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Public Audit Committee

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Session 6

Thursday 25 April 2024

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PUBLIC AUDIT COMMITTEE
13th Meeting 2024, Session 6

CONVENER

*Richard Leonard (Central Scotland) (Lab)

DEPUTY CONVENER

*Jamie Greene (West Scotland) (Con)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)
*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)
*Graham Simpson (Central Scotland) (Con)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Jonathan Athow (HM Revenue and Customs)
Phil Batchelor (HM Revenue and Customs)
Lorraine King (Scottish Government)
Alyson Stafford (Scottish Government)

CLERK TO THE COMMITTEE

Lynn Russell

LOCATION

The James Clerk Maxwell Room (CR4)

Scottish Parliament

Public Audit Committee

Thursday 25 April 2024

[The Convener opened the meeting at 09:00]

Decision on Taking Business in Private

The Convener (Richard Leonard): Good morning. I welcome everyone to the 13th meeting in 2024 of the Public Audit Committee. The first item on our agenda is to agree to take agenda items 3, 4 and 5 in private. Are we agreed?

Members *indicated agreement.*

Administration of Scottish Income Tax 2022-23

09:00

The Convener: Our main item of business this morning is consideration of the report "Administration of Scottish income tax 2022-23". I am delighted to welcome our witnesses. We are joined in the committee room by Alyson Stafford, director general of the Scottish exchequer; Lorraine King, deputy director for tax strategy, engagement and performance at the Scottish Government; Jonathan Athow, director general for customer strategy and tax design at His Majesty's Revenue and Customs; and Phil Batchelor, deputy director for income tax policy at His Majesty's Revenue and Customs.

Good morning to you all. We have a number of questions to put to you. We will get to those shortly but, before we do that, I invite Alyson Stafford and then Jonathan Athow to give short opening statements.

Alyson Stafford (Scottish Government): Thank you, convener, and good morning. It is welcome that the National Audit Office and Audit Scotland continue to assess that HMRC has rules and procedures in place to properly assess and collect Scottish income tax. That said, we are not complacent, and the Scottish Government works with HMRC to examine further areas for improvement. I will highlight three areas that we have focused on since last year's session with the committee.

First, in supporting HMRC to maintain a complete and accurate tax base and to be vigilant in identifying Scottish taxpayers, we have taken the decision to run the third-party data clash exercise in 2024 rather than waiting until 2025, which is what we would have done under the previous pattern. I draw that area to the committee's attention.

Secondly, in recognition of the vital role of compliance work, we have established a joint compliance working group that draws on a range of subject matter experts from compliance business areas within and across HMRC. That group will refresh the assessment of compliance risk so that any changes that are needed can be addressed.

Thirdly, we now publish the minutes of the Scottish income tax board meetings on both the Scottish Government and HMRC websites in order to increase the transparency of the measures that are planned and taken by that board.

We will continue to work with HMRC to ensure that the Scottish public finances are underpinned by tax administration arrangements that function effectively and as intended, and to ensure value for money for taxpayers. Any insights from the committee are welcome.

Jonathan Athow (HM Revenue and Customs): I will draw out two or three main points. I will not repeat what Alyson Stafford said, but we have been administering the Scottish income tax system for a number of years now and we want to learn and continue to innovate. The issues that Alyson addressed are about how we continue to learn. We are on a journey, and we need to make certain that we reflect.

There are some important changes. I am pleased that we were able to promptly introduce the new rate of Scottish income tax this year. That reflected very close working with the Scottish Government and it is a good example of how we can work together to deliver the Scottish Government's agenda on income tax.

We are also continuing to monitor what is going on. Two reports were published yesterday on how we use data to understand what is happening on cross-border migration and how divergence between income tax rates in Scotland and those in the rest of the United Kingdom affects behaviour. We will continue to look at that. We have invested in the data so that we can continue to monitor and understand what is going on.

That brings me to my third point, which I am certain we will discuss throughout the meeting. We are considering the divergence between rates in Scotland and those in the rest of the UK and what that means for behaviours and for work on compliance. That picks up on some of the things that Alyson Stafford talked about.

I thank the auditors for their work in looking at how we administer the Scottish income tax system. I am very grateful for their work and I am very pleased with their audit report. There are no recommendations, but there are, of course, as we have said, things that we need to continue to monitor and make certain that we are on top of.

The Convener: Thank you very much indeed. Before I invite the deputy convener to come in, I think that it is fair to say that the committee is disappointed that the two reports that you have produced came out less than 24 hours before your appearance before the committee. My understanding is that one of the reports was due to be published back in January. Will you explain the timing of the publication of these reports?

Jonathan Athow: I wanted to make certain that they were out before the committee's meeting. That would be better than afterwards. We have processes for clearing reports internally within HMRC and the UK Government. That took a little longer than we would ideally have liked, but I was very keen that the reports should be out. As I said, they are also investments in data that we will come back to. We have created that longitudinal data set, and we will be able to monitor that in the future. I hope that we have now invested in the right data and the right analysis that will allow us to have the right conversations in the future.

The Convener: Without overstating the obvious, publishing them before the committee's meeting could have involved them being published a week ago, two weeks ago or a month ago. As I understand it, you did not even give us the courtesy of informing us that you were about to publish that information.

Jonathan Athow: On that, I apologise. We should have given you more of a heads-up on what we were planning to do.

The Convener: Okay. Being resourceful, as it is, the committee will do its level best to tackle some of the issues that are raised in those two reports. To begin, I invite the deputy convener, Jamie Greene, to put some questions to you.

Jamie Greene (West Scotland) (Con): Good morning to our guests. I want to get straight into the meat and bones of the content of the HMRC reports. There are more than 100 pages to digest and, as the convener said, we have not had much time to do that, but what is contained therein has been the source of a lot of commentary over the past 24 hours from an analysis point of view, but also from the media and, unfortunately, as is always the case, from a political point of view.

It is important that the committee gets under the skin of the facts and figures, so I ask HMRC to enlighten us on the key findings of the reports. They singularly pick out the year 2018-19, but nothing since then. They give a snapshot—I understand that—but it seems odd that we have had no further analysis of any subsequent years. Maybe you can comment on that. I would also like to know what you found when you analysed the 2018-19 tax year, when Scotland moved to a five-tier system. What is the situation regarding our income tax base? Is it better, worse or indifferent?

Jonathan Athow: I will give you a very high-level summary. Part of our reason for wanting to publish the statistics was that, without them, it would be very difficult to analyse what has happened or what would have happened without the tax changes. Publishing the statistics is part of the process. I am certain that there will be discussions about the methodology involving experts in that area.

There are two important points. First, throughout the period, we continued to see net migration to Scotland from the rest of the United Kingdom, but there is some evidence that the divergence in rates has slowed that migration—that the higher rates in Scotland have had a small negative effect on migration. That is what we would expect from economic theory, and we have seen that. However, those effects are relatively modest at the moment. The Scottish Fiscal Commission has highlighted them in its report, given its work on the effects of higher rates in Scotland.

