



HM Revenue
& Customs

Jonathan Athrow
Director General
Customer Strategy & Tax Design
100 Parliament Street
London
SW1A 2BQ

By email only

Tel 03000 541029

Email jonathan.athow@hmrc.gov.uk

3rd November 2022

Dear Richard,

Thank you for your letter of 4 October on HMRC's administration of Scottish income tax (SIT). I will address the issues you have raised, concerning our use of estimates and the impact of COVID-19 on our compliance work, in turn.

HMRC's use of estimates in the administration of SIT

I also agree with the Comptroller and Auditor General regarding the importance of continuing to maintain an accurate record of the Scottish taxpayer population and monitor the risk of SIT non-compliance. Our identification of Scottish taxpayers is based on address information we hold about individuals across the UK, not on estimates or samples. We receive this information from a variety of sources, including individuals and employers.

As my colleague Jackie McGeehan said when we gave evidence to the Public Audit Committee on 12 May, we have undertaken an exercise to compare the address data we hold with equivalent private sector data. This has enabled us to corroborate 98 to 99% of Scottish taxpayers as being resident in Scotland. The remaining 1 to 2% are not necessarily taxpayers whose residency status is incorrect, but those for whom we have been unable to corroborate that status as part of the exercise. We continue to assess the risk of SIT non-compliance, and an explanation of this risk and our plan to address it is provided to the Scottish Government each year.

The outturn methodology reflects trade offs between timeliness and budgetary certainty discussed below. The current SIT outturn methodology was developed through consultation with the Scottish Government and agreed by the Scottish Income Tax Board, which oversees our administration of SIT and includes Scottish Government representatives. The methodology has also been the subject of extensive review and analysis by the National Audit Office.

The final SIT outturn statistics are published around 14 months after the end of the tax year they relate to. This is due to various lags which are a feature of the income tax system, such

as the Self Assessment (SA) filing deadline taking place the January after the tax year the returns relate to. HMRC's analysis is therefore based on near complete administrative data from SA and Pay As You Earn (PAYE) taxpayers. Around 97 per cent of the final SIT outturn figure comes from established data, and around 3 per cent being estimated.

The remainder of the final SIT outturn figure is estimated to account for liabilities that may be established in the future and those that HMRC estimates will not be collected. For example, late filing and compliance activity can lead to liabilities being established several years after the tax year in question, or income tax debts can be written off due to insolvency. HMRC's estimates of unestablished liabilities are themselves based on analysis of historic data. The production of the SIT outturn will always require a degree of estimation due to liabilities continuing to be established for several years after the statistics for a given tax year are published.

Increasing the lag between the end of the tax year and the production of the statistics would somewhat reduce the reliance on estimates, since more late returns/payments would have been received and more compliance activity completed in relation to the outturn tax year. However, this would mean there is a long period between the end of the tax year and the final reconciliation for that tax year, leading to greater budgetary uncertainty.

Similarly, the reliance on estimates could be somewhat reduced if past years' outturn figures were revised with the latest data each time the statistics are published. However, this would mean that the figures for all past outturn tax years could change annually, with implications for the combined overall reconciliation and increased budgetary uncertainty.

Any methodological changes would require agreement with colleagues in the Scottish Government and HM Treasury. Scottish Government and HM Treasury colleagues have previously emphasised the importance of maintaining a consistent methodology for estimating the Scottish outturn. This ensures funding for the Scottish Government is not impacted by purely methodological changes, rather than real changes in income tax liabilities in Scotland and the rest of the UK.

Impact of COVID-19 on compliance

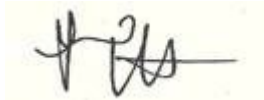
Broadly speaking, HMRC aims to maintain a stable tax gap, which is the difference between the tax we would raise if everyone complied with the law and actual tax receipts, and is therefore a measure of non-compliance. In addition, HMRC has received funding to tackle specific tax gap risks, and over time this has allowed us to actually reduce the tax gap. Nonetheless, without HMRC intervention we would expect the tax gap to grow, so our compliance activity as measured by compliance yield needs to keep pace. But the compliance yield needed to keep the tax gap stable will vary according to a number of factors. As the tax gap is expressed as a proportion of receipts, we therefore expect the required value of compliance yield will vary in proportion to the size of the economy and tax receipts over the medium to long term. Reduced tax receipts during the COVID-19 pandemic therefore naturally reduced our yield performance.

Even after adjusting for lower economic activity in the two pandemic years, compliance performance was below the level to maintain a stable tax. Some of this gap is just timing effects. During the pandemic we moved many of our experienced compliance staff to tackle error and fraud in the Covid support schemes. We then backfilled the tax compliance work with new staff who will take some time to become fully productive. There were also some other delays introduced by the pandemic reflecting more general disruption. Given timing variances, compliance yield performance should always be considered on a multi-year rolling average basis.

In any year, the department will decide how best to deploy its finite compliance resources against available risks to deliver the best outcomes. Any tax compliance cases that were not acted on during the COVID period are not lost. They are still there and available for the department to work. HMRC constantly assesses the full range of risks available, both new and historical, when deciding how best to deploy its resources. HMRC's approach is to prioritise according to robust risking processes. Compliance yield is a very important performance indicator for HMRC, and therefore plays an important role in planning activities.

In 2021-22 HMRC collected or protected £30.8 billion compliance yield, and the department's debt balance was £41.6bn at the end of March 2022. In the 2022-23 Annual Reports and Accounts, expected to be published in July 2023, we will publish the 2022-23 compliance yield and debt figures.

I hope this response is helpful.

A handwritten signature in black ink, appearing to read 'J Athow', is placed on a light yellow rectangular background.

Jonathan Athow,
Director General, Customer Strategy & Tax Design