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Date 28 September 2018

Dear Bruce,

The Service Level Agreement for the administration of Scottish income tax between HMRC and Scottish Government commits HMRC to report annually on its delivery of specific services. I attach HMRC's 2017/18 service report in fulfilment of that commitment.

Paragraph 6.2 of the Memorandum of Understanding between HMRC and the Scottish Government relating to Scottish Income Tax commits HMRC to providing the Scottish Parliament with extracts from our accounts covering all matters relating to Scottish income tax. The attached paper provides the relevant extracts from the 2017/18 accounts, outlining HMRC's outturn of Scottish rate of income tax receipts and the costs HMRC has recharged to the Scottish Government.

Both the documents have been shared with the Scottish Government and I am also today sending copies to the Scottish Parliament Audit and Post-legislative Scrutiny Committee.

Jim Harra
DEPUTY CHIEF EXECUTIVE AND SECOND PERMANENT SECRETARY



Scottish Income Tax HMRC Annual Report 2018

Scottish Income Tax – HMRC Annual Report

Purpose

Scotland Act 2012 enabled the Scottish Parliament to set a **Scottish rate of income tax** to apply to the non-savings and non-dividend income of Scottish taxpayers. This power was exercised for the first and only time in February 2016 setting a rate of 10% for the **2016-17 tax year**. However, the power to set a Scottish rate was superseded by Scotland Act 2016, which provides the Scottish Parliament with **further Scottish income tax powers** – enabling them to set the income tax rates and thresholds that apply to the non-savings and non-dividend income of Scottish taxpayers.

The Scottish Parliament exercised this further power for the first time in February 2017, setting rates/thresholds for the **2017-18 tax year** which mirror those which apply elsewhere in the UK, with the exception of the higher rate threshold. The Scottish Parliament kept the threshold for Scottish taxpayers at £43,000, whereas the UK Parliament raised the threshold for taxpayers in the rest of the UK to £45,000.

In the **2018-19 tax year** the Scottish Parliament introduced two new tax bands, the Starter rate at 19% and the Intermediate rate at 21% and added 1p to the Higher and Additional/Top rate. The higher rate threshold was increased to £43,431, while the UK Parliament raised it to £46,351 for taxpayers in the rest of the UK.

All Scottish income tax remains part of the UK income tax system and continues to be administered by Her Majesty's Revenue and Customs (HMRC) who are therefore accountable for the collection and management of Scottish income tax. The Scottish Government is required to meet any net additional costs incurred by HMRC as a result of the introduction of Scottish income tax.

To ensure consistent quality of service to Scottish taxpayers, allowing both HMRC and the Scottish Government to meet their respective Scottish income tax responsibilities, a Service Level Agreement (SLA) has been agreed. The SLA set out requirements and performance measures for the operation of Scottish income tax. One of the key requirements is for HMRC to report annually on their delivery of the agreed services. This document is HMRC's second such report.

Context

Scottish income tax remains part of the UK income tax system and HMRC administers it through existing Pay As You Earn (PAYE) or Self-Assessment (SA) processes and within existing approaches to income tax compliance and communications. This ensures the correct amount of tax is collected and in the vast majority of cases, Scottish taxpayers will notice no difference in how HMRC interacts with them.

SECTION 1 - COMPLIANCE

The SLA requires HMRC to:

- *Identify and maintain an accurate and robust record of the Scottish taxpayer population; and*
- *Apply risk based compliance activity to the collection of Scottish income tax in the same way as is applied to the collection of income tax from taxpayers in the rest of the UK*

Scottish taxpayer identification

The exact nature of the compliance activity HMRC undertakes to identify Scottish taxpayers for any given year will depend on income tax decisions made by the UK and Scottish Parliaments. In broad terms, the greater the divergence between the two regimes, the greater the risk of a non-compliant behavioural response by customers requiring HMRC compliance activity to address.

HMRC have therefore agreed with the Scottish Government that we will each year produce an assessment of risk, a plan of activity to address that risk and annually publish high level compliance outcomes relating to that activity. This paper outlines planned activity for the 2018-19 tax year.

HMRC has carried out a further exercise to compare our address data against third party address data (as we did in 2015) to identify potential instances of out of date addresses and maintain the accuracy of our data. Further detail of the findings of this exercise is included on page 6 of this report.

Compliance into tax affairs of Scottish taxpayers

HMRC will continue to assess risk and undertake compliance activity into the wider, generic tax affairs of Scottish taxpayers, in the same manner as it does now, as part of its administration of the UK income tax system as a whole. HMRC will apply risk based compliance activity to the collection of Scottish income tax in the same way as is applied to the collection of income tax from taxpayers in the rest of the UK. The Scottish Government will not be recharged for this activity.

CONTEXT

HMRC's approach to compliance

All aspects of HMRC's compliance activity in relation to Scottish income tax will be undertaken as part of and within HMRC's UK-wide approach to income tax compliance:

- **Promote** – designing processes to encourage and help customers get things right first time (i.e. before they file returns or we make repayments).

- **Prevent** – designing processes and exploiting our digital channels, using what we know about customers, to prevent them from getting things wrong and give them the opportunity to correct their mistakes before they reach HMRC.
- **Respond** – tailoring our activity when we have to intervene to investigate compliance risks and correct non-compliance.