Secondly, the challenges in estimating and keeping on top of such effects have been the long lags in our data and the effects of Covid. We might well move on to talk about Covid, but it created uncertainty in the economic modelling as it slowed and restricted people's ability to move. That has created a particular challenge for those years. Also, the way in which the income tax system works means that there is a long lag before we get the full picture of what is happening with self-assessment customers. That inevitably means that much analysis of the type that we are discussing, which requires very good data, is likely to lag quite heavily.

Jamie Greene: I understand that, but I have a concern that, if we have to wait five or six years for the 50-page reports that contain that data, it is impossible for them to be used to inform Government decisions. They just show what has happened, and not what might happen in the future. What we really need to know is what the trend has looked like over the past few years, particularly when there has been further divergence in tax bands and fiscal drag.

You said that there was a small or moderate loss of income. The analysis in your report says that it was about £60 million in the financial year 2018-19, but that related to a very small number of people. It does not take a lot of behavioural change or a lot of people to drop out of the Scottish tax system for there to be a fairly substantial loss in the income that the Government receives and, therefore, has available to spend on public services. Will you give us an indication of how worrying that figure might be? Table 19 in the report shows that just 60 people coming out of the system at the top rate equated to a loss of almost £38 million of income. That is huge.

Jonathan Athow: As I said, that figure is relatively small in terms of the overall revenue that is raised by the Scottish income tax rate, although it is obviously significant in absolute terms.

The report looks backwards but, to use the terminology, it provides an estimate of semi-elasticity, which is about how people respond to the divergence, and that can be used to look at future trends. For example, the Scottish Fiscal Commission will take that into account in its appraisal of how future tax changes will affect revenue. In that sense, although the data looks backwards, it gives us some understanding of what will happen in the future. It was deliberately structured in that way to give us some insight for the future.

Jamie Greene: Perhaps you could share your expertise this morning. What are people doing? If there is divergence as a result of either more bands or higher tax rates, what sorts of things do people do? Do they move out of the country? Do they not take pay rises? Do they not do overtime? Do they put more money into their pensions? Is there more tax avoidance or evasion? What are the risks when there is divergence?

Jonathan Athow: I will distinguish between legitimate behaviours and non-compliant behaviours. On the former, migration is an important element. The labour market is very dynamic and people move throughout the country for jobs, so a lot goes on there. That is one aspect that we have looked at. We also looked at other responses, but we did not find a particular impact on employment. We have not found any evidence that divergence has affected people's employment prospects. Another way in which people may respond is through what we call tax planning. Someone might decide to put more of their income into a pension, which can benefit from tax relief, or divergence might encourage somebody to think about timing their retirement slightly differently. However, as I said, we did not see a particular labour market impact. There will probably be some migration effects. People who might have thought about coming to Scotland might choose not to do that. There might also be some tax planning.

09:15

I am certain that we will move on to talk about non-compliance but, when we are thinking about that, we again have to think carefully about the different sorts of taxpayers. Pay-as-you-earn tax represents about 85 to 87 per cent of Scottish income tax, and the ability of PAYE taxpayers to not comply is limited as their tax is taken at source, which is an effective and efficient way of collecting revenue. For a self-employed person, there is an incentive to suppress or underreport income. At the highest rates, there is a strong incentive to underreport income tax at 45 per cent, as well as at 48 per cent.

I would not want to overstate it and say that divergence radically alters the incentives for people to be non-compliant, but there is a risk of non-compliance. I am thinking in particular about people who are self-employed, whose tax is not deducted at source and for whom we do not have the real-time information that we have for employees. I hope that that gives you a sense of the situation.

Jamie Greene: It does. Of course, someone does not need to be ultra-rich for divergence to affect them. When someone earns just £50,000, there is a 20 per cent differential between the income tax rates. That could affect a much wider range of people.

Ms Stafford, you are director general of the Scottish exchequer. Is it a concern to the Scottish Government that just 16 per cent of Scottish taxpayers form more than 62 per cent of the tax base? As we see in the report on 2018-19, any change in the number of people in the higher bands, or any behavioural change, will have a huge detrimental effect on the amount of money that the Government has to spend.

Alyson Stafford: Let me start by talking about the importance of our having the research that HMRC has done and the previous studies. We did a 2018-19 evaluation, which was published in December 2021, and we have the two reports that were published yesterday, which will continue. We have that database and we are committed to working through the policy evaluations, publishing them and taking the learnings from them. Behavioural responses are taken into account when we provide advice to ministers each time tax policy is being set. As Jonathan Athow said, there is also the independent assessment by the Scottish Fiscal Commission of whatever policy is produced.

On the particular study that we are discussing, it is interesting to note that, since the introduction of Scottish income tax in 2017-18, more taxpayers have come to Scotland than have left. The inflows average around 4,200 per year. I realise that the questioning so far has looked at a particular year—2018-19—and Jonathan Athow has taken us through that. However, it is important to look at the whole of the study that was published yesterday. In 2021-22, which is the latest year for which data is available, net migration was positive across all tax bands and almost all age groups. We are vigilant, as Mr Greene suggested, and we look at the distribution, which is an important aspect. However, the latest data that we have shows that the position in 2018-19 was not replicated in the final stages of the analysis and net migration was positive across all tax bands. That is encouraging. In 2021-22, taxable income in Scotland increased by £200 million as a result of the positive inward migration of taxpayers.

The important thing is that we have the data, which is there for us all to see and analyse. Although there was that change in 2018-19, when more bands were introduced, we have subsequently seen net migration being positive across all bands in more recent years.

Jamie Greene: It was notable that the Scottish Government was quick to comment publicly on the net migration figure. However, over the past 24 hours, various commentators and analysts whom we often rely heavily on for independent, neutral analysis, such as the Institute of Directors, the Fraser of Allander Institute, Scottish Financial Enterprise and a bunch of others, all say that the numbers themselves are quite meaningless if we look only at the net migration figure and that what matters is how much money is coming into the system and how much money has been lost from it.

That goes back to my original question, which I am not sure was answered. If we lose higher-rate and top-rate taxpayers, that will have a much more substantial impact on the amount of money that comes into the system. We do not have a year-by-year analysis of that, and it is very difficult for the committee or anyone else to take a view on that if we do not have the data.

Alyson Stafford: The longitudinal data set covers a longer timeframe than 2018-19. That is why I shared with the committee that the latest date that is in it is for the 2021-22 tax year. That shows that taxable income increased by £200 million and that net migration coming into Scotland was across all tax bands in a positive direction. The other thing that Jonathan Athow said was that, from the data that we can see so far, nothing is particularly impacting on the labour market.

Jamie Greene: I think that many people would disagree with that. Anecdotally, we are hearing a number of voices being very vocal maybe not necessarily about the statistical analysis of migration, but the quantitative analysis is that every respected industry body says that it is really struggling to recruit people and that tax divergence is the primary cause of that. I hear what you are saying, but business leaders are saying entirely the opposite.

