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Public Audit Committee

Wednesday 26 March 2025

Session 3

The Scottish Parliament
Pàrlamaid na h-Alba

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CONTENTS

PUBLIC AUDIT COMMITTEE

11th Meeting 2025, Session 3

CONVENER

*Richard Leonard (Central Scotland) (Lab)

DEPUTY CONVENER

*Jamie Greene (West Scotland) (Con)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)
*Stuart McMillan (Greenock and Inverclyde) (SNP)
*Graham Simpson (Central Scotland) (Con)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Jonathan Athow (HM Revenue and Customs)
Phil Batchelor (HM Revenue and Customs)
Alyson Stafford (Scottish Government)

CLERK TO THE COMMITTEE

Katrina Venters

LOCATION

The Sir Alexander Fleming Room (CR3)

Scottish Parliament

Public Audit Committee

Wednesday 26 March 2025

[The Convener opened the meeting at 09:31]

Decision on Taking Business in Private

The Convener (Richard Leonard): Good morning. I welcome everyone to the 11th meeting in 2025 of the Public Audit Committee.

Agenda item 1 is to decide whether to take items 3, 4 and 5 in private. Do we agree to do so?

Members *indicated agreement.*

"Administration of Scottish income tax 2023-24"

09:31

The Convener: Agenda item 2 is further consideration of the National Audit Office's report, "Administration of Scottish income tax 2023-24", along with the Auditor General for Scotland's assurance report. I welcome our witnesses to the meeting. We are joined from the Scottish Government by Alyson Stafford, who is the director general Scottish exchequer, and Lorraine King, who is the deputy director for tax strategy, engagement and performance. We are also pleased to welcome back, from His Majesty's Revenue and Customs, Jonathan Athow, who is the director general for customer strategy and tax design, and Phil Batchelor, who is the deputy director for income tax policy.

Before we get to our questions, I invite Jonathan Athow and Alyson Stafford to make short opening statements.

Alyson Stafford (Scottish Government): Thank you, convener, and good morning.

It is close to nine years since Scotland was granted the fiscal powers to vary tax rates and bands for non-savings, non-dividend income tax. During that period, the Scottish Government and HMRC have worked closely together to ensure the smooth administration and collection of Scottish income tax. In 2025-26, the tax is forecast to raise £20.5 billion. The National Audit Office and Audit Scotland continue to assess that HMRC has adequate rules and procedures for Scottish income tax, which I am assured by. Since our evidence session with the committee in April last year, further work has taken place to strengthen the position, particularly in three areas in which it has been important to continue to safeguard Scotland's tax base and receipts.

I will briefly address each one in turn. First, on compliance, the Scottish Government and HMRC's joint compliance working group works to be assured of HMRC's view that Scottish income tax compliance risk is low. It tests interventions for impact and value for money.

Secondly, an additional third-party data clash exercise, which scans the details of Scottish taxpayers against third-party data sources, has corroborated HMRC address data for 98 to 99 per cent of Scottish taxpayers. We are assured by those results and will fund HMRC to repeat the exercise in 2025.

Thirdly, on the completeness of S codes, HMRC has undertaken additional work to identify employers and industries that are continually failing to apply those codes correctly. HMRC is contacting those employers to correct the issues and fully understand the reasoning behind the failure, which I am sure that Jonathan Athow will say more about.

Finally, although this is not directly related to the administration of Scottish income tax, the Scottish Government published its tax strategy alongside the 2025-26 budget. It sets out a clear policy intent for income tax for the remainder of this session of Parliament and commits to continued evaluation of the impacts of policy decisions as data becomes available.

Any insights from the committee, either today or in subsequent meetings, will be helpful. I know that Audit Scotland will do a further performance audit of tax and fiscal sustainability this year, and we continue to welcome insights from the committee.

Jonathan Athow (HM Revenue and Customs): I will say three things. I very much agree with Alyson Stafford's statement and will try not to repeat what she said.

First, I very much welcome the audit reports, which give us confidence in the operation of Scottish income tax.

Secondly, I echo the point that we have a close working relationship with the Scottish Government, which remains important, particularly as Scottish income tax evolves and changes. The advanced rate was introduced in April 2024 as part of that constant change in policy, and we work together make certain that those policies are implemented carefully and appropriately.

Lastly, I echo the point that the issue of compliance remains front and centre. The compliance working group that we have established is there to make certain that we are on top of the issues. Some of that work is on addresses and some of it is on the wider aspects of non-compliance in the income tax system. I would be happy to talk about any of that later.

Those three points give an important basis for our conversation.

The Convener: Thank you both for that. I have a question for you in turn. Do you accept the key messages that are contained in the Auditor General's report on his inquiry into the NAO audit of the administration of Scottish income tax?

Alyson Stafford: There are messages about the National Audit Office findings. Both we and the Auditor General need to rely on the National Audit Office producing the account as set out. We have to rely on the NAO's work, and it is always good to see that being endorsed by the Auditor General.

Jonathan Athow: I have nothing to add. We are happy with the auditors and the way that they have carried out their work, and their report is a fair summary of the situation. It highlights areas of risk that we must be alive to, so there is nothing that I would disagree with in anything that has been said.

The Convener: You have already spoken about additional assurance, more checks and so on, so that is already built into your work programme, is it not?

Jonathan Athow: Yes.

Alyson Stafford: Yes, very much so.

The Convener: I turn to the vexed question of the estimates and adjustments that take place. We are looking at the income tax revenues for 2022-23. There is an estimate that covers about £1 billion-worth of tax revenue out of a tax take of £15 billion that year. That seems to us to be, on the surface, quite a high figure. Is that the level of estimate and adjustment that you would expect? Is it an apportioning of a United Kingdom figure that has been transposed into the Scottish context? To what extent is an adjustment made for the profile of taxpayers in Scotland?

Jonathan Athow: There will always be a degree of estimation in our figures. Even though we are talking about 2022-23, some of the things that needed to happen so that we could finalise those figures have not yet happened. We see debt and late payment in the income tax system, which means that we do not have that money yet and have to make adjustments for any money that has not yet been paid over. Where there are uncertainties or estimates, the direction of travel that we have taken as far as possible—and increasingly take—is to use Scotland-specific data to make those estimates. I say estimates, but I mean that they are based on historical patterns of Scottish taxpayer behaviour in Scotland.

That is what we would like to do, but, in some cases, that is not always possible. One area in which we cannot make full adjustments is gift aid, because we do not always ask charities to provide address data when they collect the information for gift aid. We will know that there is a deduction to be made, but we will not always know how much of that deduction is for Scottish taxpayers compared with taxpayers in the rest of the United Kingdom.

There are some limits. As I said, those limits are sometimes there for good reason, because we do not wish to put compliance burdens on charities where we do not need to. However, as far as possible, our aim is always to use Scotland-specific data.

This is an evolving agenda. As technology changes and as our information technology systems change, we might get more data and be able to do more of that. Our direction of travel is that we will always use data on Scotland or Scotland-specific taxpayers where that exists. However, there will always be an element of estimation, given the nature of the income tax system and the behaviours that we see from taxpayers.

The Convener: Do you retrospectively check how accurate the estimates and adjustments were—particularly the estimates—and set them alongside the actual outturns?

Jonathan Athow: Yes. Methodologically, we will always ask, "Were our estimates either optimistic or pessimistic? Does that need to change now?" You will not need me to tell you that there are often a lot of factors that can affect tax receipts. Sometimes that can be the behaviours that I was talking about, and sometimes it can be wider economic factors, which can make some of those adjustments more difficult to do. However, we will always look. Also, we will always try to be transparent. Part of the audit process is about being transparent with our methods and how we look at them and adjust them in light of those outturns.

The Convener: On the point about transparency, when you do those retrospective digs into where you made estimations and adjustments in previous tax years, does that become published information?

Jonathan Athow: The audit process will often drive out that estimate. I do not know whether we do a particular bottom-up analysis of each of the assessments, but we could easily provide assessments of the reliability of our estimates to the committee as part the regular updates that we give you. Bear in mind that it can sometimes take many years for the absolutely final figures to be established.

The Convener: Yes, we understand that.

I will now invite Colin Beattie to put some questions to you.