COMPLIANCE STRATEGY OVERVIEW

Whilst 2017-18 Scottish rates and thresholds differ from those across the rest of the UK, the difference is both small (£400 at most) and affects a relatively small proportion (8% pay the higher rate) of taxpayers. As a result, HMRC considers the likelihood of customers changing behaviour in response to be very low to the low impact of the change and our compliance approach is tailored accordingly.

Although the changes to tax rates in 2018-19 are more pronounced their impact on customer behaviour is still estimated to be low as an individual element in the overall picture of risk. For the 90% of customers below the Higher Rate the difference is less than £200. Where the impact is greater the potential behavioural change is within what we would expect for the relevant customer segments. Increasing tax rates increases the risk of avoidance but the potential to avoid just the SRIT element is low. The increased risk relates, therefore, to the whole income where the increased risk is marginal. Apart from specific work to ensure the correct status as Scottish customers we will risk-assess all customers in line with our current approaches.

Address assurance

- For all individuals, whether in Self-Assessment or PAYE, HMRC will continue to monitor cross-border migration trends through comparison of customer base, analysis of returns and changes to tax accounts to identify possible evidence of customer behavioural response and also validate the accuracy of reported moves and the completeness of its address data.
- HMRC will continue communications activity reinforcing to customers the need to update address details with HMRC when they move.

Knowledge building

- HMRC will, for 2017-18, use the relative lack of divergence in regimes to build up our knowledge of the Scottish taxpayer base – e.g. within the Self-Assessment population we propose to continue tapping into on-going (non-Scottish tax payer status) investigations to better understand the population and the likelihood/nature of behavioural changes/trends that might occur when 2018-19 returns are completed.
- The 2017-18 PAYE returns will be reconciled for all employed individuals during the 2018-19 year which will give a broader picture of the impact of the changes in thresholds in the 2017-18 year. Along with the work on address assurance this gives us a relative picture of the risks that are likely when the 2017-18 returns are submitted.

Wealthy Individuals

- HMRC will continue to use the existing Customer Relationship Manager (CRM) model and other interactions with wealthy customers to raise awareness, educate customers of their Scottish income tax obligations and assess risk related to misrepresentation of Scottish taxpayer status.
- A specific Scottish income tax lead, within HMRC's Wealthy Taxpayer Unit, has been appointed in East Kilbride to oversee activity in relation these customers.

Employer compliance/assurance

- HMRC are keen to ensure that the Scottish 'S code' is being accurately and correctly applied in the PAYE regime and will therefore include this as part of our checks against monthly returns from.
- In addition, changes to HMRC's coding system mean that any alteration to a customer's code can be given earlier effect. It also means that should codes be incorrectly applied we can identify these without a specific Employer Compliance intervention.

Timing

Activity aimed at promoting compliance and preventing issues began for 2017-18 we are continuing to undertake this work in the 2018-19 year through our Customer Compliance Managers in Large Business, Wealthy and Public Bodies groups.

Activity for employees continues with checks taking place in year as part of regular employer compliance activity to ensure that Scottish rates are being correctly applied. In addition, the end of year PAYE reconciliation programme checks all customer records against the tax code that should have been operated. Self-employed customers remain on an annual return cycle and Self-Assessment returns for 2017-18 tax year are not required to be submitted until January 2019. Investigative respond work would therefore commence in 2019. For 2018-19 tax year Self-Assessment returns would not begin to be submitted until after the year end in April 2019 and are no required until January 2020.

COMMUNICATIONS OVERVIEW

HMRC has continued to use the extensive existing channels of communications it has with taxpayers to reinforce key Scottish income tax messages. This includes the Employer bulletin, Agent bulletin, Customer Compliance managers links to large businesses and public bodies, forums for employers, payroll managers and agents and gov.uk.

HMRC will continue to work with Scottish Government on our communications approach, particularly with regard to messaging around the importance of informing HMRC of a change of address.

SPECIFIC ACTIVITY UNDERTAKEN IN 2017-18

- Comparison of HMRC address data with third party address data

As part of the preparations for the commencement SRIT in 2016, HMRC undertook a data clash exercise which looked to match HMRC address records with third party data. This enabled HMRC to test if our identification of Scottish taxpayers was corroborated by other address records (firstly using sources including the Electoral roll and data held by credit reference agencies and then using employer records). The results of this exercise provided evidence to suggest that HMRC's identification of Scottish taxpayers was correct in 98-99% of cases. This year a similar exercise was undertaken to establish whether HMRC's address data and thus its identification of Scottish taxpayers, remains accurate.

The comparison of HMRC address records with third party data found that where an individual was identified in both data sets, the third party data corroborated the taxpayer status in 99.9% of such cases. Where third party data suggested an alternative potential address on the opposite side of the Scotland/England border to that held by HMRC, a letter was sent to the individual asking them to update their address data. Sample data suggests that a significant majority of those recipients who replied indicated that the HMRC held address was correct.

