Public Audit Committee
Wednesday, 19 February 2025
6th Meeting, 2025 (Session 6)

Administration of Scottish income tax 2023/24

Introduction

1. At its meeting today, the Public Audit Committee will take evidence from the Comptroller and Auditor General (C&AG) on the National Audit Office report on the Administration of Scottish income tax 2023-24. It will also take evidence from the Auditor General for Scotland (AGS) on his associated Administration of Scottish income tax 2023/24 assurance report. Both reports were published on 17 January 2025.

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 report on Scottish income tax for the reporting period 2023/24 can be found in **Annexe A**.

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

Consideration of the Administration of Scottish income tax 2022/23

5. The Committee considered the NAO's 2022/23 report on the Administration of Scottish income tax, alongside the AGS's assurance report at its meeting on 22 February 2024, where it heard evidence from the C&AG and the AGS.

6. The Committee continued its scrutiny on 25 April 2024, when it took oral evidence from the Scottish Government and HMRC. At this meeting, the Scottish Government advised the Committee that, in supporting HMRC to maintain a complete and accurate tax base and be vigilant in identifying Scottish taxpayers,

it had made the decision to run the third-party data clash exercise in 2024 rather than waiting until 2025. The Scottish Government also advised that it had established a joint compliance working group drawing on a range of subject matter experts from compliance business areas within and across HMRC to refresh assessment of compliance risk.

7. Following a previous joint commitment by the Scottish Government and HMRC to publish minutes of the Scottish income tax board from 2023/24, these minutes are now available on both the Scottish Government and UK Government websites.

8. Following the evidence session on 25 April 2024, the Scottish Government and HMRC provided further written evidence to the Committee on issues which were raised during the meeting —

   - Letter from HMRC, 29 May 2024
   - Letter from the Scottish Government, 29 May 2024

9. On 24 April 2024, HMRC published two reports on Scottish income tax—

   - Intra-UK migration of individuals: movements in numbers and income

   - Impacts of 2018 to 2019 Scottish Income tax changes on intra-UK migration and labour market participation.

10. As there was no opportunity to consider these reports in any detail in advance of the evidence session on 25 April, the Committee considered this information in more detail at a work programme discussion at its meeting on 13 June 2024.

11. At the meeting, the Committee considered the correspondence from HMRC and the Scottish Government and agreed to close its scrutiny of the Administration of Scottish income tax 2022/23.

Next steps

12. The Committee will decide any further action it wishes to take after the evidence session today.

Clerks to the Committee
February 2025

Annexe A: NAO report on Administration of Scottish income tax 2023/24

National Audit Office

REPORT

Administration of Scottish income tax 2023-24

HM Revenue & Customs

SESSION 2024-25
17 JANUARY 2025
HC 541

SG/2025/6

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Administration of Scottish income tax 2023-24

HM Revenue & Customs

Report by the Comptroller and Auditor General

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

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

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

Gareth Davies
Comptroller and Auditor General
National Audit Office

10 January 2024

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SG/2025/6

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Summary

Introduction

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

2 The Scottish Parliament has set different income tax bands and rates in Scotland from the rest of the UK. In 2018-19 it introduced a five-band system, which continued until 2023-24. There are three tax bands in the rest of the UK (**Figure 1**). In 2023-24, Scottish taxpayers paid a lower marginal rate of tax for those in the lowest band and a higher marginal rate for taxpayers earning more than £25,688. The threshold at which the higher rate was payable in Scotland was lower than in the rest of the UK. For 2023-24, the top rate of income tax in Scotland increased from 46% to 47% and the higher rate of income tax increased from 41% to 42%. The level at which taxpayers pay the top rate of income tax reduced from £150,000 to £125,140 for taxpayers in both Scotland and the rest of the UK. All other income tax rates and thresholds were frozen.

3 HM Treasury is responsible for paying Scottish income tax to the Scottish Government. HM Revenue & Customs (HMRC) administers and collects Scottish income tax as part of the UK tax system. It identifies taxpayers living in Scotland by applying a 'flag' in its systems that indicates they are subject to Scottish income tax rates and thresholds. HMRC has calculated that there were 2.8 million Scottish taxpayers in 2022-23 (2021-22: 2.7 million).

4 Following the end of each tax year, HMRC produces a provisional estimate of Scottish income tax revenue for that year. It calculates the final outturn the following year, once it has received further information from taxpayers and employers. This report covers the final outturn for 2022-23 and HMRC's provisional estimate for 2023-24. HMRC expects to publish the outturn for 2023-24 in its 2024-25 Annual Report and Accounts.

Figure 1
Income tax rates and bands in Scotland and the rest of the UK for 2023-24

For 2023-24 there were five tax bands above the personal allowance in Scotland compared with three in the rest of the UK

	Income tax rates in Scotland		Income tax rates in the rest of the UK	
Band	Taxable income	Tax rate	Taxable income	Tax rate
	(£)	(%)	(£)	(%)
Personal allowance	Up to 12,570	0	Up to 12,570	0
Starter rate	12,571 to 14,732	19	12,571 to 50,270	20
Basic rate	14,733 to 25,688	20		
Intermediate rate	25,689 to 43,662	21		
Higher rate	43,663 to 125,140	42	50,271 to 125,140	40
Top rate	More than 125,140	47	More than 125,140	45

Notes
1 A taxpayer's personal allowance is reduced by £1 for every £2 of net income above £100,000.
2 The top rate is known as the additional rate in the rest of the UK.

Source: HM Revenue & Customs, Income Tax rates and Personal Allowances, available at: www.gov.uk/income-tax-rates/previous-tax-years, accessed October 2024; and HM Revenue & Customs, Income Tax in Scotland, available at: www.gov.uk/scottish-income-tax, accessed October 2024

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

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

6 This report assesses:

- HMRC's calculation of the 2022-23 income tax revenue for Scotland (the 'outturn') and assurance on the correctness of amounts brought to account (Part One);
- HMRC's estimate of the 2023-24 income tax revenue for Scotland and our view on the estimate methodology (Part One);
- key controls operated by HMRC to assess and collect income tax (Part Two);
- HMRC's approach to assessing and mitigating the risk of non-compliance with Scottish tax requirements (Part Two); and
- the cost of administering Scottish income tax. We provide assurance on the accuracy and fairness of these amounts in the context of costs incurred by HMRC (Part Three).

7 For the 2024-25 tax year, the top rate of income tax increased further to 48%, and a new advanced rate of income tax, of 45%, applies to incomes between £75,001 and £125,140. For the 2025-26 tax year, the Scottish Government proposes to increase by 3.5% the threshold at which Scottish taxpayers will pay the basic and intermediate rates of income tax.

8 Appendix One sets out our audit evidence base.

Key findings

Scottish income tax 2022-23 final outturn and 2023-24 estimate

9 HMRC calculated the final outturn for 2022-23 as £15,169 million, representing amounts collected under Scottish income tax policy. This represents an increase of 11.5% compared with the outturn for 2021-22. HMRC largely based the outturn calculation on established tax liabilities where HMRC has finalised the tax owed and fully reconciled the taxpayer records. The calculation includes some areas of estimation and adjustments, for instance where HMRC had not yet received returns from taxpayers or where HMRC does not have Scotland-specific data. In these areas, we have evaluated the basis of HMRC's estimates, including the relevant assumptions and available data. The gross total of the estimates and adjustments made by HMRC constituted 7.1% of the reported outturn in 2022-23, a proportion which was similar in 2021-22. Based on our audit work, we have concluded that the Scottish income tax revenue outturn for 2022-23 is fairly stated (paragraphs 1.2 to 1.13 and Figure 2).

10 **HMRC has estimated Scottish income tax revenue for 2023-24 as £17,254 million.** This represents an increase of £2,085 million (13.7%) compared with the 2022-23 outturn. Income tax for the whole of the UK increased by 11.9% in 2023-24. These increases reflect rises in earnings, the reduction of the threshold at which taxpayers pay the top rate of income tax (from £150,000 to £125,140), the increase in the higher and top rates of income tax in Scotland and the freezing of most other thresholds. HMRC expects to calculate the finalised 2023-24 income tax outturn attributable to Scotland by July 2025. The estimate HMRC produces is solely for financial reporting purposes in its annual accounts. Based on the performance of the estimate in recent years, it has proved to be a reasonable indicator of the amount of income tax likely to be collected from Scottish taxpayers. The outturn in 2022-23 was £300 million (2.0%) higher than HMRC's provisional estimate. The estimate does not affect the amount of revenue that the Scottish Government ultimately receives, which is based on independent forecasts from the Scottish Fiscal Commission and the Office for Budget Responsibility (paragraphs 1.14 to 1.18 and Figure 4).

Administration of Scottish income tax

11 **HMRC has adequate rules and procedures in place to ensure the proper assessment and collection of Scottish income tax and it is complying with those rules.** Our work on Scottish income tax builds on our wider assessment of HMRC's rules and procedures, completed as part of our annual audit of HMRC. As part of that audit, we concluded that HMRC had framed adequate regulations and procedures to secure an effective check on the assessment, collection and proper allocation of revenue, and that these regulations and procedures are being duly carried out (paragraphs 2.2 to 2.15).

12 **Maintaining an accurate and complete record of the addresses of Scottish taxpayers remains HMRC's key challenge in administering the system.** HMRC relies on taxpayers notifying it of a change of address, although there is no legal requirement for them to do so. The number of Scottish residents with taxable income in 2023-24 found to have a missing or invalid postcode through HMRC's address-cleansing work remained relatively low at 1,766 (2022-23: 1,567). As part of its assurance work, HMRC updated all these records. In its 2023 exercise to compare the Scottish address records it holds with third-party data, the latest available, HMRC was able to successfully match 72.9% of address records, up from 72.2% in August 2021 (paragraphs 2.20 to 2.27 and Figure 8).

