Public Audit Committee

4th Meeting, 2022 (Session 6), Thursday 3 February 2022

Administration of Scottish income tax 2020/21

Introduction

1. At its meeting today, the Public Audit Committee will take evidence from the Comptroller and Auditor General (C&AG) and the Auditor General for Scotland (AGS) on the National Audit Office report on the Administration of Scottish income tax 2020-21 and the assurance report from the Auditor General for Scotland.

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. HM Revenue and Customs (HMRC) collects and administers Scottish income tax. HMRC's accounts are audited by the National Audit Office (NAO).

3. The C&AG is required to report to the Scottish Parliament on HMRC's administration of Scottish income tax. His seventh report on Scottish income tax was laid in the Scottish Parliament on 14 January 2022. The report by the Comptroller & Auditor General can be found in **Annexe A.**

4. When the predecessor Public Audit Committee published its report, Framework for auditing Scottish income tax in 2014, the Committee recommended that the AGS should provide additional assurance on the NAO's audit work. The report and briefing paper from the AGS can be found in **Annexe B**.

Clerks to the Committee
31 January 2022

Annexe A

National Audit Office

Administration of Scottish income tax 2020-21

HM Revenue & Customs

REPORT

by the Comptroller and Auditor General

SESSION 2021-22
14 JANUARY 2022
HC 1011

SG/2022/12

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National Audit Office

Administration of Scottish income tax 2020-21

HM Revenue & Customs

Report by the Comptroller and Auditor General

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Gareth Davies
Comptroller and Auditor General
National Audit Office

10 January 2022

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Key facts

2.5m
Scottish taxpayers in 2019-20

£11,833m
Scottish income tax revenue in 2019-20

£12,035m
HM Revenue & Customs' estimate of Scottish income tax revenue in 2020-21

£0.7 million costs of administering Scottish income tax in 2020-21

Summary

Introduction

1 The Scotland Act 2016 gave the Scottish Parliament full power to determine the rates and thresholds (excluding the personal allowance) paid by Scottish taxpayers on all non-savings, non-dividend income from 6 April 2017. The Scottish Government receives all income tax revenue generated from non-savings, non-dividend income under Scottish income tax policy.

2 The Scottish Parliament sets income tax rates in Scotland using the five-band system first introduced in 2018-19. For 2020-21, the tax bands for higher and top rate taxpayers were frozen, with the starting thresholds for basic and intermediate rate taxpayers increasing in line with inflation. The rest of the UK opted to freeze tax rates for all taxpayers, resulting in further divergence between the two tax regimes (see **Figure 1**). The personal tax allowance was £12,500 in both Scotland and the rest of the UK in 2019-20.

Figure 1

Income tax rates and bands in Scotland and the rest of the UK for 2020-21

There are five tax bands in Scotland compared with three in the rest of the UK

	Income tax rates in Scotland		Income tax rates in the rest of the UK	
Band	**Taxable income**	**Tax rate**	**Taxable income**	**Tax rate**
	(£)	(%)	(£)	(%)
Personal allowance	Up to 12,500	0	Up to 12,500	0
Starter rate	12,501 to 14,585	19	–	–
Basic rate	14,586 to 25,158	20	12,501 to 50,000	20
Intermediate rate	25,159 to 43,430	21	–	–
Higher rate	43,431 to 150,000	41	50,001 to 150,000	40
Top rate[2]	More than 150,000	46	More than 150,000	45

Notes

1 A taxpayer's personal allowance is reduced by £1 for every £2 of net income above £100,000.

2 This is known as the Additional Rate in the rest of the UK.

Source: HM Revenue & Customs, *Income Tax rates and Personal Allowances*, available at: www.gov.uk/income-tax-rates/previous-tax-years, accessed November 2021; and HM Revenue & Customs, *Income Tax in Scotland*, www.gov.uk/scottish-income-tax/2020-to-2021-tax-year, accessed November 2021

3 HM Revenue & Customs (HMRC) administers and collects Scottish income tax as part of the UK tax system. HMRC identifies taxpayers resident in Scotland by applying a 'flag' in its systems that indicates they are subject to Scottish income tax rates and thresholds. HM Treasury is responsible for paying Scottish income tax to the Scottish Government.

4 Following the end of each tax year, HMRC produces a provisional estimate of Scottish income tax revenue for that year. The final outturn is calculated the following year once HMRC receives further information from taxpayers and employers. This report covers the final outturn for 2019-20 and the provisional outturn for 2020-21. HMRC expects to publish the outturn for 2020-21 in its 2021-22 Annual Report and Accounts.

5 Section 80HA of the Scotland Act 1998, as amended by the Finance Act 2014 and the Scotland Act 2016, requires the Comptroller and Auditor General (C&AG) to prepare a report for each financial year on:

- the adequacy of HMRC's rules and procedures, in consequence of the Scottish rate provisions, to ensure the proper assessment and collection of income tax charged at rates determined by those provisions;
- whether these rules and procedures are being complied with;
- the correctness of sums brought to account by HMRC relating to income tax attributable to a Scottish rate resolution; and
- the accuracy and fairness of amounts reimbursed to HMRC as administrative expenses.

6 This report considers:

- HMRC's calculation of the 2019-20 income tax revenue for Scotland, the 'outturn', and assurance on the correctness of amounts brought to account (Part One);
- HMRC's estimate of the 2020-21 income tax revenue for Scotland and our view on the estimate methodology (Part One);
- key controls operated by HMRC to assess and collect income tax (Part Two);
- HMRC's approach to assessing and mitigating the risk of non-compliance with Scottish tax requirements (Part Two); and
- the cost of administering Scottish income tax. We provide assurance on the accuracy and fairness of these amounts in the context of costs incurred by HMRC (Part Three).

7 Appendix One sets out our audit approach and methodology.

Key findings

Scottish income tax 2019-20 final outturn and 2020-21 estimate

8 **HMRC calculated the final outturn for 2019-20 as £11,833 million, representing amounts collected under Scottish income tax policy.** HMRC's estimate of 2019-20 Scottish income tax revenue, published in September 2020, was £11,703 million, meaning the actual outturn was £130 million higher than HMRC had originally estimated. We examined the methodology for the calculation of the actual outturn, which necessarily includes some remaining areas of estimation. In these areas, we have evaluated the basis of HMRC's estimate including the relevant assumptions and the available data. Based on that audit work, we have concluded that the Scottish income tax revenue outturn for 2019-20 is fairly stated (paragraphs 1.2 to 1.17).

9 **HMRC has estimated Scottish income tax revenue for 2020-21 as £12,035 million.** This represents an increase of £202 million (1.7%) against the 2019-20 outturn. Despite the impact of public health restrictions arising from the COVID-19 pandemic on the economy and HMRC compliance activity, income tax revenues remained stable because growth in wages and salaries was stronger than anticipated. HMRC expects to calculate the finalised 2020-21 income tax outturn attributable to Scotland in 2022. The estimate HMRC produces is solely for financial reporting purposes in its annual accounts and does not affect the amount of revenue ultimately received by the Scottish Government (paragraphs 1.18 to 1.23).

10 **The impact of COVID-19 on both the economy and individual taxpayers increases the level of uncertainty in HMRC's estimate of Scottish income tax revenue in 2020-21.** HMRC identified the collectability of tax revenues as the key source of uncertainty and took account of this as part of its normal calibration to outturn adjustment. We consider the approach adopted by HMRC to estimating the impact of COVID-19 on Scottish income tax revenue in 2020-21 to be reasonable (paragraph 1.24).

Administration of Scottish income tax

11 **HMRC has adequate rules and procedures in place to ensure the proper assessment and collection of Scottish income tax and those rules are being complied with.** Our work on Scottish income tax matters builds on our wider assessment of HMRC's rules and procedures, completed as part of our annual audit of HMRC. As part of that audit, we concluded that HMRC framed adequate regulations and procedures to secure an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out (paragraphs 2.2 to 2.14).

12 **Maintaining an accurate and complete record of the addresses of Scottish taxpayers to correctly determine residency remains the key challenge in administering the system.** HMRC relies on taxpayers notifying it of a change of address, although there is no legal requirement for them to do so. We found that there had been an increase in the number of missing Scottish postcodes identified by HMRC's address-cleansing work, with 23,351 identified compared with 13,708 when we last reported. This continues to represent less than 1% of the overall taxpayer population, with HMRC having investigated and updated all identified cases where individuals were either employed or receiving a pension (paragraphs 2.15 to 2.24).

13 **HMRC continues to assess as 'low' the risk of non-compliance as a result of divergence between Scottish income tax and the rest of the UK.** In 2020-21, HMRC produced a Scottish Strategic Picture of Risk (SPR). It considers the main areas of risk to Scottish income tax to be the same as those compliance risks which are tackled at the whole-of-UK level. There are no risks identified in the Scotland SPR specific to Scotland (paragraphs 2.25 and 2.37).

14 **The tax regimes in Scotland and the rest of the UK diverged further in 2020-21.** The most significant change in income tax paid by Scottish taxpayers is for those earning around £150,000, which now differs from the UK by 6.3% compared with 5.1% the previous year. As in previous years, Scottish income tax diverges the most from the rest of the UK for those earning around £50,000. HMRC continues to assess the risk of a Scottish taxpayer manipulating their address to minimise their tax liability. HMRC has not identified any significant or widespread instances of taxpayers changing their address to obtain a tax advantage (paragraphs 2.34 to 2.38).

15 **HMRC calculated a compliance yield of £270 million relating to Scotland for 2019-20, the most recent data available.** HMRC measures the effectiveness of its enforcement and compliance activities through compliance yield: its estimate of the additional revenues that HMRC considers it has generated, and the revenue losses it has prevented. HMRC also estimates Scotland's share of net losses was £800 million. These figures are calculated based on a proportion of the UK figure, rather than using Scotland-specific data to quantify the risks. HMRC does not consider geographical variations in the level of compliance risk, or the relative success of compliance activity in Scotland compared with the rest of the UK (paragraphs 2.26 to 2.28).

16 **HMRC has limited performance data available about its compliance activities in Scotland.** Unlike its income tax system which flags residents as Scottish, HMRC's compliance system cannot readily identify people living in Scotland. HMRC therefore cannot easily track and monitor compliance activity in Scotland and this affects its ability to collect performance data about the extent of Scottish non-compliance (paragraph 2.29).

17 **COVID-19 has continued to have an impact on HMRC's compliance and debt management activities.** Across the UK, there were 29% fewer civil compliance cases opened and 26% fewer cases closed in 2020-21 than in 2019-20, which reduces the level of tax receipts that HMRC has collected through its compliance activities. Our recent report *Managing tax debt through the pandemic* found that the debt balance for income tax across the UK increased from £11 billion at the end of 2019-20 to more than £16 billion at the end of 2020-21. An analysis of income tax debt attributable to Scotland is not currently available (paragraphs 2.30 to 2.33).

Costs

18 **In 2020-21 HMRC incurred and recharged £0.7 million of costs to the Scottish Government for the cost of administering Scottish income tax.** We examined HMRC's method for estimating the costs of collecting and administering Scottish income tax for the year ended 31 March 2021. Based on our audit work, we have concluded that the amount paid by the Scottish Government was accurate and fair in the context of the agreement between HMRC and the Scottish Government. The 2020-21 costs were lower than in previous years, largely because 2020-21 is the first year since income tax powers were devolved to Scotland that expenditure relates exclusively to operating costs with no costs for implementing the Scottish Income Tax Project being incurred. In 2019-20 HMRC recharged costs of £1.5 million, comprising £0.9 million of operating costs and £0.6 million of implementation costs (paragraphs 3.3 to 3.5 and Figure 10).