Colin Beattie (Midlothian North and Musselburgh) (SNP): I will start my questions by asking whether the HMRC representatives can help me with a figure that I do not think has come out. We have seen evidence that more people are coming to Scotland than leaving, but what is the aggregate value of the tax gains or losses when comparing the inward taxpayers with the outward taxpayers?

Jonathan Athow: I do not have that information in front of me. I will check whether anything is in my pack, but I have not seen that information. However, you are right that the information that we have published so far shows that there has been net migration to Scotland. Therefore, other things being equal, there will be more taxpayers in Scotland. Obviously, there will be some people who are moving the other way, but I do not have the exact figures on how that plays out in terms of Scottish—

Colin Beattie: If it were to be possible to get that information, that would be really helpful.

Jonathan Athow: Yes.

Colin Beattie: I will return to the issue of estimates, which is something that has exercised this committee and me for a number of years. There seems to be a difference between what the National Audit Office says and what HMRC says. It is in the nature of being an auditor that you always approach things from a more negative point of view, because that is the job. However, the Comptroller and Auditor General noted:

> "When it comes to the outturn calculation, our exercise shows that we can take material assurance on the accuracy of the figure, most of which is based on actual records of Scottish taxpayers. However, while we have our current systems, an element of it will always be an estimate. Reducing the uncertainty even further will require significant investment in more accurate Scottish data."—[*Official Report, Public Audit Committee,* 19 February 2025; c 13-14.]

It is obviously a concern that we get accurate figures. I am not saying whether it would be a gain or a loss for Scotland if we had accurate figures, but accurate figures are important for planning ahead. If additional resources were available to invest in more accurate Scottish income tax data, where should that be prioritised? Which area would give the biggest results?

09:45

Jonathan Athow: We should be investing in a number of areas. One of those, which we might come on to later, is making certain that we have all of our data on a single system, or more readily accessible on a single system. At the moment, we have a pay-as-you-earn system that collects lots of tax from employees, and we also have a self-assessment system. The self-assessment system is quite old. When we need to do particular analysis, we often have to bring data together in different ways, which can be challenging, because we are in essence taking data from different systems and putting them together.

The key issue is the underlying system. We would like an IT system that automatically joins up that data, because that is better for taxpayers. It means that if a bank or building society sends data to us, we can automatically put it on your record.

Those sorts of things will allow us to improve the system.

That would have a number of benefits. You are absolutely right that it could improve the accuracy of the data that we publish, but it would also make life easier for taxpayers, because they would know that all their information was in one place and was all reconciled.

Those are the sorts of challenges that we face as an organisation. We have a spending review to come in the summer, but we have plans to improve our income tax platforms and our IT systems, which would allow for improved outcomes for customers and better data.

However, there will be some limits—I have mentioned gift aid. We have designed a system that does not allow us to fully accurately reflect Scottish taxpayers. That was done for wider reasons in relation to reducing burdens on charities. There will be limits, but the key thing is investing in our underlying systems, because the better the underlying systems, the better the data and the better the experience for the taxpayer.

Colin Beattie: What you have described is a UK-wide issue, and, in that respect, we in Scotland might benefit by having more accurate data. When it comes to improving information, there are two levels to take into account: the overall UK improvement, and the potential Scotland-level improvement—that is, what the Scottish Government might or might not be prepared to invest in to get better data. If the Scottish Government were to suddenly win the lottery and were able to spend some money on improving the data, what would be the most productive area for that spend?

Jonathan Athow: The most productive areas would be the things that we are already doing. For example, the address matching exercise is important, and we will be investing in that. As for IT build and such issues, a lot of the benefit will come from the changes to the UK-wide system.

At the moment, there are no areas where we have data but are not using it, or planning to use it. It is more about making certain that we have a wider pool of data, and the main way of tackling that will be on a UK-wide basis. I cannot think of any particular area where I would say, "If we invested in our IT systems, the Scottish Government or the Scottish Parliament would have better data." It is about doing the things that we are already doing.

Perhaps additional needs will arise as part of the compliance work, but again, that would not be about putting in place new IT systems or changes. It would be about using data we already have more effectively. There is no limit to what we could do there.

We have gone from doing the address matching exercise every two years to doing it annually, and we will need to be quite responsive. There are risks of non-compliance, and we need to be on top of them. Those are the sorts of issues that we will be working on, but that does not require our getting some money for a new piece of IT kit. Instead, it is about how we invest the time of our analysts and the analysts that the committee has met to best produce the data and analysis that can give the best understanding of what is going on in Scotland.

Alyson Stafford: It is important for me to say a little bit about how I am responding. As you have said, so many of the figures are estimates. I do not know whether members have the NAO report in front of them, but I would point out the information contained in figure 2 on page 12. I have to say that, when I read the report and saw the figure in paragraph 1.5, which the convener has mentioned, for the total amount of estimates, I felt much the same as Mr Beattie did, and I obviously wanted to investigate it further. When I look at figure 2, though, I take comfort in the National Audit Office saying that, out of the total of £15.169 billion that is collected in income tax in Scotland, £15.187 billion is based on established amounts, and is absolutely confirmed, assessed and collected either through the pay-as-you-earn system or the self-assessment system.

The fact is that a large proportion of the outturn is based on tax liabilities that individuals have needed to pay, and the estimation is predominantly because of what has changed in the actuals in the final outturn. The table shows an adjustment of £17 million for that; I think that the figure would actually be £18 million, but some rounding has taken place. The National Audit Office has added up the various elements of estimates, and, as you can see from the estimates column, many of them net each other out. The fact that such a large proportion of the outturn is in established liabilities gives me a greater level of comfort that the tax that we expected to be collected has actually come through.

I am also heartened by the fact that, because we have now had a few years of tax activity in Scotland, when HMRC needs to do proportions and estimations, it is, as Jonathan Athow has said, at least able to use some Scottish historical trends and apply them to the particular year. The first number that was read out is striking, and that is why it is important to point out that when you actually look at it, you will see pluses and minuses and that many cancel each other out.

I agree with Jonathan that in some areas, such as gift aid, the burden would be on charities to collect information every time someone gifted something, and to work out whether the person had an S code. We would need to work through the accuracy of that. However, gift aid is part of the “Deductions from revenue” line in figure 2—the £394 million figure—which is one of the larger changes. It is important to look at those established amounts and understand what the estimates are adjusting.

Moreover, Scottish income tax is what we would call partially devolved. We rely on the UK system, because of all the elements of how income tax works. Jonathan Athow will be more expert at explaining those elements, but whether the income comes from sole traders, from PAYE, from allowable expenses, from married couples relief or from all other such things, all of it has to be administered in the UK, because all of the reliefs are part of the UK system. The element that is devolved to Scotland is tax rates and bands. The overall calculation of the tax liability relies totally on the UK system, because those rules are UK-wide, and it is then a question of how the rates and bands apply to anyone who is designated by specific criteria as being a Scottish taxpayer.

I hope that that gives you the sense that we, too, scrutinise the things that come through. As I said in my opening remarks, to improve compliance, we test for impact and the value for money that can be achieved.

Colin Beattie: What you have said actually emphasises my concerns. The NAO report shows so many estimates, projections and UK-wide calculations, including for the south-east of England—which, of course, distorts any figures for any other place—and we are relying on those figures to calculate the Scottish rate of income tax. Looking at the NAO report, you would say, “My gosh, so many areas here are actually quite weak.” However, when I speak to HMRC or to you, you give reassurance that things are not, in fact, quite as drastic as they would appear in the NAO report. Would you agree with that?

Alyson Stafford: I think that that is fair, yes. The vast majority of the £15 billion that is collected is calculated established liabilities from PAYE and self-assessment. I looked at the matter in previous years, and I will continue to do so. The vast majority of the tax that is due to Scotland is calculated through the PAYE system and self-assessment, which gives a strong foundation.

Colin Beattie: But we are very reliant on the UK systems here.

Alyson Stafford: Totally.

Colin Beattie: Jonathan, you were talking about the need to upgrade and modernise your systems. To be blunt, I would point out that the last time that you tried to do that, it did not work so well—I cannot remember how many billions you wrote off on that one. What are the prospects of getting the money that you need to drive those changes, which will clearly be beneficial not just for Scotland but for the whole of the UK?

Jonathan Athow: Some elements will depend on the spending review. We think that we have a good case for additional investment but, obviously, that will need to be played out through that process.