Alyson Stafford: I hear what you are saying, too. We have the data up to 2021-22 so far. That is being produced with the statistical kite mark. At least it is good that we are able to look at that now. Today is the first opportunity for us to work through that with the committee. As Jonathan Athow said, subsequent sets of data will come through. However, we all have to be mindful that there is a lag.

Jamie Greene: Okay. I know that other members have a lot of interest in that issue.

The Convener: Yes. I have a very quick question for Alyson Stafford. You are the director general of the Scottish exchequer, and you have a service level agreement with HM Revenue and Customs. When did you first get sight of these reports?

Alyson Stafford: I saw the reports on Monday.

The Convener: Okay. When did the Scottish Government first see drafts of those reports?

Lorraine King (Scottish Government): The Scottish ministers had access to the results from the reports when they were making their budget decisions for the draft budget that was published in December last year. The results have not changed since then, but we have had interim results throughout that period.

The Convener: I repeat that my understanding is that at least one of the reports was due to be published in January, and ministers had sight of that last year. Why was it only yesterday that the Public Audit Committee of the Scottish Parliament, which is conducting an inquiry into the administration of Scottish income tax, received that? Could somebody explain that? Alyson Stafford, can you explain that?

Alyson Stafford: I would need to revert to Jonathan Athow, who has already explained that the report is published by HMRC and has to go through its clearance processes.

The Convener: But it was shared with ministers last year.

Jonathan Athow: There is a nuance here—the final report has been drawn up only relatively recently. However, we will share relevant information that affects Scottish policy making. Some of the interim results would have been shared because that information was germane to ministers making decisions. I recognise that that is a nuance, but I want to clarify that particular point.

The Convener: One of the reports that we are discussing is the Auditor General's report on "Administration of Scottish income tax 2022/23", in which he says that getting some of the longitudinal analysis on behaviour, for example,

"will help inform future tax policy decisions and enable more informed scrutiny."

That is why we are here, so I find it extraordinary that you have had that information, in whatever form, that you have not shared with us, as members of the Parliament. Do you not see anything wrong with that?

Jonathan Athow: I take that point, and—as I said—I apologise in particular for not engaging with the committee in a more structured way in the run-up to the publication of these reports.

The Convener: Okay, but from our perspective, we also direct some of those criticisms to the Scottish Government. I accept that we are talking about an HMRC publication, but if the Scottish Government has had access to it, why was it not prepared to share that with the Scottish Parliament?

Alyson Stafford: The key thing is that we were waiting for the report to be final so that we would know that it had gone through all the appropriate scrutiny that has to happen to ensure that the statistical validity is there. That is the reason.

The Convener: So, ministers were setting the budget on the basis of information that might have been statistically invalid.

Jonathan Athow: What we would normally do—again, this is not restricted to these matters—is ensure that ministers always have all the information that is available. Some of that information has been validated and will have been completely signed off, while some of it would be early indications.

Whenever we advise ministers, whether they are ministers in Scotland or United Kingdom ministers, we are very clear with them. We want them to have the full information that we have, but we also want them to understand that some of that information may be more robust than other information—some of it will be early indications. That is our approach: when ministers are making decisions, we try to make certain that they have all the relevant information, even if that includes unpublished or initial estimates.

The Convener: But the ministers make proposals to Parliament, and the decision on income tax rates and so on is made by the Parliament as a whole, not just by the Government.

I am going to move on now, because we have other questions that we want to put, but Graham Simpson wants to come in on a quick point in that regard.

Graham Simpson (Central Scotland) (Con): I am struggling to understand what the delay was. Who was responsible for the delay in publishing these reports? Mr Athow, you indicated earlier that it had to go through a process.

Jonathan Athow: Yes.

Graham Simpson: So, at some point, that process has slowed down. Where was the block?

Jonathan Athow: We sit down with ministers to look at a wide variety of information. We publish a lot of information. We will put a timetable together; sometimes that will be slowed down because of a particular stage—for example, somebody wants to understand what is behind something.

As we have discussed, there is a lot of information that has come out in these reports. There will often be an understanding of what we are intending to publish, and that can mean an extra stage of asking, "Can you please clarify this?" or "Can you explain what this means and what the implications of this research are?" Often, a delay will be down to those stages. It is often not a specific decision—sometimes it is the cumulative effect of extra information being asked for or clarification being sought by ministers.

Graham Simpson: So, has a minister, at some point—we are probably talking about a UK minister here—said, "You can't publish this yet; it's not ready" and told you to go away and come back with more information?

Jonathan Athow: It would not often be that sort of decision. It would often be, "Can I understand more? You've put this in front of me—can I understand what the implications of this are? What is the scope of this? How will it be interpreted?" Extra questions will often be asked, and that sometimes slows down the process.

The Convener: I will bring Graham Simpson back in later, but I will bring in Willie Coffey at this juncture.

09:30

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): I am slightly less concerned about the hoo-ha around the timing of the reports that were published yesterday than I am about the key messages that are contained in them. That is the most important thing to focus on today. The "Intra-UK migration of individuals: movements in numbers and income" report includes some fairly positive messages for the Scottish Government, but the "Impacts of 2018 to 2019 Scottish Income Tax changes on intra-UK migration and labour market participation" report, which Jamie Greene referred to, contains slightly more negative coverage. Can you explain why a report that relates to 2018-19 appeared only yesterday, almost five years after it perhaps could have been produced?

Jonathan Athow: You are absolutely right that there are two sides of the coin here. Net migration continues to be positive, but there is some evidence that the divergence in rates has dampened migration to Scotland.

Part of the issue was creating the underlying database. All the data was available, but it needed to be pulled together in a way that allowed us to understand what was going on. As I said, we do not normally set up our systems to track individuals over time, but we have now invested in that database, which is really important because, as Mr Greene said, there have been further changes that will need to be analysed and understood.

We needed to invest in the data to ensure that we had the database. Now that we have the database, we can look back at 2018-19 and, given that we have invested in the database, as more data comes along, we will be able to be much quicker in analysing, say, the effects of the 2024-25 changes to the tax system.

We invested in getting the database right, and we think that it will be very useful much more generally. Obviously, I am here to talk about Scottish income tax, but there are also Welsh rates of income tax. Those are aligned with the rates in the rest of the UK at the moment, but, if that changes, the investment in our database will allow the Welsh Government to understand what impact there has been.

We were making what I would describe as strategic investment in the data, and it took some time to get that right. Independent researchers will now also be able to access the database. I hope that we have invested for the long term. That is how I would characterise it. It took some time and effort to set up the database, because it was not straightforward—data does not automatically fall out of our systems in a way that allows such analysis to be done.

Willie Coffey: I understand that, but a 2018-19 report involves five-year-old data. Surely the findings from that time could have been shared in advance of developing your data analysis methodologies and your database. Surely the messaging could have been released far earlier. Why was the report published only yesterday?

Jonathan Athow: The final data for 2019 would not have been reported to us until January 2020, so there are long lags in the system. We could have perhaps done the analysis a couple of years earlier, but not much more than that. There was a decision to be made about whether to analyse the 2018-19 data or invest in building a data set for the future, and we made our decision. I am certain that other people would say that we should have done something different, but we wanted to invest the time and effort into building something that could be reused in the future rather than into analysing only the 2018-19 data.