For those records where a match between HMRC and third party data was not found, HMRC sought alternative corroborating evidence for taxpayer status. All remaining active records with a Scottish address and correct NINO were analysed for evidence of a Scottish employer. In the majority of such cases records showed the HMRC Scottish address record accompanied by the PAYE reference of a Scottish employer, corroborating HMRC's taxpayer status.

The completion of this second exercise left just 3.5% of HMRC's address records still uncorroborated. However, it should be noted that, as was the case when HMRC previously undertook these address assurance exercises:

- the second exercise could not provide corroborating evidence for those in self-employment or working for a UK business operating in Scotland but registered elsewhere in the UK (i.e. many big cross-UK employers). There is no alternative way of providing corroborating evidence for such records; and that
- an uncorroborated taxpayer status doesn't mean an incorrect taxpayer status, evidence from the third party data comparison suggests HMRC's data may be more up to date than the third party's data.

As such, the evidence of this year's assurance exercises continues to provide evidence to support the view that HMRC's identification of Scottish taxpayers remains correct in 98-99% of cases.

- Ongoing process to ensure accuracy of 'S' codes on Scottish taxpayers under Section 80D(4) of Scotland Act.

All Scottish Parliamentarians are automatically Scottish taxpayers, regardless of their residence (by virtue of Section 80D(4) of Scotland Act). HMRC can confirm that all Scottish Parliamentarians have a PAYE code identifying them as Scottish taxpayers.

- Quality Management checks on postcode data supporting the identification of Scottish taxpayers.

Postcodes and the properties within them occasionally change to reflect new properties being built and subdivision of existing properties. HMRC receives quarterly post code updates from Royal Mail and with it updates its processes for flagging Scottish residency to ensure ongoing postcode accuracy.

SECTION 2 – COLLECTING & ACCOUNTING FOR SCOTTISH INCOME TAX REVENUES

The SLA requires HMRC to:

- ***Collect and account for Scottish income tax revenues Scottish income tax rates.***

HM Revenue & Customs (HMRC) continues to administer and collect Scottish income tax as part of the UK tax system. It pays Scottish income tax revenues into the UK Consolidated Fund in the same way as it does for all other tax receipts. These revenues are subsequently transferred to the Scottish Government and the Scottish Government's resource block grant will be reduced accordingly, reflecting its revenue-raising powers.

HMRC will account for the amount of Scottish income tax collected and report this in an Extract of HMRC's Accounts to the Scottish Parliament each year.

Scottish Rate of Income Tax – 2016-17

For 2016-17, the only year for which Scottish Rate of Income Tax (SRIT) legislation applies, the amount of income tax receipts attributable to the Scottish Government budget is £4.35 billion. This figure was included in the HMRC 2017-18 accounts and has therefore been audited by the National Audit Office.

This time lag in confirming the actual amount of SRIT collected in 2016-17 is due to the Pay As You Earn (PAYE) and Self Assessment (SA) processes for the UK. To administer PAYE for taxpayers, HMRC undertakes an end-of-year-reconciliation to assess whether individuals have paid too much or too little tax in any given tax year. Similarly, SA tax returns are, in some cases, not provided to HMRC until ten months after the end of the tax year to which they relate.

Further Income Tax Powers – 2017-18 onwards

In addition to publishing the final outturn figure for 2016-17 SRIT receipts, HMRC's 2017-18 Accounts included the first estimate of Scottish income tax receipts arising from the further powers in 2017-18 of £11.9 billion. From 2017-18 onwards, all the income tax on non-savings, non-dividend income of Scottish taxpayers will be attributed to the Scottish Government's budget.

Other analysis

In addition to the 2016-17 Scottish Income Tax outturn and 2017-18 Scottish Income Tax forecast figures, HMRC has produced and shared other information to support the Scottish Fiscal Commission's forecasting and the calculation for the Block Grant adjustment.

The 2016-17 rUK non-savings/non-dividends final outturn figure

Table 1 below shows the revenue from income tax on non-savings/non-dividend (NSND) income for non-Scottish taxpayers (i.e. rest of the UK or rUK taxpayers) in 2016-17. The table also shows the components of the rUK figure. These are the same components as set out in the table describing the final revenue for Scottish Income

Tax (SIT) reported in the technical note accompanying HMRC's 2018 Trust Statement. This showed that Scottish income Tax, for 2016-17, would have been £10.72bn if the further income tax powers from the Scotland Act 2016 were in place for 2016-17. The rUK figure, outlined in Table 1 below, is compiled in line with the income tax powers devolved to Scotland as part of the Scotland Act 2016, where all tax on NSND income from Scottish taxpayers is SIT.

Table 1 – 2016-17 Income Tax Revenue from Non-Saving, Non-Dividend (NSND) Income of Scottish and non-Scottish Taxpayers*

| | rUK NSND (£bn) | Scottish NSND (£bn) |
|---|---------------------------|--------------------------------|
| SA Established Liability** | 79.76 | 4.36 |
| PAYE Established Liability | 68.21 | 6.37 |
| Estimated further Liability | 5.77 | 0.31 |
| Less: Adjustment for uncollectable amounts | (1.09) | (0.07) |
| <u>Reliefs***</u> | | |
| Relief at Source (RAS) | (1.73) | (0.15) |
| Gift Aid | (1.20) | (0.11) |
| Final Revenue for the tax year 2016-17 | 149.71 | 10.72 |

* Based on Scottish powers from Scotland Act 2016

** Includes an element of PAYE for SA customers

*** These reliefs are those not allocated to individual taxpayer accounts.

The number of Scottish taxpayers by marginal tax rate

Table 2 shows the number of Scottish taxpayers by their marginal tax rate. Income tax on savings and dividend income has not been considered when assigning an individual to a marginal rate as only tax due on NSND income is devolved to Scotland and so tax on savings or dividends income does not contribute to SIT.