However, we are already making some investments. As part of our IT modernisation, we have the making tax digital programme, in which we will be asking self-employed people to use software to keep records and update us quarterly on what is going on with their income and expenses. We are already starting the testing phase; the programme will launch properly in April 2026, and we have the money for it. Not only will that change how people interact with us; behind the scenes, we will also be rebuilding our IT systems on to newer platforms. Some of that change is already happening in relation to income tax, with a particular focus on the self-employed; after all, self-assessment has the slightly older system. We are hoping to do more of that work, but the final outcome will really depend on the spending review.

Yes, there have been challenges in delivering some of our tax system, but we have a record of achieving good changes, too. As I have said, making tax digital is coming along; we have already done elements of that programme for VAT—and very successfully, too, so we are confident that we can make those changes.

However, we are talking about a very large and complex system and IT estate. As Alyson Stafford has said, the calculation for income tax is about your income, but there are lots of deductions and quite an extensive set of allowances that need to be built into that calculation, too. Moreover, some income tax comes in through PAYE and some through self-assessment. The way that we operate the tax system means that there are challenges and complexities. It is always a challenge to make such changes, but we are confident that we can do so, should we get the funding.

10:00

Colin Beattie: A service level agreement is in place between HMRC and the Scottish Government. To start with, I want to ask a daft question, which Alyson Stafford can perhaps answer. The page that is headed “Purpose” references a requirement for the Scottish Government to meet any “net additional costs”. Can you define what a net additional cost is?

Alyson Stafford: That takes into account what we already pay. Each year, our costs are pretty flat: £0.6 million. If particular changes are ever required in the delivery of Scottish income tax collection, incremental costs—or net additional costs—might be required to assist with that.

The most recent example is the introduction of the advanced rate in 2024-25, which included some build costs. After such a change, we move to what you might call a more steady state, which is business as usual. HMRC and Lorraine King, who is on the Scottish income tax board alongside HMRC, will work through the on-going incremental costs—the net additional costs—that might come from the change. I expect that, once we have gone past the build phase—the advanced rate was implemented in 2024-25—the costs will need to follow through.

Fairly recently, we will have had to build something in recognition of the fact that, pretty soon, people will start their self-assessment returns. They will do so nice and early, I hope—I thought that I would do the plug for you, Jonathan. That will have happened more recently, so that people can start to fill in their self-assessment returns once they get to the end of the tax year. Once we have got past that, we will assess whether a net increase is required in the business-as-usual costs. We expect that to be negligible.

Jonathan Athow: To elaborate on that, the cost to the Scottish Government shows what would have happened if there had been no devolution of income tax and we had maintained a single UK-wide system. The net cost is the cost of making changes—such as implementing a new tax band, as Alyson Stafford said—and the on-going cost of having Scotland-specific income tax rates.

It is not the total cost of the income tax system divided by the share for Scotland but the incremental cost of operating the Scottish income tax system as we do. That is what we charge. That is the approach that we have taken. Whether it is the on-going costs or the costs of change, the method is the same. The Scottish Government bears only the incremental costs.

Colin Beattie: Looking at the service level agreement, I am struck by the lack of flexibility in the overarching aims of the service requirement. Among those aims are that

“HMRC will identify the Scottish taxpayer population and collect from it the correct rates of SIT … HMRC will account for the amount of SIT collected”

and

“HMRC will continue to administer income tax.”

There are a couple of pages of requirements. Some are stronger than others, but there are definite commitments on the part of HMRC all the way down.

We have been talking about all the estimates and workarounds that are being used. Is there any intention to revisit the SLA?

Jonathan Athow: The SLA is in place to make certain that we are accountable. I do not apologise for the agreement using quite strong language about our purpose and what we are here to do. The principles would be the same at a UK-wide level.

We are here to collect the tax that is due under the law—that is our aim. We are here to collect the Scottish income tax that is due under the law and to make certain that that is accounted for to the Scottish Government. That is our purpose, and I want us to be held to the highest standards in doing that. As I said, we always try to ensure that we are improving in what we do.

The aims and purposes should be there and should be absolutely unambiguous. It is never likely that we will get every penny absolutely right, but we should always aspire to be as accurate as we can. Of course the SLA should change as the relationship between the Scottish Government and HMRC changes. We are putting in place new arrangements, such as the compliance working group. Things in the SLA will have to change, but the overall aims that we are here for are really important, and that is what I and my department should be held to account for.

Colin Beattie: So—to be clear—there is an intention to revisit the SLA.

Alyson Stafford: The SLA is reviewed annually. We still absolutely want to hold HMRC to account and to see it delivering at the maximum level possible and keeping our tax collection as robust as possible.

I can give you some examples of times when we have agreed specific updates as part of the annual review process. In 2022, we required additional data asks. In 2023, we added some very specific requirements in relation to confidentiality agreements. That was particularly pertinent when there was a desire to bring in the advanced rate tax band. All the preparations had to be done before that could be announced in order to have confidence that that could be delivered from an operational point of view, and confidentiality agreements were brought in so that HMRC could gain advice ahead of formal announcements here to allow the operational work to be tested. It is not unusual for tax authorities to do that.

In 2024, the wording was adjusted to reflect the joint working group on compliance. There has been an agreed compliance plan with HMRC for a number of years, but it was a question of having the right people convened. That group is not made up only of the people you see around the table here today; it draws in subject matter experts from

HMRC to join the work that supports the devolved arrangements.

The key thing about the SLA is that there is vigilance in ensuring that it still holds HMRC to account while also being flexible and adapting to the particular needs of our circumstances here. The process that we are talking about is more of an annual refresh of scrutiny to ensure that the agreement is doing what it needs to do. I hope that that goes some way towards illustrating the work that is done.

Colin Beattie: I have one final question, which is about the impact of tax divergence. The Comptroller and Auditor General said:

> "One of our big critiques of Government generally, including HMRC, is the surprisingly low level of investment in evaluation of the impact of different policies."—[*Official Report, Public Audit Committee,* 19 February 2025; c 10.]

Does the Scottish Government have enough information about the impact of its tax policies to be able to make informed choices in the future?

Alyson Stafford: Scottish income tax is still relatively new. As soon as there have been any changes, we have taken pains to assess those. We use a range of elements to support us in providing advice to ministers about the potential impacts of policy preferences. There are tax policy differences, which are raising more funds for us here in Scotland because of the progressive preferences of the tax system here.

A number of exercises have been done to ensure that we continue to get the data and to find out what that tells us about our tax policies. Four key evaluation studies have been done, and I will talk about the most recent ones first.

You may remember that, last April, as we were giving evidence to the committee, HMRC published two data sets. One was longitudinal and was primarily to do with migration. Another looked at extensive taxable income elasticities, which is another aspect of behaviour. Studies were also done on the more material changes that took place in 2018-19, when the Scottish Government introduced a five band tax system. One of those was conducted by HMRC, while the Scottish Government conducted its own analysis that was published in December 2021 to evaluate the impact of those changes on migration. It is necessary to allow a bit of time for the results to come through because of self-assessment.

The longitudinal data set relating to migration showed that, since the devolution of income tax, net migration into Scotland has increased each year. In 2021-22, which is the most recent data set that we have, net migration was positive across all tax bands. The other study that was published last year found that there was no evidence of changes in labour market participation. It was peer reviewed by the Fraser of Allander Institute and the University of Westminster. I can go into any of the studies in more detail if you wish.

HMRC's study on the changes in 2018-19 matched a cohort of taxpayers in Scotland with a control group in the rest of the UK. It concluded that there was limited evidence of Scottish taxpayers lowering their taxable income, but although there was an element of behavioural change, there was no particular evidence on migration. The Scottish Government's analysis, which we published in December 2021, showed that there was no evidence of significant behavioural change. It will be key for us to stay vigilant in tracking all those things, but those are the evaluations that we have.

At the start, I mentioned the tax strategy that has been published, which sets out a full set of areas of research interest. That was based on the Scottish Government's engagement with more than 65 different groups and individuals when it put together the tax strategy. For the areas of research interest that we are interested in, we have set aside a modest amount of money in order to be able to support and fund research from a broader range of researchers, so that it is not just the usual suspects who will do that work. We will continue to get results from those studies so that we can continue to scrutinise and test the impact of the various policy choices that ministers have made over a number of years.