13 **HMRC's latest assessment is that the risk of address manipulation by Scottish taxpayers remains very low, though this relies on compliance information gathered up to two years in arrears.** HMRC produces an annual Strategic Picture of Risk (SPR) for Scottish income tax. In 2023-24, it considered the main areas of risk to Scottish income tax to be the same as those compliance risks which it assesses at the whole-of-UK level. In this SPR, HMRC identifies no risks as specific to Scotland as HMRC assesses that compliance risk in Scotland is consistent with the rest of the UK. This assessment draws on insights gathered through compliance investigations which, given when HMRC requires taxpayers to submit tax returns, typically apply to tax liabilities from two years previous. Through these investigations, HMRC has not identified any significant or widespread instances of taxpayers changing their address to obtain a tax advantage. However, this means that any increased risk from diverging tax policy may not be apparent through these investigations until at least 2025-26. HMRC monitors trends in various data to give a more timely indication of whether compliance risk is increasing, including the number of discrepancies from its third-party data exercise and the number of cross-border movements. The data on cross-border movements are also subject to a time lag in its availability, and HMRC has encountered difficulties for the last two years with importing relevant land and property transaction data into its system. HMRC instead has had to use other sources of information on cross-border movements which are not as reliable (paragraphs 2.17 and 2.29 to 2.32).

14 **HMRC is reviewing its compliance strategy in the face of increasing divergence in tax policy in Scotland, but it has not yet assessed the options available, or their costs.** Where taxpayers are subject to higher Scottish tax rates, there is a risk that they may seek to manipulate their residency status to reduce their tax liability, although HMRC considers that the risk of these behaviours is relatively low. While HMRC waits to see whether increased compliance risk from further divergence in tax policy features in compliance investigations in 2025-26, it is using 2024-25 to evaluate whether its current compliance approach in Scotland will remain sufficient and identify what more it could do, such as carrying out additional compliance checks or calculating a Scotland-specific tax gap. In reviewing its compliance strategy, HMRC and the Scottish Government must ensure they evaluate the costs and benefits of each option and implement timely changes to identify any increased compliance risks. They have set up a compliance working group to oversee this work. It expects to report to the Scottish Income Tax Board on the first phase of this evaluation in January 2025, including the likely costs of additional compliance work, after which the Scottish Government must decide on the merits of funding any additional activity (paragraphs 2.17, 2.30 and 2.31).

15 HMRC calculated a compliance yield of £350 million relating to Scotland for 2022-23, the most recent data available. Compliance yield is HMRC's estimate of the additional revenues it has generated through its compliance work, and the revenue losses it has prevented. It is how HMRC measures the effectiveness of its enforcement and compliance activities. HMRC estimated that Scotland's share of net losses from compliance risks in 2021-22, the most recent data available, was £1.1 billion. HMRC calculates these figures as a proportion of the equivalent UK figure, rather than using Scotland-specific data to quantify the risks. HMRC does not consider or report on geographical variations in the level of compliance risk, or the relative success of compliance activity in Scotland compared with the rest of the UK (paragraphs 2.36 and 2.37).

Costs

16 In 2023-24 HMRC incurred £1.0 million for the cost of administering Scottish income tax, and re-charged this to the Scottish Government. Of this amount, £0.6 million related to running costs, which is similar to that for 2022-23. The remaining £0.4 million related to the implementation of the advanced rate of Scottish income tax, in particular ensuring Pay As You Earn systems were updated ahead of the new tax band becoming operational in 2024-25. We examined HMRC's method for estimating the costs of collecting and administering Scottish income tax for the year ended 31 March 2024. Based on our audit work, we have concluded that the amount paid by the Scottish Government was accurate and fair in the context of the agreement between HMRC and the Scottish Government (paragraphs 3.4 and 3.5).

Part One

Income tax collected from Scottish taxpayers

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

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

The Scottish income tax 2022-23 final outturn

1.2 HMRC's calculation of the outturn for Scottish income tax revenue for 2022-23 is £15,169 million. HMRC calculates the final outturn figure from several components, which it aggregates to produce the total Scottish income tax liability. HMRC calculates each component using one or more sources of data.

1.3 The outturn for 2022-23 represents an increase of 11.5% compared with 2021-22. The outturn for non-savings, non-dividend income tax for the whole of the UK increased by 10.5% in 2022-23. HMRC attributes the growth in Scottish income tax in 2022-23 to higher nominal earnings growth, likely due to economic recovery following the pandemic and tight labour market conditions during a period of increasing inflation.

Components of the outturn

1.4 HMRC largely based the outturn calculation on established tax liabilities, some £15,187 million, where HMRC has finalised the tax owed and fully reconciled the taxpayer records. HMRC calculates the established liabilities from the final tax liability data extracted from the Pay As You Earn (PAYE) and Self Assessment income tax systems.

1.5 HMRC makes adjustments or estimates where it has not yet finalised the tax due, or where it must estimate the Scottish share of uncollectable amounts or tax reliefs. The reduction in Scottish income tax outturn arising from these adjustments was £17 million (net) (**Figure 2** overleaf).[1] In some areas of the calculation, HMRC does not have data in sufficient detail to identify income tax liabilities, reliefs or other adjustments relating to individual taxpayers. HMRC estimated the Scottish share of these balances by using other available data, such as population and income data, to apportion the balance between Scotland and the rest of the UK. The gross total of all the estimates and adjustments made by HMRC totalled £1,077 million in 2022-23, or 7.1% of the reported outturn, which is similar to the proportion in 2021-22.[2]

1.6 In July 2024, HMRC reported some discrepancies identified in the outturn figures it had previously published in respect of Scottish income tax and the equivalent taxes elsewhere in the UK. The discrepancies occurred due to double-counting of certain taxpayer records where the taxpayer had elected to submit a Self Assessment tax return when one was not needed. Between 2016-17 and 2021-22, this led to HMRC overstating the Scottish income tax outturn by an average of £78 million per year, or 0.7% of the previously reported outturn.[3] HMRC has since revised its outturn calculations to remove the duplicate records for each of the affected years (**Figure 3** overleaf).[4] These revised calculations do not affect individual taxpayer circumstances or suggest that any taxpayers paid the wrong amount of income tax. We have reviewed calculations and are satisfied that the adjustments determined are reasonable.

1.7 HM Treasury and the Scottish Government have been discussing the historical discrepancies in the outturn calculations but have not yet agreed whether any adjustments are needed to amounts previously paid to the Scottish Government. HM Treasury and the Scottish Government have calculated that the revised outturn figures in Scotland and the rest of the UK between 2016-17 and 2021-22, together with revised population estimates following the Scottish Census in 2022, would have reduced the Scottish budget by £29 million overall.[5]

1.8 The other components of HMRC's methodology for calculating the outturn have remained broadly the same since the prior year. The methodology includes areas of estimation, for instance where HMRC had not yet received returns from taxpayers. In these areas, we evaluated the basis for HMRC's estimate including relevant assumptions and available data. We concluded that the Scottish income tax revenue outturn for 2022-23 is fairly stated. We describe the key components of the outturn calculation in more detail below.

1 The sum of the established tax liabilities and the net adjustments does not equal the reported outturn due to rounding.
2 This gross total is made up of £530 million estimated liabilities and £547 million deductions. Estimates and adjustments for Self Assessment and PAYE liabilities include both amounts that are added as estimates and those deducted from revenue, so this gross total is higher than the sum of the individual components presented in Figure 2.
3 Given the discrepancies affected the calculation of outturn figures in both Scotland and the rest of the UK, the net effect on the income tax revenue that should have been paid to the Scottish Government does not equal the amounts reported here.
4 HM Revenue & Customs, *Scottish Income Tax Outturn Statistics: 2022 to 2023*, July 2024.
5 HM Treasury and the Scottish Government, *Scottish Income Tax outturn reconciliation for 2022-23,* 3 October 2024.

Figure 2

HM Revenue & Customs' (HMRC's) calculation of the 2022-23 Scottish income tax revenue outturn

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

	2022-23 outturn			2021-22 outturn
	Established amounts	Estimates and adjustments	Total	Total
	(£mn)	(£mn)	(£mn)	(£mn)
Self Assessment liabilities	6,597	(57)	**6,540**	**6,047**
Pay As You Earn (PAYE) liabilities	8,590	19	**8,609**	**7,578**
Estimated further liabilities	–	414	**414**	**372**
Deductions from revenue	–	(394)	**(394)**	**(389)**
Total	**15,187**	**(17)**	**15,169**	**13,607**

Notes

1 Self Assessment and PAYE liabilities are based primarily on the tax liability data held by HMRC, although some amounts are based on estimates as well.

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

3 Deductions from revenue include tax relief on pension contributions and Gift Aid and an estimate for the share of tax liabilities that either employers or taxpayers fail to pay.

4 Numbers shown in brackets are negative numbers.

5 Totals may not sum due to rounding.

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

Figure 3

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

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

Year	Original outturn	Revised outturn	Percentage difference
	(£mn)	(£mn)	(%)
2016-17	10,706	10,655	0.5
2017-18	10,908	10,845	0.6
2018-19	11.549	11,476	0.6
2019-20	11,825	11,750	0.6
2020-21	11,948	11,859	0.7
2021-22	13,724	13,607	0.9

Note

1 Stated figures may not equate to percentage differences due to rounding.

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

Self Assessment liabilities

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

PAYE liabilities

1.10 The PAYE total liability of £8,609 million represents all income tax attributable to Scotland from Scottish PAYE taxpayers in 2022-23. Under PAYE, employers submit data monthly to HMRC on the earnings and tax deductions made for their employees and HMRC records this information in its National Insurance and PAYE Service (NPS) system. HMRC identifies Scottish taxpayers in the NPS using a residency indicator based on taxpayer postcode information. HMRC identifies the total Scottish income tax liabilities by extracting Scottish taxpayer records from the NPS.