Part One

Income tax collected from Scottish taxpayers

1.1 Part One of this report covers HM Revenue & Customs' (HMRC's) calculation of the final revenue outturn for Scottish income tax in 2019-20 and its provisional estimate of Scottish income tax revenue for 2020-21. This includes:

- our assessment of HMRC's Scottish income tax outturn calculation for 2019-20, including data limitations and HMRC's judgements in areas of uncertainty; and
- our views on HMRC's estimate of Scottish income tax revenue for 2020-21 and the features and limitations of HMRC's methodology.

The Scottish income tax 2019-20 final outturn

1.2 HMRC's calculation of the outturn for Scottish income tax revenue for 2019-20 is £11,833 million (**Figure 2**). HMRC calculates the final outturn figure from several components, which are aggregated to produce the total Scottish income tax liability for 2019-20. Each component is calculated using one or more sources of data to extract total Scottish income tax liability.

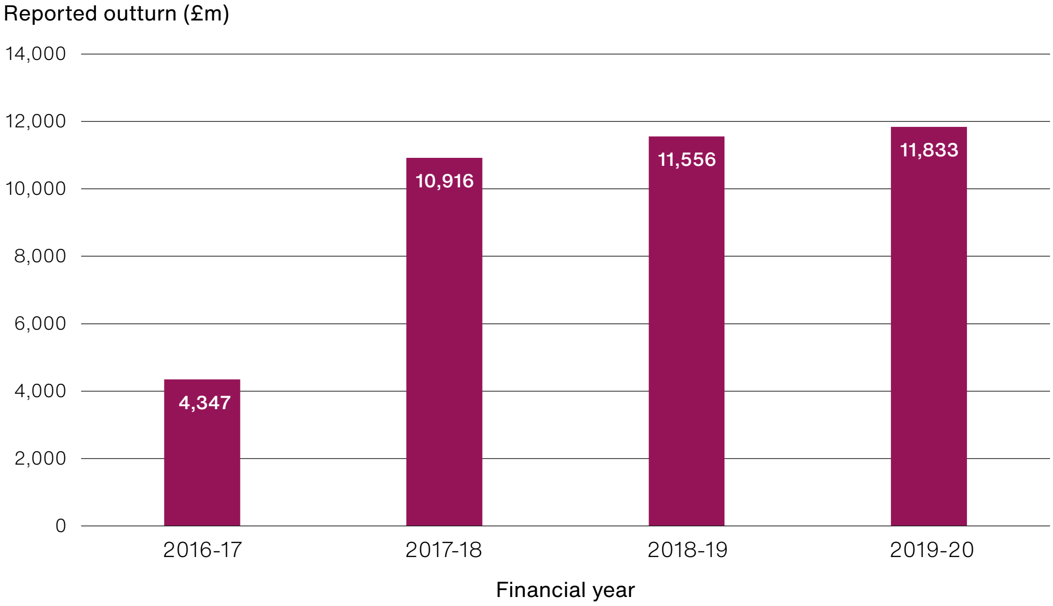
1.3 Figure 2 shows how the outturn for Scottish income tax has changed over time. The calculated outturn for 2019-20 represents an increase of 2.4% compared to 2018-19. This is broadly in line with the rest of the UK, which saw an increase in the total amount of non-savings, non-dividend income tax of 2.3%.[1] HMRC's estimate of 2019-20 Scottish income tax revenue, published in September 2020, was £11,703 million, meaning the actual outturn was £130 million higher than HMRC had originally estimated.

1.4 The outturn calculation is largely based on established tax liabilities, some £11,983 million, where HMRC has finalised the tax owed and fully reconciled the taxpayer records.[2] The established liabilities are calculated from the final tax liability data extracted from the Pay As You Earn (PAYE) and Self Assessment income tax systems.

1 HM Revenue & Customs, *Scottish Income Tax Outturn Statistics: 2019 to 2020*, July 2021.
2 See Figure 5 for details of HMRC's reconciliations process.

Figure 2
Reported outturn for Scottish income tax revenue, 2016-17 to 2019-20

Scottish income tax revenue has been relatively stable since 2017-18, when changes made following the Scotland Act 2016 came into effect[1]



Note

1 The outturn for 2016-17 is substantially lower than subsequent years due to a change in the legislation governing Scottish income tax rates. The Scotland Act 2016 gave the Scottish Parliament full power to determine the rates and thresholds (excluding the personal allowance) paid by Scottish taxpayers on all non-savings, non-dividend income from 6 April 2017. Prior to this the Scottish Government could only set a proportion of the overall tax rate.

Source: National Audit Office summary of HM Revenue & Customs information

1.5 Adjustments or estimates are made where tax due has not yet been finalised, or where HMRC must estimate the Scottish share of uncollectable amounts or tax reliefs. The reduction in Scottish income tax outturn arising from these adjustments was £150 million (net) (**Figure 3** overleaf). In some areas of the calculation, data are not available in sufficient detail to identify income tax liabilities, reliefs or other adjustments relating to individual taxpayers. HMRC estimated the Scottish share of these balances by using other available data, such as population and income data, to apportion the balance between Scotland and the rest of the UK.

1.6 The methodology used to calculate the 2019-20 outturn for Scottish income tax was discussed by HMRC and the Scottish Government at the Scottish Income Tax Board in February 2021 and formal agreement was received from the Scottish Government in May 2021. The methodology used to calculate the outturn has remained broadly the same since the prior year.

Figure 3

HM Revenue & Customs' (HMRC's) calculation of the 2019-20 Scottish income tax revenue outturn

The majority of the outturn is based on established liabilities with a small proportion estimated by HMRC

	Amounts based on established taxpayer liabilities	Amounts based on estimated liabilities and adjustments	Total	Prior year total
	(£m)	(£m)	(£m)	(£m)
Self Assessment established liabilities[1]	5,142	(93)	5,049	4,954
PAYE established liabilities[1]	6,841	4	6,845	6,587
Estimated further liabilities[2]	–	307	307	366
Deductions from revenue[3]	–	(368)	(368)	(350)
Total	**11,983**	**(150)**	**11,833**	**11,556**

Notes

1 Self Assessment and Pay As You Earn (PAYE) established tax liabilities are based primarily on the tax liability data held by HMRC, although some amounts are based on estimates as well.

2 This is HMRC's estimate of PAYE tax liabilities that have not yet been finalised and where tax liabilities are expected from future Self Assessment returns or compliance activity.

3 Deductions from revenue include tax relief on pension contributions and Gift Aid.

4 Totals do not sum due to rounding.

Source: HM Revenue & Customs, *Annual Report and Accounts 2020-21*, HC 696, November 2021; HM Revenue & Customs, *Scottish Income Tax Outturn Statistics: 2019 to 2020*, July 2021; and National Audit Office analysis of HM Revenue & Customs data

1.7 We examined the methodology for the outturn calculation, which necessarily includes some remaining areas of estimation. In these areas, we evaluated the basis for HMRC's estimate including relevant assumptions and available data. Based on our procedures, we conclude the Scottish income tax revenue outturn for 2019-20 is fairly stated. The key components of the calculation of outturn are described in more detail below.

Self Assessment established liability

1.8 The Self Assessment established liability of £5,142 million represents the calculation of all income tax attributable to Scotland from Scottish Self Assessment taxpayers in 2019-20. The calculation of Self Assessment liabilities is mainly based on the extraction of Scottish taxpayer data from HMRC's systems but with some apportionment of other balances.

1.9 HMRC identifies Scottish taxpayers using a 'Scottish indicator flag' in its Computerised Environment for Self Assessment (CESA) system. It can identify total Scottish income tax liabilities by extracting Scottish taxpayer records from CESA. HMRC has also made minor adjustments to apportion Scotland's share of other relevant Self Assessment balances where specific data are not available.[3]

PAYE established liability

1.10 The PAYE established liability of £6,845 million represents the sum of all income tax attributable to Scotland from Scottish PAYE taxpayers in 2019-20. While most PAYE liabilities are based on extracting Scottish taxpayer data from HMRC's systems, some apportionment of other smaller elements is required.

1.11 Under PAYE, employers submit data monthly to HMRC on the earnings and tax deductions made for their employees and this information is recorded in HMRC's National Insurance and PAYE Service (NPS) system. HMRC identifies Scottish taxpayers in the NPS using a residency indicator based on taxpayer postcode information. By extracting Scottish taxpayer records from the NPS, HMRC can identify the total Scottish income tax liabilities. HMRC deducts an estimate of the Scottish share of tax reliefs given against PAYE liabilities.

1.12 An adjustment is made to apportion the tax collected from employers under PAYE settlement agreements.[4] The Scottish share calculated for 2019-20 was £32 million. As tax liabilities are settled through one payment for the employer, the identity of individual taxpayers is not recorded and therefore HMRC undertakes an analysis of employer submissions to determine the Scottish proportion of UK-wide settlement agreement revenue. PAYE settlement agreement returns from employers were not all received in line with the expected timetable due to the COVID-19 pandemic. HMRC estimated the value of agreements due based on historical trends and the agreements already in place with employers.

3 This includes an estimate of £24 million from manually entered liabilities and assessments, which do not provide a split of the liability between taxes. It also includes sensitive records, which are not accessed by HMRC to calculate Scottish income tax. An estimate of £117 million deducted for the Scottish share of tax reliefs claimed through Self Assessment was also made.

4 A PAYE settlement agreement allows employers to make one annual payment to cover all tax due on minor, irregular or impracticable expenses or benefits for employees in the scheme.

Estimated further liabilities

1.13 Most Self Assessment liabilities for 2019-20 are established prior to calculating the outturn. Nevertheless, HMRC knows from past years that Self Assessment tax liabilities will continue to be established and collected for up to six years afterwards. This is because HMRC continues to receive additional information from taxpayers and through its compliance activity. The estimated additional liability for these elements is calculated based on past performance and is valued at £298 million in the 2019-20 outturn. An estimated adjustment of £9 million is also made in relation to further PAYE liabilities that have not yet been determined, such as where year-end totals or information about benefits-in-kind received by the taxpayer is still outstanding.

Deductions from revenue

1.14 HMRC makes a series of deductions from the outturn revenue, recognising that not all taxpayer liabilities will be collected in practice. It uses historical information to calculate these deductions and apportions an amount for Scottish taxpayers.

1.15 Some PAYE and Self Assessment income tax liabilities are never settled because either employers or taxpayers fail to pay the full amounts due. HMRC has analysed historical data for all the UK to determine patterns of uncollected liabilities and then apportioned an amount relating to Scottish taxpayers. This was calculated to be £89 million for 2019-20.

1.16 Further deductions are made for pension contributions and Gift Aid, both of which attract income tax relief at the taxpayer's marginal rate of income tax. Pension scheme administrators claim tax relief at the basic rate from HMRC on behalf of their scheme members, while charities claim tax relief at the basic rate from HMRC on behalf of their donors. HMRC calculated both deductions by estimating the Scottish share of each tax relief claimed across the UK using historical data. The Gift Aid deduction was calculated to be £108 million for 2019-20 and pension contributions £172 million.

Impact of the COVID-19 pandemic on the revenue outturn

1.17 HMRC undertook specific work to consider the impact of COVID-19 on the outturn for 2019-20 and identified the collectability of tax revenues as the key risk. HMRC undertook less compliance activity in 2020-21 and therefore recorded fewer losses, which it does not think is representative of future years. HMRC accounted for this in the calculation of the outturn by using 2019-20 rather than 2020-21 collection data because it deemed that this was a better proxy for likely collection rates in the future. More information on the impact of COVID-19 on HMRC's compliance activities can be found at paragraphs 2.30 to 2.33.