Colin Beattie: From what you are saying, a lot more is going on than the committee was aware of. We go by what the NAO says, and it is unequivocal about the low level of investment in such evaluations. Why does the information from the NAO seem to be pointing in one direction, when you are saying that a lot of other stuff is going on? Does the NAO not have access to that information?

The Convener: Can we get a succinct answer to that question?

Alyson Stafford: The short answer is that the NAO would have access to that information. I can speak for myself, but any auditor who comes to audit the Scottish Government or any department in Whitehall is provided with the information that is requested. The studies that I have referred to have been published and are in the public domain, so it is not the case that we are holding information that other people do not see.

The Convener: I take you back to one of your previous answers, which I think will be of interest to the committee. You mentioned that when the Government was contemplating introducing a new tax band—the advanced rate of tax—you signed a confidentiality agreement with HMRC and you set to work. Did you set to work on looking at whether that was feasible, or did you set to work on setting up the systems?

10:15

Alyson Stafford: That work was about feasibility. It was about knowing that setting up the new rate was operationally feasible, and HMRC had the expertise on that.

The Convener: Okay. I presume that there was no question but that the answer would have been that it was feasible.

Alyson Stafford: Maybe Jonathan Athow should come in on that.

Jonathan Athow: The key question is often about timing. There are often a lot of changes going on in our IT systems, so we need to understand the work that would be required to introduce a new tax band, how long it would take and whether it could be factored into our existing plans. Our advice to the Scottish Government would be, "You need to announce it now so that it can come in at this point." That is the sort of question that we would give advice on.

The Convener: On the chronology, if we are looking at the tax year 2023-24, which I think is when the higher rate came in—

Alyson Stafford: The advanced rate.

The Convener: The advanced rate—okay.

Alyson Stafford: There are so many different labels; you have to get them right.

The Convener: I will do my level best to get things right. The advanced rate came in, but it was not agreed until February 2024, at stage 3 of the budget process in the Scottish Parliament. When does your system have to be set up? Is it too short notice to set it up between February and 6 April?

Jonathan Athow: Yes, that would be too short a period. We need to work with the Scottish Government to understand when an announcement is likely, and that is normally when we would start the preparation work for the implementation of new rates.

The Convener: Just to be clear, Mr Athow, when would you start that preparation work? When did you start it in the case of the advanced rate?

Jonathan Athow: Doing the feasibility work helps you to understand those sorts of things. The feasibility work started before the announcement was made. Once the announcement has been made, we would then—

The Convener: When you talk about the announcement having been made, do you mean at stage 1 of the budget process or at stage 3, when the Parliament has agreed to the budget?

Jonathan Athow: The announcement would be the—

The Convener: Would it have been at stage 1?

Alyson Stafford: It would have been when the draft budget was set out. In that case, it would have been a date in December.

Jonathan Athow: Yes, it would have been the December date. I am sorry—I am using our language. An announcement is made on a Government intention to introduce a rate, and we would start the IT work pretty much immediately afterwards. We would draw on the work that we had already done, so we would not be starting from scratch. Because of the feasibility work, we would know what the challenges were and how the work would be sequenced. Again, the delivery would need to be factored in to other things that were going on at the time to build up for the start of the tax year.

The Convener: What if the Parliament had rejected that announcement? The governing party does not necessarily have a majority, although there was a coalition at that time. If the Parliament had decided that it did not want the advanced rate to be introduced or that it wanted a variation of the advanced rate, how would you have coped with that?

Jonathan Athow: It is difficult to know what would happen in hypothetical scenarios. If it was decided that there was never going to be such a rate, could we suppress it in our IT system between a decision being made in the Parliament and that coming forward?

The other issue is that the income tax system is an annual system, so although we try not to do it, changes can be made within year—we have done that in the past. We might start the year by building a proposal into the IT system, but it could be taken out during the year so that the tax that was collected at the end of the year was fully in line with Scottish legislation.

There are options for doing that. Again, we have a conversation with the Scottish Government about how it wants us to proceed, given the timetable for announcements. It is not a decision that we make unilaterally. We talk to the Scottish Government about the best way of planning it, particularly in the run-up to significant changes, such as the introduction of a new rate.

The Convener: Thank you for that. Graham Simpson has some questions for you.

Graham Simpson (Central Scotland) (Con): HMRC starts its work when the Scottish Government announces its intentions on tax, so I think that what the convener was getting at is that, after you have done all your preparatory work, the Government's final decision might be different from what was originally proposed. In those circumstances, how quickly can you turn things around and change what you have done?

Jonathan Athow: It depends on the nature of the change. I am more familiar with UK finance bills, and there can sometimes be changes in those, but those changes are often minor, so they do not have particularly large impacts and can be managed. If a decision was made to not implement the advanced rate and simply stick with the five-band system, that would be quite a big change. Again—

Graham Simpson: That would be a big change.

Jonathan Athow: It would be a big change. If a decision was made in February to not implement a rate in April, that would be a very big change. We would have to do some very quick work to understand what we could do to address that. We can sometimes make changes behind the scenes so that an employer or a taxpayer would not see that there were, in fact, six bands and that we had suppressed one of them so that it looked like there were five. There are different ways of doing that, but the key thing for tax is making certain that it is right at the end of the year. If you had started with six bands, you would reinstate the five-band system by the end of the year, at which point the reconciliation would ensure that the Scottish Government got only the money that it was due under the law and that taxpayers would be no better or worse off.

That is a challenge with all IT deliveries that are dependent on legislation. All Governments, including the Scottish and UK Governments, sometimes look to implement changes as quickly as possible. As administrators, our aim is to make certain that we are as flexible as we can be to meet the particular needs. I do not think that it is credible to say, "It's going to take us 15 months to implement a new rate of income tax." We need a few months to do that, but the Parliament is sovereign and its decision is final, so there is always a degree of risk in delivering such things.

Graham Simpson: Alyson Stafford, in response to Mr Beattie, you referred to a number of reports that were published in April last year. One of those was an HMRC paper, so it might be that HMRC should respond to this question—you can decide between you. The HMRC paper, which is called "Impacts of 2018 to 2019 Scottish Income Tax changes on intra-UK migration and labour market participation"—a nice short title—says:

> "In total, we estimate a loss in NSND Income Tax"—

which means non-savings, non-dividend income tax—

> "from cross-border migration of £60.6 million".

In other words, £60 million would have stayed in Scotland if tax bands had not changed. Is that correct?

Jonathan Athow: Yes, that is broadly correct.

Graham Simpson: That was for 2018-19. Have you done any analysis on other years? Has there been any analysis on how that gap might change in the future if the tax gap was to widen further?

Jonathan Athow: As Alyson Stafford has said, part of the challenge is that it takes a while for us to have a complete data set in order to do such analysis. We are collecting that data. We have invested in a database that allows us to track people over time, and more up-to-date estimates will be available. We also make that data available to academic researchers, so it does not have to be just us doing the work—others can do it.

The best way to look at the overall estimates is to consider what the Scottish Fiscal Commission has done. It uses something called taxable income elasticity, which relates to how much taxable income changes as tax rates go up. That encompasses a whole set of behavioural assumptions. It takes account of migration within the UK and people on higher rates deciding to, for example, bring forward their retirement a bit, because there would be little marginal benefit to their working a bit longer.

The estimates on additional yields that the Scottish Fiscal Commission makes include those estimates, but they will not be broken down in a way that shows how much of the figure is based on migration and how much is based on other behaviours. We will be able to see that only in the future; it will take a while for all that data to come together.

However, all other things being equal, you would expect a growing differential in tax rates to increase those sorts of behaviours. That is against a backdrop of net migration to Scotland—it is a case not of migration falling but of migration perhaps not being as high as it otherwise would have been. Those are important caveats to bear in mind.

Graham Simpson: Yes, I get that. The figures show that there has been net migration to Scotland, but you have said in your paper that there has been a financial loss because of the tax difference.

Jonathan Athow: The simple way of putting it is that there would have been even higher migration to Scotland if there had been no divergence in rates.

Graham Simpson: And more money.

Jonathan Athow: Yes.

Graham Simpson: The conclusion is that, if the tax gap is widened, potentially even fewer people will come and the money will go down even further.