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

Estimated further liabilities

1.12 Most Self Assessment liabilities for 2022-23 were established prior to calculating the outturn. Nevertheless, HMRC knows from past years that Self Assessment tax liabilities will continue to be established and collected for up to six years afterwards. This is because HMRC continues to receive additional information from taxpayers and through its compliance activity. HMRC calculates the estimated additional liability for these elements based on past performance and estimated it at £414 million in the 2022-23 outturn.

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

7 This includes a deduction of £28 million to cover the Scottish share of tax reliefs given against PAYE liabilities, for which HMRC does not collect Scotland-specific data. HMRC also made an adjustment of £47 million to apportion the tax it collects from employers under PAYE settlement agreements. These agreements allow employers to make one annual payment to cover all tax due on minor, irregular or impracticable expenses or benefits for employers in the scheme. As tax liabilities are settled through one payment for the employer, the identity of individual taxpayers is not recorded and, therefore, HMRC analyses employer submissions to determine the Scottish proportion of UK-wide settlement agreement revenue.

Deductions from revenue

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

- £83 million for liabilities HMRC does not expect to collect: Some PAYE and Self Assessment income tax liabilities are never settled because either employers or taxpayers fail to pay the full amounts due. HMRC analyses historical data for the UK as a whole to determine patterns of uncollected liabilities and then apportions an amount relating to Scottish taxpayers.
- £190 million in pension contributions and £121 million in Gift Aid, both of which attract income tax relief at the taxpayer's marginal rate of income tax. Pension scheme administrators claim tax relief at the basic rate from HMRC on behalf of their scheme members, while charities claim tax relief at the basic rate from HMRC on behalf of their donors. HMRC calculates both deductions by estimating the Scottish share of each tax relief claimed across the UK using historical data.

The Scottish income tax estimate for 2023-24

1.14 HMRC estimates it will collect £17,254 million of Scottish income tax revenue relating to the 2023-24 year.[8] This represents an increase of £2,085 million (13.7%) against the 2022-23 outturn. For the UK overall, the increase was 11.9%. These increases reflect rises in earnings, the reduction of the threshold at which taxpayers pay the top rate of income tax (from £150,000 to £125,140), increases in the higher and top rates of income tax in Scotland, and the freezing of most other thresholds. HMRC expects to publish the final outturn for the 2023-24 year in its 2024-25 Annual Report and Accounts by July 2025.

1.15 HMRC's estimate is solely for financial reporting purposes in its annual accounts. It does not affect the amount of revenue that the Scottish Government receives, which is based on independent forecasts of Scottish income tax from the Scottish Fiscal Commission (SFC) and the Office for Budget Responsibility (OBR). When HMRC confirms the final outturn, an adjustment is then made to the Scottish Government's budget to account for any difference between the forecasts and the final amount.

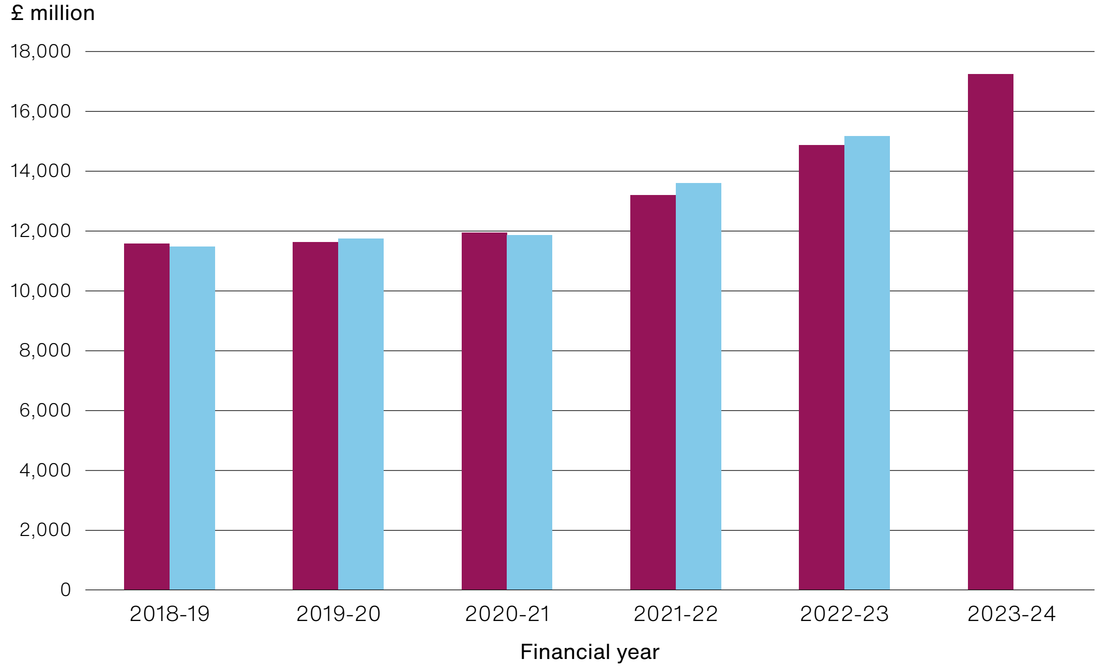
1.16 The Scottish Government uses the SFC and OBR forecasts, as well as regular updates on the amount of income tax paid through PAYE systems, to understand the amount of income tax likely to be collected from Scottish taxpayers, though HMRC's provisional estimate can also provide a useful indicator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

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

Figure 4

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

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



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

Notes

1 All data are nominal amounts, meaning they have not been adjusted for inflation.

2 In July 2024, HMRC published revised outturn figures for the years prior to 2022-23 after it discovered some duplication of income tax revenue in its calculations. HMRC has also revised the provisional estimates for years 2018-19 to 2022-23 to account for the duplication.

3 HMRC expects to publish the final outturn for the 2023-24 year in its 2024-25 Annual Report and Accounts by July 2025.

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

1.17 HMRC's methodology to estimate Scottish income tax revenue in 2023-24 is largely unchanged from that it used to calculate the 2022-23 estimate. The methodology relies on taxpayer data from HMRC's Survey of Personal Incomes (SPI). The latest SPI data available to HMRC at the time it produced the estimate were from 2021-22. HMRC then adjusted the data to reflect demographic and policy changes that it expects or knows have taken place between 2021-22 and 2023-24. The SPI is a sample of 1.5% of UK taxpayers, which introduces sampling uncertainty into the revenue estimate. It also combines the calculation of PAYE and Self Assessment liabilities so does not reflect the differing proportions of each type of taxpayer between Scotland and the rest of the UK. There is also an inherent risk that data from 2021-22 will not accurately reflect the taxpayer base for 2023-24.

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

Part Two

Administering Scottish income tax

2.1 This part of the report covers:

- HM Revenue & Customs' (HMRC's) key processes to administer the income tax system and how we have obtained assurance on them;
- HMRC's procedures to identify and maintain a complete and accurate record of the Scottish taxpayer population; and
- how HMRC identifies and responds to compliance risks.

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

2.3 Under Section 2 of the Exchequer and Audit Departments Act 1921, the Comptroller and Auditor General (C&AG) must consider the adequacy of HMRC's systems to assess and collect tax in the UK, including income tax. Each year we publish a report (the Standard Report) alongside HMRC's Annual Report and Accounts setting out the C&AG's conclusions in this respect. Our 2023-24 Standard Report concluded that HMRC had framed adequate regulations and procedures to secure an effective check on the assessment, collection and proper allocation of revenue, and that they are duly carried out.

2.4 To support the conclusions of this report, we extended our UK-wide testing to address risks and approaches arising from divergences in income tax policy. We also undertook specific procedures looking at HMRC's address-cleansing and wider tax compliance activities. These informed our assessment of the completeness and accuracy of HMRC's Scottish income tax estimates. To reach our conclusions, we examined several elements of devolved tax administration, such as HMRC's ongoing maintenance of Scottish taxpayer records, and how it identified and responded to devolved tax compliance risks.

The income tax system

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

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

Assurance of income tax processing

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

- automated system controls around handling, storing and processing data; and
- complex key business controls that have a high level of automation.