As we work together with the Scottish Government, we are learning what the analytical needs are. We started on this journey using the current system only in 2016, so we are learning as we go. We are learning what your needs are and what the Scottish Government's needs are. If we knew then what we know now, we probably would have invested in the database from the get-go.

Willie Coffey: My next question is perhaps for both Jonathan Athow and Alyson Stafford. The 2021-22 data is much more positive, and the report has established that the previous predictions of gloom and doom about the policy have proven to be untrue. As Robert Burns said, facts are chiels that winna ding—once you get facts, you cannot overturn them. All data is helpful, and we are all able to interpret it in the ways that we choose. We have seen that in the press and the media. Nevertheless, the 2021-22 report provides positive indications for the tax base in Scotland. Could you summarise what you believe the key findings are in relation to the 2021-22 data?

Jonathan Athow: Again, I go back to some very high-level messages. Scotland continues to see inflows of taxpayers, so there is positive evidence there. However, as I said, the implication of the analysis from 2018-19 is that those inflows are probably lower than they would have been without the divergence. Essentially, that becomes a trade-off for ministers to consider in making their decisions.

As you said, it is not a picture of complete doom and gloom, but there is some evidence that, in 2021-22, that number could plausibly have been higher if there had not been divergence. However, I repeat that, in making their decision, ministers will have to weigh up all the factors that are relevant to setting Scottish income tax, including where that money is spent. Ultimately, that becomes a decision for ministers on those issues of trade-offs.

That situation is not unique to Scottish income tax. We have done similar analysis of what happens to UK income tax rates. Ministers must always make trade-offs in relation to how taxes will fall, where they might affect behaviour and whether a decision is the right decision for them. Essentially, that is a political decision.

Willie Coffey: I turn to Alyson Stafford. From the Scottish Government's point of view, you must be encouraged by the most recent findings from 2021-22, but what, collectively, are we doing—Jamie Greene asked about this—to monitor behavioural change in all its facets? In your data collection and data analysis, do you try to find out why people do what they do and why they decide not to make changes? Do we look at the whole blanket of issues to see what affects people's behaviour?

Alyson Stafford: On behavioural aspects, we could turn to HMRC as well, but let us start off by looking specifically at 2021-22, which you asked about. Two key facts have come out from the longitudinal data set. In 2021-22, which is the most recent year for which data is available, net migration was positive across all tax bands and almost all age groups, and taxable income in Scotland increased by £200 million as a result of that positive inward migration of taxpayers.

If we take an overview and look in the round at all the various elements that ministers take into consideration in setting tax policy, we find that the policy move to a more progressive income tax system in 2018-19 raised additional revenue for investment in public services. At that particular point in time, that additional revenue was assessed as being around £230 million to £245 million. The fact that those structural changes have increased the overall tax take and the revenue that has been raised for investment in public services continues to be borne out.

I will make a couple of other key points before moving on to the question of what sort of things people take into consideration. I am referring here to the study that went alongside the longitudinal data set—the one that deals with extensive TIEs. "TIEs" stands for "taxable income elasticities". The study did not find any evidence that the 2018-19 reforms had an impact on labour market participation. In 2021-22, which is the most recent tax year for which data is available, more high-earning taxpayers came to Scotland than left.

As you have said, a number of factors will have an impact on people's choices about where to live and work. We have already heard that the labour market aspects have not been among them, whereas we are aware that others have, such as the cost of living, family ties and overall quality of life. The committee will have other sources of what might be described as anecdotal data. It will be interesting to understand what data HMRC has on such factors. However, given what has been involved in getting to the longitudinal data set just on the migration numbers, it will be interesting to see whether there is anything richer and deeper than that. You are right, though. People will take into account much broader considerations than the rate of taxation.

Jonathan Athow: I will come in on that. We often see what happens, but not necessarily why. For example, when someone puts in their tax return, they will tell us what they have done—

Willie Coffey: But not why they have done it.

Jonathan Athow: —but not necessarily why they have done it.

We are able to monitor employment trends across the United Kingdom in close to real time. That provides good geographical data on Scotland. Each month, data is published on employment levels, which covers people who are employees. Self-employment is much harder to moderate, but we do that. Each month, we publish information on payrolled employees, so there is real-time data on employment. We are then able, through that database and our other data, to understand what is going on. From that, we can often surmise whether, for example, people are putting more money into pensions.

However, decisions on migration, how much to work, and where and how to work are quite complex. Many factors will form part of such decisions, and sometimes tax is one of them.

Although we have found evidence that tax affects migration to Scotland, as Alyson Stafford said, so far, we have not found any that the difference in tax rates has affected anyone's decision to work here or not. However, we need to keep on top of such factors and understand them.

As I said, another aspect is that some of the behaviours that we see in that context are not ones that we like, such as avoidance or evasion behaviours. We have some evidence about why people do that. Often, it is because they think that other people are doing it, or because their friends are doing it and telling them about it. We therefore have some evidence, but I am afraid that it does not give us neat answers. Expecting such answers when people are making decisions about their lives is unlikely to be realistic.

Willie Coffey: We have all skipped past the mathematical analysis part of the report's content, but I want to go back to that. Is it worth while? Are both Governments interested in why people do what they do in relation to those important matters? In future, should we consider conducting a separate analysis of why the many facets of behavioural change occur? Otherwise, members sitting around this table might simply interpret those as we see fit.

Jonathan Athow: We do want to know that. Again, we are not the only source of the analysis. Part of the approach is ensuring that researchers are able to look at the hard data, but also carry out other research. I know of research projects that are examining attitudes to changes in tax and how people's decisions affect them. We are interested in those aspects, too. However, for the core elements of our role, we are really interested in the numbers—as an audit committee, you will understand that. We want to affect people's behaviour. We do not want them to get into avoidance schemes or to evade tax, so we need to understand such behaviours, and we would like to understand more about them. That will be difficult, but we will not be the only source of evidence. Many researchers out there are exploring such questions. They will have just as valid an input as we have, if not more so.

09:45

Willie Coffey: Thank you for that. I hope to come back later on on the S codes issue, but other colleagues are waiting to ask questions.

Graham Simpson: I think that you are all correct to say that people make decisions on where to live for all sorts of reasons. It does not just come down to how much tax they pay. It might come down to that, but they would probably be having to pay quite a lot of tax if that was what was making them move.

I have a question for Mr Athow. I have had a quick read of your report. Why do you use such complex mathematical formulas that even the experts whom I have managed to get a hold of cannot get their heads around them?

Jonathan Athow: We want to present credible evidence that stands up to external scrutiny, and part of the publication approach is to make certain that the experts—we are talking about the Fraser of Allander Institute and others—are able to understand what we have done and to critique it.