The Scottish income tax estimate for 2020-21

1.18 HMRC estimates it will collect £12,035 million of Scottish income tax revenue relating to the 2020-21 year.[5] This represents an increase of £202 million (1.7%) against the 2019-20 outturn. Despite the impact of public health restrictions arising from COVID-19, income tax revenues in both Scotland and the rest of the UK performed better than expected because growth in wages and salaries was stronger than anticipated. The final outturn for the 2020-21 year is expected to be published in HMRC's 2021-22 Annual Report and Accounts. The estimate produced by HMRC is solely for financial reporting purposes in its annual accounts and does not affect the amount of revenue ultimately received by the Scottish Government.

1.19 HMRC's methodology to estimate Scottish income tax revenue for 2020-21 is based on taxpayer data from 2018-19, extracted from its Survey of Personal Incomes. Scotland's percentage share of the overall UK income tax liability is determined through analysing data in a model replicating the UK income tax system known as the Personal Tax Model. The data are adjusted to reflect demographic and policy changes that are expected or known to have taken place between 2018-19 and 2020-21. The share is then applied to the total UK tax liability to produce an estimate of revenue for Scottish income tax (**Figure 4** overleaf).

1.20 HMRC's current methodology for estimating Scottish income tax revenue is consistent with the Office for Budget Responsibility's methodology to forecast income tax receipts for both Scotland and the whole of the UK. The methodology is largely consistent with that used to calculate the 2019-20 estimate.

1.21 HMRC made a 'calibration' adjustment to the revenue estimate because its methodology has historically resulted in actual outturn being lower than estimated outturn. HMRC made this adjustment by comparing the 2019-20 outturn with a revised estimate of 2019-20 revenue using the same methodology but with the most recent assumptions and data. The impact of the calibration adjustment reduced the 2020-21 provisional estimate by £0.6 billion (4.5%) (see Figure 4).

1.22 The calibration adjustment is subject to the following limitations:

- It assumes the 2020-21 over-estimation would be consistent with the over-estimation observed in 2019-20 in percentage terms.
- The causes of the over-estimate in 2019-20 are not fully understood and any socioeconomic factors contributing to it may be different in 2020-21.

5 HM Revenue & Customs, *Annual Report and Accounts 2020-21*, HC 696, November 2021.

Figure 4

Method for calculating the Scottish 2020-21 income tax revenue estimate

The revenue estimate relies upon sample data and an apportionment of UK-wide estimates to calculate a Scottish share of income tax revenue

Survey of Personal Incomes

HM Revenue & Customs (HMRC) collected data from a 1.5% sample of UK taxpayers in 2018-19.[1]

→

Personal Tax Model

HMRC calculated the percentage share of UK income tax that related to Scottish taxpayers to be 6.90%.

→

Adjusted Scottish share

HMRC adjusted the percentage share to reflect changes to population, earnings and tax legislation since the Survey of Personal Incomes.

This resulted in a revised Scottish share of 6.93%.

→

Total UK income tax liability 2020-21

HMRC combined Self Assessment liabilities[2] with PAYE receipts to calculate the total liability[3] for the UK of £182.8 billion.

→

Total Scottish income tax liability 2020-21

HMRC applied the previously calculated Scottish share to the total income tax liability. The estimate of Scottish income tax calculated was £12.6 billion.[4]

→

Calibrated 2020-21 Scottish Revenue Estimate

HMRC calculated a calibration adjustment of 4.5% to reflect that historically the actual outturn has been lower than the initially estimated amount from this methodology. The calibrated estimate is £12.0 billion.

Notes

1 HMRC's annual Survey of Personal Incomes is a sample of UK taxpayers' data from the Pay As You Earn (PAYE) and Self Assessment tax systems. The Personal Tax Model (PTM) projects the outcome for income tax liabilities in 2020-21, adjusting for differing rates of population growth and economic factors such as wage increases, to calculate the Scottish share.

2 Non-savings, non-dividend income only.

3 PAYE data come from HMRC's Real-Time Information system. Self Assessment data come from HMRC's Self Assessment Model.

4 HMRC applied the previously calculated Scottish share to the total income tax liability before Gift Aid, and then removed the estimated share of Scottish Gift Aid along with other much smaller adjustments.

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

1.23 Our review concluded that HMRC's approach is reasonable. However, the limitations we described in previous reports relating to HMRC's methodology for estimating Scottish income tax revenue remain relevant for 2020-21:

- The use of sample data introduces sampling uncertainty into the revenue estimate from which the Scottish portion is calculated as a percentage.
- The methodology combines the calculation of PAYE and Self Assessment liabilities for the UK such that the amount apportioned to Scotland does not reflect the differing proportions of each type of taxpayer between Scotland and the rest of the UK.
- The data used for PAYE include all income types and do not exclude tax from savings and dividend income.
- An assumption must be made around the volume and value of under- and over-payments relating to PAYE liabilities.

1.24 The impact of COVID-19 on both the economy and individual taxpayers increases the level of uncertainty in HMRC's estimate of Scottish income tax revenue. HMRC identified the collectability of tax revenues as the key source of uncertainty and took account of this as part of its normal calibration to outturn adjustment. We consider the approach adopted by HMRC to be reasonable.

Part Two

Administering Scottish income tax

2.1 This part of the report covers:

- HM Revenue & Customs' (HMRC's) key processes to administer the income tax system and our approach to obtaining assurance on them (paragraphs 2.5 to 2.14);
- HMRC's procedures to identify and maintain a complete and accurate record of the Scottish taxpayer population (paragraphs 2.15 to 2.24); and
- HMRC's activity to identify and respond to compliance risks (paragraphs 2.25 to 2.38).

2.2 HMRC uses the same systems to administer income tax whether it is received from a taxpayer in Scotland or the rest of the UK. However, HMRC also operates additional rules and procedures for Scotland, and we assess these below. This reflects HMRC's responsibility to administer income tax for Scottish taxpayers in the same way as the service provided elsewhere in the UK.

2.3 Under Section 2 of the Exchequer and Audit Departments Act 1921, the Comptroller and Auditor General (C&AG) must consider the adequacy of HMRC's systems to assess and collect tax in the UK, including income tax. Each year we publish a report (the Standard Report) alongside HMRC's Annual Report and Accounts setting out the C&AG's conclusions in this respect. Our 2020-21 Standard Report concluded that HMRC had framed adequate regulations and procedures to secure an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out.

2.4 To support the conclusions of this report, we extend our UK-wide testing to address divergences due to devolution. We also undertake specific procedures looking at HMRC's address-cleansing and wider tax compliance activities. These inform our assessment of the completeness and accuracy of HMRC's Scottish income tax estimates. To reach our conclusions, we examine several elements of devolved tax administration, such as the ongoing maintenance of Scottish taxpayer records, and how devolved tax compliance risks were identified and responded to.

The income tax system

2.5 HMRC's system to collect income tax is consistent across the UK. Depending on the type of income an individual receives, income tax is assessed and collected by employers deducting earnings through Pay As You Earn (PAYE), by the taxpayer submitting a Self Assessment return, or both.

2.6 The PAYE and Self Assessment processes share common principles, despite using different IT systems and data sources to assess and collect tax. **Figure 5** overleaf identifies these principles and describes the main processes for each income tax stream.

Assurance of income tax processing

2.7 Our annual audit work programme on HMRC includes procedures providing assurance over key tax processing controls. These controls are broadly divided into two categories:

- Automated system controls around data-handling, storage and processing.
- Key business controls that have a high level of automation but are complex.

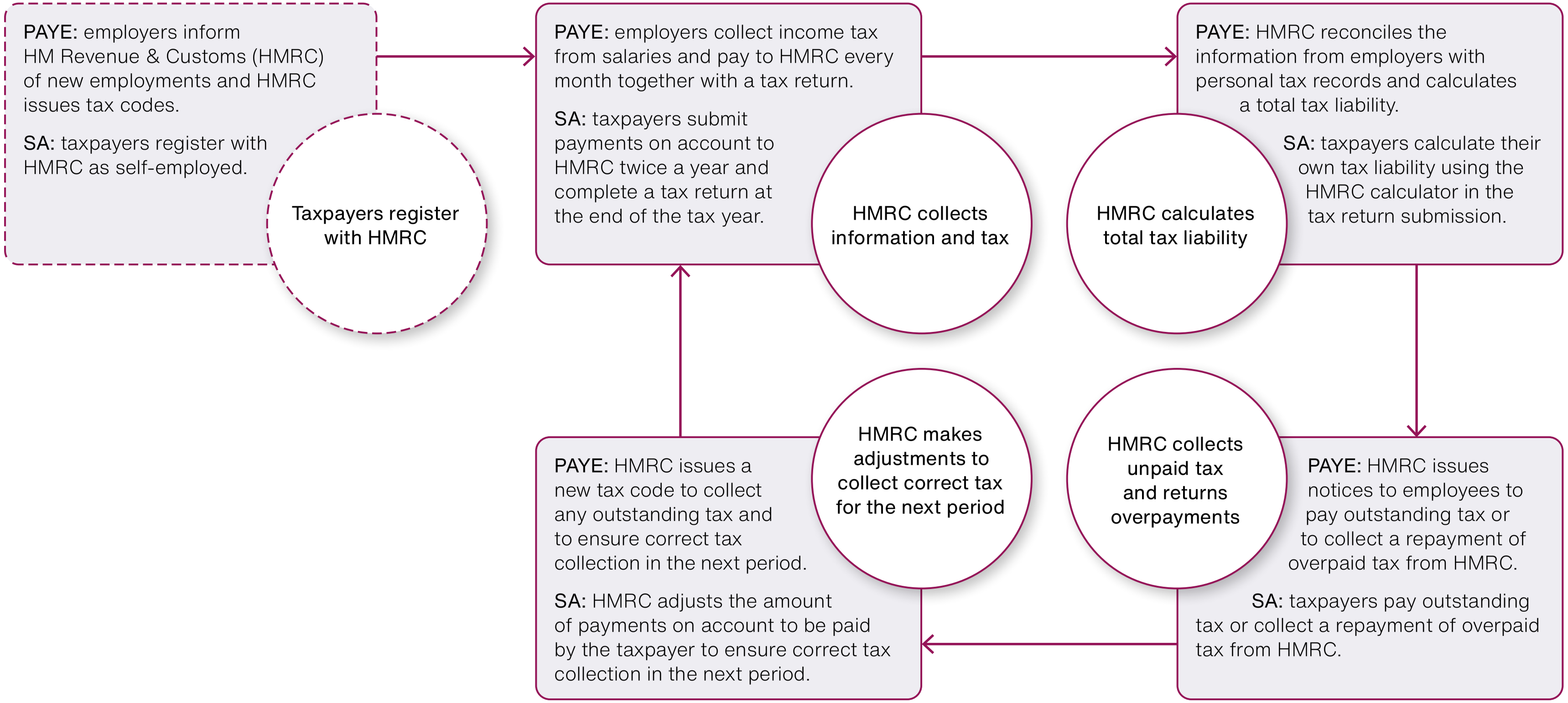
2.8 Following annual updates to business rules to reflect changing tax rates, thresholds and allowances for the UK and devolved administrations, HMRC completes several phases of assurance testing on key business controls to confirm system functionality. We evaluate the scope of this testing and re-perform elements to confirm HMRC's conclusions as part of our audit. The key processes in PAYE include annual:

- reconciling of PAYE taxpayers to confirm tax due on earnings and calculate any over- or under-payments of tax based on country of residence; and
- issuing of tax codes to PAYE taxpayers which incorporate residency information to ensure employers deduct tax under the tax rules of the correct country.