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

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

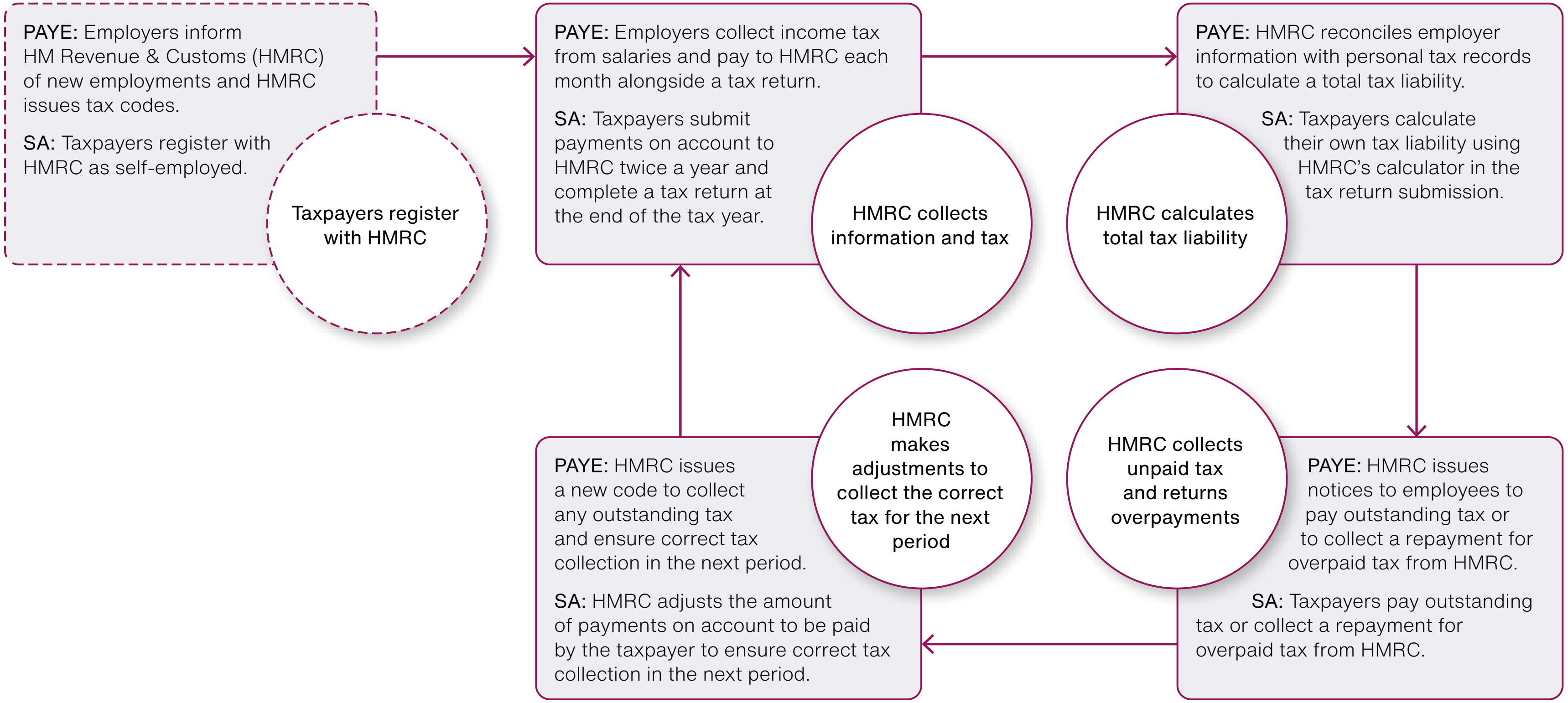
2.9 HMRC applies similar processes to each individual Self Assessment return that it receives. Self Assessment taxpayers make payments on account and at the year-end calculate their own tax liability using HMRC's calculator in their tax return submission.

Devolved income tax

2.10 The main differences in administering Scottish income tax, when compared with UK processes, are the business rules that the HMRC system applies when completing tax liability and tax code calculations. There have been no significant changes to system rules since our last report covering 2022-23.

Figure 5
The UK income tax system

The Pay As You Earn (PAYE) and Self Assessment (SA) processes share common principles to assess and collect income tax



Notes

1 PAYE and Self Assessment do not occur simultaneously. PAYE is processed during the tax year (6 April to 5 March) and reconciled after the tax year ends. Self Assessment returns are not submitted until the January following the end of the tax year

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

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

2.11 A Scottish taxpayer is someone with a tax liability whose main place of residence during the tax year is Scotland.[9] The rules that the HMRC system applies for Scottish taxpayers are as follows.

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

2.12 Self Assessment returns include a check box for the taxpayer to state whether they resided in Scotland during the tax year. If this contradicts HMRC's records, HMRC uses the address it holds to calculate the taxpayer's tax liability. HMRC notifies taxpayers of the discrepancy and asks them to update their address if required. **Figure 6** overleaf shows where these divergences occur within the income tax system.

Tax relief on pension contributions

2.13 HMRC must identify Scottish taxpayers so that tax relief is correctly allocated. Pension administrators claim tax relief at source on behalf of their members and add this to their members' contributions. HMRC applies tax relief on pension contributions at the basic rate of 20% for all taxpayers. Scottish taxpayers paying a tax rate above 20% can claim the remaining tax relief through a Self Assessment return or by contacting HMRC.

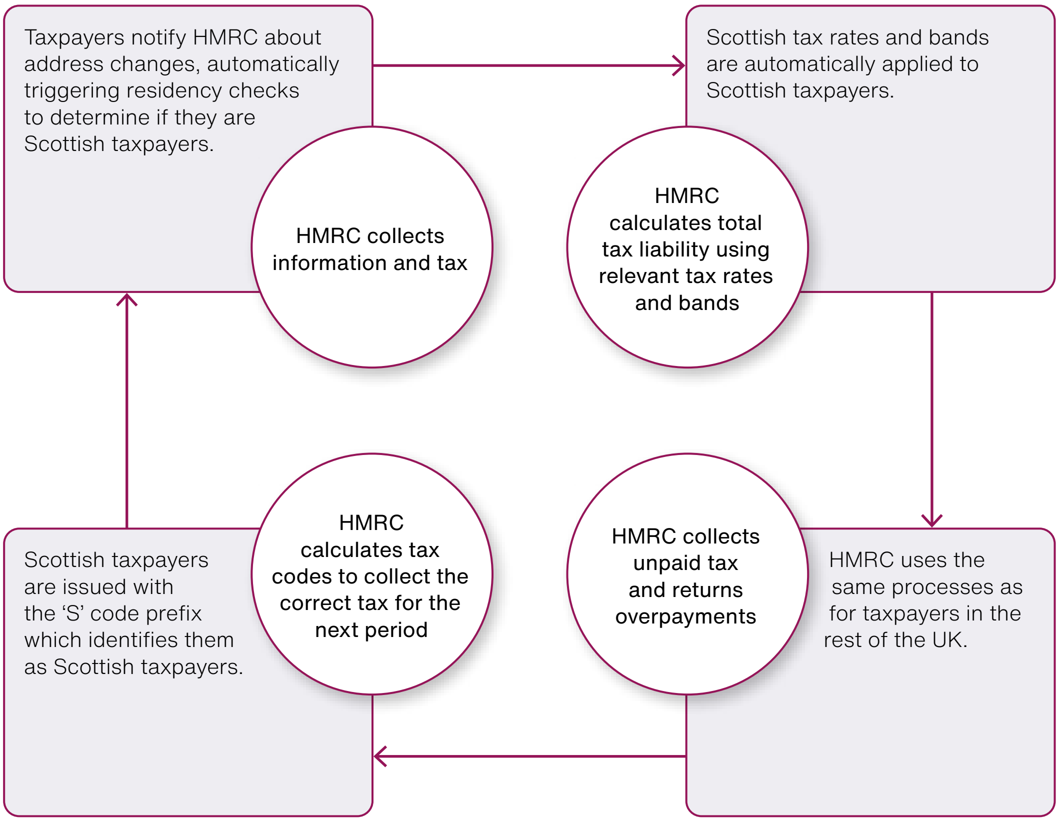
2.14 To administer relief at source, HMRC requires all pension administrators to submit an annual return of information, which provides details of their members and their pension contributions during the previous tax year. HMRC's Relief at Source system then automatically matches scheme members against addresses held by HMRC and confirms the residency status of pension scheme members to identify Scottish taxpayers and ensure the correct relief is applied at source. HMRC then issues a report to all pension administrators confirming the residency of their members. HMRC confirmed the residency status for 93% of Scottish and Welsh pension scheme members following the 2022-23 tax year, which is a similar proportion to that of the past six years. A Scotland-specific figure for the proportion of residency statuses confirmed is not available.

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

Figure 6

Divergences in the income tax system for Scottish taxpayers

HM Revenue & Customs' (HMRC's) business rules are configured to process income tax using the rates and thresholds applicable to a taxpayer's residency status



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

Tax relief on Gift Aid contributions

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

Scottish taxpayer population

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

Figure 7
Proportion of income taxpayers by band and income tax paid by band in Scotland, 2018-19 to 2022-23

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

Note

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

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

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

Address assurance

2.18 Maintaining accurate and complete records of the Scottish taxpayer population continues to be the main challenge for HMRC in administering Scottish income tax. HMRC considers a number of information sources for changes of address but relies primarily on taxpayers informing it of such changes in a timely manner, although taxpayers are not legally required to do this. HMRC has been exploring in 2024-25 how it can better remind taxpayers about their responsibility to inform HMRC of a change of address, including through messaging in the online Personal Tax Account. HMRC also obtains address information from other sources, such as employers, although it is not mandatory for employers to provide updates when their employees' addresses change.