The real challenge is that, essentially, we are trying to estimate what would have happened if there had been no divergence. We will never know that with certainty, so we have to use mathematical models that try to estimate what would have happened if Scottish income tax rates had remained in alignment with those in the rest of the United Kingdom. That is the really challenging part of the analysis, and it requires quite complex techniques because the demographics of Scottish taxpayers are different from the demographics of taxpayers in the rest of the United Kingdom.

We would expect there to be differences anyway. We have to control for those and for the fact that the economies of Scotland and the rest of the United Kingdom might have moved slightly differently. That necessarily requires some quite complex analytical techniques. Those techniques are well understood—there is quite a lot of literature on how they are applied elsewhere. I am not an expert, but we see quite a lot of differences between taxes in different states in the United States, for example, which means that there is well-trodden research.

We need to make certain that we are as accurate as we can be and that we are not confusing matters. There are extraneous factors, such as different economic challenges, and we have to use the right techniques to bring that out.

I am an economist by background. As always, the key is to make certain that you explain the implications of those things as clearly as possible. I hope that we can try to do more of that now that we have the technical reports out. However, it is very important that we are robust in what we do so that we can offer the best evidence. That necessarily requires some quite complex techniques.

I hope that that has set out a little bit how we go about doing those things.

We will never observe the world where Scottish income tax rates do not diverge from those of the rest of the UK. As I said, the challenge is trying to work out what would have happened if that had been the case. That is very difficult—indeed, that is the heart of the problem and why we need those complex mathematical techniques.

Graham Simpson: Okay. I will not ask you to explain any of those formulas. [*Laughter*.]

The Convener: Night school, Mr Simpson.

Graham Simpson: Yes, I might have to go there. No doubt maths experts will come back to us with a view.

I have some other questions. This goes back to a previous session that we had. It is a simple question, which anyone can answer. Do we know where every taxpayer lives in Scotland or, indeed, across the UK?

Jonathan Athow: The UK does not have a population register in which people must, by law, declare where they are living. That means that we have slightly less robust data compared with other countries, such as Scandinavian ones.

We rely on two channels of reporting: individuals telling us where they live and, more commonly, employers telling us where people live. That is our main source of information. As we have said, we check that by clashing the data, as the jargon has it; in other words, we compare our data on where people live with other databases, and that gives us quite high levels of confidence. However, it is always going to be challenging, given that we rely on individuals or employers to report that data and there is no national database that we can go and check it against.

Graham Simpson: I just want to stop you there. So it is not a legal requirement for people to tell HMRC where they live. We know that—that is a fact.

Jonathan Athow: That is right.

Graham Simpson: Therefore, people—if they tell you anything—could lie.

Jonathan Athow: Yes, but to be able to carry that off, a person would need an address where they could pick up post, because we mail out information. We do use digital means, but often we mail things out to people, so a person would need a second address or something like that.

In certain circumstances, people could misrepresent their address. Certainly one of the things that we will want to consider in future—and this is certainly why we will want to do the data clash on a more regular basis—is the fact that, in the recent past, the differences in tax rates between Scotland and the rest of the UK have not been particularly large and therefore the incentive to misrepresent one's address has been lower. However, we know that, particularly with the changes coming in this year, that differential has grown. That is something that we need to be alive to. That is how we have thought of the matter in the past, but we are also alive to the fact that things might change in future.

Graham Simpson: So the divergence almost creates an incentive. Let us say that you have two legitimate addresses—one is your main home and the other is your second home. Could you flip addresses for the purposes of HMRC? In other words, could you tell HMRC, "Well, actually, my main address is in England, not Scotland."?

Jonathan Athow: In theory, yes, but we would want to make certain that that was your true address. We have a residency test that we can carry out if we think that there are concerns. That is why we would use the data clash. If you told a private sector company one thing about where you were resident and you told us something different, we would be interested in that, and we would need to work out the true situation.

We can do those tests but, as I have said, we are not seeing particular angles or areas of concern when we match with private sector data. We are getting good levels of match. That said, we are seeing that incentive changing and growing over time, so we need to make certain that we respond appropriately.

Graham Simpson: In that case, I have a question for Ms Stafford. Could the Scottish Government legislate to make it a legal requirement for you to inform HMRC if you change address?

Alyson Stafford: That is a question that I would want to take away and get some legal advice on. I would be happy to come back in writing to the committee on that.

Graham Simpson: Okay—that would be useful. I put the same question to you, Mr Athow. Could the UK Government legislate on that?

Jonathan Athow: It could, but, in advising ministers, I would want to think about whether such a response would be proportionate to the risk. At the moment, we are not seeing huge evidence of anything particularly concerning.

The challenge with making something a legislative requirement is that it has to be policed, and fining people for not updating their address with us would be something that I could see ministers being nervous about. Again, the concern here would, I think, be about proportionality to the risk.

Graham Simpson: Because we have different tax rates across the UK, a person's address becomes important. You have said that you spend time checking whether the information that people give you is accurate.

Jonathan Athow: Yes. Again, simply requiring somebody to report a change of address does not necessarily mean that the correct one will be given. People might misrepresent. We would still need to do some enforcement activity.

As I said, large numbers of people provide the information. Occasionally, if people are moving house, flat-sharing or moving around, their address might not be up to date. However, for the larger proportion of people—90-plus per cent—we are confident of having up-to-date address information. Again, therefore, the question is whether the response is proportionate to the risk that we face.

Graham Simpson: Okay. I want to look at a couple of other areas. One is tax debt; the other is pension contributions, which were dealt with in a section in the earlier report that we looked at.

We have explored tax debt before. On 31 March 2023, the UK tax debt was £43.9 billion, according to the National Audit Office report. However, we do not seem to have a breakdown of where that debt falls across Scotland, England and Wales. I suppose that this is a question for you, Ms Stafford: does the Scottish Government intend to build up an accurate picture of what the tax debt is in Scotland?

Alyson Stafford: We get estimates through from HMRC. I will leave Jonathan Athow to explain how those are arrived at. The estimate is worked through as a particular percentage of UK tax debt. As I said, we are provided with an estimate. That is set up.

Graham Simpson: However, it is only an estimate.

Alyson Stafford: It is only an estimate.

Graham Simpson: Why is it only an estimate, Mr Athow?

Jonathan Athow: I will take you back to the two ways in which we collect income tax.

For self-assessment, we know where people are, in the main. We do not have a particular concern about not knowing their address. We can identify where they are.

For PAYE, debt often arises because an employer has not paid over tax that they have collected. If you are a UK-wide employer, we might not know exactly how much of that tax relates to a particular individual. Entirely hypothetically, if you are a large supermarket chain that operates across the UK, and you do not pay over your income tax, we might not know exactly how that underpayment relates to particular taxpayers. That is due to the way in which we administer PAYE. In many ways, that is a lot simpler for the individual, but it limits what we can understand about that debt. Again, why it is problematic is part of the challenge.

We do not see Scotland as having a larger share of debt than we would expect. Our evidence is that it is slightly below the overall UK position; again, however, we want to monitor and understand that. There are limitations on our data, and PAYE is a particular source of challenge.

