post-legislative Scrutiny Committee will take evidence on the National Audit Office report on the Administration of Scottish Income Tax 2017-18 from—

- Jim Harra, Deputy Chief Executive and Second Permanent Secretary, HM Revenue and Customs (HMRC); and
- Jackie McGeehan, Deputy Director for Income Tax Policy, HMRC.

Background

2. From April 2016, the Scottish Parliament set a Scottish rate of income tax and from April 2017 onwards, the total amount of non-savings, non-dividend income tax collected in Scotland is paid to the Scottish Government. HMRC collects and administers Scottish income tax. HMRC’s accounts are audited by the National Audit Office (NAO).

3. The Comptroller and Auditor General is required to report to the Scottish Parliament on HMRC’s administration of Scottish income tax. His fourth report on Scottish income tax was laid in the Scottish Parliament on 29 November 2018.

4. When the predecessor Public Audit Committee published its report, Framework for auditing Scottish income tax in 2014, the Committee recommended that the Auditor General for Scotland should provide additional assurance on the NAO’s audit work. The report from the Auditor General for Scotland was also published on 29 November 2018.

Committee scrutiny

Letter to the HMRC

5. At its meeting on 28 February, the Committee took evidence from the Comptroller and Auditor General and the Auditor General for Scotland on their respective reports on the administration of Scottish income tax 2017/18. Following the evidence session, the Committee agreed to invite HMRC to provide oral evidence. The Committee further agreed that the invitation letter should set out the issues of concern that were raised during the evidence session.

6. The response from HMRC is attached in the Annexe.

Clerks to the Committee

7 May 2019
Dear Jenny,

Thank you for your letter of 13 March following the Committee’s evidence session with Sir Amyas Morse, Comptroller and Auditor General.

I am happy to provide some further detail on HMRC’s administration of Scottish income tax and will address the points you raised in turn.

**HMRC’s work on address accuracy to ensure that employers operate the correct code for Scottish taxpayers**

Where HMRC identifies someone as a Scottish taxpayer, we record this status in our systems and send a relevant ‘S’ PAYE coding notice to the employer. The employer should use this code in order to deduct the correct tax from their employee’s wages. After the end of the tax year, we always reconcile the tax deducted by the employer with the tax due, and recover any underpayment from, or repay any overpayment to, the employee. So, if an employer has failed to use the PAYE code correctly during the tax year, this will automatically be corrected, and will not result in any loss of revenue to the Scottish Government.

HMRC works with payroll software developers to ensure that their products enable employers to operate PAYE correctly. We also provide advice and guidance to employers to help them comply. We also carry out a programme of PAYE compliance checks on employers to detect and correct any errors in their operation of PAYE; this includes checking that ‘S’ codes have been operated correctly.

Shortly after the introduction of Scottish income tax HMRC carried out a series of scans to test employer application of the new ‘S’ codes. We will repeat these scans after the start of the new tax year to test whether employers are applying the 2019/20 ‘S’ codes that they have received. Where we find a discrepancy we will re-issue the tax code to the employer to alert them to the problem.
The issue of oil industry workers and whether their tax falls north or south of the border

With the exception of parliamentarians, where someone works does not determine their status as a Scottish or rUK taxpayer – rather, their status is determined by where they live. Customers paying income tax will be considered to be Scottish taxpayers if they have a close connection to Scotland, either through having only a single ‘place of residence’ in Scotland or, where they have more than one ‘place of residence’, having their ‘main place of residence’ in Scotland for at least as much of the tax year as it has been in any one other part of the UK. These tests apply to oil industry workers in the same way as other workers.

The process for estimating the number of Scottish taxpayers, including reliance on the survey of personal incomes

The extract of the official report you refer to raises a number of issues in relation to the Survey of Personal Incomes and how this is used to forecast Scottish income tax. I have included a summary of the Survey of Personal Incomes (SPI) and the forecasting of Scottish income tax in an annex to this letter.

The identification of 45 MSPs as not being Scottish taxpayers

All MSPs, Scottish MPs and Scottish MEPs should be treated as Scottish taxpayers by default, as provided in Scotland Act 2012. This default position means that the process to allocate tax codes to parliamentarians does not follow HMRC’s normal automated business rules (which are based on the taxpayer’s residential address) and instead requires manual intervention. Unfortunately, this was not completed correctly in all cases this year, and HMRC incorrectly issued 2019/20 tax code notices without a Scottish residency identifier to 45 MSPs.

We identified our error and corrected these tax codes well in advance of the start of the new tax year, and so no-one will pay an incorrect amount of tax because of this. We have also undertaken a review of the tax records of parliamentarians for 2017/18 and 2018/19 and I can confirm that the correct tax has been paid, or will be paid, once the relevant Self Assessment return is made.