Only individuals with an income tax liability on their NSND income are included and the liability is based only on NSND income.

Table 2 – Number of Scottish taxpayers by marginal rate in 2016-17

| Marginal Rate | Number of Scottish taxpayers |
|-------------------------------|-------------------------------------|
| Basic rate | 2,221,100 |
| Higher rate | 294,000 |
| Additional rate | 13,300 |
| All Scottish taxpayers | 2,528,400 |

The recent pattern of NSND Income tax receipts for Scottish Taxpayers

As part of understanding the pattern of forecast and outturns we thought it would be helpful to provide some commentary on the relationship between the forecast and outturn of the SRIT and SIT.

Comparison of outturn and forecast Scottish income tax (SIT) figures for 2016-17

As part of developing and implementing the devolved tax system in Scotland, the OBR publishes forecasts of SIT. In 2017 HMRC published forecasts of income tax receipts for SRIT in the Trust Statement. The following year HMRC's 2018 Trust Statement published an outturn SRIT for 2016-17. Alongside the 2018 Trust Statement the technical note also published a figure for the outturn of SIT for 2016-17. So for the first time forecasts for SRIT and SIT receipts can be compared to outturn. HMRC intends to use this information to develop and refine its approach to forecasting.

The outturn of SIT was around 6% below the previous forecast which was published in the OBR's 2018 Devolved Tax and Spending Forecast. Outturn SIT has been calculated using a different methodology to forecast SIT and differs in a number of ways. Most notably outturn is calculated by the system in which liability is reconciled (i.e. Self-Assessment or Pay As You Earn). The forecast, by contrast, was calculated by the system in which receipt and repayment occurs. Due to the fundamental difference in approach it is only possible to compare estimates at the global level, and we therefore cannot break down the difference between forecast and outturn into the various explanatory factors.

There are a number of possible factors that account for the difference. Some of these can be tested once the forecast is updated at later fiscal events (e.g. 2016-17 SA data, and, later, the 2016-17 Survey of Personal Incomes).

Forecasts are inherently uncertain and there are several reasons why forecast income tax can differ from outturn. The forecasts of the economic determinates that drive income tax may be revised. For example if the level of employment is different to the forecast there will be an impact on receipts.

In addition to this, the March 2018 forecast did not have the full breakdown of Self-Assessment (SA) returns data for 2016-17, as this data was not available at the time the forecast was constructed. By contrast, the outturn SIT figure was produced later in 2018, and was able to reflect this data.

For 2016/17, the full breakdown was particularly important because of changes to dividend taxation. The SA breakdown is used to inform the share of tax receipts which are NSND (the taxation of which is devolved) and Savings/Dividends (the taxation of which is not devolved). In March 2018, prior to this breakdown being available, an estimate of the respective shares of SA from these income streams was made. Tax receipts in respect of 2016-17 were affected by large changes to the taxation of dividends and savings - there was exceptionally large scope for the NSND liabilities estimate to differ from the estimate on which the March 2018 forecast was based.

Further to this, the March 2018 forecast for SIT was based on a projected share of tax from Scottish taxpayers from HMRC's 2015-16 Survey of Personal Incomes, adjusted for policy changes and population growth. By contrast, the outturn SIT estimate was able to use outturn "Scottish taxpayer" flags from HMRC administrative data to

identify Scottish taxpayers. Although the SPI is considered representative of the UK taxpayer population, it is less reliable at a sub-UK level. Projecting the SPI data by one tax year also introduces further uncertainty, including the difference between projected and actual wage growth and changes in population.

Comparison of 2016-17 outturn SIT and forecast 2017-18 SIT

The forecast for 2017-18 SIT in the Trust Statement is broadly unchanged from that scrutinised by the OBR and published in their March Devolved Tax and Spending publication. No major methodological updates were made, although there were updates as a result of more recent PAYE data. The updated PAYE data fed into the Trust Statement 2018 PAYE figures, and also affected the NSND figures from which the SIT forecast is based. This is a relatively small update as most of the 2017-18 PAYE information was held by the time of the March 2018 forecast.

The 2016-17 SIT outturn was produced later in the Trust Statement process, and was not incorporated into this forecast. The forecast for 2017-18 SIT was based on the established methodology used in previous years when the outturn was not available. So the forecast for the 2017-18 SIT does not reflect the lower than expected outturn in the previous year. As a result, the 2017-18 forecast may well be revised down and the current implied high level of growth in SIT between 2016-17 and 2017-18, although possible, is unlikely. Future forecasts (e.g. at subsequent fiscal events) will be able to take on board outturn SIT figures.