Graham Simpson: I do not understand why that is. You said earlier that PAYE is a relatively simple thing.

Jonathan Athow: Yes.

Graham Simpson: In PAYE, your employer pays your tax for you. It should be working.

Jonathan Athow: In many cases, it is. Obviously, however, large amounts of money are involved. About 87 per cent of Scottish income tax comes through PAYE. If an employer is in financial difficulty—some businesses are in distress—they might not pay over their PAYE as promptly as we would like. That is therefore a debt.

Although the numbers are small—the tax gap, which is how much we do not collect on PAYE, is around 1 per cent—given that 87 per cent of Scottish income tax revenue is through PAYE, that 1 per cent is quite substantial.

10:00

Graham Simpson: What is the figure?

Jonathan Athow: I am just doing some quick maths in my head. The tax gap is probably around £100 million or so, assuming that it is spread equally.

Graham Simpson: Is that in Scotland?

Jonathan Athow: It is in Scotland.

Graham Simpson: So, £100 million is owed.

Jonathan Athow: I am doing some maths in my head.

Graham Simpson: You have done this in your head—so, roughly £100 million is owed.

Jonathan Athow: Going back to overall tax compliance, there is roughly £100 million a year in PAYE that we are not collecting that is relevant to Scotland. Again, I am doing some quick mental arithmetic, but that gives a sense that 1 per cent is quite—

Graham Simpson: That is quite a bit. It is a big figure. You said that it comes down to, or can come down to, employers not handing the money over.

Jonathan Athow: Yes, indeed.

Graham Simpson: That is a serious issue.

Jonathan Athow: It is. Often, it is related to debt. If companies are in distress and they have a number of creditors who are pursuing them, we will be one of them, but there might well be others. There are issues for such companies. As I said, my point is that, although 1 per cent sounds small, when it is applied to a large number, it gives you a greater value.

Graham Simpson: It comes to a big number, and that money is not flowing to Alyson Stafford's department. Ms Stafford, you must have a concern about that.

Alyson Stafford: Yes, absolutely. That is why it is important that we continue to support HMRC with all its work on compliance and that we follow up once the tax has been calculated and collected. His Majesty's Revenue and Customs carries out work to improve the yield that comes from the tax that is due. Targets are set nationally for HMRC as part of its work across the whole of the income tax base. We look to HMRC to continue to be vigilant and to close the gap as much as possible.

Graham Simpson: You should all be doing better on that, because it seems a relatively straightforward thing to do. You will know which employers are not paying what they should. However, I will leave that there, because I want to ask about pensions.

The section on pension contributions in the National Audit Office report says:

"Pension scheme administrators 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's Relief at Source (RAS) system automatically confirms the residency status of pension scheme members".

Of course, we have to know where people live to ensure that the correct relief is applied at source.

The report goes on to say that the RAS system

"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."

How many people know that they can do that or realise that it is an issue?

Jonathan Athow: That is a more general issue. Most pension scheme administrators are keen to point that out to individuals, because it is a benefit to them. It is saying, "Please come and invest with us, and you will get tax relief." It is part of how they market some of the schemes.

We require people to make a claim, so it is dependent on them. We will be very clear in guidance. People who are investing in pensions will want to understand their tax position, and we try to be clear in guidance on that. We will sometimes have targeted information that we can use, either to contact people directly or to raise awareness among a particular group. That is a wider issue, however, which will affect higher-rate taxpayers in the rest of the UK, too.

Graham Simpson: But why can Scottish taxpayers not have that dealt with at source, so that they get the correct relief at source? Why do they have to put that down on a self-assessment form?

Jonathan Athow: Part of the challenge with much of the way that the tax system works is that we do not know people's full tax position until the end of the year. We need to be able to consider where someone has ended up in the tax band at the end of the year, and to apply that correctly. In the rest of the UK, that could relate to what side of the higher-rate boundary someone is on. It depends on where they are and, in Scotland, on which rate they are in. What exactly someone's true relief should have been can only really be determined at the end of the year.

We do the basic rate relief because we assume that anybody who is claiming it will be a basic-rate taxpayer. That is the minimum relief that can be given, so we give people back the minimum in real time. They then have to claim any top-up, because we cannot calculate that in real time. It is an annual system.

If someone has more complex tax affairs, with employment income and some savings income—and we know that some people are landlords, too—that can only be brought together at the end of the year to work out people's tax position. That requires us to go through an end-of-year process, and we need people to engage with that process to make certain that they get their tax right.

Graham Simpson: I will leave it there, convener.

The Convener: I will bring in Colin Beattie shortly but, before I do, I turn your attention back to the Comptroller and Auditor General's "Administration of Scottish income tax 2022-23" report. He says something in it that he has said in previous years. He notes at page 9 of his report that HMRC does not have Scotland-specific data on compliance risk. Furthermore,

"HMRC has limited performance data available about its compliance activities in Scotland."

The report adds that that

"may not be sustainable in the longer term".

Alyson Stafford, you mentioned in your opening statement that you were establishing a joint compliance working group. Is that working group going to tackle those deficiencies?

Alyson Stafford: It will certainly start to work through quite a lot of those areas and reassess where the risk is and where there might be an opportunity for more specific things. It is important for us to pull out the point that part of what we do is to seek further data from HMRC through the year on things that might have particular resonance and things that are distinct in Scotland. We have agreed that we will require the third-party data clash to take place in 2024, to address the important issues that committee members have already brought up regarding addresses and to establish a robust tax base.

Aside from that data clash, we have already requested some analysis from HMRC on paper migration. That relates to Mr Simpson's point about people feeling that they have a choice as to where they declare as their main place. We are scrutinising the whole area of paper migration and the underlying data in order to mitigate some of the compliance issues.

I know that a committee member has already mentioned S codes in passing, and I am sure that we will return to that topic. We have been working with HMRC on its monitoring of the correct use of S codes and wider taxpayer identification in that regard. We requested additional data on S code misapplication by employer size to see whether there was distinct or different treatment. That did not, in fact, yield anything worthy of further investigation, but we will keep the situation under review.

The point about pensions is really relevant. We have been talking a lot about tax policy changes in Scotland, but the UK Government made two important tax policy changes that apply to the whole of the UK in a reserved area—pensions. In 2023-2024, the annual allowance for pensions was increased to £60,000 from £40,000, and, in the current year, the pension lifetime allowance has been abolished. That touches on what Jonathan Athow said about tax planning and the extent to which there might be different motives for different arrangements in relation to pensions. We are in discussions with analytical experts in HMRC on bespoke data analysis with regard to that element.

Those are some tangible examples of work that we are looking to HMRC to undertake in order to continue to understand and mitigate, as far as possible, some of the risks that the Auditor General has underlined. That gives the committee a sense of the better information that we continue to strive for in order to mitigate some of the further risks to compliance.

The Convener: Could you share with the committee the joint compliance working group's terms of reference and make-up? I do not necessarily mean right here, right now, but it would be useful if you could furnish the committee with a bit more information and outline some of the areas of work that you have just told us about. Going back to my original question, the report by the Comptroller and Auditor General addressed some clear areas around compliance where further work could be done. There might be gaps that could be closed.