Jonathan Athow: As Alyson Stafford has said, the changes are still relatively new—this is our first data point on the matter—and you will want to keep evaluating the situation. As I said, the Scottish Fiscal Commission had already built an assumption on behavioural responses, including migration, into its forecast, so that should already be taken into account in the numbers. However, we will know only in retrospect, once we have all the data and are able to do a more complete evaluation, whether that was a good estimate. Other things being equal, you are right that a higher tax rate will have a stronger behavioural effect than a lower tax rate.

Graham Simpson: That is very useful.

I will ask you about something else: self-assessment. I hate filling in any kind of form—I do not know why you would fill in a form if you did not have to do it—but a number of people on PAYE fill in self-assessment forms even though they do not have to, which they perhaps do not realise.

According to the Auditor General, no taxpayers have paid the incorrect tax as a result of that situation, but it led to HMRC overstating the Scottish income tax outturn by an average of £78 million a year. It is calculated that the Scottish budget should have undergone further negative reconciliation of £29 million as a result of that issue. Have any decisions been made on how to account for the potential £29 million reduction to the Scottish budget?

Jonathan Athow: I am sorry for the statistical error that was made. As I hinted at earlier, bringing data together from different systems is sometimes a challenge—in that case, we faced a statistical challenge, and we have been open and transparent with the Scottish Government and the auditors about that.

The question on what happens to the £29 million is really for the Scottish Government and the UK Treasury, so I will hand over to Alyson Stafford.

Alyson Stafford: Discussions are continuing and we expect the matter to be resolved.

Graham Simpson: When?

Alyson Stafford: As soon as it is resolved, I will write to the committee. That is probably the best thing to say.

10:30

Graham Simpson: Let us talk about S codes. For some reason, you do not have to tell HMRC where you live. Should it be a legal requirement to tell HMRC, given that we have tax divergence?

Jonathan Athow: At the moment, there is no case for a change in that regard. Looking at the data that we have, we think that our address data, which is often provided through employers—although some people automatically report to us when they change address—is working well. There are some challenges and there will be some issues, but, in general, that system is working well.

When we introduce a new requirement on people to tell us something, the challenge is that we have to put in place sanctions. Simply having a requirement to do something without any sanctions does not seem particularly helpful, so you would have to have sanctions, which would create uncertainty.

I am certain that, as MSPs, you would be concerned if constituents approached you with concerns about penalties that they had incurred for not telling us about an address move. If it was an address move in Scotland, that would have no impact on their return. We would have to think carefully about whether it would be proportionate to require people to inform us. At the moment, we do not see it as being proportionate, but that could change in the future.

The other aspect of the question is whether there are other ways in which we can get data from individuals. People do not like filling in forms. If there are ways in which we can collect that data from other records that the Government holds, that will always be a priority for us.

We are probably a long way from requiring people to inform us of address changes, either because it would be unduly burdensome or because we can get data in other ways from other parts of the Government. Many citizens will not see the difference between HMRC and other parts of the Government. They think that they have told the Government that it should share that data. There is a burden on us to make certain that we explore all those opportunities to try to make things as simple and straightforward as possible for citizens.

Graham Simpson: Okay, but where you live is important. I am a bad example because I am an MSP, but if I was not an MSP and I moved to Carlisle, I would pay less tax. Where I live is important.

Jonathan Athow: Yes, it is. At the moment, the divergence is between Scotland and the rest of the UK. The Welsh Senedd also has the power to vary its income tax rate, so we could end up with someone’s address being more important in the operation of the income tax system across the UK. I agree with that point.

Given our high confidence in our address matching, it is not the right time to increase the burdens on taxpayers in terms of reporting to us. However, we need to be alive to the matter. Just because that is the situation at the moment does not mean that it will always be so—perhaps there will be changes that we will need to make. If we were to introduce such legislation, we would need to have very good evidence about why it was a proportionate response to a problem.

Graham Simpson: Okay. On 11 March, you wrote the committee a useful letter in which you addressed the issue of employers not applying S codes. We are talking about a small number of employers; in your letter, you mention that two employers are "consistently" getting this wrong. You obviously do not say who they are—and I am not asking you to name them, as you will not do that—but can you tell us what size those companies are? Why are they getting it wrong? You also refer to software in your letter. Are they now getting it right?

Jonathan Athow: We will find out whether they are getting it right, and we will write to let you know how that changes.

I might bring in Phil Batchelor to say a bit more about this, but the beginning point is that we expect all employers to operate the PAYE system. Tax codes have been a long-standing part of our system; with devolution, we now have S codes in Scotland and C codes in Wales, and we expect employers to operate them effectively.

The challenge that we have found is that different employers have very different payroll systems. Perhaps I can elaborate on that: some of the most modern businesses have cloud-based systems, which are very easy to change, as all the calculations are done in the cloud. Other businesses have what we call on-premises systems, any improvements to which require people taking disks to the employer and installing things. Sometimes, employers might well have old systems that are not really delivering.

There is no real benefit to an employer from not operating an S code. We do not think that there is any deliberate decision not to do so; it might simply be that people are using old systems or have not updated their systems recently.

Phil, do you want to say something more about S codes?

Phil Batchelor (HM Revenue and Customs): Yes, certainly. I thank the committee for its interest in this topic. I think that that has helped to keep us straight, as it is a topic that we have regularly reviewed at our Scottish income tax board meetings.

We have commissioned some additional research. We have not finalised that report yet, and we will be happy to share it when we have, but its initial findings are that the mistakes are fairly evenly split between large, medium and small employers, so the issue is fairly broad across the range. We think that it largely affects employees who earn less than £43,000, but we need to do a bit more work to see whether those groups are being disproportionately affected.

We think that the best-performing sectors are health and social work, and that most of the issues are arising in the finance and insurance sectors. That might confirm, or deny, any ideas that you previously held. As Jonathan Athow mentioned, we have granular enough information to identify two particular employers, and I will take a personal interest in ensuring that we follow that up with them and get the right action plan in place to get the issue resolved.

As has been mentioned, we can tell which software products are associated with the problem. Another avenue that we can investigate is contacting those software developers to see whether there are any systematic issues that we can address.

Again, thank you for the interest in this topic. It has definitely prompted quite a rich field of work to follow up on.

Graham Simpson: I am pleased to hear that.

You have identified two companies that are getting it wrong, perhaps because of their software. Have you approached them to say, "Look, you've a problem here and it needs to be sorted out"?

Phil Batchelor: We certainly will—

Graham Simpson: But you have not done that yet.

Phil Batchelor: I do not know. We only just got this report in the past couple of weeks.

It depends on the size of the business. I am keen not to disclose anything, but if we are talking about a larger employer, HMRC has someone called a customer compliance manager who will have a close relationship with that large employer, and we will pursue the issue through that channel.

Jonathan Athow: Obviously, we cannot disclose the names of the companies, but we can report back to you on this. We wanted to bring the evidence to you as soon as we could and in good time for this meeting. It is hot off the press at our end as much as it is at yours, but we will follow up and write back to the committee, once we have had those conversations.

Of course, we will need to be careful not to disclose anything, but we will write back to you. As

I have said, this is an area that we will not stop working on and the committee can expect regular updates on it.

Graham Simpson: That is very much appreciated. However, the potential losers are not the companies, but the employees themselves. If they get taxed at the wrong rate, you will end up chasing them, and it is not their fault.

Jonathan Athow: At the end of the year, we have something called an end-of-year reconciliation. If people have underpaid tax, we will say, "Can you please pay that?" and if there has been an overpayment, we will say, "Here's how you can reclaim it."

The cost is the burden that falls on the individual who has to make a payment. Moreover, if the S codes are not being operated, some people could be missing out and could be due a tax repayment, given that the Scottish tax rates are lower for some groups of individuals. Obviously, though, people on higher incomes could end up facing a larger bill.

The cost falls entirely on the taxpayer, in terms of the administrative burden, and that could be challenging for people on a tight budget. You are absolutely right: the cost falls on the companies' employees as taxpayers.

Graham Simpson: Finally, have any Scottish taxpayers received such a bill from you, asking them to pay up?

Jonathan Athow: There will have been some, but often—

Graham Simpson: How many?

Jonathan Athow: We could tell you the total number of reconciliations in Scotland. However, we are often reconciling a number of things at once. For example, if you have bank and building society interest that is taxable, we will often bundle that up in the same calculation. We can probably tell you about reconciliations in Scotland, but not necessarily about the reconciliations that are caused by S codes. The reconciliations are about getting everything right.