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

Postcode scans

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

Figure 8
Assurance over the Scottish taxpayer population

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

Assurance activity	Description and purpose	Results
Controls ensuring Scottish residency is correctly determined using the address held by HMRC		
New postcodes	Comparison of HMRC's list of Scottish postcodes with Office for National Statistics (ONS) data to ensure postcodes are up to date.	HMRC receives postcode data quarterly from the ONS. HMRC added 1,129 new postcodes in 2023-24.
Address cleansing	Scans of taxpayer records held by HMRC to identify missing or invalid postcodes which would result in an incorrect residency status being applied.	Scans undertaken in August 2023 identified 52,170 missing or invalid postcodes. HMRC updated 1,766 of these postcodes because they had a record of current employment or pension.[1]
Cross-border postcodes	HMRC's systems flag address changes where new addresses lie in a postcode that crosses the England—Scotland border. HMRC reviews these cases to ensure it determines the correct residency.	In 2023-24, HMRC reviewed 34 cross-border cases, of which it amended eight following investigation. HMRC amended all eight to Scottish residency.
Missing residency flags	Scans to identify Scottish taxpayer records that are not flagged as such in the system.	HMRC's scans during 2023-24 identified 2,618 cases, all of which it updated.
Controls monitoring the operation of Pay As You Earn (PAYE) by employers		
Tax code comparison scans	A comparison between tax codes in PAYE submissions with HMRC's taxpayer record to identify cases where the employer is applying a different tax code to HMRC.	In January 2024 HMRC identified 45,809 cases where 'S' prefixes were not correctly applied to tax codes.[2] It wrote to employers to ask them to update the incorrect tax codes.
Controls to identify incorrect addresses held by HMRC		
Third-party data assurance exercise	A comparison of taxpayer address records held by HMRC with third-party data sources to identify cases where HMRC records are inconsistent with third-party data. The exercise is HMRC's main source of assurance over the accuracy of its address records.	The exercise performed in August 2023 compared 5.3 million Scottish address records. HMRC identified 8,540 records where the residency determined from the address held by HMRC did not match the residency suggested by the third-party data. Data from the exercise in August 2024 were not available at the time of publication.
Wealthy individuals	HMRC performs checks and procedures to review the movements of wealthy individuals and ensure their addresses are up to date.[3] Specialist teams develop an in-depth understanding of the finances, behaviours and compliance risks of these taxpayers.	

Notes

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

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

3 HMRC defines wealthy individuals as those with incomes of £200,000 or more, or with assets equal to or above £2 million in any of the last three years.

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

The administration of Scottish tax codes

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

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

2.23 Each month, HMRC compares tax codes in PAYE submissions with its own taxpayer record to identify cases where employers are using a different tax code. In January 2024, there were 45,809 cases (1.4% of cases) where employers were not operating a tax code with an 'S' prefix. This number varies across the year but has remained below 1.5% since April 2020. We have previously encouraged HMRC to follow up with employers applying incorrect tax codes, particularly those making persistent errors. In November 2024, HMRC expanded its reporting to include the characteristics of employers using incorrect tax codes, including the sector they operate in, number of employees, and the payroll system used.

2.24 When HMRC identifies that an employer is not using the correct tax code, it issues a P6 notification to the employer asking them to update the employee's tax code. HMRC told us that from January 2025 it will begin contacting employers who make large numbers of errors to understand the reasons and to provide support.

Third-party data exercise

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

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

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

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

Compliance risk assessment and planning

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

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

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

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

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

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

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

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

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

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

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

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

HMRC's compliance activity and debt management

Compliance activity

2.35 Across the UK, HMRC opened 311,000 compliance cases in 2023-24 (2022-23: 299,000) and closed 320,000 (2022-23: 280,000). HMRC has limited information on how much of this compliance activity is undertaken in Scotland. Its compliance system enables HMRC to raise a flag where potential manipulation of residency status has been identified. We understand that there are currently no such flags on the compliance system. HMRC told us that information about numbers of active compliance cases relating to Scottish taxpayers for reasons not related to their status as a Scottish taxpayer requires interrogation of separate information systems. Unlike the income tax system, which can flag Scottish residents, HMRC's compliance management information system cannot readily identify people living in Scotland, and information must be compared with other data to provide numbers on the total extent of Scottish non-compliance.

2.36 HMRC measures the effectiveness of its enforcement and compliance activities through compliance yield, its estimate of the additional revenues it considers it has generated, and the losses it has prevented. HMRC's yield from its tax compliance activities for the whole of the UK was £41.8 billion in 2023-24, up 23% compared with 2022-23 (in cash terms). Compliance yield in 2023-24 exceeded HMRC's target of £40.5 billion.

2.37 HMRC estimates a compliance yield of £350 million in 2022-23 for Scotland's share of the risks in the SPR. HMRC also estimates that Scotland's share of net losses from the risks in the SPR was £1.1 billion in 2021-22. These data are the most recent available. HMRC calculates these figures as a proportion of the equivalent UK figure, rather than using Scotland-specific data to quantify the risks. HMRC does not consider or report on geographical variation between Scotland and the rest of the UK when assessing compliance risk or the relative success of compliance activity.

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

Tax gap

2.38 The tax gap is the difference between the amount of tax that should be paid and what is actually paid. HMRC does not currently produce a Scotland-specific tax gap. HMRC's view remains that calculating a Scotland-specific tax gap would be difficult for methodological reasons, including the increased burden on taxpayers who would be selected for further enquiry, the additional HMRC resource which would need to be deployed, and the loss of Exchequer revenue associated with redeployment of compliance staff away from yield-bearing work.

Debt management

2.39 HMRC's management of tax debt affects how much income tax that is initially unpaid is subsequently collected across the UK, including in Scotland. HMRC's debt balance is affected by external factors that have an impact on taxpayers' ability to pay their tax liabilities, including current inflationary pressures and increases in the cost of living. At 31 March 2024, total tax debt for the UK was £43.0 billion, 1.9% (£0.9 billion) lower than the debt reported at 31 March 2023. Despite the decrease, tax debt remains higher than in the five years leading up to the pandemic, when tax debt was typically around £15 billion. HMRC does not currently produce a Scotland-specific estimate of tax debt. It last estimated total tax debt in respect of Scottish taxpayers to be £2.0 billion as at 31 December 2021, 5.7% of UK tax debt at that time. By comparison, Scotland received around 6.6% of UK income tax revenue in 2021-22.

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

Part Three

Costs

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

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

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

Costs incurred in 2023-24

3.4 HMRC invoiced the Scottish Government for £1.0 million of costs relating to the implementation and administration of Scottish income tax in 2023-24. Of this amount, £0.6 million related to running costs, which is similar to 2022-23. The remaining £0.4 million related to the implementation of the advanced rate of Scottish income tax, in particular ensuring that systems such as its National Insurance and Pay As You Earn system, and the Annual Tax Summary were updated ahead of the new tax band becoming operational in 2024-25. These changes were supported by a project board. HMRC expects to re-charge the Scottish Government a similar amount of £0.6 million in 2024-25 to finish implementing the advanced rate, this time for HMRC's Self Assessment systems. There have been no significant changes to the re-charging process in 2023-24.

3.5 We examined HMRC's method for estimating the costs to collect and administer Scottish income tax for the year ended 31 March 2024. Based on our audit work, we concluded that the amount paid by the Scottish Government was accurate and fair in the context of the agreement between HMRC and the Scottish Government.

Appendix One

Our evidence base

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

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

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

Financial audit

3 We audited the data, methodologies, assumptions and mechanics of the calculation for the revenue outturn for 2022-23 and the revenue estimate for 2023-24, which are described in this report. For the estimate, and where appropriate for the outturn, we applied the principles set out in International Standards on Auditing (UK) 540 Auditing Accounting Estimates and Related Disclosures to design audit procedures relevant to the nature of the estimates and to a sufficient level of precision.

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

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

6 We completed our financial audit fieldwork between April 2024 and July 2024.

Document review

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

8 We carried out our review between September 2024 and December 2024.

Interviews with departmental officials

9 We carried out two interviews with officials from HMRC, selected to participate because of their job role and their relevance to the audit. This included staff responsible for (or involved in) devolved tax policy and compliance.

10 We also spoke to the Scottish Government and Audit Scotland to inform our risk assessment and planning for this report.

11 Fieldwork took place between October 2024 and November 2024. We carried out interviews online. They typically lasted one hour, and we took notes.

Quantitative analysis

12 We analysed financial data from HMRC on Scottish income tax revenue, HMRC's estimate of Scottish income tax revenue and the administrative costs of Scottish income tax.

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Annexe B

Briefing Paper by the Auditor General for Scotland

1. The Auditor General's report the Administration of Scottish Income Tax 2023/24 was published on 17 January 2025.

2. From 2017/18 onwards, Scottish income tax, collected by HM Revenue and Customs (HMRC) is paid over 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 2023/24 HMRC Annual Report and Accounts on 26 July 2024. 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. This report was also published on 17 January 2025.

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 tenth 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 C&AG 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 the Auditor General for Scotland and the C&AG. This describes the respective powers and responsibilities and sets out a framework for collaborative working. It concluded that the NAO's approach to providing assurance over Scottish income tax was reasonable and covered the key audit risks.

6. HMRC applies the same risk-based compliance approach to collecting income tax in Scotland as it does in the rest of the UK. This is based on its assessment that compliance risk in Scotland is consistent with the rest of the UK. HMRC's compliance activity typically applies to tax liabilities from two years previous, therefore any compliance risk from the further divergence in

tax policy between Scotland and the rest of the UK from 2023/24 is unlikely to be apparent through compliance cases until at least 2025/26.

7. The C&AG concludes that, with tax policy divergence there is a risk that HMRC's assessment may not be sustainable in the longer term. The Scottish Income Tax Board has commissioned an update to its Compliance Plan to further consider how HMRC's Scottish income tax compliance activity fits into its wider work to administer Scottish income tax.

8. HMRC together with the Scottish Government has produced a dataset tracking the behaviour of taxpayers over time in response to any income tax changes between Scotland and the rest of the UK. The analysis of this dataset is under way, but it is not yet clear when or whether the results will be published. Publicly available better-quality data about taxpayer behaviour will help inform future tax policy decisions and enable more informed scrutiny.

9. The difference between actual UK and Scottish tax outturns for 2022/23 and the amounts forecasted at the time is adjusted through the 2025/26 budget. This is known as a budget reconciliation. The reconciliation for the 2022/23 outturns results in an increase to the 2025/26 budget of £449 million. This is the largest adjustment to date.