I go back to a point that I made in a previous year, which is that the Scottish Government pays £600,000 for this service level agreement, and we are talking about a tax yield of up to £15 billion. Our view, as a committee, has been—I think that this is still our view—that, if that agreement was revisited and a more generous settlement was reached, a lot more useful data could be produced and shared with the Government, the Parliament and those of us who have to scrutinise what is going on with the administration of Scottish income tax.

Alyson Stafford: Obviously, the tax take will be even higher for 2024-25—just under £19 billion will come through from income tax.

The Convener: That is an estimate, presumably.

Alyson Stafford: It is the estimate that is provided by the Scottish Fiscal Commission and is factored into our budgets. We know that we can deploy that amount in 2024-25 because the fiscal framework allows us to have certainty on that. If there is anything different in the actual performance, the fiscal framework will bring a reconciliation down the track.

We are vigilant in that whole area of compliance. We ensure that HMRC's systems—which have continued to be given the green light by the NAO and Audit Scotland—are vigilant in ensuring that we are able to maximise the tax take fairly, based on the rules and policies that have been set for Scotland.

I am happy to set out and send through to the committee what the terms of the working group will be, plus a small digest of the areas that, as I have explained, we are vigilant on and working through.

The Convener: Thank you. By mentioning the fiscal framework, you are in danger of opening up another front, but I will resist the temptation.

Alyson Stafford: If you want to get into complex formulae, that is definitely where to go. [*Laughter*.]

10:15

Colin Beattie (Midlothian North and Musselburgh) (SNP): For the past several years, I have been expressing concern about the accuracy of the figures that we get for Scottish income tax. Indeed, in 2021-22, I extracted lists of all the areas in which HMRC had used estimates, guesstimates, UK-based averages and other things, all of which, in aggregate, bring considerable uncertainty to the actual amount of income tax that relates to Scotland. Clearly, I did not bother doing the same thing this year, because there has been no change. Nothing has happened, and there has been no improvement in the accuracy of the figures or in eliminating some of the anomalies that so obviously and clearly exist. Does HMRC have a plan to eliminate such concerns?

Jonathan Athow: There are two elements to that. First, unless there is some fundamental change, there will be challenges with the administration of tax. As I have said, there has been a long lag in self-assessment, which means that the data that has been reported just this January relates to 2022-23. Some people will not have reported their data to us in January and, even now, there will be some people who have not filed their tax return. As a result, unless there is a big change in how we administer tax, there will always be a challenge with people who are late filers, and we will always have to estimate how many of those people will finally come in.

We have also talked about debt. Sometimes we know what the debt will be, but we do not know how much of it will be paid, and we will always have to estimate that, too. In other areas, though, we want to learn and improve the way in which we operate. Can we find, say, new ways of cutting data if there is a new information technology system? Will that system give us more granular data for Scotland?

There will be some areas in which we can make improvements and, with some of that, it will be a case of learning as we go. We are not quite through the first 10 years of this, but the fact is that, in the first few years, you will learn things and find things that can be improved. That said, there are just going to be challenges that will have to be faced. There will always be people who will file late or who will not file with us at all, and we will always have to estimate how many of those people will finally file and tell us about their tax affairs. I cannot see some of those fundamental things changing, unless we make a really big change in how we administer tax, and such a change is certainly not on the cards at the moment.

Colin Beattie: Quite a few of these issues are Scotland related. I can understand that, in the UK context, there are well-tried and established procedures, and if it were the same for Scotland, that would be more acceptable. After all, there will always be a slight uncertainty. However, there are 30-odd areas here in which you are basically sticking your finger in the air and hoping that the figures will be right. Surely some work should be done on some of these Scotland-specific issues to try to drill down to get the right figures and to eliminate anomalies.

Jonathan Athow: It might be helpful to have that list of 30 areas, so that we can look at where we think we can make progress and where there is a more fundamental challenge. When we have Scotland-specific data, we would want to try to use it. I am going slightly off piste here, but if it was a matter of people not filing their self-assessment tax returns, ideally we would want to use Scottish figures to reduce that estimate instead of apportioning a UK-wide number. I do not know where we are with that work, but when we have that data, we will want to improve things.

If you have that list of 30 areas, we will certainly look at it and give you an estimate of where we think there are fundamental challenges that will make it very difficult to make changes and where we think incremental improvements can be made by using more Scotland-specific data.

Colin Beattie: I am happy to share the list with you and the committee.

I want to come back to all these anomalies that in aggregate—in my mind, at least—create a concern about the final figure. I am looking at the service level agreement of December 2023 and the first bullet point in clause 23, which says:

> “HMRC will identify the Scottish taxpayer population and collect from it the correct rates of SIT to ensure the Scottish Government receives the correct amount of income tax revenue each year”.

Can you put your hand on your heart and say that that is the case?

Jonathan Athow: Well, we do our best to achieve that.

Colin Beattie: It does not say that you are going to do your best.

Jonathan Athow: No, but as I explained, there are challenges and limitations around things such as addresses, for example, and I identified those. We also rely on the auditors. Given the uncertainties that there are, the process is not mechanical, and we have to estimate some elements. We have to ask, “Is this a fair statement?” and the auditors have said that it is.

We are doing our best to give the most accurate picture that we can, while recognising there are limitations in our systems that mean that it is not possible to give you everything precisely to the nearest decimal point. We have got our best estimate, and the auditors have said that it is a fair estimate.

Colin Beattie: But just to clarify that particular point, in response to questions from the committee, the C and AG stated:

> “Our conclusion that the methodology is reasonable is not the same as saying that we are giving assurance on the number itself. That is an important distinction in audit

terms."—[*Official Report*, *Public Audit Committee*, 22 February 2024; c 7.]

The C and AG is therefore not saying that your figures are accurate; he is saying that the methodology is acceptable.

Jonathan Athow: Yes, and in some ways, that is as much as we can hope to provide. We are transparent about how we do it. If the auditors think that we need to make improvements, we will make them. As I said, the overall auditor's report is that the estimates are fairly stated.

Alyson, do you want to come in?

Alyson Stafford: Yes, from the point of view of wishing to be helpful. There are two areas that the National Audit Office and, therefore, the Auditor General comment on in relation to materials for particular tax years. There is the 2021-22 tax year, and the actual calculation of income tax revenue or the actual outturn of what was collected, which is distinct from a forecast of what might be the actual tax collected for the subsequent tax year of 2022-23. That latter figure—the future projection—will naturally contain a lot of estimation, because it has not happened yet. That second figure is not used, and the Scottish Government does not require its use, because we have to use the Scottish Fiscal Commission and OBR numbers in determining what tax will come in a future year.

The important area in the NAO reports is the actual income tax that has been collected for the year. It is important that it is as complete as it can be. For the report that we are looking at, that is for the tax year of 2021-22. If colleagues look at figure 3 on page 13 of the NAO's report that focuses on the 2021-22 outturn, they will see that £13.8 billion of the tax outturn has been established on known taxpayer liabilities that come through PAYE and self-assessment.