In future, HMRC will adopt a rolling programme of assurance for all Scottish parliamentarians, and check tax codes for this population at several points in the year. Alongside this additional assurance, we are looking at what further action we can take to improve our management of parliamentarians’ tax affairs. HMRC’s Internal Audit department will also undertake a review of our processes in this area. We will use the oversight and governance arrangements we have in place, particularly the Scottish Income Tax Board, on which Scottish Government officials sit, to monitor how effective our processes are and consider further improvements.

For the vast majority of the population, Scottish taxpayers are automatically allocated ‘S’ codes based on their address through HMRC’s normal business rules. Only Scottish parliamentarians are subject to the rules that mean they are Scottish taxpayers by default. We are therefore confident that there is not a wider problem with the identification of Scottish taxpayers.

The reliance on Scottish taxpayers self-identifying by ticking a box

The online Self Assessment return includes a question asking taxpayers to identify themselves as a Scottish or rUK taxpayer. When completing their 2017/18 returns, some taxpayers did not tick the relevant box confirming that they were a Scottish taxpayer. As a result, our systems calculated their tax using UK, rather than Scottish, tax rates, and we had to make corrections for around 30,000 customers. These customers were advised of this correction in their Self Assessment calculation.

Under Self Assessment, a tax return is a return of all the information needed for the taxpayer or HMRC to calculate the total taxable income and the tax due, including their residency status. Where someone enters a residence status that doesn’t match the one held by HMRC, and they haven’t provided us with details of a change of address, our systems automatically
pick up the discrepancy but we use the information provided to calculate their tax. However, we had not anticipated that so many customers would not complete this field correctly and would instead select a different status to that held by HMRC without providing address change details.

We have amended our systems to ensure that in future where a return does not match information we hold regarding Scottish taxpayer status, we will calculate tax based on the information in our records, rather than the tax return. We will alert the taxpayer to the mismatch between their return and our records and make enquiries into these mismatches as necessary. This should give a more accurate result.

**The process for alerting taxpayers who now live predominantly in England but previously lived in Scotland**

When a customer moves house they should inform HMRC of their new address, and most do. HMRC will issue a confirmation of the new tax code when we receive details of the change of address which alerts customers to the change in their taxpayer status.

The taxpayer status applies for the whole of the tax year. When HMRC receives notification of a change of address we assess where the customer’s main residency has been for the majority of the year. For example, where a taxpayer moves from Scotland to England in January, their taxpayer status will be changed from the following 6 April because they have spent more of the previous year in England. And they will be treated as a Scottish taxpayer in the new tax year following their move, because they spent more of that tax year in Scotland than in England.

**The reason for (and the impact of) the delay in finalising the strategic picture of risk**

The strategic picture of risk was provided to the Scottish Government in December 2018. Pressure on resources meant it could not be provided earlier but compliance activity to assure Scottish income tax continued. HMRC published a summary of compliance activity in this area in the Annual Report on Scottish Income Tax, provided to your Committee in September 2018. The SPR was also provided to the NAO in January 2019, to confirm that HMRC had actioned one of the recommendations in their report on the administration of Scottish income tax.

I am copying this letter to Alyson Stafford, Director General Scottish Exchequer at the Scottish Government and Amyas Morse, Comptroller and Auditor General at the National Audit Office.

I hope this is helpful. If you have further questions I would be happy to give oral evidence to the Committee.

Jim Harra
DEPUTY CHIEF EXECUTIVE AND SECOND PERMANENT SECRETARY
The number of Scottish Taxpayers and estimates based on the Survey of Personal Incomes

Your letter asked for further information on the process for estimating the number of Scottish taxpayers, including reliance on the Survey of Personal Incomes.

HMRC provided the number of Scottish taxpayers at each marginal rate for tax year 2016-17 to the Scottish Government and the Scottish Fiscal Commission in September 2018. This showed 2.528m Scottish taxpayers, of which 2.221m were basic rate taxpayers, 0.294m were higher rate taxpayers and 0.013m were additional rate taxpayers (based on their non-savings/non-dividend income only).

These figures are based on actual data held at April 2018 when the final Scottish Income Tax (SIT) outturn was calculated. Scottish taxpayers have been identified using the S-flag from the NPS and Self Assessment business systems. The only estimation included in these figures is to take account of individuals who had been issued to in Self Assessment but had not filed by April 2018 (this is around 1% of the total). The income tax for these individuals is also included in the unestablished liability of the SIT outturn.

Additionally, HMRC have recently published Personal Income Statistics based on the 2016-17 Survey of Personal Incomes (SPI). The SPI is based on information held by HMRC on individuals who could be liable to UK Income Tax. It is carried out annually by HMRC and covers income assessable to tax for each tax year. The 2016-17 SPI contains around 736,000 individuals. Of the 736,000 sample in the SPI, around 56,000 are identified from their postcode as living in Scotland.