10. While income tax revenues are continuing to rise, the impact on the Scottish budget is significantly reduced by relatively slower economic growth in Scotland compared to the rest of the UK. Between 2017/18 to 2022/23, Scottish taxpayers have paid an additional £3,367 million due to tax policy differences. However, slower economic growth means the net benefit to the budget over the same period has been £629 million.

11. Taxes and the economy are important pillars of the Scottish Government's approach to financial sustainability. This current economic performance gap underlines the importance of relative economic growth to Scotland's public finances and should be a key area of focus for the Scottish Government in the coming years.

Administration of Scottish income tax 2023/24

AUDITOR GENERAL

Prepared by Audit Scotland
January 2025

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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 2022/23 is £15.169 billion. The net reconciliation of 2022/23 income tax will increase the 2025/26 Scottish budget by £449 million. This is the largest adjustment to the budget resulting from the reconciliation to date. Reconciliations correct for the difference between forecasted tax receipts used in the Scottish budget and the actual outturn which is known later.
- HMRC's provisional estimate of Scottish income tax for 2023/24 is £17.254 billion. The provisional estimate is provided for financial reporting purposes and does not affect the Scottish budget. The C&AG concludes that HMRC's approach to establishing the provisional estimate is reasonable.
- While income tax revenues are continuing to rise, the impact on the Scottish budget is significantly reduced by relatively slower economic growth in Scotland compared to the rest of the UK. Between 2017/18 to 2022/23, Scottish taxpayers have paid an additional £3.367 billion due to tax policy differences in Scotland (both Scottish and UK policy changes). However, slower economic growth means the net benefit to the budget over the same period has been a much lower £629 million. Taxes and the economy are important pillars of the Scottish Government's approach to financial sustainability. This current economic performance gap underlines the importance of relative economic growth to Scotland's public finances and should be a key area of focus for the Scottish Government in the coming years.
- There have been positive developments in governance and assurance arrangements in 2024. For example, I previously reported that the Scottish Government and HMRC should consider if more frequent checks are required to provide additional assurance over the accuracy of HMRC's address records. The completion of the additional third-party data exercise in 2024, one year earlier than originally planned, is a positive development, however the results of this exercise have not yet been published and

therefore cannot be reflected in this report. The timeliness of these exercise is critical to support public scrutiny. I also note that HMRC and the Scottish Government set up a compliance working group in 2024 to evaluate HMRC's approach to compliance in Scotland. HMRC expects to report to the Scottish Income Tax Board on the first phase of the evaluation in January 2025.

- HMRC continues to apply the same risk-based compliance approach to collecting income tax in Scotland as it does in the rest of the UK, as it has assessed the compliance risk to be consistent. This relates to the risk of tax evasion, rather than taxpayers changing their behaviour in legal ways, such as working less hours or leaving Scotland. The C&AG reports that HMRC is now carrying out work to assess whether its current compliance approach in Scotland remains sufficient if the further divergence in tax policy from 2023/24 increases compliance risks.

- HMRC has also now published further analysis in 2024, both of Scottish taxpayers' behavioural responses to Scottish income tax policy over time, and of the incomes and location of UK taxpayers over a 12-year period. It may not be until 2027 that HMRC can assess how migration has been affected by the recent changes in tax rates in Scotland in 2023-24 and 2024-25. Obtaining better quality data will help inform future tax policy decisions. In my view, further analysis in the coming years is needed to draw out the extent of any causal relationship between tax policy changes and taxpayer behavioural responses.

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 annual report and accounts are audited by the National Audit Office (NAO) and the Comptroller and Auditor General (C&AG) issued his opinion on the 2023/24 HMRC annual report and accounts in July 2024. 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 the Auditor General for Scotland 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.

Background

4. HMRC collects and administers Scottish income tax on behalf of the Scottish Government 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

[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.

- discussing and agreeing with HMRC aspects of the approach to the administration of Scottish income tax as set out in a Service Level Agreement.

5. The amount of Scottish income tax collected each year is identified separately in HMRC's annual report and accounts. HMRC's annual accounts for 2023/24 were published in July 2024. This report relates to 2023/24, including the final outturn calculation of Scottish income tax for the 2022/23 tax year. This amount is used to calculate the reconciliation applied to the Scottish budget for 2025/26.

6. In 2022/23, income tax receipts across the UK increased markedly due to factors such as recovery from Covid-19 and increases in inflation. Total Scottish NSND income tax revenues rose by 11.5 per cent between 2021/22 and 2022/23, compared to an increase of 10.5 per cent in NSND income tax revenues across England and Northern Ireland.[3] Between 2020/21 and 2021/22, Scottish income tax revenues rose by 14.9 per cent compared to a rise of 15.4 per cent across England and Northern Ireland.

7. The report also covers HMRC's provisional estimate of Scottish income tax receipts for 2023/24. This provisional estimate does not affect the Scottish budget. The final outturn for 2023/24 is expected to be reported in summer 2025.

[3] Scottish Income Tax Outturn Statistics: 2022 to 2023, HM Revenue & Customs, July 2024.

Audit and assurance

8. The C&AG made his tenth annual report to the Scottish Parliament on 17 January 2025. His report relates to 2023/24 and considers:

- HMRC's calculation of the 2022/23 income tax revenue attributable to Scotland and provides assurance on the correctness of the amounts brought to account
- HMRC's estimation of the 2023/24 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.

9. 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.

10. 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.

11. 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.

12. To support audit scrutiny, following assurances over the NAO's approach and findings, this report contains a further section on audit insights. This is to draw attention to issues and developments useful for scrutiny and outside of the scope of NAO activity. This includes analysis of how Scottish income tax figures impact the Scottish budget, and Scottish Government developments and activity in areas such as behavioural change.

Correctness of the sums brought to account

13. HMRC's 2023/24 annual report and accounts included Scottish income tax outturn figures relating to the 2022/23 year. Scottish income tax in 2022/23 was £15.169 billion.[4]

14. For the 2023/24 tax year, HMRC provided a provisional estimate that Scottish income tax revenue will be £17.254 billion. HMRC will publish the final Scottish income tax outturn for 2023/24 in its 2024/25 accounts, and an adjustment will be made to the 2026/27 Scottish Budget. The impact of tax outturns on the Scottish budget is explained in further detail at paragraphs 52-57 of this report.

2022/23 final outturn

15. The C&AG concludes that Scottish income tax revenue outturn for 2022/23 is fairly stated.

16. The 2022/23 outturn calculation of £15.169 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; including, 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.

17. The net effect of these estimation adjustments is to reduce the Scottish income tax outturn arising by £17 million (0.1 per cent of the outturn). The methodology used to arrive at these adjustments was agreed between the Scottish Government and HMRC. The C&AG notes that this methodology has remained broadly the same since the prior year.

18. As in 2021/22, both income tax receipts and the number of people paying tax has increased markedly in 2022/23, both in Scotland and in England and Northern Ireland. The C&AG notes that in Scotland, the outturn for 2022-23 represents an increase of 11.5 per cent compared with 2021/22 (£15.169 billion compared to £13.607 billion). The outturn for NSND income tax for England and Northern Ireland increased by 10.5 per

[4] Administration of Scottish income tax 2023-24, National Audit Office, January 2025.

cent in 2022/23. HMRC and the Scottish Fiscal Commission have pointed towards economic recovery from the pandemic and tight labour market conditions in a period of inflation as contributing factors.

19. The Scottish Fiscal Commission highlights higher earnings growth in Scotland than in the UK in 2022/23 as being an important driver of the relatively higher growth in tax revenues in Scotland. The Commission also highlights the distribution of tax rates in Scotland has resulted in a greater proportion of taxpayers crossing into a higher tax band than in the rest of the UK, which contributes to relatively greater income tax revenue growth in Scotland. The combined growth in revenue from higher rate and top rate taxpayers was around three percentage points higher in Scotland than in the equivalent bands in the UK in 2022/23.

20. There was a 4.4 per cent increase in taxpayers overall in 2022-23 compared to 2021/22. HMRC noted in their outturn publication report[5] that fiscal drag has resulted in the increases in the proportion of intermediate, higher, and top rate taxpayers in Scotland. There was a larger increase in taxpayers overall in England and Northern Ireland, with the number of taxpayers increasing by 4.9 per cent in 2022/23.

21. Fiscal drag occurs when wages rise, due to factors such as inflation, while tax rates and bands remain unchanged. Some taxpayers will become newly liable to pay income tax or to move between tax bands and consequently pay more tax.

22. The impact on the Scottish budget, explored later in this paper from paragraph 52 onwards, relates to per capita growth in receipts relative to the rest of the UK under the terms of the **Fiscal Framework**.

The **Fiscal Framework**, established in 2016, is an agreement between the Scottish and UK governments in response to the Scottish Parliament's new responsibilities for taxes, social security and borrowing. The framework sets out the Scottish Government's financial arrangements including how the grant received from the UK Government is calculated and how much money the Scottish Government can borrow. We have previously reported on the operation of the Fiscal Framework, setting out detail on the arrangements and the financial, economic and policy risks for the Scottish Government. The Scottish and UK governments agreed a revised Fiscal Framework in August 2023.

[5] Scottish Income Tax Outturn Statistics: 2022 to 2023, HM Revenue & Customs, July 2024.

The percentage growth in tax receipts does not result in a similar level of growth in the Scottish budget. It is therefore important that the Scottish Government continues to monitor and consider the impact of relative economic performance and tax policy change in the rest of the UK to the Scottish budget. This is particularly important given that the Scottish taxpayer base has a different **income distribution** to that of the rest of the UK, meaning factors such as fiscal drag may affect Scotland differently. This is likely to remain the case for future budget years, influencing budget growth from future tax policy decisions.