Graham Simpson: I appreciate that.

Jonathan Athow: We can perhaps give you something about reconciliations, but it is tricky to give you a number for S-code driven reconciliations.

Graham Simpson: We will take whatever you can tell us.

Jonathan Athow: Our colleagues will go away and see what we can say about that. In general, though, most employers operate the S codes well. However, there is, in a small number of areas, a persistent problem that we need to tackle.

Graham Simpson: Thank you.

The Convener: In the interests of time, I go straight to Stuart McMillan to put some questions.

Stuart McMillan (Greenock and Inverclyde) (SNP): I want to follow up on Graham Simpson's question about the S codes. Mr Athow, you used the word "sanctions". Surely, you would not need to sanction people; if you have presented them only with guidance, sanctions might be a step too far.

Jonathan Athow: Sanctioning employers is our last resort. With S codes, no tax is at stake overall, although there is the issue of inconvenience. We are not seeing the sorts of behaviours whereby people are deliberately trying not to hand over PAYE that they have collected; that would be a much more serious issue, and sanctions would be involved. We want to stay away from that and help employers get things right. That is our starting point.

In the example that we have been talking about, all the evidence suggests that it is a case of people inadvertently getting it wrong, maybe because they have not updated their systems or they have not updated themselves on the latest guidance. The aim, therefore, is to educate people rather than to levy sanctions. Sanctions would definitely be a long way further down the track, and there would have to be something much more serious than not operating an S code for us to consider them, because the issue does not affect overall tax liabilities. I apologise if I was unclear about that.

Stuart McMillan: No, that was helpful.

I also want to follow up one of Colin Beattie's questions regarding the IT systems. I assume that the IT for every country's tax system will be bespoke for that country, because all tax systems will be totally different. I assume, too, that you are engaging with other countries on their IT systems and the like. Are there any good examples that you would share with others, and that others would share with you, to help you design a new IT system?

10:45

Jonathan Athow: I will just highlight two things that are important in tax collection, the first of which is getting data close to when a transaction arises. We already have that in the PAYE system, and our current system has been copied by other countries. Every time an employee is paid in the UK, we get that information pretty much in real time. PAYE allows us to collect 99 per cent of the tax due, because it is secure; it gives us both the data and the money, and it is a good system. The closer that you can get the payment to the information, the better, because if you do not get the payment with the information, it can become a debt. That is our drive.

The self-assessment system is more challenging. We give people nine or 10 months after the end of the tax year to complete their return, which is problematic for us, because people who get a tax bill might have spent the money during that period and might not have budgeted for the bill. We are also asking people, particularly self-employed people, to keep records, because a transaction that takes place in April 2025 will not have to be shared with us via the self-assessment tax return until January 2027, so there is a lot of opportunity for people to get that wrong.

That brings back to my point about our making tax digital programme. We are trying to encourage people to keep their data digitally—after all, digital records are more durable than a piece of paper that can easily be lost—and to update us regularly. Our aim is to try to have a more real-time tax system, so that we get data that we can understand.

If you look across the world, you will see that that is the way that other countries are going: you build the tax into something that people are already doing. Everybody has a payroll system, so you build PAYE tax into that, and self-employed people are increasingly using business software, so you build the tax into that. That is the strategy that we are trying to move towards. It will help people get things right, because it is automatically built in, and it also works with the grain of how self-employed business people are moving, because of digital uptake.

Stuart McMillan: You talked about quarterly updates. How do they marry up with the third-party checks that you are currently using?

Jonathan Athow: There is a spectrum of things that we can do. We get some third-party data at the moment and sometimes use it for risking. We look at all the taxpayers that we have to see what they have reported to us and whether we have a source of corroboration to say that it was either right or different. That is one key way in which we look at small businesses. We can say that they have told us something but that the merchant acquirer that looks after all their card payments says that they have a different income, and we can ask them what is going on.

We sometimes do it that way but, increasingly, we want to be able to do what, in the jargon, is known as pre-populating. To go back to Mr Simpson’s question about form filling, we would like to be able to fill in the forms for people. If we have information about bank or building society interest, that should be on your tax return already so that there is less opportunity for you to forget it or not to include it.

Those are the areas where we would like to do more with data, but we start with the idea of risking, so that we can look at which taxpayers are telling us things that are different from the third-party data that we have. That data is sometimes wrong and we find out, when we inspect it, that there is no tax liability, but it sometimes gives us an insight into what is going on when there is non-compliance.

Stuart McMillan: I want to bring the focus back to Scotland and tax collection. On engagement with other countries, I know that Germany has both a federal system and the Länder, which will have a range of local taxes. You could argue that Spain has the same structure, but I will use Germany as the example. It has a federal structure and something that is similar, no doubt, to the system that you operate—that is, an overarching system with local taxation potentially feeding into it. Can we learn lessons from Germany, for example, about the divergence in taxation that will take place?

Jonathan Athow: We will see different international experiences. My focus is mainly on the administration of the system, and many of the administrative systems tend to operate in quite similar ways.

However, if you are asking about tax policy variation, I have to say that I am less sighted on that. The United States is an example of where there is significant variation, and, again, there are often three levels of taxation—federal, state and perhaps a local government level. There are different models internationally. Part of the challenge in some countries—again, the US is a good example—is that, sometimes, the more variation that you allow, the more people you end up having to put into the self-assessment system. They do not call it that, but, in essence, the US system is 100 per cent self-assessment, and there will be challenges involved in that.

The UK has, as far as possible, always tried to keep people in the PAYE system. Sometimes, the more degrees of freedom that there are in taxation, the more administrative challenges there will be and the bigger the administrative burden will be—for example, there will be more self-assessment. We are always trying to take people out of the self-assessment system if they do not need to be in it. It is an obligation on people to undertake that process; people can face penalties if they do not comply; and the self-assessment system costs us more to operate than the PAYE system. We are always looking for administrative simplifications, but there is sometimes a trade-off between policy flexibility and administrative simplification.

Stuart McMillan: Policy decision making happens at a political level, but, with regard to implementation and tax gathering, I notice that there have been huge changes in IT over the past three decades in particular, so the system could be designed with flexibility built in, particularly if new systems were to come on stream.

Jonathan Athow: It could be, but an issue that is sometimes overlooked is the data infrastructure. Some countries have digital identities, which means that all the information in the Government can be brought around you. The UK does not have that arrangement, which makes flexibility difficult. Therefore, the technology does exist, yes, but how do we know that Stuart McMillan is a particular Stuart McMillan and that we should be putting this particular income information against his tax record? It can be very difficult to do those sorts of things. Sometimes, then, it is not about the technology but about the data infrastructure.

Again, that varies a lot between different countries. The Nordics tend to have digital identities to a much greater extent; they have a history of identity cards and so on and—to go back to Mr Simpson's point about this—they also have a population register, which means that you are obliged to tell the authorities where you live and to update that if you move. There are different cultures around data, which can affect the processes, and they can sometimes be more important than the technology when it comes to joining up the data behind the scenes.

Stuart McMillan: Would a drive to develop that kind of data technology provide the opportunity to no longer use such checks?

Jonathan Athow: Yes. I think that if we could get better data, we would be less dependent on third-party checks.

However, third-party data will always be useful. There will always be things that we do not know. Essentially, the self-assessment system caters for things that we do not have data on. We have data on employees, so we do not collect it. There will always be things that we do not know, but the question is: can we bring that data in behind the scenes, so that the taxpayer does not need to know that we have it but can be assured that we are getting it and using it securely to give them the right tax bill?

That is definitely the direction of travel that we would like to be going in. We are always thinking about how we consult on and build a case for that, because we know that we need to be very alive to the issue of data privacy and ensure that we are not ahead of the public's appetite for data sharing.

Stuart McMillan: Okay. Thank you.

The Convener: Thank you very much. The deputy convener, Jamie Greene, will ask the last round of questions.

Jamie Greene (West Scotland) (Con): Good morning. I will start by looking at an area of the report that we have not covered, which is Scotland's overall economic performance relative to that in the rest of the United Kingdom. For your information, that sits on pages 19 to 23 of the AGS report.

