

**THE ADMINISTRATION OF THE SCOTTISH RATE OF INCOME TAX 2014/15  
REPORT TO THE SCOTTISH PARLIAMENT'S PUBLIC AUDIT COMMITTEE  
BY THE AUDITOR GENERAL FOR SCOTLAND**

## **Introduction**

1. From April 2016, the Scottish Parliament will set a new Scottish rate of income tax (SRIT). The main UK rates of income tax will be reduced by ten pence for each tax band for Scottish taxpayers. Each year, the Scottish Parliament will vote to approve the Scottish rate to be added to the reduced UK rates. Taxes raised by the SRIT will be added to the Scottish Government's budget and a corresponding reduction will be made to the block grant funding that the Scottish Government receives from the UK Government.
2. HM Revenue and Customs (HMRC) will collect and administer the SRIT and is responsible for the project to implement it. The Scottish Government is responsible for funding this project and ensuring that the cost of the SRIT represents value for money and for seeking assurances that the new system will collect the correct amount of tax.
3. The reimbursement by the Scottish Government of HMRC's costs incurred in implementing the SRIT is identified separately in HMRC's Resource Accounts. From 2014/15, HMRC provides the relevant audited extracts of its accounts to the Scottish Parliament for scrutiny each year.<sup>1</sup> For 2014/15 and 2015/16, the accounts will relate only to the setting up of systems to calculate and collect the SRIT. From 2016/17, the first year of operation of the SRIT, HMRC's Trust Statement will disclose the SRIT collected and the application of related rules and procedures.

## **Audit and assurance**

4. HMRC's accounts are audited by the National Audit Office (NAO). The Comptroller and Auditor General is required to report to the Scottish Parliament on HMRC's administration of the SRIT by 31 January of the financial year after the one to which the report relates.<sup>2</sup> Specifically, the Comptroller and Auditor General is required to report on:
  - the adequacy of any of HMRC's rules and procedures put in place, in consequence of the Scottish rate provisions, for the purpose of ensuring the proper assessment and collection of income tax charged at rates determined under those provisions
  - whether these rules and procedures are being complied with
  - the correctness of the sums brought to account by HMRC which relate to income tax which is attributable to a Scottish rate resolution; and
  - the accuracy and fairness of the amounts which are reimbursed to HMRC as administrative expenses incurred as a result of the charging of income tax.

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<sup>1</sup> Memorandum of understanding on the Scottish rate of income tax, Scottish Government and HM Revenue and Customs, February 2013.

<sup>2</sup> Section 80HA of the Scotland Act 1998, inserted by section 297 of the Finance Act 2014.

5. The Public Audit Committee of the Scottish Parliament recommended that I should provide additional assurance on the NAO's audit work on the SRIT.<sup>3</sup> I make this report in response to that recommendation.
6. The Comptroller and Auditor General and I have confirmed to the Public Audit Committee that we will work together to ensure that the Scottish Parliament receives appropriate reports on the operation of the SRIT. We have agreed a Memorandum of Understanding that describes our respective powers and responsibilities and sets out a framework for collaborative working.
7. I am reporting separately on the preparations for the implementation of the Scotland Act 2012.<sup>4</sup> This includes my assessment of how the Scottish Government is working with HMRC to prepare to introduce the SRIT in April 2016.

### **Audit Scotland's review of the NAO's audit work on SRIT**

8. The Comptroller and Auditor General made his first report to the Scottish Parliament on SRIT on 26 November 2015. As the SRIT has yet to be introduced, his report considers the accuracy and fairness of the amounts reimbursed to HMRC by the Scottish Government and the progress HMRC has made in implementing systems that will ensure the proper collection and assessment of income tax under the SRIT.
9. Audit Scotland considered the NAO's planning and approach to its audit work on the SRIT, discussing this with the NAO staff involved in the work. On completion of the NAO's audit work, Audit Scotland met with the NAO to review its documentation and the basis for the findings and conclusions included in the Comptroller and Auditor General's report.
10. In particular, Audit Scotland considered:
  - the NAO's approach to identifying the key risks to the successful implementation of SRIT
  - the NAO's audit working files, with particular focus on the audit evidence underpinning the key findings and conclusions in its report; and
  - the NAO's arrangements for ensuring the quality of the audit work and reporting.
11. Audit Scotland's review was limited to consideration of the NAO's audit work; it did not directly review evidence obtained from HMRC or discuss any matters relating to SRIT directly with HMRC. The judgements and conclusions set out in the report of the Comptroller and Auditor General are his alone, based on the audit work undertaken by the NAO on his behalf.

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<sup>3</sup> Public Audit Committee, 1st Report, 2014 (Session 4): Framework for auditing the Scottish rate of income tax

<sup>4</sup> Preparations for the implementation of the Scotland Act 2012, Auditor General for Scotland, December 2014

## Conclusion

12. On the basis of Audit Scotland's review, I am satisfied that the NAO's approach was sufficient and robust and that its audit work covered the key audit risks. I am also satisfied that the findings and conclusions in the Comptroller and Auditor General's report are reasonably based.
13. In relation to the key findings in the Comptroller and Auditor General's report, I would in particular draw the Committee's attention to the following matters:

- (C&AG key finding 4). *HMRC is aware of the risk of tax avoidance and evasion presented by the possibility of a different rate of income tax in Scotland from April 2016. But so far it has put only limited resources into specific planning for potential tax loss as result of SRIT.*

HMRC has developed a clear and detailed compliance strategy that considers the SRIT's impact on taxpayer behaviour and potential tax avoidance and evasion but has yet to confirm the exact nature of the compliance activity it will undertake from April 2016. The most obvious form of non-compliance is cross-border tax avoidance and evasion if there is disparity between the SRIT and the rate of income tax in the rest of the UK. Whether or not there is an overall rate disparity, and even if there is a limited risk of cross-border tax avoidance, the Scottish Government needs assurance that compliance activity that HMRC undertakes will support the effective collection of the SRIT.

- (C&AG key finding 7). *Due to a delay by the Scottish Government in announcing the Scottish Government's budget, letters to individuals will not advise them on the actual SRIT they will pay in the 2016/17 tax year. The delay in announcing the rate leaves an increasingly narrow timeframe for HMRC to react to responses from taxpayers and refine its taxpayer data before SRIT begins in April 2016.*

The UK Government published the outcome of its spending review on 25 November 2015. This included the amount of funding that the Scottish Government will receive by way of block grant. The Scottish Government decided not to publish its draft budget for 2016/17, including the proposed rate for the SRIT, until after this. Consequently, HMRC's communication with Scottish taxpayers will not be able to illustrate the financial impact of the SRIT as intended. This may affect taxpayers' engagement with the new arrangements. It also compresses the time available for HMRC to ensure its taxpayer information is as robust as possible.

14. This is the first year of audit reporting on the SRIT. I will continue to work with the Comptroller and Auditor General to develop our approach to the audit and assurance process relating to the SRIT, taking account of views and comments the Committee may have.