Income distribution is a measure of how many people earn different amounts of income.

2023/24 provisional estimate

23. HMRC's provisional estimate is for reporting purposes and does not affect the Scottish budget. The C&AG concludes that HMRC's approach to establishing the provisional estimate is reasonable.

24. Since 2018/19 the provisional estimate methodology is based on data from its Survey of Personal Incomes (SPI) and Personal Tax Model to give a Scottish percentage share of UK NSND tax income. HMRC compares this amount to the liabilities from the latest (2022/23) Scottish income tax outturns and adjusts its estimate accordingly. HMRC performs this calibration because, historically, actual tax outturns have been lower than the provisional estimates. The C&AG notes that the methodology is largely consistent with that used to calculate last year's 2022/23 estimate.

25. The C&AG notes that the estimated share that HMRC calculates is based on 2021/22 survey data. The C&AG has outlined several limitations in using SPI data to determine the provisional estimate, which includes the risk that using 2021-22 data may not be reflective of the taxpayer base for 2023-24.

26. The C&AG reports that for the 2023/24 tax year, HMRC provided a provisional estimate that Scottish income tax revenue will be £17.254 billion. The C&AG remarks that the 2023/24 Scottish income tax estimate represents an increase of £2,085 million (13.7 per cent) against the 2022/23 outturn, compared to an 11.9 per cent increase for the UK overall against the 2022/23 outturn. The C&AG notes that these increases reflect continued rises in earnings, together with the changes to the Scottish taxpayer thresholds and rates in 2023/24, moving some taxpayers into higher tax brackets.

27. I note that the Scottish Fiscal Commission's most recent forecast[6] for 2023/24 Scottish income tax receipts is £17.315 billion which is similar to HMRC's provisional estimate of £17.254 billion (a difference of less than 0.5 per cent).

[6] Scotland's Economic and Fiscal Forecasts – December 2024.

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

28. The C&AG concludes that 'HMRC has adequate rules and procedures in place to assess and collect Scottish income tax and that these are being complied with'.

29. The administration of Scottish income tax is governed by a Service Level Agreement (SLA) between HMRC and the Scottish Government.[7] 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.[8]

30. 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. From 2023/24 onwards, the Scottish Government and HMRC have published the minutes of the Scottish Income Tax Board.

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

[7] HM Revenue & Customs, Service level agreement for operation of Scottish Income Tax by HMRC, 14 December 2023.

[8] Scottish Income Tax HMRC Annual Report 2024, HMRC, November 2024.

population. This includes a series of checks on HMRC's records of Scottish taxpayers. 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. This comparison is the main source of assurance over HMRC's address information and is part of a wider suite of assurance activity as detailed in Figure 8 of the C&AG's report.

33. The C&AG has reported that HMRC has agreed with the Scottish Government to run an additional third-party data exercise in 2024, and in each of the next two years to more closely track any impact from increasing divergence in tax policy. HMRC and the Scottish Government have agreed that they will return to undertaking the third-party data assurance exercise every two years if, in the 2026 exercise, there are fewer than 15,000 address records where the residency data held by HMRC does not match the residency suggested by third-party data.

34. The C&AG has reported that the results of the 2024 exercise have not yet been made available. The most recent exercise for which results are available was completed in August 2023. These were included in last year's additional assurance report, and showed a slight increase in the number of taxpayer records that could be corroborated to third-party data. The undertaking of the additional exercise in 2024 and subsequent years is a positive development, however it is disappointing that the results are not available in time to include in this report. In my view, the Scottish Government should continue to consider the assurance required over the accuracy of HMRC's address records and how existing arrangements could be strengthened, including more timely publication of results.

35. The Scottish Government's joint statement with HMRC, Income tax reconciliation 2022/23, published in October 2024, highlights revisions to prior years outturns based on an HMRC data discovery. Between 2016/17 and 2021/22, HMRC had double counted PAYE liabilities where PAYE taxpayers had also submitted unsolicited self-assessment (SA) returns. This issue related to all taxpayers in the UK, including Scotland and Wales.

36. No taxpayers have paid the incorrect tax as a result of this issue. However, it has led to both the Scottish income tax outturn figure, and the corresponding UK income tax figure being overstated in each of these years. The C&G has reported that between 2016/17 and 2021/22, this led to HMRC overstating the Scottish income tax outturn by an average of £78 million per year, or 0.7 per cent of the previously reported outturn. HMRC has since revised its outturn calculations to remove the duplicate records for each of the affected years.

37. The C&AG reports that he has reviewed the revised calculations of Scottish income tax outturns for the period 2016/17 to 2021/22 and is satisfied that the adjustments determined are reasonable.

38. HMRC has calculated that, cumulatively over the period from 2016/17 to 2021/22 the Scottish budget should have had undergone a further negative reconciliation of £29 million as a result of this issue. The process of producing the outturn figures has been corrected for the 2022-23 outturn.

39. The C&AG has reported that HM Treasury and the Scottish Government have been discussing the historical discrepancies in the outturn calculations but have not yet agreed whether any adjustments are needed to amounts previously paid to the Scottish Government.

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. Scotland's share of the estimated revenue lost in 2021/22 (the latest year for which data is available) from risks identified in the SPR, such as tax evasion and not declaring income, is £1.1 billion.

41. The C&AG reports that HMRC generated an estimated additional £350 million in Scottish income tax through its enforcement and compliance activities in 2022/23 by generating additional revenues or preventing revenue losses.

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 emphasises that HMRC has limited information on specific compliance activity undertaken in Scotland. Unlike the income tax system which can flag Scottish taxpayers HMRC's compliance system cannot readily identify people living in Scotland.

43. The C&AG notes that, as in previous years, HMRC's compliance approach is based on its assumption that compliance risk in Scotland is consistent with the rest of the UK. This assumption is not tested by HMRC because of the methodological challenges and costs involved. The C&AG has previously reported that, with tax policy diverging further there is a risk that HMRC's assessment may not be sustainable in the longer term.

44. The C&AG also reports that there is typically a lag in HMRC's compliance procedures and the reporting or analysing of the data that HMRC monitors. Therefore, any compliance risk arising from further divergence in tax policy between Scotland and the rest of the UK from 2024/25 is unlikely to be considered until 2026/27.

45. This can lead to two separate risks for the Scottish Government to manage. Firstly, the delay means that the Scottish Government are not able to make tax policy decisions on the most up to date consideration of compliance risk. Secondly, the delay means that by the time any change in compliance risk is identified, it is too late to reflect in the confirmed outturn for the year in question.

46. For example, the outturn for 2024/25 Scottish NSND income tax will be known in summer 2026, with the adjustment to the Scottish budget then being made to the 2027/28 budget. Therefore, reconciliations to the 2027/28 budget would be made before compliance risks arising from further tax divergence in 2024/25 are fully known.

47. In line with the SLA, further compliance activity can be undertaken by HMRC and paid for by the Scottish Government. The C&AG reports that HMRC is now carrying out work to assess whether its current compliance approach in Scotland remains sufficient and to ensure it is prepared if the further divergence in tax policy from 2023-24 increases compliance risks. HMRC and the Scottish Government set up a compliance working group, which met for the first time in May 2024 and has been directed by the Scottish Income Tax Board to evaluate HMRC's approach to compliance in Scotland. This evaluation will cover how the current approach is working; the limitations in the approach and how these can be addressed; and how the scope of compliance activity could be increased and to what impact. HMRC expects to report to the board on the first phase of the evaluation in January 2025.

48. The C&AG has highlighted that as part of its evaluation, HMRC is seeking agreement from the Scottish Government on what is an appropriate response to any discrepancies identified from its assurance exercises both on third-party data and the number of incorrect 'S' codes applied by employers for Scottish residents. Responses being considered include opening a selected number of compliance cases to investigate further; sending letters to taxpayers; or doing further work to understand the reliability of third-party datasets.

49. Each year, HMRC also monitors cross-border migration trends to identify potential instances of taxpayers erroneously changing their address to obtain a tax advantage. The C&AG reports that for 2022/23 and 2023/24 HMRC encountered difficulties with importing land and property transaction data into its systems for the purposes of identifying Scottish taxpayers who have purchased property outside Scotland. It is instead reliant on other sources of information which are not as reliable.

50. In my view, the Scottish Government should regularly evaluate the costs and benefits of additional compliance activity in Scotland. The setting up of the compliance working group is an important step towards recognising the need to monitor, respond to, and report on the effects of the increasing divergence in tax policy between Scotland and the rest of the UK.

The accuracy and fairness of the administrative expenses

51. The C&AG notes that ‘based on our audit work, we have concluded that the amount paid by the Scottish Government (for the year ended 31 March 2024) was accurate and fair in the context of the agreement between HMRC and the Scottish Government’. HMRC invoiced the Scottish Government for £1.0 million of costs relating to the administration of Scottish income tax in 2023/24 (£0.6 million in 2022/23). Of this amount, £0.6 million related to running costs, a similar amount as in 2022/23. The remaining £0.4 million related to the implementation of the advanced rate of Scottish income tax, in particular ensuring systems such as its National Insurance and Pay As You Earn system and the Annual Tax Summary were updated ahead of the new tax band becoming operational in 2024-25. HMRC expects to recharge the Scottish Government £0.6 million in 2024-25 to finish implementing the advanced rate, this time for HMRC’s self-assessment systems.

Audit insights

Impact of tax outturns on the Scottish budget

52. 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 total resource funding is now adjusted to take account of actual Scottish income tax revenues raised in Scotland. These are known as block grant adjustments (BGAs).