SECTION 3 – CUSTOMER SERVICE & SUPPORT

The SLA requires HMRC to:

- ***Apply the same level of customer service, support and transparency to Scottish income taxpayers as is applied to income tax payers in the rest of the UK.***

HMRC continues to administer Scottish income tax as part of the UK income tax system. In the vast majority of circumstances Scottish taxpayers will therefore notice no difference in the manner in which HMRC interacts with them and ensures that the correct amount of tax is collected.

Scottish income tax will continue to be collected through existing PAYE and Self-Assessment processes which have been adapted to accommodate Scottish income tax rates and thresholds. Scottish taxpayers will also continue to be able to use HMRC guidance and customer contact channels for advice and guidance.

In the majority of areas customer service provided to Scottish taxpayers will therefore be included and reported within HMRC's UK customer service reporting.

The customer service and support for Scottish taxpayers, agents and employers HMRC has incorporated into its existing processes includes the following:

- Providing all Scottish taxpayers and their employers with Scottish tax codes (reflecting the changed higher rate threshold decided on by the Scottish Parliament) prior to the start of the tax year.
- Updating online calculators with the Scottish income tax rates/thresholds set by the Scottish parliament to ensure they remain accurate for Scottish taxpayers.
- Guidance for payroll software providers on how to correctly incorporate Scottish rates/thresholds into their PAYE products for employers.
- Guidance on how Scottish taxpayer status is decided and what to do if you feel HMRC has wrongly identified your status
- Issuing paper tax tables to digitally exempt employers reflecting Scottish rates and thresholds.

While most interaction Scottish customers have with HMRC will be via existing processes (and customer service therefore reported within UK figures) some aspects of customer service are specific to Scottish income tax e.g. guidance on Scottish taxpayer status and ability to discuss with HMRC if you disagree with the Scottish tax code you've been given.

It is important that HMRC can demonstrate that its customer service in these, albeit limited, areas matches that it provides across the UK as a whole. The SLA between HMRC and the Scottish Government therefore commits HMRC to collect and report on key, Scottish income tax specific, customer contact metrics – the key metrics for 2017-18 are outlined in Annex A to this report.

SECTION 4 – DATA FOR SCOTTISH INCOME TAX RATE SETTING AND FORECASTING.

The SLA requires HMRC to:

- ***Provide the Scottish Government with sufficient relevant and timely information and data for rate-setting and forecasting for Scottish income tax.***

An overarching aim of the Service Level Agreement between HMRC and the Scottish Government is for HMRC to provide the Scottish Government with the data it needs to allow it to discharge its own duties in respect of Scottish income tax.

Key to enabling this is for HMRC to provide Scottish Government with relevant data to discharge its duties in respect of rate-setting and forecasting (alongside the Scottish Fiscal Commission) for Scottish income tax. At a UK level, these tasks are fulfilled using the Survey of Personal Incomes (SPI).

The SPI is compiled to provide a quantified evidence base from which to cost proposed changes to tax rates, personal allowances and other tax reliefs for Treasury Ministers. It is used to inform policy decisions within HMRC and the Treasury, as well as for tax modelling and forecasting purposes¹.

The SPI is based on information held by HMRC on individuals who could be liable to UK tax. It is carried out annually by HMRC and covers income assessable to tax for each tax year. Not all of the individuals are taxpayers because the operation of personal reliefs and allowances may remove them from liability. Where income exceeds the threshold for operation of Pay-As-You-Earn (PAYE), the survey provides the most comprehensive and accurate official source of data on personal incomes.

HMRC provides the Scottish Government with an annually updated copy of the SPI data set. This year's set was provided earlier, on request, in May 2018 to both the Scottish Government and Scottish Fiscal Commission from which to undertake their policy costing and receipts forecasting duties. This copy was identical to that used, for similar purposes, at a UK, with the exception of some minor aggregation of taxpayer data at the highest income levels to avoid potential breaches of taxpayer confidentiality. HMRC continues to work with the Scottish Government and Scottish Fiscal Commission to ensure the information provided meets their requirements and supports forecasting and rate setting for Scotland.

This SPI data set is subsequently published to enable researchers and academics to use it for statistical purposes.

¹ It is also used to provide summary information for the National Accounts that are prepared by the Office for National Statistics and to provide information to Members of Parliament, other Government Departments, companies, other organisations and individuals.

SECTION 5 – DATA FOR SCOTTISH GOVERNMENT CASH MANAGEMENT

The SLA requires HMRC to:

- ***Provide Scottish Government with sufficient relevant and timely information and data to discharge its duties in respect of cash management due to any change between forecast and collected amounts of Scottish income tax.***

From 2017-18, with the Scottish Parliament taking on further income tax powers, there will be a reduction in Scotland's resource block grant equal to the total non-savings non-dividend income tax generated in Scotland in 2016-17, uplifted using the mechanism set out in the fiscal framework agreed between the UK and Scottish Governments in February 2017.

Each year, both the tax receipts generated and the block grant deduction will initially be based on a forecast and then reconciled to actual receipts collected which will become known around 15 months after the end of the financial year in question.