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

Figure 5
The UK income tax system

The Pay As You Earn (PAYE) and Self Assessment (SA) processes share common principles in the assessment and collection of income tax



Notes

1 PAYE and Self Assessment do not occur simultaneously. PAYE is processed during the tax year and reconciled after the tax year ends. Self Assessment returns are not submitted until the January following the end of the tax year.

2 After the tax year ends, HMRC's PAYE reconciliation process calculates the income tax liability for each taxpayer using all available data. The calculated liability is compared with amounts deducted at source or collected from taxpayers directly to determine whether the correct tax has been collected.

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

Devolved income tax

2.10 The main differences in administering devolved taxes, when compared with UK processes, are the business rules the system applies when completing tax liability and tax code calculations. There have been no significant changes to system rules since our last report covering 2019-20. The rules applied for Scottish taxpayers are as follows:

- The system checks the individual's residency status and applies the 'S' tax code prefix where they are identified as a Scottish resident. This instructs employers to collect tax under Scottish tax rates. Where an individual is no longer resident in Scotland, the 'S' prefix is removed.
- Where an individual is identified as a Scottish resident, Scottish tax rates and bands are applied to the reported income when calculating the liability for the current tax year.
- If an individual has been identified as a Scottish resident and is enrolled on a PAYE scheme, the system uses Scottish income tax rates and thresholds to calculate a new tax code for the following year.

2.11 Self Assessment returns include a check box for the taxpayer to state whether they resided in Scotland or Wales. If this contradicts HMRC's records, HMRC uses the address it holds to calculate the taxpayer's tax liability. Taxpayers are notified of the discrepancy and asked to update their address if required. **Figure 6** overleaf shows where these divergences occur within the income tax system.

Tax relief on pension contributions

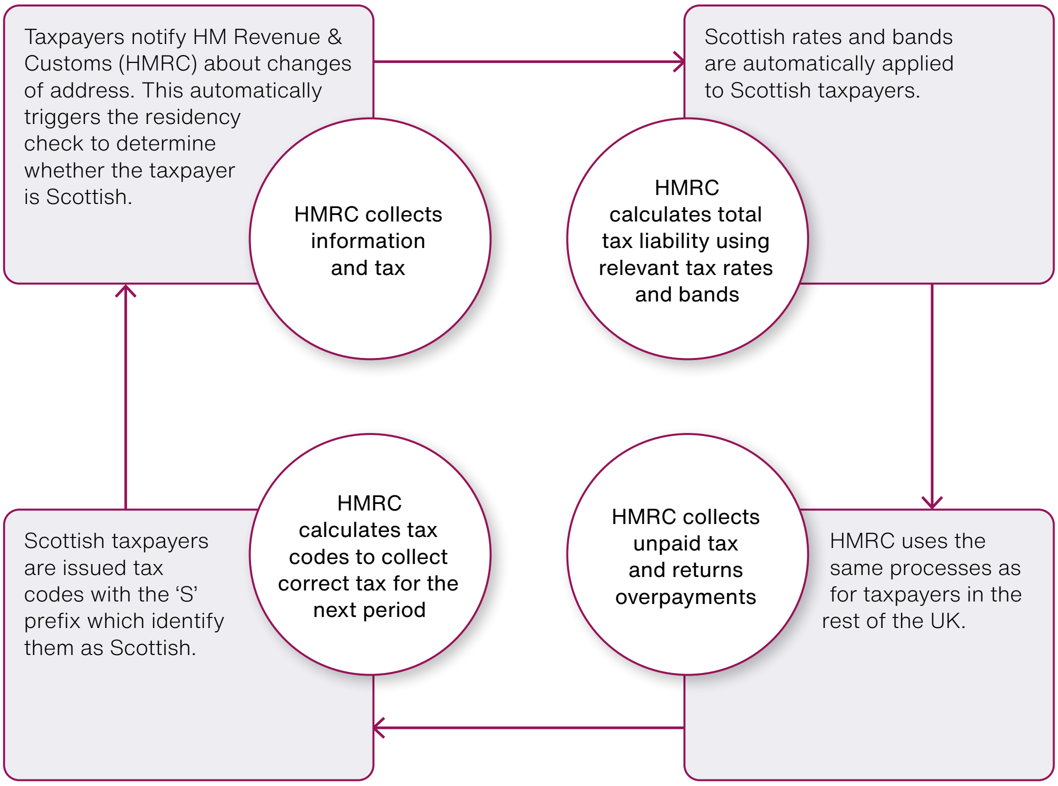
2.12 Scottish taxpayers must be identified within pension schemes so that tax relief is correctly allocated. Pension administrators claim tax relief at source on behalf of their members and add this to their members' contributions. HMRC's Relief at Source (RAS) system automatically confirms the residency status of pension scheme members to ensure the correct relief is applied at source. It applies tax relief on pension contributions at the basic rate of 20% for all taxpayers. Scottish taxpayers paying a tax rate above 20% can claim the remaining tax relief through a Self Assessment return or by contacting HMRC.

2.13 To administer relief at source, HMRC requires all pension providers to submit an annual report listing their members' contributions during the previous tax year. HMRC's systems automatically trace scheme members and match them against addresses held to identify Scottish taxpayers. An Annual Notification of Residency Report is then issued to all pension providers. HMRC confirmed the residency status for 92% of Scottish and Welsh pension scheme members following the 2019-20 tax year and provisionally estimates that 94% have been confirmed following the 2020-21 tax year. Following the 2019-20 tax year, HMRC issued Annual Notification of Residency Reports to pension scheme providers in January 2021.

Figure 6

Divergences in the income tax system for Scottish taxpayers

The business rules are configured to process income tax using the rates and thresholds applicable to a taxpayer's residency status



Source: National Audit Office review of HM Revenues & Customs processes

Tax relief on Gift Aid contributions

2.14 Tax relief on Gift Aid contributions in Scotland is provided at the UK basic rate of 20%. This is because HMRC does not have systems in place to establish the residency of taxpayers donating to charity. All taxpayers paying tax above the basic rate can claim the difference between their tax rate and the basic rate on their donation. Where donations are made by Scottish taxpayers, the correct rate of relief is applied when HMRC is notified of the donated amount either through a request to amend a tax code or via a Self Assessment return.

Scottish taxpayer population

2.15 HMRC has calculated there were 2.5 million Scottish taxpayers in 2019-20.[6] A Scottish taxpayer is someone with a tax liability whose main place of residence during the tax year is Scotland. Scottish parliamentarians are also deemed Scottish taxpayers. Higher-rate and top rate taxpayers accounted for around 15% of the Scottish income tax population in 2019-20 and contributed more than 60% of tax paid. Starter-rate and basic rate taxpayers accounted for more than half of the population (51%) and provided around 11% of tax paid (**Figure 7** overleaf).

2.16 Maintaining accurate and complete records of the Scottish taxpayer population continues to be the main challenge for HMRC in administering Scottish income tax. HMRC has many information sources for changes of address but relies primarily on taxpayers informing it of such changes on a timely basis, although taxpayers are not legally required to do this. HMRC also obtains address information from other sources such as employers, although it is not mandatory for employers to provide updates when their employees' addresses change.

2.17 Address information must be correct to ensure the right amount of tax is collected from individuals and allocated to the appropriate government. HMRC has several assurance processes in place to maintain the completeness and accuracy of the address data it uses to identify Scottish taxpayers (**Figure 8** on page 25).

Postcode scans

2.18 HMRC scans taxpayer records to identify missing or invalid postcodes which would result in an incorrect residency status being applied. The most recent scan performed in September 2020 identified 23,351 missing postcodes, of which 3,914 were updated. This compares with 13,708 missing postcodes when we last reported, of which 1,391 were subsequently updated. Numbers of missing postcodes increased over the previous year but still represent a very small proportion (less than 1%) of the 2.5 million Scottish income tax payer population. HMRC investigates and updates identified cases where individuals were either employed or receiving a pension. Cases not updated are identified as dormant because they have no current taxable income.

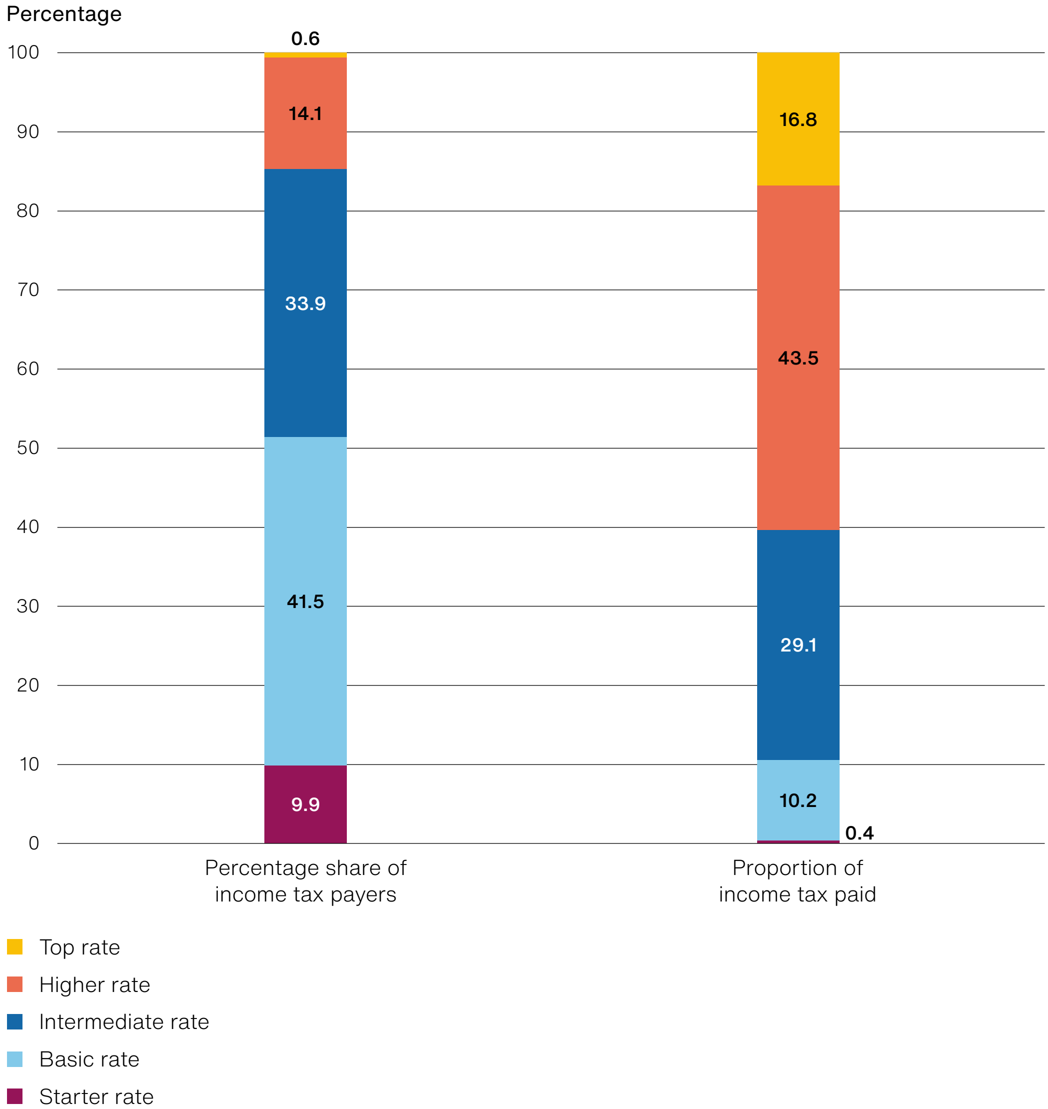
The administration of Scottish tax codes

2.19 Where an employer does not apply the 'S' prefix to an employee's tax code, they will deduct tax at the UK rate. HMRC reconciles what each taxpayer has paid in tax against what it thinks they should have paid at the end of the tax year. HMRC then uses this finalised information and the residency status held on its systems to calculate the tax liability each taxpayer should pay. The outturn for Scotland is, therefore, unaffected where the 'S' prefix in an individual's tax code is not correctly applied by an employer.