The 2016-17 Personal Income Statistics include two new Experimental Statistics tables showing Income Tax liabilities from non-savings/non-dividend (NSND) income for Scottish and non-Scottish taxpayers.

These new tables provide a comparison of the number of Scottish taxpayers and their NSND Income Tax liability, identifying a Scottish taxpayer based on the Scottish taxpayer indicator (Table 3.16) or by their residential postcode (Table 3.17).

These tables show that using the postcode to identify Scottish taxpayers produces very similar results to those based on the Scottish indicator. Furthermore, the number of Scottish taxpayers, as estimated in the 2016-17 SPI (identified S-flag) is 2.530m, very close to the outturn figure of 2.528m. This suggests that the difference between the forecast and outturn for 2016-17 (explored in more detail below) is not due to the difference in the approach to identifying Scottish taxpayers based on their postcode instead of the S-flag.

Forecasts of Scottish Income Tax

The Committee transcript (col 5-7) covered a number of issues in relation to forecasts of Scottish Income Tax (SIT) and HMRC’s provisional estimate of SIT published in our Annual Accounts. Below, we set out who is responsible for producing forecasts of Scottish Income Tax, how estimates from the SPI are used by the OBR and HMRC to forecast SIT, and how these forecasts have been updated now outturn data is available for 2016-17. We also address the concern that the data used for PAYE in the forecast “includes all income types”.

Summary of forecasts and estimates
The Office for Budget Responsibility (OBR) and the Scottish Fiscal Commission (SFC) each produce independent forecasts for Scottish devolved income tax – they are responsible for their respective forecasts and they own the judgements and economic assumptions that feed into them.
The OBR’s forecast of Scottish tax receipts is created from a model of UK receipts. The OBR produces UK-level forecasts, and calculates the Scottish share of NSND IT receipts. This ensures that its Scottish receipts forecast is consistent with its whole UK forecast. The model is based on the SPI and run by HMRC on the OBR’s behalf but it is agreed with the OBR, and economic forecasts for key economic variables such as wages and employment are provided by the OBR.

The Scottish Fiscal Commission (SFC) produces the devolved Scottish income tax forecast used in the Scottish Government’s Budget. This is published in their Economic and Fiscal Forecasts document. The SFC does not forecast income tax for the rest of the UK or the non-devolved income tax paid by Scottish taxpayers on their savings and dividend income. The SFC produces forecasts for Scotland alone, based on its own forecasts for the Scottish economy – including for employment and wage growth. Differences between SFC and OBR forecasts generally reflect differences in methodology assumptions, data and timing. The SFC uses a publicly available anonymised version of the SPI, known as the Public Use Tape (PUT).

HMRC publish the final outturn for Scottish devolved income tax in the annual Trust Statement. The 2019 Trust Statement will include the final outturn figure for SIT in 2017-18. The outturn is based on actual data available from our PAYE and Self-Assessment systems, about 3 months after the SA filing peak. It is the final measure of income tax liability for that year and will not be revised.

HMRC’s Trust Statement also contains a provisional estimate for SIT published approximately 3 months after the end of each tax year. The 2019 Trust Statement will include a provisional estimate of the 2018-19 SIT figure. This follows the same methodology as the OBR forecast and uses the latest economic determinants by the OBR. It is updated compared with the OBR’s previous forecast based on a number of factors including receipts data and any policy adjustments.

**How the SPI is used in the forecast**

Forecasts are inherently uncertain and there are several reasons why forecast income tax (both UK and devolved) can differ from outturn including methodology, data and assumptions.

Prior to outturn data being available, the OBR forecast of Scottish devolved income tax for 2016-17 was based on estimates from the latest SPI available at the time, for 2015-16. HMRC first published outturn data for Scottish devolved income tax for 2016-17 in July 2018. This was factored into the OBR’s October 2018 and March 2019 forecasts, prompting a revision from its forecast in March 2018.

The OBR’s latest Devolved tax and spending forecasts examines the reasons as to why the forecast differs from the outturn now both the 2016-17 outturn and 2016-17 SPI are available. The OBR comment that “sampling error in the SPI is likely to play some part, although it draws on a large sample” but that “the largest source of difference between our March 2018 forecast and the full HMRC outturn was due to the assumptions we made in projecting from the 2015-16 SPI base year to 2016-17.”

HMRC’s provisional estimate for 2018-19, due to be published in July 2019, will take account of the 2016-17 outturn figure for SIT and will therefore not solely rely on estimates from the SPI, as was the case in previous years before outturn data was available.

**Types of income in the forecast**

The forecasts of Scottish income tax (and the final outturn) are aiming to measure Income Tax due on non-savings/non-dividend income which is devolved to Scotland. The forecast method effectively measures non-savings/non-dividend income and tax receipts, however there can be a minimal impact from savings & dividend income through tax collection in PAYE.