The elements that have any estimation take that number of £13.8 billion to £13.7 billion, so the estimated elements are to the tune of £100 million. Those are drawn out from specific things that are happening with that self-assessed number, and that could be the previous year's adjustments that are just coming through in that particular year. Some deductions that come through are to do with pensions or gift aid. I wanted to give a sense of that, as we are in danger of talking about two different types of exercise on which the NAO comments.

The area where there is estimation that I make sure of, and which we drill into, and that is really relevant to Scotland is the outturn figure for the actual year. There is a lot in that estimation space, looking forward, and we do not require to place any reliance on that; it is just for financial accounting reporting purposes that HMRC generates it. In Scotland, we rely on what comes through from the Scottish Fiscal Commission and the Office for Budget Responsibility, because that is what actually drives the budget-setting number for a future year in Scotland.

I do not know whether that illuminates the issue, but it was intended to be helpful about where the risks really lie in estimation for us in Scotland. I hope that that helps.

Colin Beattie: Are there areas in which better data would be helpful?

Alyson Stafford: Yes, absolutely, but we recognise that taxpayers do not necessarily respond neatly within the tax years. There can be quite a lag, and people can—legitimately—take several years to update their tax affairs, so some estimates need to be done.

Colin Beattie: I come back to the service level agreement, which says that

"key requirements have been identified for HMRC's operation and administration of the SIT powers".

Under that, the first bullet point is:

"identify and maintain an accurate and robust record of the SIT taxpayer population".

That is a strong statement, but I am not sure that it is borne out by what we have heard. The second bullet point refers to allowing

"HMRC to collect and account for the correct amount of income tax revenue due to the Scottish Government",

which goes back to having correct, robust and accurate assurances, and all the rest of it. I am not sure that we have that.

Are we actually complying with the service level agreement, or is it just a statement of intent?

Jonathan Athow: We are complying as far as possible, within the constraints in which we operate. As I said to Mr Simpson, there are some uncertainties around addresses. With income tax, there are always risks of non-compliance. We try to manage all those risks—we have talked about addresses and compliance risks, and what we do to try to manage that, and we have talked about debt. All those things affect the final amount of tax that is collected for Scottish income tax. We do our best to manage all those risks and to give the most robust and accurate estimates of outturn that we can. As we have said, the Auditor General thinks that those are fairly stated, so that gives us confidence that we are meeting our service level agreement.

The Convener: Thank you very much. I do not know whether Willie Coffey has one final question to put.

Willie Coffey: I do, convener.

The Convener: You can have the final word from the committee.

Willie Coffey: It is about the application of the S codes—we ask about that every year. Every year, we see that around 37,000 codes are incorrectly applied, mainly by employers. When will we ever resolve that issue? Is it the same employers, and the same people who are not having their S codes correctly applied? We ask these questions every year, but we never really get close to any solution. What value is placed on the potential loss of tax because of the misapplication of S codes?

Jonathan Athow: We send an S code to all employers, where they have Scottish income tax payers, which means that the tax in-year is correct. If somebody does not properly implement an S code, and we assume, incorrectly, that they are a rest-of-UK taxpayer, we will, when we get to the end of the year, say, "Actually, the in-year collection has not been right, and there will be a reconciliation." We want to avoid that, because it can mean that someone has not been paying the right tax through the year and might end up with a tax bill at the end of the year that is inconvenient for them to pay.

We could potentially collect what is owed from a future tax year, but that is not what we want. We want to get people's tax right in year. There will be no loss to the Scottish Government, but there will be inconvenience for taxpayers. I would say that that is the best summary. Sometimes, that inconvenience will mean unexpected tax bills, which we understand can be difficult.

10:30

We also need to bear in mind that, although the overall number of people in employment stays quite stable, the number of people starting and leaving employment in any one year is quite high. Around a quarter of employments turn over in any one year—in other words, a lot of people join the workforce and a lot of people leave the workforce. Someone with a UK-wide business who decides to open a new branch in Scotland will suddenly have to deal with the Scottish income tax system.

Although the number that Mr Coffey referred to is quite high and, as I said, there can be problems for the individuals concerned, we do not see that as being particularly problematic in the context of the overall levels of employment and overall levels of churn.

You alighted on the right area. My concern would be about people who were systematically not operating the system. The problem might not only be with S codes; they might not be operating other aspects of PAYE correctly. We would be concerned if there was a problem with the same people year after year. We are not seeing that at the moment, but we and the Scottish Government have a particular focus on establishing whether there are particular sectors of the economy or particular areas where people are not operating the PAYE system well. We want people to be operating the PAYE system well. S codes are important, but an issue with the implementation of those might be symptomatic of a wider issue.

I come back to my overall point. In general, the PAYE system is operated well by employers. It is not a great source of concern to us. As I said, there would not be a loss to the Scottish Government—the outcome of not applying S codes correctly would be inconvenience to taxpayers.

Willie Coffey: You have made it clear that the reconciliation process returns the correct amounts that are due.

Jonathan Athow: Yes.

Willie Coffey: We have always been interested in who is not applying the S codes properly. Are you able or willing to share such information? I am talking about employers rather than individuals. Does the S code error always arise with high tax payers or low tax payers?

Jonathan Athow: I will write to the committee on what we can say. The issue might well affect particular sectors. My sense is that the employers concerned will often be relatively small employers. Large, sophisticated employers such as supermarket chains that work across the UK have extremely good payroll systems that work very well. It might well be the case that it is other sectors that are involved. We will see what we can do and write to you on that.

With regard to whether we are talking about larger or smaller businesses, my assumption is that we are talking about smaller businesses who might have only a handful of employees in Scotland, so they might not be familiar with the system.

Willie Coffey: There are 37,000 such cases.

Jonathan Athow: Indeed. I will write to the committee about what we are seeing in that population and whether we are spotting particular sectors or particular types of employers that are problematic. Often, it will not be the same employers year on year, because we reach out to employers that have had a problem. They are often very grateful that we have helped them, because they will often know that they are struggling with their payroll.

Willie Coffey: I appreciate your answers—thank you.

The Convener: We are out of time, so I will draw this morning's session to a close. I think that we might have further questions to put to you, not least—frankly—because of the late arrival of the two documents, which are lengthy and detailed and require proper scrutiny by the committee. We also look forward to the further information that Jonathan Athow and Alyson Stafford have said that they will supply to the committee. I think that I can safely say that Colin Beattie will supply you with his top 30 before the week is out to illuminate his point about those areas where he thinks that there are still significant gaps.

With that, I thank our witnesses Phil Batchelor, who got off very lightly this morning, Jonathan Athow, Alyson Stafford and Lorraine King, who got off quite lightly, too, although I thought that she made a very telling intervention. Thank you very much for your time.

I close the public part of the committee's deliberations so that we can move into private session.

10:34

Meeting continued in private until 11:18.

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