53. 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

54. The 2022/23 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). The OBR forecasts the BGAs and the SFC forecasts the Scottish income tax revenues. A budget adjustment (or 'reconciliation') is made in later years once outturn data is known.

55. The reconciliation resulting from 2022/23 outturn figures is a budget increase of £449 million. This is the largest adjustment to the budget resulting from the reconciliation to date. This will be added to the funding envelope for the 2025/26 Scottish budget.

56. The forecasts originally used for the 2022/23 Scottish budget reduced the budget by £190 million, the net difference between forecast tax foregone by HM Treasury and forecast Scottish Income tax receipts.

Outturn data shows that there was an increase of £259 million, a positive difference of £449 million from the forecast reduction (Exhibit 2).

Exhibit 2
How the Scottish income tax outturn relates to the 2025/26 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 2022/23 budget	-13,861	13,671	-190
Final outturn	-14,909	15,169	259
Reconciliation required through the 2025/26 budget			**+449**

Source: Audit Scotland, based on Scotland's Economic and Fiscal Forecasts, Scottish Fiscal Commission, December 2024

57. The SFC notes that it set its forecasts during a period of uncertainty as the UK was still being affected by the Covid-19 pandemic, and after the forecast was published there was a period of high inflation caused in part by the impact of the invasion of Ukraine and a subsequent increase in energy prices.

The economic performance gap

58. The positive reconciliation provides additional funding in 2025/26 beyond the block grant that can be used to support the Scottish Government's overall financial challenges. Audit Scotland has previously published more detail on the mechanics of tax reconciliations in its Operation of the Fiscal Framework papers.

59. The Scottish Government set out in its 2023 Medium-Term Financial Strategy that economic growth and tax revenue generation are important levers to move towards a more financially sustainable position.

60. Since the devolution of Scottish income tax in 2017/18, the net benefit to the Scottish budget has been significantly less than the additional taxes actually paid in Scotland. This is due to the relatively slower economic growth in Scotland.

61. The net amount added to, or deducted from, the Scottish budget for Scottish income tax depends on two main factors:

- the relative tax policy of Scotland compared to the rest of the UK (for example different tax rates and tax bands)
- the relative economic performance of Scotland compared to the rest of the UK. Specifically, this is the relative change in tax per head of the population, indexed from a 2016/17 baseline year.

62. To date, higher rates of tax compared to the rest of the UK, and a different tax band structure has increased relative tax revenues. However, as the SFC points out in its Fiscal Update, August 2024, relatively slower economic growth has 'acted as a drag' on these revenues for budget purposes.

63. Exhibit 3 shows how Scottish tax policy and economic performance compared to the rest of the UK has impacted the Scottish budget since Scottish income tax was devolved.

Exhibit 3

The impact of relative tax policy and economic performance on the Scottish budget for Scottish income tax

(£ million)	17-18	18-19	19-20	20-21	21-22	22-23	Cumulative
Additional tax paid due to tax policy differences (both Scottish and UK policy changes)	94	386	620	638	749	881	**3,367**
Economic performance differences (relative employment and earnings divergences and other factors)	-185	-259	-465	-542	-663	-624	**-2,738**
Net position (increase or decrease to the Scottish budget)	**-91**	**127**	**155**	**96**	**85**	**257**	**629**

Source: Audit Scotland analysis of Scottish Fiscal Commission, Fiscal Update – Charts and Tables – August 2024. Note: the final net position in December 2024 shown in Exhibit 2 is £259 million, compared to the £257 million known at the point of the SFC August report

64. For 2022/23, the SFC estimates that differential income tax policies implemented since 2017/18 have raised up to an additional £881 million from Scottish taxpayers. However, slower economic growth and other factors reduced the net benefit to the budget by £624 million. This is called the economic performance gap.

65. Cumulatively, the analysis at Exhibit 3 shows that of the additional £3.367 billion contributed by Scottish taxpayers due to tax policy divergence since the tax was devolved, the direct net impact on Scottish budgets arising over the same period is £629 million.

66. The economic performance gap is expected to grow in 2025/26. SFC forecasts published alongside the 2025/26 Scottish budget estimate that, of the additional £1,676 million income tax estimated to be raised because of tax policy divergence, £839 million will be netted off because of slower Scottish economic growth. This means that of the additional £1.7 billion Scottish taxpayers will pay in 2025/26, the Scottish budget will increase by only around half of this sum, £839 million.

67. This highlights the importance of relative economic performance in Scotland compared with the rest of the UK, including relative earnings and employment compared to the baseline 2016/17 year.

Potential future economic performance and the impact on tax

68. The SFC stated in its December 2023 Scotland Economic and Fiscal Forecasts publication that from 2024/25 through to 2028/29, its forecasts for earnings growth in Scotland were higher than those for the rest of the UK. This, alongside expected increased relative tax revenues due to factors such as fiscal drag and higher tax rates, were forecast to lead to increasingly positive budget reconciliations over the medium term.

69. Positive budget reconciliations from all devolved taxes, including Scottish income tax, were forecast to add around £1.5 billion to the budget in 2024/25, rising to around £2.4 billion by 2028/29. Improvements in the income tax net position account for most of the growth.

70. These forecast additions to the budget are important to the Scottish Government in managing the fiscal sustainability of its budget over the medium term. However, the SFC flagged as an explicit risk that if, rather than stronger growth, earnings growth in Scotland is more similar to the UK, then the income tax net position and the funding available for the Scottish budget will be lower than currently projected.

71. In its August 2024 Fiscal Update, the SFC noted that the latest data suggests Scottish earnings growth is indeed slowing relative to the UK, meaning the period of catch-up in Scottish income tax revenues may be coming to an end in 2024/25.

72. In its most recent December 2024 forecasts, published alongside the 2025/26 Scottish budget, the SFC states that while it still expects Scottish income tax policy and fiscal drag to continue to contribute positively to the income tax net position in the coming years, the income tax net position may not turn out to be as positive as thought a year earlier (Exhibit 4).

Exhibit 4
Changes in the income tax net position since December 2023

£ million	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
Dec-23	827	1,412	1,749	1,896	2,178	2,288
Dec-24	788	711	838	1,314	1,774	2,051
Change	**-39**	**-701**	**-911**	**-582**	**-405**	**-237**

Source: Audit Scotland analysis of Scottish Fiscal Commission, Scotland's Economic and Fiscal Forecasts – Charts and Tables - December 2024

73. The Scottish Government will need to monitor this closely, given the impact on overall fiscal sustainability of lower than forecast returns. I have highlighted previously the importance of economic performance to public finances, and this is also a key pillar of the Scottish Government's overall approach to medium-term fiscal sustainability. I have recently set out the need for better medium-term planning in my Fiscal Sustainability and Reform in Scotland performance report.

Taxpayer behaviour

74. Due to the importance of both tax policy and economic growth, the way that taxpayers respond in relation to diverging tax policies between Scotland and the rest of the UK is important. The Scottish Government's additional work in this area through the Scottish Income Tax Board is encouraging, and understanding the way taxpayers behave will be important to understand the potential future budget impact or tax policy decisions.

75. Taxpayers may respond to divergences in tax policy by changing their behaviour. Behavioural responses can cover a wide range of taxpayers' responses to policy changes, including:

- **Economic responses**: seeking work or increasing the number of hours worked or vice versa.
- **Cross-border mobility**: taxes could also affect migration, both into and out of Scotland.

- **Tax planning or avoidance**: shifting income into a more tax-efficient source, such as dividends; or artificially reducing one's tax liability.
- **Evasion**: where there is a deliberate (and illegal) attempt not to pay the tax which is due.

76. The SFC account for behavioural change in their forecasts (behavioural costings), which can reduce the overall impact of tax policy changes on the budget. These costings represent the legal responses that could arise, such as migration and economic responses.

77. In 2023, SPICe published a blog on behavioural change which set out the inherent uncertainties of forecasting and measuring behavioural change.

78. In December 2021, HMRC published an analysis of Scottish taxpayer liabilities and behaviour over time. This showed some limited evidence of Scottish taxpayers lowering their taxable income in response to increasing tax rates. The analysis also found that generally taxpayers earning higher levels of income decreased their declared income by more than those on lower incomes. The Scottish Government reflected the findings in relation to Scottish taxpayers in its policy evaluation of Scottish income tax, also published in December 2021.

79. The C&AG has reported that HMRC published further analysis in April 2024 which showed no evidence of a change in labour market participation, but some evidence of a decrease in net migration to Scotland from the rest of the UK in the first year of the policy change for Scottish taxpayers above the higher rate income tax threshold.

80. HMRC also published in April 2024 its first analysis of incomes and location of UK taxpayers over a 12-year period up to and including 2021/22. The analysis showed a gradual increase in net migration to Scotland and Wales from the rest of the UK from 2016-17 onwards, with this increase accelerating in 2020-21 and 2021-22, the years of the Covid-19 pandemic. However, HMRC says it cannot draw conclusions about whether migration trends were affected by income tax policy as it does not know what level of migration would have been expected without any divergence in tax policy. The C&AG remarks that it may not be until 2027 that HMRC can assess how migration has been affected by the recent changes in tax rates in Scotland in 2023-24 and 2024-25.

81. The publication by HMRC of the analysis on migration and taxpayer behaviour in relation to income tax changes over time is a positive development. Obtaining better quality data will help inform future tax policy decisions. In my view, further analysis to draw out the extent of any causal relationship between tax policy changes and taxpayer behavioural responses and migration would be beneficial.

Administration of Scottish income tax 2023/24

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