A key requirement of the SLA is therefore for HMRC to provide the Scottish Government with sufficient data to discharge its duties in respect of cash management linked to any change between forecast and collected amounts of Scottish income tax. To fulfil this requirement HMRC have agreed with the Scottish Government and Scottish Fiscal Commission to provide **Scottish Income Tax figures from the Real Time Information (RTI) data received from employers**. This is the best indication of trends in income tax liabilities available in real time, but is not a complete picture of income tax liabilities because it excludes tax paid through self-assessment [and some adjustments made to PAYE liabilities] after the end of the tax year. This data is now provided by HMRC to Scottish Government on a monthly basis.

HMRC will work with Scottish Government and Scottish Fiscal Commission to better analyse and understand the figures before publishing more widely. Once a common understanding of this new data set is reached the intention is for HMRC to publish these figures, initially as experimental statistics, to a timetable aligned with monthly publication of UK receipts.

SECTION 6 – RECHARGING OF HMRC COSTS: DATA FOR SCOTTISH GOVERNMENT ASSURANCE/BUDGETING PURPOSES

The SLA requires HMRC to:

- ***Provide the Scottish Government with sufficient relevant and timely information for assurance purposes and to budget effectively for any net additional administrative costs to be recharged to the Scottish Government.***

HMRC is responsible for the operation of Scottish Income Tax as part of the UK Income Tax system. Under the Fiscal Framework Agreement between the UK and Scottish Government, the Scottish Government will reimburse the HMRC for net additional costs wholly and necessarily incurred as a result of the implementation and administration of Scottish income tax powers.

Under HMRC's Tax Devolution Programme and Projects, HMRC has made changes to its systems and processes to ensure the effective and efficient collection and management of Scottish Income Tax. Associated with these changes are new and ongoing administrative costs to operate Scottish income tax processes and systems.

HMRC and Scottish Government have jointly agreed a framework that sets out the principles that HMRC will apply when identifying the Scottish Income Tax administrative costs that will be recharged to the Scottish Government.

The Framework document will be kept up to date to reflect all known and anticipated administrative costs and should be read in conjunction with the Memorandum of Understanding and Service Level Agreement (to which it is annexed) between HMRC and the Scottish Government.²

² The Memorandum of Understanding can be found at: <https://beta.gov.scot/publications/scottish-income-tax-powers-memorandum-of-understanding/Scottish%20Income%20Tax%20-%20Memorandum%20of%20Understanding,%20December%202016.pdf?inline=true>

ANNEX - HMRC Annual Report – Scottish Income Tax 2017-2018

Annual Business Intelligence Report

Customer contact - Telephone

HMRC introduced a Scottish income tax telephone route within the HMRC Personal Tax helpline. This gives customers generic pre-recorded Scottish income tax messages prior to speaking to an HMRC Customer Advisor. These figures do not represent all calls by Scottish taxpayers to HMRC.

| Quarter | Total Calls | IVR (ITA) Deflected | Busy | Abandoned in Queue | Average wait before abandoned | Average Queue of answered | Answered | Percentage Answered In | | | | | |
|---------------|-------------|---------------------|-------|--------------------|-------------------------------|---------------------------|----------|------------------------|----------|----------|-----------|------------|----------|
| | | | | | | | | <2mins | 2-3 mins | 3-5 mins | 5-10 mins | 10-20 mins | >20 mins |
| Quarter 1 | 1,703 | 26 | 1,153 | 34 | 04:21 | 05:19 | 490 | 32.9% | 1.8% | 5.6% | 14.0% | 26.7% | 18.9% |
| Quarter 2 | 348 | 12 | 10 | 34 | 05:55 | 05:51 | 292 | 26.9% | 1.3% | 5.2% | 11.8% | 32.0% | 19.0% |
| Quarter 3 | 290 | 30 | 8 | 24 | 03:51 | 05:45 | 228 | 27.2% | 3.3% | 1.3% | 8.5% | 28.1% | 13.1% |
| Quarter 4 | 217 | 24 | 7 | 18 | 05:41 | 06:04 | 168 | 21.7% | 1.6% | 3.3% | 7.5% | 20.3% | 10.8% |
| Total/Average | 2,558 | 92 | 1,178 | 110 | 04:57 | 05:45 | 1,178 | 27.2% | 2.0% | 3.9% | 10.5% | 26.8% | 15.4% |

Customer contact - Post

HMRC track all post to ensure the correspondence is being processed within customer service targets. Scottish income tax post enquiries are monitored as part of the wider “Impact Indicators – Customer measures” which are published on Gov.uk in the “Business plan indicators quarterly performance update”.

HMRC received no Scottish income tax specific postal queries in the year to April 2018. This figures **does not** represent all postal enquiries by Scottish taxpayers to HMRC.