6 HM Revenue & Customs, *Scottish Income Tax Outturn Statistics: 2019 to 2020*, July 2021.

Figure 7
Proportion of income tax payers and income tax paid by band in Scotland, 2019-20

Higher-rate and top rate income tax payers accounted for 15% of the population and contributed around 60% of income tax paid



Note

1 2019-20 is the latest year for which data are available.

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

Figure 8
Assurance over the Scottish taxpayer population

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

Assurance activity	Purpose	Results
Controls ensuring Scottish residency is correctly determined using the address held by HMRC		
New postcodes	Comparison of HMRC's list of Scottish postcodes with Office for National Statistics (ONS) data to ensure postcodes are up to date.	Postcode data are received quarterly from the ONS. There were 1,264 new postcodes added in 2020-21.
Address cleansing	Scans of taxpayer records held by HMRC to identify missing or invalid postcodes which would result in an incorrect residency status being applied.	Scans undertaken in September 2020 identified 23,351 missing postcodes. Of these, 3,914 cases were updated because they had a record of current employment or pension. The remaining records were not updated because no employment was listed. HMRC also identified 37,862 invalid postcodes and updated 5,515 taxpayer records where there was a record of current employment or pension.[1]
Cross-border postcodes	HMRC's systems flag address changes where new addresses lie in a postcode that crosses the England-Scotland border. HMRC reviews these cases to ensure the correct residency is determined.	This process has been in place since October 2019. In 2020-21, 29 cross-border cases were reviewed, of which 11 were amended following investigation.
Missing residency flags	Scans to identify Scottish taxpayer records that are not flagged as such in the system.	Scans undertaken during 2020 identified 8,254 cases, all of which were updated.
Controls monitoring the operation of Pay As You Earn (PAYE) by employers		
Tax code comparison scans	A comparison between tax codes in PAYE submissions with HMRC's taxpayer record to identify cases where the employer is applying a different tax code to HMRC.	In March 2021 there were 39,364 cases identified where 'S' prefixes were not correctly applied to tax codes.[2]
Controls to identify incorrect addresses held by HMRC		
Third-party data comparison	A comparison of taxpayer address records held by HMRC with third-party data sources to identify cases where HMRC records are inconsistent with third-party data. The exercise is HMRC's main source of assurance over the accuracy of its address records.	HMRC and the Scottish Government previously agreed in October 2020 to run this exercise every two years and the most recent one was completed in June 2021. The data have not yet been analysed by HMRC and we will assess the results in our 2021-22 report.
High net worth individuals	HMRC performs checks and procedures to review the movements of high net worth individuals and ensure their addresses are up to date.	

Notes

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

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

Source: National Audit Office summary of HM Revenue & Customs activities

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

2.21 Each month, HMRC compares tax codes in PAYE submissions with its own taxpayer record to identify cases where employers are using a different tax code. The number of cases where the correct ‘S’ prefix was not being operated varies across the year. In May 2020, HMRC identified 31,478 Scottish taxpayer records (1.3% of cases) where employers were not operating a tax code with an ‘S’ prefix. In March 2021, there were 39,364 cases (1.2% of cases). We noted in previous reports that HMRC has not set a target as to how low the number of missing ‘S’ prefixes would be before it considers its compliance activity has been successful.

2.22 When HMRC identifies an employer is not using the correct tax code, it issues a P6 notification to the employer asking them to update the employee’s tax code. HMRC carries out work targeting employers making persistent errors and works with them to implement the correct tax code. HMRC were unable to tell us how many employers are repeatedly using the incorrect tax code.

Scottish parliamentarians

2.23 Scottish parliamentarians are automatically deemed as Scottish taxpayers in any tax year they are in office. This applies to the 129 elected members of the Scottish Parliament (MSPs) and the 59 members of Parliament in Westminster representing a constituency in Scotland.

2.24 Records for Scottish parliamentarians are not processed using normal business rules. HMRC previously used a manual process to identify these records and ensure they were recorded as Scottish taxpayers regardless of residency. This required employers or parliamentarians themselves to provide the required information to HMRC and was completed annually. System changes designed to remove the need to annually update parliamentarians’ records were introduced in August 2020. HMRC told us that it did not identify any issues in relation to Scottish parliamentarians’ tax during 2020-21.

Compliance risk assessment and planning

2.25 HMRC applies the same risk-based compliance approach to collect income tax in Scotland as it does in the rest of the UK. This approach involves:

- **promoting** compliance by designing processes to encourage and help customers get things right first time;
- **preventing** non-compliance through process design and customer insight and providing an opportunity to correct mistakes; and
- **responding**, investigating and correcting compliance risks using tailored activity when intervention is needed.

2.26 As part of its Service Level Agreement with the Scottish Government, HMRC produces an annual Scottish Strategic Picture of Risk (SPR) to assess and plan for compliance risks applicable to Scotland. For the Scottish SPR, HMRC considers key compliance risks at the overall UK level and applies a value to represent the Scottish proportion of these risks. This value is in line with Scotland's share of UK income tax in the Scottish Income Tax Outturn Statistics. As with previous years, HMRC has not identified any significant risks specific to Scotland and considers the main risks to Scottish income tax are the same as for the whole of the UK. These risks include:

- evasion, where individuals or businesses deliberately omit, conceal or misrepresent information to reduce their tax liabilities;
- the hidden economy, where taxable income is not declared or where declared income is deliberately understated; and
- tax avoidance, where tax rules are exploited to gain a tax advantage that Parliament never intended.

2.27 HMRC measures the effectiveness of its enforcement and compliance activities through compliance yield, its estimate of the additional revenues it considers it has generated and the losses it has prevented. HMRC estimates a compliance yield of £270 million in 2019-20 for the risks in the SPR relating to Scotland. It also estimates Scotland's share of net losses from these risks was £800 million. HMRC does not consider geographical variation between Scotland and the rest of the UK when assessing compliance risk or the relative success of compliance activity.

2.28 The tax gap is the difference between the amount of tax that should be paid and what is actually paid. HMRC does not currently produce a Scotland-specific tax gap. In response to a letter from the Convenor of the Public Audit and Post-legislative Scrutiny Committee, HMRC noted that calculating a Scotland-specific tax gap would be difficult due to methodological reasons, including the increased burden on taxpayers who would be selected for further enquiry, the additional HMRC resource which would need to be deployed, and the loss of Exchequer revenue associated with redeployment of compliance staff away from yield-bearing work.[7]

2.29 HMRC has limited information on specific compliance activity undertaken in Scotland. It told us that information about numbers of active compliance cases could be commissioned but would require interrogating separate information systems. Unlike the income tax system, which can flag Scottish residents, HMRC's compliance system cannot readily identify people living in Scotland as the systems are based around risk, not individuals. It is therefore challenging for HMRC to collect useful performance data about the extent of Scottish non-compliance.

Impact of COVID-19 on HMRC's compliance activity and debt management

2.30 The impact of the COVID-19 pandemic, and HMRC's response to it, affected its core compliance activity in 2020-21 and will reduce the level of tax receipts that HMRC has collected through its compliance activities. Across the UK, there were 29% fewer civil compliance cases opened and 26% fewer cases closed in 2020-21 than in 2019-20, partly due to:

- HMRC's ability to visit its customers was limited because many of its staff were required to work from home, there were travel and social distancing restrictions and many businesses were not operating;
- some staff were reallocated from compliance work to support other COVID-19 measures during the year; and
- HMRC said it carried out its compliance activity in a way that recognised the needs and challenges that businesses and individuals were facing.

2.31 Our Standard Report on the HM Revenue & Customs 2020-21 Accounts includes further detail on the impact of COVID-19 on compliance activity and HMRC's work more generally.

7 Letter from HMRC to the Public Audit and Post-legislative Scrutiny Committee of the Scottish Parliament, on 12 March 2021, titled *Impact of Covid-19 on estimate and outturn*. URL: https://archive2021.parliament.scot/S5_Public_Audit/General%20Documents/2103112_Ruth_Stanier_to_PAPLS_Committee.pdf

2.32 Our report *Managing tax debt through the pandemic* provides detail on how HMRC changed its debt management work in response to the pandemic.[8] HMRC's management of tax debt will affect how much income tax that is initially unpaid is subsequently collected across the UK, including in Scotland.

2.33 In responding to the pandemic, HMRC paused most of its debt collection activity and created new employment support schemes to provide grants to employers and self-employed people to help protect jobs. We found that the debt balances for both PAYE and Self Assessment income tax were higher in 2020-21 than they were before the pandemic, and while both balances were reducing by March 2021, they had not fallen to pre-pandemic levels. The combined debt balance for PAYE and Self Assessment income tax at the whole-of-UK level was almost £11 billion at the end of 2019-20 and more than £16 billion by the end of 2020-21. An analysis of income tax debt attributable to Scotland is not currently available.[9]

Divergence between Scottish and rest-of-UK income tax rates

2.34 In 2020-21, the tax regimes in Scotland and the rest of the UK diverged further (**Figure 9** overleaf). As reported previously, Scottish income tax diverges the most from the rest of the UK for those earning around £50,000. Compared with 2019-20, the most significant change in income tax paid by Scottish taxpayers is for those earning around £150,000, which now differs from the UK by 6.3% compared with 5.1% the previous year.

2.35 Increased divergence means the potential risk remains that taxpayers subject to higher Scottish rates could manipulate their residency status to reduce their tax liability. This could include failure to notify HMRC of address changes or deliberately manipulating address information. HMRC considers the risk of these behaviours is very low compared with the overall risk of non-compliance across the UK, such as efforts to avoid or reduce liabilities altogether.