I will start with a question for the Scottish Government. Perhaps you can talk me through exhibit 3, which is the table on page 20. According to the Auditor General, between 2017 and 2023, the cumulative additional tax paid by Scottish taxpayers due to tax policy differences was £3.36 billion. The net increase to the Scottish budget is displayed not far away from that figure, and it is only £629 million. Why is that the case?

Alyson Stafford: Tax policy differences are raising more funds for Scotland because we have a more progressive income tax system. The first thing I will say is that all the income tax that is raised in Scotland comes to Scotland and goes towards the Scottish budget. I think that those are really important elements.

Allow me to break down what is happening with the numbers. There are three key elements, which I will go through in turn: they are behaviours, distributional differences and residual elements.

The £3.367 billion that you mentioned is the cumulative figure over those six years and is described as "additional tax paid". However, it is not actually additional tax paid, because when the Scottish Fiscal Commission sets out its forecasts for tax in a particular budget year, it takes into account behavioural effects such that the actual tax figure that we build into our budget each year is reduced to account for those expected behavioural effects. Behavioural effects will happen in all different tax systems, depending on how tax rates are set. So, first off, that figure is not actually additional tax paid, and those behavioural effects are accounted for in the Scottish Fiscal Commission's forecasts each year.

For the purposes of looking at the table in exhibit 3, the analysis that we did says that our assessment of those behavioural responses, which are taken into account each year by the Scottish Fiscal Commission and are included in that figure, is £0.6 billion. When you take into account the adjustment of £2.738 billion that is illustrated in the middle row of the table, £0.6 billion of which is actually behavioural and is already taken into account in the figures that we calculate and use, based on the Scottish Fiscal Commission forecast in our budget—

Jamie Greene: That is a very long answer that has not answered my question. You are using completely different language from that in the Audit Scotland report, but I can only use the language that the Auditor General has used. I appreciate that you are explaining the question.

Alyson Stafford: There are two other elements—

Jamie Greene: Exhibit 3 says that the additional tax paid due to tax policy differences came to £3.367 billion. However, you are saying that that is not additional tax paid due to tax differences. Either you are correct or the Auditor General is correct—I am not sure which.

11:00

Alyson Stafford: I am saying that the figure was not calculated as tax to be paid under any of the policies.

When the Scottish Fiscal Commission does its forecasts, it factors three elements into that middle number: behaviours, distributional differences and residual elements.

Jamie Greene: What do you mean by “behaviours”? I am just getting my head around that. It is not a trick question, by the way; I am just trying to understand the table.

Jonathan Athow: I might be able to help here. The top line is what the extra tax would have been if taxpayers had continued with the same economic activity—no behavioural assessment is made. From what Alyson Stafford said, my understanding is that that figure is what taxpayers would have paid if they had not changed their behaviour but carried on exactly as they did before.

However, with any tax change, people change their behaviour in a variety of ways. They might retire early or take advantage of tax planning and so on. As I understand it, such things are included not in that figure but in the line below.

Alyson Stafford: Exactly. Thank you, Jonathan.

Jamie Greene: That is really helpful.

Alyson Stafford: That is exactly the case when it comes to those behavioural elements, which is why I say that the tax is not actually paid; it is what the potential is, I suppose. I am trying to find another word that links together the different language that is used.

Jamie Greene: That is interesting. Does that not demonstrate, though, that the potential tax income that could have been achieved through divergence is £3.367 billion? That is what the table is sort of saying; it is not saying what was actually paid but what the maximum potential was. The bottom line is that we actually get £0.6 billion in extra revenue from the divergence, which is only 20 per cent of the overall £3.3 billion. I am trying to get my head around where the 80 per cent loss is happening.

Alyson Stafford: The difference around behaviours happens with all tax policies—it is taken into account that there will be a behavioural reaction through tax planning in the way that Jonathan Athow described. Any tax figure that is set out in our budgets in any budget year already takes into account that people will change some of their tax planning if they have the means to do so. The Scottish Fiscal Commission takes that into account.

In the middle row, what is described as “economic performance” is not economic performance alone, because behavioural responses are factored into the number. The SFC takes that into account and says, “We will already have adjusted for that in our forecast.”

When we go into the other elements—

Jamie Greene: Is it not a source of concern to you that 80 per cent of the potential tax take that could be achieved by having a different tax policy in Scotland is being lost to behavioural changes? You mentioned some of them—tax planning and early retirement—

Alyson Stafford: To be specific, £0.6 billion as a proportion of £3.367 billion—

The Convener: What is that as a percentage, roughly? It is not 80 per cent, is it?

Jonathan Athow: No, it is 15 to 20 per cent.

The Convener: So 15 to 20 per cent is due to behavioural factors. The rest is due to things such as the fiscal framework and so on, is it not?

Alyson Stafford: The rest of it is depends on how the block grant is adjusted.

I will work with the cumulative figures, because that is what is on the page. If you put the behavioural factors to one side, convener—and those are accounted for at the outset when budgets are being set—you are absolutely right that that is the point when the block grant adjustment comes in.

Next year, we will raise £20.5 billion from income tax, so the block grant has to be reduced. Because of the fact that we are raising tax in Scotland and have moved away from the old system in which no income tax was raised here, the block grant has to be adjusted. The block grant adjustment will take into account what we call “distributional differences”. I will unpack what that is about.

Distributional differences speak to where there are different sectors in the economy and to the way that the distribution of earners sits across the UK. The rest of the UK has a relatively higher proportion of very high earners. That means that, even if earnings were growing at a broadly similar rate overall in Scotland and in the rest of the UK, we would see some differential and that would have to be taken into account. Those differentials are due to structural differences in the two economies. Some of those structural differences are to do with sectors as well as regions. Let me give you some examples that will illuminate the point a lot more.

The financial services industry operates in Scotland and in the rest of the UK, but the composition of that sector plays out in the distributional differences that are adjusted for in the block grant adjustment. There is a concentration of financial services in London, which means that the rest of the UK raises substantially more of its tax from that sector than in Scotland.

Let me bring out the differences. The very, very high earners are people who work in investment banking, investment management and financial trading. Those sectors have a concentration around London and the south-east. Contrast that with the nature of financial services in Scotland, which has more of an emphasis on pensions and insurance. We still have those service sectors but, as you can tell, the London and the south-east factor, with those very, very high earners with the bonuses that go with that status, starts to bring out a distributional difference in our economy and how that plays out into the block grant adjustment.

Those are some of the key elements in that distributional element.

Jamie Greene: I will interrupt you in the interests of time—it has been a long session already. My questions are about economic performance differentials in Scotland. I am hearing that the economy in London is different from that in Edinburgh. We understand and accept that. We understand that the block grant adjustments alter the amount of money that the Scottish Government gets and that different regions of the UK will have different economic activities. However, I am trying to understand the bigger picture.

Are there issues? Is there, as the Audit Scotland report highlighted, an underwhelming economic performance in Scotland relative to that in the rest of the UK, and does that affect how much money the Scottish Government has to spend? That is the underlying point that I made in the original question. It is not a trick question; I am just using the data that is in front of me.

Let us look at this financial year. The SFC has done some work on the 2025-26 forecast. It estimates that £1.676 billion in additional revenue will be generated through tax divergence in Scotland. That is great and I am sure that the Government will say that it is bringing in extra money. However, the SFC forecasts that it will result in only a net £837 million in cash to the Scottish Government, so that is about half.

Scottish taxpayers are paying more in tax but that is not generating the same amounts of money for the Government to spend on public services as we all want it to do. Is that because of relative economic performance differences between Scotland and the rest of the UK?

Alyson Stafford: The key thing to focus on is earnings growth and the distributional factors. It is not about economic performance per se; it is about the structural distributional differences where there are very high earners.

If you look at how much tax comes from the high earning proportion of taxpayers, it is definitely the case that an even larger proportion of the total tax take that comes from those high taxpayers is for RUK; and it is skewed by the factors in our economy that mean that the very high earners are concentrated in London and the south-east.

Jamie Greene: But we also have high earners, and 0.8 per cent of all Scottish taxpayers pay 18 per cent of all Scottish tax, so we already have a significant, if small, group of people who pay a huge amount of tax. Surely the Government's ambition should not be to increase that.

Alyson Stafford: The 0.8 per cent that you have quoted as a proportion of Scottish income tax payers equates to 1.6 per cent in RUK. That is why I say that there is a structural skewing, and it is to do with sectoral differences.