Complaints

HMRC track all Scottish income tax customer complaints to ensure they are processed within the HMRC customer service targets. These figures do not represent all customer complaints received from Scottish taxpayers.

| Quarter | Less than 15 days | More than 15 days | HMRC Target % | Less than 15 days | More than 15 days |
|-----------|-------------------|-------------------|---------------|-------------------|-------------------|
| Quarter 1 | 0 | 0 | 80% | 0% | 0% |
| Quarter 2 | 0 | 0 | 80% | 0% | 0% |
| Quarter 3 | 1 | 0 | 80% | 100% | 0% |
| Quarter 4 | 3 | 1 ** | 80% | 75% | 25% |
| Total | 4 | 1 | 80% | 80% | 20% |

** cleared on 16th day.

Details of all customer contact are included in the HMRC Annual Report

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/726849/HMRC_Annual_Report_and_Accounts_2017-18_web.pdf

Web-hits

HMRC have a number of Scottish income tax related webpages that are hosted on [gov.uk](https://www.gov.uk), hits to these pages are monitored.

| Quarter | scottish-income-tax | guidance/work-out-if-youll-pay-the-scottish-rate-of-income-tax | hmrc-internal-manuals/scottish-taxpayer-technical-guidance | tell-hmrc-change-of-details |
|-----------|-------------------------------------|--|--|---|
| Quarter 1 | 20,409 | 1,796 | 382 | 272,532 |
| Quarter 2 | 29,165 | 1,440 | 341 | 327,786 |
| Quarter 3 | 68,509 | 3,092 | 616 | 352,675 |
| Quarter 4 | 81,348 | 2,972 | 820 | 397,741 |
| Total | 199,431 | 9,300 | 2,159 | 1,350,734 |

HM Revenue and Customs

Annual Report and Accounts 2017/18

Extract covering matters relating to Scottish Income Tax

Introduction

Paragraph 6.2 of the Memorandum of Understanding¹ (MoU) between HMRC and the Scottish Government relating to Scottish Income Tax (SIT) confirms that HMRC will provide the Scottish Parliament with an extract from their accounts covering all matters relating to SIT. This paper provides the required extract from the 2016/17 accounts.

Scottish income tax powers commenced in April 2016. This extract reflects both the funding HMRC has received from Scottish Government in respect of the marginal cost of implementing SIT (which is shown in the Resource Account) and an outturn of the 2016/17 tax paid at the Scottish rate (which is shown in the Trust Statement). This is consistent with HMRC's written evidence² to the Scottish Parliament's Public Audit Committee (22 May 2014), that the 2017-18 accounts will show the final figure for 2016-17 and an indicative figure for 2017-18.

The National Audit Office has examined HMRC's spending in 2017-18, our outturn of SIT receipts and the effectiveness of our implementation/administration of SIT. NAO will be laying before the Parliament a report setting out its findings, as required by section 80HA of the Scotland Act 1998, as inserted by the Finance Act 2014.

Extract from HMRC Resource Account (p149) - the full document is available [here](#)³

"Figure 70: Analysis of income where full cost exceeds £1 million"

The fees and charges table lists the services HMRC provides to external and public sector customers where the full cost to HMRC exceeds £1 million. In accordance with HM Treasury guidance on managing public money, it is HMRC's financial objective to recover the full cost of each service unless otherwise stated. Disclosed in the table for each service is the income received, the full cost incurred and the amount of any surplus or deficit between the income received or full cost charged. Surpluses and deficits can arise for a number of reasons, including demand fluctuations or variations to HMRC costs during the year.

| Fees and charges raised by the core department | 2017-18 (£m) | | | 2016-17 (£m) | | |
|--|--------------|-----------|--------------------|--------------|-----------|--------------------|
| | Income | Full cost | Surplus/ (deficit) | Income | Full cost | Surplus/ (deficit) |
| Scotland Act Implementation ³ | 4.5 | 4.8 | (0.3) | 6.2 | 6.2 | - |

³ The Scotland Act 2012 and Scotland Act 2016 gave the Scottish Parliament powers over income tax which have applied from 2016-17 onwards. This tax is accounted for within HMRC's Trust Statement, see pages 180 to 182. HMRC has incurred costs which are included in the Resource Accounts.

¹ <https://beta.gov.scot/publications/scottish-income-tax-powers-memorandum-of-understanding/Scottish%20Income%20Tax%20-%20Memorandum%20of%20Understanding,%20December%202016.pdf?inline=true>

²

http://www.parliament.scot/S4_PublicAuditCommittee/General%20Documents/HMRC_responses_to_Pac_May_22.pd

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³

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/628377/HMRC_Annual_Report_and_Accounts_2016-17__print_.pdf

13. Scottish income tax (p180)

Last year a note on the new Scottish rate of income tax appeared for the first time in the Accounts which included a provisional estimate for the financial year 2016-17. The final outturn figure for 2016-17 is now available and is shown in the note below broken down into its key components. The note finishes by providing a provisional estimate for 2017-18. This will be refined during 2018-19 as further information on revenue for the 2017-18 tax year becomes available. Updated figures will be provided in the 2018-19 Trust Statement.

13.1 Scottish rate of income tax 2016-17

The Scotland Act 2012 gave the Scottish Parliament the power to set a Scottish rate of income tax. Scottish rate of income tax (SRIT) applies to non-savings non-dividend (NSND) income. It allows the Scottish Government to change the amount of income tax that Scottish taxpayers pay and, as a result, the amount that the Scottish Government had to spend in Scotland. Extract from Notes to the Trust Statement (p161)

SRIT replaced ten percentage points of each of the main UK rates of tax from the 2016-17 tax year. In that year the UK basic, higher and additional rates for NSND income were reduced by 10p in the pound for Scottish taxpayers. This reduction was replaced by a Scottish rate set at ten percentage points, so the overall rates paid by Scottish taxpayers remained the same as elsewhere in the UK.