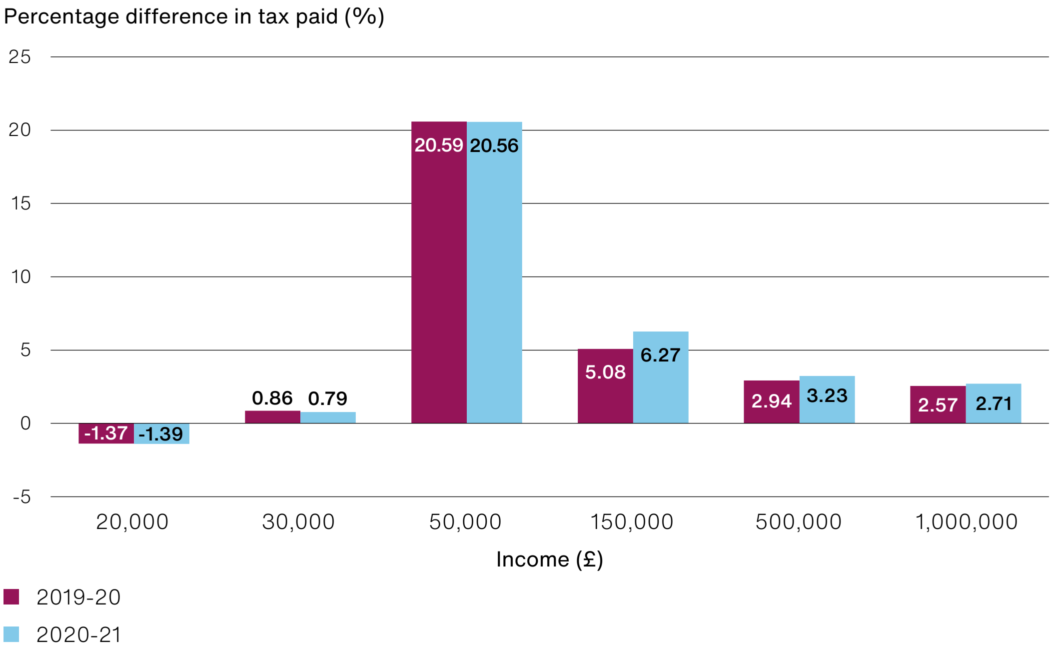
8 Comptroller and Auditor General, *Managing tax debt through the pandemic*, Session 2021-22, HC 799, National Audit Office, November 2021.

9 In January 2020, before the pandemic had affected tax debt, the UK debt balance for PAYE income tax debt was just below £4 billion; by April 2020 it had increased to £10 billion and continued to increase, reaching almost £13 billion in May, but by March 2021 it had reduced to around £8 billion. UK Self Assessment income tax increased from £4 billion in January 2020 to £5 billion at the start of 2020-21; it continued to increase to around £12 billion in August, then began reducing and was around £8 billion by March 2021 (all values are reported in 2021-22 prices).

Figure 9

Differences in the tax liability between taxpayers in Scotland and the rest of the UK

Compared with 2019-20, income tax liabilities have changed the most for Scottish taxpayers earning above £150,000, although overall divergence with the rest of the UK remains greatest for taxpayers earning around £50,000



	2020-21				2019-20
Income	UK income tax	Scottish income tax	Difference compared to UK income tax	Difference compared to UK income tax	Difference between Scottish and UK income tax in 2019-20
(£)	(£)	(£)	(£)	(%)	(%)
20,000	1,500	1,479	-21	-1.4	-1.4
30,000	3,500	3,528	28	0.8	0.9
50,000	7,500	9,042	1,542	20.6	20.6
150,000	52,500	55,792	3,292	6.3	5.1
500,000	210,000	216,792	6,792	3.2	2.9
1,000,000	435,000	446,792	11,792	2.7	2.6

Note

1 These figures assume a taxpayer has a full personal allowance and only had non-savings, non-dividend income during the year. It does not include any other allowance or reliefs.

Source: National Audit Office analysis of income tax rates and bands in Scotland and the UK for 2019-20 and 2020-21

2.36 HMRC has not identified any significant or widespread instances of taxpayers changing their address to obtain a tax advantage. HMRC has several ways to identify compliance risk:

- HMRC periodically compares its address records with those of third-party data sources. If the number of discrepancies increase, this may indicate taxpayers are not updating HMRC with address changes, either through error or deliberately.
- Each month, HMRC compares PAYE submissions with its own records to identify cases where employers are not correctly applying ‘S’ prefixes to tax codes for Scottish residents. If the number of incorrect ‘S’ codes vary from HMRC’s expectations, this could suggest wider compliance issues.
- HMRC monitors cross-border migration trends. This work began in 2019 and initially relied on HMRC’s core address assurance work, such as postcode scans. HMRC’s more recent work in this area suggests around 1% of cross-border movements merited further scrutiny after initial review.

2.37 HMRC began work in 2020 looking into Scottish taxpayer liabilities and behaviour in response to Scottish income tax changes introduced in 2018 to 2019. The analysis from this work was published in December 2021. Behavioural analysis will become increasingly important to support HMRC’s assessment of compliance risk if tax rates and bands continue to diverge. We will review the findings of HMRC’s work in our 2021-22 report.

2.38 Having completed our additional work on devolved tax issues, we are satisfied HMRC has adequate rules and procedures in place to assess and collect Scottish income tax and that these are being complied with.

Part Three

Costs

3.1 This part considers the administrative costs of Scottish income tax and whether they are reasonable.

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

3.3 A supporting framework sets out the principles for identifying net additional costs. HMRC recharges costs that can be validated as specifically related to administering devolved Scottish income tax powers and not the costs of administering the overall income tax system in Scotland.

Costs incurred in 2020-21

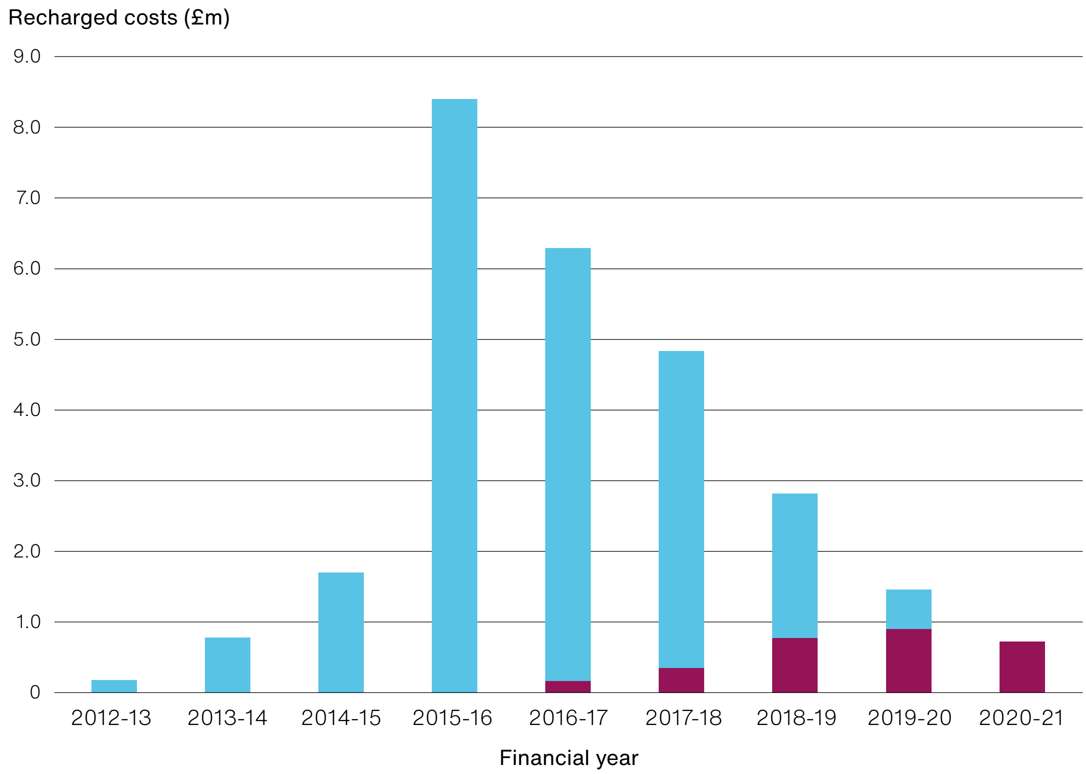
3.4 HMRC invoiced the Scottish Government for £0.7 million of costs relating to the administration of Scottish income tax in 2020-21. The 2020-21 costs were lower than in previous years, largely because 2020-21 is the first year since income tax powers were devolved to Scotland that expenditure relates exclusively to operating costs with no costs for implementing the Scottish Income Tax Project being incurred. In 2019-20 HMRC recharged costs of £1.5 million, comprising £0.9 million of operating costs and £0.6 million of implementation costs (**Figure 10**).

3.5 We examined HMRC's method for estimating the costs to collect and administer Scottish income tax for the year ended 31 March 2021. Based on our audit work, we concluded the amount paid by the Scottish Government was accurate and fair in the context of the agreement between HMRC and the Scottish Government.

Figure 10

Actual spending on Scottish income tax projects from 2012-13 to 2020-21

Spending during the 2020-21 financial year relates solely to operating costs



	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Operating costs	0.0	0.0	0.0	0.0	0.2	0.4	0.8	0.9	0.7
Implementation costs	0.2	0.8	1.7	8.4	6.1	4.5	2.0	0.6	0.0

Note

1 Figures may not sum due to rounding.

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

Appendix One

Our audit approach

1 Section 80HA of the Scotland Act 1998, as amended by the Finance Act 2014, requires the Comptroller and Auditor General (C&AG) to prepare a report for each financial year on:

- the adequacy of any of HM Revenue & Customs' (HMRC's) rules and procedures put in place, in consequence of the Scottish rate provisions, for the purpose of ensuring the proper assessment and collection of income tax charged at rates determined under those provisions;
- whether these rules and procedures are being complied with;
- the correctness of the sums brought to account by HMRC which relate to income tax which is attributable to a Scottish rate resolution; and
- the accuracy and fairness of the amounts which are reimbursed to HMRC as administrative expenses.

2 To reach the conclusions of this report relating to the rules and procedures operated by HMRC, we drew directly from our statutory audit work on HMRC's Annual Report and Accounts, including the C&AG's report on HMRC's controls for the proper assessment, collection and allocation of tax under Section 2 of the Exchequer and Audit Departments Act 1921. We also completed specific audit procedures over controls relevant to administering devolved taxes.

3 We audited the data, methodologies, assumptions and mechanics of the calculation for the revenue outturn for 2019-20 and the revenue estimate for 2020-21, and which are described in this report. For the estimate, and where appropriate for the outturn, this work was planned and completed by applying principles set out in International Standards on Auditing (UK) 540 Auditing Accounting Estimates and Related Disclosures, to design audit procedures relevant to the nature of the estimates and to a sufficient level of precision.

4 In relation to administration costs, our conclusion on the accuracy and fairness of the costs HMRC charged to the Scottish Government is based upon evaluating costs against the details of the Service Level Agreement and supporting framework for costs agreed between both parties. HMRC estimated some of the incurred costs from available data on customer contacts and staff time. During the audit, we saw evidence that both parties regularly discuss and review cost budgets and forecasts as well as agreeing any amounts to be invoiced and paid.

5 All of these audit procedures were planned, performed and reviewed in accordance with our internal quality control procedures for financial audit.

6 To evaluate HMRC's approach to compliance risk, we reviewed published and unpublished HMRC documents about Scottish income tax including project documentation, risk, and compliance documentation and details of key assurance work performed by HMRC.

7 This document review was supplemented by semi-structured interviews with HMRC staff in several areas of its business. We also spoke to the Scottish Government and Audit Scotland to inform our risk assessment and planning for this report.

8 We reached our findings following analysis of evidence collected between May and November 2021.

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BRIEFING PAPER BY THE AUDITOR GENERAL FOR SCOTLAND

Administration of Scottish income tax 2020/21

1. The Auditor General's report the Administration of Scottish Income Tax 2020/21 was published on 14 January 2022.

2. From 2017/18 onwards, Scottish income tax, collected by HM Revenue and Customs (HMRC) in Scotland is paid to the Scottish Government. HMRC's accounts are audited by the National Audit Office (NAO) and the Comptroller and Auditor General (C&AG) issued his opinion on the 2020/21 HMRC Accounts in November 2021. The C&AG is also required to report to the Scottish Parliament on HMRC's administration of Scottish income tax by 31 January of the financial year after the one to which the report relates.