Earnings growth is an important factor. Earnings are growing faster in Scotland that in the rest of the UK. That is certainly what we have seen in outturn figures for two years in a row.

Part of the issue with the block grant adjustment is that it uses not only the evidence from Scotland and the assessments from the Scottish Fiscal Commission, but evidence from the Office for Budget Responsibility. The Scottish Fiscal Commission has been predicting, projecting and forecasting a faster rate of earnings growth in Scotland. The OBR was predicting that the equivalent growth in the rest of the UK would be much slower, but it is now catching up; the OBR is saying that it is going to be a bit faster. We are therefore seeing the interface of two different forecasters making their assessments at different points in time.

The labelling of this is not the most helpful because it is not about the performance of the economy; it is about those distributional elements, the sectors and the structural nature of the economy. However, even with the OBR restating its numbers, we are seeing much faster earnings growth here in Scotland.

Jamie Greene: Just to be clear, I am not talking about a race to the bottom. I do not want other parts of the UK to perform poorly relative to Scotland just so that we can say we are doing better. I am sure that we all want it to be true that every extra penny that is spent on additional taxes in Scotland creates more opportunity for the Scottish Government to spend money on public services. Surely that has to be a shared ambition.

What we are trying to unearth through these sessions is what is causing that difference. What percentage of every pound of additional tax that is spent achieves a net benefit to the Government? We are trying to unearth some of that.

For example, if we compare Scottish gross domestic product per capita to that in the rest of the UK, we can see that it was consistently lower for a long period of time. Levels of economic inactivity in the working-age population have been higher in Scotland than in other parts of the UK, and the SFC's analysis from last year shows that Scotland's working-age population is growing more slowly than that in the rest of the UK. There are therefore a number of factors. You have picked out a couple in which there have been some improvements and I am happy to hear that, but there are other areas in which there are major factors that mean that we are not achieving the sort of economic performance that we need to make sure that all that tax money comes back to the Scottish Government.

Alyson Stafford: The key thing is that Scotland is continuing to play to its strengths. We have been drawing out the distributional differences, but Scotland has absolutely been playing to its strengths.

You mentioned next year's budget, but work is being done on a range of policies to increase the numbers in employment and to increase the hours or earnings of those who are in employment. We are also making investments in particular areas. We are putting £200 million into the Scottish National Investment Bank to support innovation and attract investment. The investment that is going into offshore wind is almost tripling, and that is an area where Scotland can bring out a differential in economic potential, and that will be important. We continue to invest in enterprise agencies and entrepreneurs. That relates to the point about enabling people to continue to go through the earnings ceilings so that they then pay higher rates.

The other issue is our overall relative competitiveness. Despite the on-going headwinds that we are seeing in the economy globally, we have seen continued improvement in Scotland's inward investment performance. Ernst & Young's annual attractiveness survey shows our performance in the UK and Europe, and it shows that we are securing a 14.4 per cent share of UK foreign direct investment projects, which is more than our proportion of the population suggests that we should secure.

11:15

Jamie Greene: That is good. You mentioned the Fraser of Allander Institute, which does some good independent analysis. I got the impression that the research that you have done on tax divergence seemed to demonstrate that it is having no, or very little, effect on behaviours. Is that the Government's position?

Alyson Stafford: One of the important things that we have not mentioned yet today is that people make choices about where they live beyond whatever happens to be the prevailing tax rate, whether that is a national tax or a local one. It is important for us to log that it is not only about tax.

The most recent migration information shows net positive migration into Scotland across all tax bands. Yes, there was the study that showed the higher rate tax band issue that Mr Simpson mentioned, which was in one year—2018-19. However, the most recent data for every year, including 2021-22, shows that all tax bands have seen net positive migration, and the overall net position is that tax revenues from that have been positive during that period.

There have been some swings and roundabouts, but we will continue to look at the studies. It is important that we do so. That is the reason why the tax strategy said that we have these areas of research interest, which are still relatively new by the time we start to see the outturn data. We need to bear in mind that there is a lag: we are sitting here in April 2025, getting assurances from the National Audit Office about outturn data from 2022-23. We will continue to get that data and we will continue to evaluate it. That is the important message. I would say that that is the Government's position.

Jamie Greene: What is the Government's position on the Fraser of Allander Institute's Scottish business monitor? I presume that you have read that as part of your analysis of tax behaviour. Its last quarterly report, showed that 34 per cent of Scottish businesses reported that tax divergence was having a "fair" or "significant" effect on their business, including on their ability to recruit and retain people, on demands on wage pressures, and on an overall perception of Scotland's competitiveness and inward investment. The number of businesses that felt that was significantly higher in particular sectors. You talked about the financial sector, but let us look at the construction sector, where nearly one third of businesses said that higher taxes had a significant effect on their ability to recruit and retain people in Scotland.

Alyson Stafford: I point to the work that went into the tax strategy. The Government stays alive to and listens to the various contributions that come through, including in particular studies.

The data that you mentioned is experiential. The data that I have referred to today has come from analytical review post-event. When we are shaping policy and giving advice to ministers on tax policies, it is fair to say that the team draws on the full range of data that is available. I assure the committee of that.

The Government has been clear about its progressive tax policies, but at the same time it stays alive to the facts. As you will have seen in *The Times* article at the weekend, the Scottish Government is seen to listen to business to a greater extent than is the case in the rest of the UK, but again, that is subjective.

The key thing is that in the administration of Scottish income tax, in working with HMRC on the correct collection of that and in setting policies for the future, as well as in evaluating the ones that have been put in place, we continue to be vigilant in seeing the evaluation data from whatever the source may be.

Jamie Greene: In the interests of time, this will be my last question. It is for HMRC, which cannot get away lightly from this evidence session.

I turn to page 23 of the Audit General's report. I was struck by a piece of commentary about migration trends and tax policy, and I wonder whether you could comment on it. Paragraph 80 states:

> "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 tax policy."

Surely that is a fundamental flaw in the analysis of tax divergence. How can the Scottish Government make appropriate decisions about tax divergence if it does not know what effect it is having on inward or outward migration?

Jonathan Athow: There are two elements to that. We have looked at more historical data on that, and we have set up a database that will allow us to understand what is happening with migration. The challenge with that is always the question about what would have happened if we had not had the divergence. To use the jargon, you are always estimating the counterfactual of what would otherwise have happened. That can be done analytically, but it is often complex. It was done, as I said, for the 2018-19 study, where net migration was still positive but was lower than it otherwise would have been.

That work can be done, but it does not automatically fall out of our statistics and data—it requires careful analysis. Analysis does not always have to be done by us. People such as the Fraser of Allander Institute are also able to do that analysis, so there is something there.

The Scottish Fiscal Commission assumes an overall taxable income elasticity that includes migration effects, but it has one assumption for all of the behavioural change, whether it relates to migration or other things, when it is making decisions. That is factored in, so you cannot separate it out as an assumption.

Over time, we might get better data that will allow us to do that more effectively, but again, with the lags in the system, it takes time before we can get all that evidence. It will be an area of interesting research. For an external academic, there is a rich source of data to do exactly the sort of analysis that you are talking about.

Jamie Greene: Data is key.

Jonathan Athow: Yes, the data is key.

Jamie Greene: Thank you very much for that answer.

The Convener: Okay. Thanks very much indeed. It has been quite a long session. I thank our four witnesses for their attempts to answer our questions.

We are at a point where you have committed to giving us a bit more information and a bit more of your analysis, as and when those are available, and we very much welcome that. We may need to follow up a little bit more on our conversation about exhibit 3 in the Audit Scotland report—the terminology and what is and is not meant by different rows and columns in that presentation.

There have been some really useful points of discussion this morning, and some things that I think we will want to follow up as a committee.

I echo remarks made by other members of the committee that we very much appreciate that you have paid heed to some of our areas of interest in previous years, particularly, for example, where there has been a failure by employers to properly comply with the S code requirements and what the profile of those employers looks like. We very much encourage you to keep on working on that.

I draw this morning's public session to a close by thanking Alyson Stafford and Lorraine King from the Scottish Government, and Jonathan Athow and Phil Batchelor from HMRC. Thank you very much indeed. We will now move into private session.

11:23

Meeting continued in private until 11:53.

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