A provisional estimate of £4.6 billion raised through the SRIT for 2016-17 was disclosed in last year's accounts. This reflected revenue solely relating to the ten percentage points of tax set by the Scottish Parliament, rather than all income tax paid by Scottish taxpayers. This figure was estimated as much of the actual data, for example outturn data for Self Assessment (SA), was unavailable at that point.

Now that most of the actual data is available, the final outturn figure of £4.35 billion for the funds raised through SRIT in 2016-17 is shown in table 1 below – this reflects revenue solely relating to the ten percentage points of tax set by the Scottish Parliament, rather than all income tax paid by Scottish taxpayers.

Table 1 SRIT final outturn figure for the tax year ending 5 April 2017

| | | <u>£bn</u> |
|---|--------|-------------------|
| SA established SRIT liability* | | 1.45 |
| PAYE established SRIT liability | | 2.94 |
| Estimated further SRIT liability: | | 0.11 |
| Less amounts estimated for: | | |
| Adjustment for uncollectable amounts | (0.03) | |
| Reliefs** Relief at Source (RAS) | (0.07) | |
| Gift Aid | (0.05) | (0.15) |
| Final SRIT revenue for the tax year 2016-17 | | 4.35 |

Estimated further SRIT liability

Although most of the 2016-17 tax liabilities have been established, there will still be some outstanding amounts identified which will be collected after the publication of the 2017-18 Accounts. In table 1 HMRC have estimated how much of the remaining liability it expects to collect based on a sample of HMRC taxpayer data over the years 2009-10 to 2015-16 to establish the historic pattern of liabilities reported late. There will be a small proportion of the SRIT liability that is never collected (as is the case with UK-wide revenues). This is shown separately as 'adjustment for uncollectable amounts' and comprises two elements.

- Adjustment for uncollected SA amounts is estimated based on the same sample of HMRC taxpayer data in the paragraph above and by applying the average from these historic collection rates to the established and unestablished SA liabilities as at April 2018.

- Adjustment for uncollected PAYE amounts is estimated by analysing data for the last four years and the PAYE schemes, who are known to have had an amount remitted or written off by April 2018. RTI data is then analysed for each of these PAYE schemes to calculate what proportion of total tax collected by these schemes is in respect of Scottish taxpayers in order to allocate the uncollected amount proportionally between SRIT and the rest of the UK.

Two tax reliefs also need to be factored into the calculation – ‘Gift Aid’ and pensions tax relief paid under the ‘Relief at Source (RAS)’ process.

- Gift Aid – An estimate of the Scottish taxpayer share of donations on which Gift Aid has been reclaimed has been made based on repayments made to charities up to April 2017, combined with a forecast of how much is expected after April 2017. The SRIT share has been calculated by analysing donations and postcode data.
- Pensions RAS – As part of the transitional arrangements until 2018-19, HMRC needs to estimate the amount of RAS tax relief which is attributable to Scottish taxpayers and include this in the calculation. After this point, it will be possible to use actual information from pension firms. The RAS for pension contributions in this SRIT calculation is determined by using information from annual returns and identifying individual contributions made by scheme members who have a Scottish postcode.

13.2 Scottish income tax 2017-18 onwards

The Scotland Act 2016 further enhanced the Scottish Parliament’s tax raising powers, allowing the Scottish Parliament to set and change its own tax rate bands and limits, introduce new ones, and include a zero rate to all NSND income tax paid by Scottish taxpayers. These enhanced powers were introduced from tax year 2017-18.

In 2017-18 Scottish income tax rates and thresholds were set at the same levels as those applicable elsewhere in the UK, with the exception of the higher rate threshold which was set at £43,000 in contrast to the £45,000 level for taxpayers elsewhere in the UK. These further Scottish income tax powers also ensure that all monies (i.e. not just the ten percentage points represented by SRIT) in respect of Scottish income tax go to the Scottish Government.

The provisional estimate of revenue raised from Scottish income tax in 2017-18 is £11.9 billion. This figure has been estimated because actual data is unavailable, for example in respect of SA revenue for the 2017-18 tax year where minimal disclosure has been made to HMRC, and PAYE revenue for taxpayers whose accounts have not been reconciled before this document is published. It also includes estimates for the impact of budget measures, Gift Aid and other effects, such as the High Income Child Benefit Charge and broader demographic changes before the amount is apportioned between Scotland and the remainder of the UK.

The Scottish share of income tax liabilities is estimated using a simulation model based on the HMRC Survey of Personal Incomes which reflects data collected in 2015-16.

The methodology behind the estimate is broadly similar to that used for estimating the SRIT 2016-17 revenue. However, the estimate reflects the extension of income tax powers to all NSND income and the 2017-18 Scottish higher rate threshold differing from that for taxpayers elsewhere in the UK.

Further information available during 2018-19 will allow refinement of these calculations. Updated figures will be disclosed in the 2018-19 Trust Statement, allowing a final reconciliation for the prior tax year.