3. Since 2014, in response to a recommendation by the predecessor Public Audit Committee, the Auditor General for Scotland has produced an annual report to provide additional assurance on the NAO's audit work on Scottish income tax. This is the seventh annual report.

4. The Public Audit Committee's report Framework for auditing the Scottish rate of income tax set out what audit information the Scottish Parliament can expect to receive to enable it to undertake its accountability role in relation to Scottish income tax. In relation to Audit Scotland, the Committee recommended that:

   - Audit Scotland provides additional assurance on the NAO's audit of HMRC and Scottish income tax. The Committee also recommended that Audit Scotland works with the NAO on its future priorities for any performance audit work on the Scottish income tax.

   - the joint working relationship between the Comptroller and Auditor General and the Auditor General for Scotland should be set out in a memorandum of understanding.

   - Audit Scotland reports annually on its assurance work in relation to Scottish income tax.

5. Audit Scotland's review was carried out in accordance with the memorandum of understanding agreed between myself and the Comptroller and Auditor General. This describes our respective powers and responsibilities and sets out a framework for collaborative working.

6. My report also considers the impact of tax outturns on the Scottish Government's budget. The difference between actual UK and Scottish tax outturns for 2019/20 and the amounts forecasted at the time is adjusted through the 2022/23 budget.

This is known as a budget reconciliation. The reconciliation for the 2019/20 outturns results in a reduction to the 2022/23 budget of £34 million.

7. Key messages from the report are:

- The National Audit Office's approach to providing assurance over Scottish income tax is reasonable and covers the key audit risks. The Scottish income tax outturn for 2019/20 is £11.833 billion, with Covid-19 having no substantial effect on HMRC's estimate of uncollectable revenue. The impact of the required reconciliation to the 2022/23 Scottish budget arising from this outturn is a reduction to the budget of £34 million.

- HMRC's provisional estimate of Scottish income tax for 2020/21 is £12.035 billion, which is within one per cent of the Scottish Fiscal Commission's most recent forecast for the year. The Scottish Government and HMRC should keep the outturn estimation methodologies under review as more data becomes available to ensure they are as accurate as possible.

- Given the continuing economic implications of Covid-19 and differences between Scottish and UK tax policies, the Scottish Government and HMRC should keep governance and assurance arrangements under continual review. This includes ongoing consideration of the frequency of third-party data checks and Service Level Agreement performance measures, such as setting compliance target levels for Scottish taxpayers without 'S' prefixes.

- HMRC and the Scottish Government have recently published analysis of taxpayer behaviour in response to tax policy divergence. Further analysis of taxpayer behaviour, along with the relative success of compliance activity in Scotland and the Scotland-specific tax gap would help the Scottish Government to assess whether any Scottish income tax compliance risks are emerging.

Annexe B

Administration of Scottish income tax 2020/21

AUDITOR GENERAL

Prepared by Audit Scotland
January 2022

Contents

Introduction

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

2. HMRC's accounts are audited by the National Audit Office (NAO) and the Comptroller and Auditor General (C&AG) issued his opinion on the 2020/21 HMRC Accounts in November 2021. The C&AG is also required to report to the Scottish Parliament on HMRC's administration of Scottish income tax by 31 January of the financial year after the one to which the report relates.[1]

3. In 2014, the predecessor Public Audit Committee of the Scottish Parliament recommended that I should provide additional assurance on the NAO's audit work on Scottish income tax.[2] I make this report to the Public Audit Committee in response to that recommendation.

Key messages

- The National Audit Office's approach to providing assurance over Scottish income tax is reasonable and covers the key audit risks.
- The Scottish income tax outturn for 2019/20 is £11.833 billion, with Covid-19 having no substantial effect on HMRC's estimate of uncollectable revenue. The impact of the required reconciliation to the 2022/23 Scottish budget arising from this outturn is a reduction to the budget of £34 million.
- HMRC's provisional estimate of Scottish income tax for 2020/21 is £12.035 billion, which is within one per cent of the Scottish Fiscal Commission's most recent forecast for the year. The Scottish Government and HMRC should keep the outturn estimation methodologies under review as more data becomes available to ensure they are as accurate as possible.
- Given the continuing economic implications of Covid-19 and differences between Scottish and UK tax policies, the Scottish Government and HMRC should keep governance and assurance arrangements under continual review. This includes ongoing consideration of the frequency of third-party

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

[2] 1st Report, 2014 (Session 4): Framework for auditing the Scottish rate of income tax, Public Audit Committee, 2014.

data checks and Service Level Agreement performance measures, such as setting compliance target levels for Scottish taxpayers without 'S' prefixes.

- HMRC and the Scottish Government have recently published analysis of taxpayer behaviour in response to tax policy divergence. Further analysis of taxpayer behaviour, along with the relative success of compliance activity in Scotland and the Scotland-specific tax gap would help the Scottish Government to assess whether any Scottish income tax compliance risks are emerging.

Background

4. In 2018/19 two new Scottish income tax bands were introduced:

- The starter rate (19 per cent) and the intermediate rate (21 per cent) either side of the basic rate (20 per cent).
- The higher and additional rates of tax were also increased by one per cent for Scottish taxpayers; increasing from 40 per cent and 45 per cent to 41 per cent and 46 per cent respectively.

5. The Scottish Government has not made any further changes to tax bands. In 2019/20, the higher rate threshold for the rest of the UK (rUK) rose from £46,350 to £50,000 but remained unchanged for Scotland at £43,430. In 2019/20, the Scottish Government increased by the rate of inflation the income thresholds for the starter, basic and intermediate tax bands, while rUK income threshold for the basic rate tax band was also increased by inflation. In 2020/21, the income thresholds for the basic and intermediate tax bands were increased by inflation, while there were no further changes for rUK.

6. Total Scottish income tax revenues rose by 2.4 per cent between 2018/19 and 2019/20 compared to an increase of 2.3 per cent in NSND income tax revenues across the rest of the UK.[3]

7. HMRC collects and administers Scottish income on behalf of the Scottish Government tax as part of the UK's overall income tax system. This includes separately identifying the amounts that relate to Scottish taxpayers. The Scottish Government is responsible for:

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

[3] Scottish Income Tax Outturn Statistics: 2019 to 2020, HM Revenue & Customs, July 2021.

8. The amount of Scottish income tax collected each year is identified separately in HMRC's annual accounts. HMRC's annual accounts for 2020/21 were published in November 2021. This report relates to 2020/21, including the final outturn calculation of Scottish income tax for the 2019/20 tax year.

9. The NAO's 2020/21 report gives assurance over 2019/20 outturns. Some adjustments for Covid-19 have been made to the outturn for the 2019/20 financial year to reflect the impact of Covid-19 on HMRC's compliance and collection activity in 2020/21. This is the first year that outturn adjustments to account for Covid-19 have been made.

10. The report also covers the estimated outturn for 2020/21. While Scottish income tax revenues for 2020/21 will be affected by the pandemic, these estimates do not affect the Scottish budget.

Audit and assurance

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

12. The C&AG made his seventh annual report to the Scottish Parliament on 14 January 2022. His report relates to 2020/21 and considers:

- HMRC's calculation of the 2019/20 income tax revenue attributable to Scotland and provides assurance on the correctness of the amounts brought to account
- HMRC's estimation of the 2020/21 income tax revenue attributable to Scotland and his view on the methodology used to estimate the amount
- key controls operated by HMRC to assess and collect Scottish income tax
- HMRC's approach to assessing and mitigating the risk of non-compliance with Scottish tax requirements
- the cost of administering Scottish income tax and provides assurance on whether the amounts are accurate and fair in the context of the costs incurred by HMRC.

13. Audit Scotland considered:

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

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

Correctness of the sums brought to account

15. HMRC's 2020/21 Annual Report and Accounts included Scottish income tax outturn figures relating to the 2019/20 year. Scottish income tax in 2019/20 was £11.833 billion.[4]

16. For the 2020/21 tax year, HMRC provided a provisional estimate that Scottish income tax revenue will be £12.035 billion. HMRC will publish the final Scottish income tax outturn for 2020/21 in its 2021/22 accounts, and an adjustment will be made to the 2023/24 Scottish Budget. The impact of tax outturns on the Scottish budget is explained in further detail at the end of this report.

2019/20 final outturn

17. The C&AG has concluded that Scottish income tax revenue outturn for 2019/20 is fairly stated.

18. The 2019/20 outturn calculation of £11.833 billion is largely based on established tax liabilities, after the tax owed has been finalised and the taxpayer records have been reconciled. The remainder is based on estimated liabilities. Estimation is required in some areas of the calculation because the income tax liability data is not available to identify the Scottish share of individual income tax liabilities, reliefs or other adjustments at the point the outturn is calculated.

19. The net effect of these estimation adjustments is to reduce the Scottish income tax outturn arising by £150 million (1.3 per cent of the outturn). The methodology used to arrive at these adjustments was agreed between the Scottish Government and HMRC at the Scottish Income Tax Board in February 2021. The C&AG notes that this methodology has remained broadly the same since the prior year.

The impact of Covid-19 on 2019/20 outturns

20. Lockdown measures in Scotland began on 23 March, near the end of the 2019/20 year. The C&AG states that HMRC identified the collectability of income tax as the key risk to the 2019/20 tax outturn. I note that for Scottish income tax, most of the outturn is based on tax already collected by the end of March 2021.

21. Estimated liabilities (amounts still expected from 2019/20 taxes but not yet received) includes a deduction for taxes that may never be collected. HMRC's calculation of this deduction is not based on the latest 2020/21 collection data, because HMRC undertook less compliance activity in 2020/21 due to Covid-19. Instead, HMRC used 2019/20 collection data.

[4] Administration of Scottish income tax 2020–21, National Audit Office, January 2022.

22. The overall estimate of uncollectable revenue deducted by HMRC from the 2019/20 outturn was £89 million. This is similar to the figure deducted from the 2018/19 outturn for uncollectable amounts, meaning that Covid-19 has not resulted in any substantial change to the overall collectability deductions to the Scottish outturn in 2019/20.

2020/21 provisional estimate

23. Since 2018/19 HMRC's provisional estimate methodology is based on data from its Survey of Personal Incomes (SPI). HMRC compares this amount to the liabilities from the latest Scottish income tax outturns and adjusts its estimate accordingly. HMRC performs this calibration because, to date, actual tax outturns have been lower than what the SPI data alone estimates. The C&AG notes that the methodology is largely consistent with that used to calculate last year's 2019/20 estimate.

24. HMRC identified the collectability of tax revenues as the key source of uncertainty arising from the impact of Covid-19 in 2020/21 and took account of this as part of its normal calibration adjustment. The 2020/21 calibration adjustment incorporates the 2019/20 final outturn, which already accounts for the estimated impact of Covid-19. This means that there is no separately identifiable estimate for Covid-19 impairments in 2020/21.

25. The C&AG concludes that HMRC's approach is reasonable, but outlines the continuing limitations described in previous reports in relation to using SPI data. The C&AG also concludes that the impact of Covid-19 on both the economy and individual taxpayers increases the level of uncertainty in HMRC's estimate of Scottish income tax revenue.

26. The 2020/21 calibration adjustment reduced the provisional estimate by £0.6 billion (4.5 per cent) to £12.035 billion. This compares to a reduction of £0.3 billion (2.3 per cent) applied to the 2019/20 provisional estimate last year. The risks to the budget caused by increasing uncertainty, complexity and volatility have never been higher, and it will be challenging to match spending to the available funding in the coming years. In my view, it is important that the Scottish Government and HMRC keep the estimation methodologies under review as more data becomes available to ensure they are as accurate as possible. However, I note that the Scottish Fiscal Commission's most recent forecast for 2020/21 of £11.938 billion is within one per cent of HMRC's provisional estimate.

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

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

28. The administration of Scottish income tax is governed by a Service Level Agreement (SLA) between HMRC and the Scottish Government.[5] This is updated every year to reflect HMRC's planned work. The SLA sets out the requirements and performance measures for the operation of Scottish income tax. HMRC shares the results of assurance exercises and compliance activities with the Scottish Government throughout the year and publishes an annual summary of its performance against the requirements.[6]

29. The Scottish Income Tax Board meets quarterly as part of its annual cycle of governance and discusses the performance of HMRC procedures on Scottish taxpayer checks, PAYE (Pay As You Earn) reconciliations and compliance plans. The Scottish Government has told us this provides it with a high level of assurance over HMRC's administration of Scottish income tax.

30. Given the economic implications of Covid-19 and differences between Scottish and UK tax policies, it will be important to keep performance against the SLA and governance arrangements under continual review.

Scottish Tax Base

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

32. The C&AG reports that HMRC carries out several assurance activities to maintain the completeness and accuracy of the Scottish taxpayer population. This includes a series of checks on HMRC's records of Scottish taxpayers.

33. The Scottish Government and HMRC agreed in October 2020 that third-party data checks (where taxpayer address records held by HMRC are compared with third-party data sources) should be run every two years. The C&AG states that the latest third-party data check was undertaken in June 2021, but the data has not yet been analysed and does not form part of assurance work for 2019/20. The C&AG will report on his findings in its 2021/22 report next year.

34. The latest analysed third-party data check took place in November 2019. The C&AG reported its findings in last year's report. I highlighted last year that the check suggested HMRC's record of Scottish taxpayers was 98-99 per cent accurate. In my view, given the continued volatility caused by Covid-19, the Scottish Government and HMRC should keep the frequency of these checks under review. If the June 2021 data check demonstrates changes in accuracy of records, parties should consider if more frequent checks or further actions are required.

35. Checks undertaken in year include a variety of postcode checks to confirm correct residency, comparing PAYE submissions with HMRC records to confirm

[5] HM Revenue & Customs, Service level agreement for operation of Scottish Income Tax by HMRC, 26 June 2019.
[6] Scottish Income Tax HMRC Annual Report 2021, HMRC, December 2021.

the 'S' code is correctly applied, and checks and procedures for high-net-worth individuals.

36. I note that there has been an increase in the number of missing postcodes identified, from 13,708 in July 2019 to 23,351 in September 2020. 3,914 cases were subsequently updated because they had a record of current employment or pension, compared to 1,391 in the prior year. The C&AG notes that, while the number of missing postcodes, has increased, it is still a very small proportion (less than one per cent) of the 2.5 million Scottish income tax population.

37. HMRC's comparison of PAYE submissions to HMRC records in May 2020 identified 31,478 Scottish taxpayer records (1.3 per cent of cases) where employers were not operating a tax code with an 'S' prefix. By March 2021, there were 39,364 cases (1.2 per cent of cases). The C&AG states that HMRC were unable to confirm how many employers are repeatedly using the incorrect tax code.

38. The C&AG highlights that in previous reports he has noted that HMRC does not set a target as to how low the number of missing 'S' prefixes would be before it considers its compliance activity has been successful. My view is that the Scottish Government should consider the scope to introduce such a target with HMRC. Scottish residents without 'S' codes should, but do not, pay Scottish rates of income tax. While the impact on the Scottish tax outturn may be limited, ensuring equity and fairness among taxpayers in Scotland is also clearly important.

39. In last year's report, I highlighted that, for the 2019/20 tax year, 45 MSPs had not initially been provided with a Scottish residency tax code. HMRC previously used a manual process to identify these records and ensure they were recorded as Scottish taxpayers regardless of residency. This required communication of required information to HMRC by employers or parliamentarians themselves and was completed annually. The C&AG reports that system changes designed to remove the need to annually update parliamentarians' records were introduced in August 2020, and that HMRC did not identify any issues in relation to Scottish Parliamentarians' tax during 2020/21.

Compliance risks

40. HMRC continues to assess compliance risk for Scottish taxpayers in the same manner as it does for the entire UK taxpayer population; through its Strategic Picture of Risk (SPR). The Scottish SPR identifies risks for Scottish income tax by taking the Scottish share of UK NSND income tax.

41. The C&AG reports HMRC estimated it generated an additional £270 million in Scottish income tax through its compliance activities in 2019/20; through generating additional revenues or preventing revenue losses. The estimated revenue lost from risks identified in the SPR, such as tax evasion and not declaring income, is £800m.

42. Both figures are calculated based on a proportion of the UK figure, rather than using Scotland-specific data to quantify the risks. The C&AG notes that HMRC does not consider geographical variations in the level of compliance risk, or the relative success of compliance activity in Scotland compared with the rest of the UK.

43. The C&AG has highlighted that HMRC has limited information on specific compliance activity undertaken in Scotland. Unlike the income tax system which can flag Scottish residents, HMRC's compliance system cannot readily identify people living in Scotland.

44. The C&AG has further highlighted that the impact of Covid-19, and HMRC's response to it, affected its core compliance activity in 2020/21 and will reduce the level of tax receipts that HMRC has collected through its compliance activities, as well as increasing the amount of debt that will become uncollectable. The debt balance for income tax was higher in 2020/21 than it was before the pandemic; almost £11 billion at the end of 2019/20 and more than £16 billion by the end of 2020/21. It was noted by C&AG that an analysis of income tax debt attributable to Scotland is not currently available.

45. The C&AG also reports on HMRC's response to a previous recommendation by the UK Government's Committee of Public Accounts (PAC) that HMRC should consider the benefits and challenges of estimating a Scotland-specific tax gap, which is the difference between the amount of tax that should be paid and what is actually paid. The Scottish Parliament's Public Audit and Post-legislative Scrutiny Committee followed up this recommendation through correspondence in February and March 2021. HMRC responded that calculating a Scottish specific tax gap would be difficult due to methodological reasons, including the increased burden on taxpayers who would be selected for further enquiry, the additional HMRC resource which would need to be deployed, and the loss of Exchequer revenue associated with redeployment of compliance staff away from yield-bearing work.

46. The increased divergence of Scottish and UK tax policies presents an additional risk that taxpayers will manipulate their place of residence to reduce their tax liability. HMRC currently considers this risk to be low compared to the overall risk of non-compliance affecting taxpayers across the UK, such as efforts to avoid or reduce liabilities altogether.

47. The C&AG also reports that HMRC began work in 2020 looking into Scottish taxpayer liabilities and behaviour over time. HMRC published its analysis from this work on 16 December 2021. The Scottish Government also published on the same day its policy evaluation of Scottish Income tax based on this analysis. The NAO will review the findings of HMRC's work in its 2021/22 report. I agree with the C&AG's view that this type of behavioural analysis is increasingly important to support HMRC's assessment of compliance risk if tax rates and bands continue to diverge.

48. In my view, further consideration of taxpayer behaviour in response to tax policy divergence, along with the relative success of compliance activity in Scotland and the Scotland-specific tax gap would help assess whether any Scottish income tax compliance risks are emerging. This would help the Scottish Government to understand the compliance risks better, and any implications for its future tax policies.

The accuracy and fairness of the administrative expenses

49. The C&AG noted that 'based on our procedures, we have concluded that the amount repaid by the Scottish Government for the year ended 31 March 2021 is accurate and fair in the context of the agreement between HMRC and the Scottish Government'.

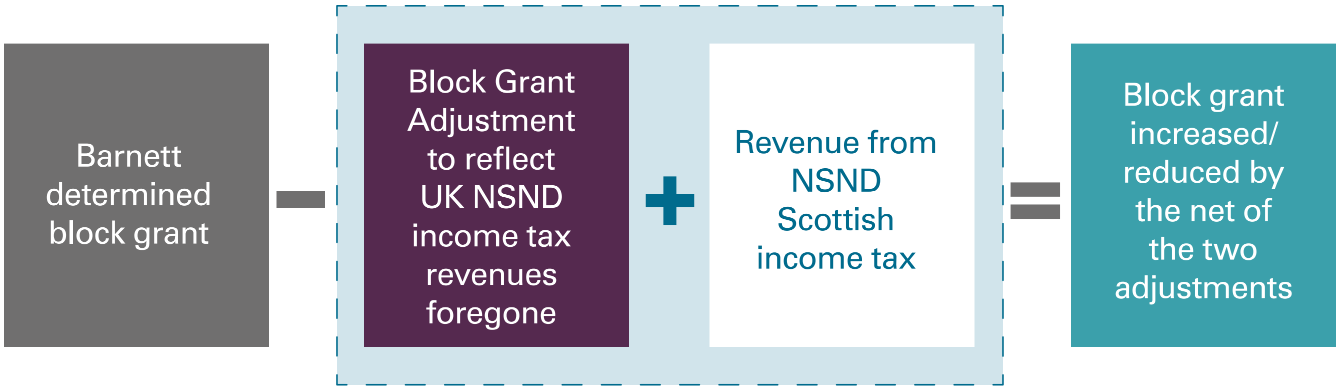
50. HMRC invoiced the Scottish Government for £0.7 million of costs relating to the administration of Scottish income tax in 2020/21 (£1.5 million in 2019/20). The reduction is due to 2020/21 being the first year since income tax powers were devolved to Scotland that costs relate exclusively to operating costs; 2019/20 was the last year that included implementation costs, which added £0.6 million to its operational costs of £0.9 million.

Impact of tax outturns on the Scottish budget

51. The block grant received from the UK Government remains the main source of funding for the Scottish budget. Since NSND income tax was devolved to Scotland in 2017/18, the block grant is now adjusted to take account of actual Scottish income tax revenues raised in Scotland. These are known as block grant adjustments (BGAs).

52. For Scottish income tax, the block grant is reduced by the amount of income tax foregone by HM Treasury by devolving it. Scottish income tax receipts are then added to the block grant in its place (Exhibit 1).

Exhibit 1
The block grant is adjusted for NSND Scottish income tax



Source: Audit Scotland

53. 2019/20 budget figures for Scottish income tax were based on independent forecasts prepared by the Scottish Fiscal Commission (SFC) and the Office for Budget Responsibility (OBR). A budget adjustment (or 'reconciliation') is made in later years once outturn data is known.

54. The reconciliation resulting from 2019/20 outturn figures is a budget reduction of £34 million. This will be made through the 2022/23 Scottish budget. Forecasts originally increased the Scottish budget by £182 million, the net difference between forecast tax foregone by HM Treasury and forecast Scottish income tax receipts. Outturns show that the increase was £148 million, £34 million less than the forecasted difference (Exhibit 2).

Exhibit 2
How the Scottish income tax outturn relates to the 2022/23 budget reconciliation

£ million	BGA – reflecting income tax foregone by HM Treasury	Revenue from NSND Scottish income tax	Net effect on budget
Forecasts used for the 2019/20 budget	-11,501	11,684	182
Final outturn	-11,685	11,833	148
Reconciliation required through the 2022/23 budget (reduction)			-34

Source: Audit Scotland, based on Scotland's Economic and Fiscal Forecasts, Scottish Fiscal Commission, December 2021

Administration of Scottish income tax 2020/21

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