Administration of Scottish income tax 2022/23

AUDITOR GENERAL

Prepared by Audit Scotland
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Contents

Introduction

1. The Scotland Act 2016 extended the Scottish Parliament's power to vary all income tax rates and thresholds to the non-savings, non-dividend (NSND) income of Scottish taxpayers. The power to determine any reliefs or exemptions, including the personal allowance, remains with the UK Government. From 2017/18 onwards, the total amount of NSND income tax, now referred to as Scottish income tax, collected by HM Revenue and Customs (HMRC) in Scotland is paid to the Scottish Government.

2. HMRC's accounts are audited by the National Audit Office (NAO) and the Comptroller and Auditor General (C&AG) issued his opinion on the 2022/23 HMRC Accounts in July 2023. The C&AG is also required to report to the Scottish Parliament on HMRC's administration of Scottish income tax by 31 January of the financial year after the one to which the report relates.[1]

3. In 2014, the predecessor Public Audit Committee of the Scottish Parliament recommended that I should provide additional assurance on the NAO's audit work on Scottish income tax.[2] I make this report to the Public Audit Committee in response to that recommendation.

Key messages

- The National Audit Office's approach to providing assurance over Scottish income tax is reasonable and covers the key audit risks.

- The Scottish income tax outturn for 2021/22 is £13.724 billion. The net reconciliation of 2021/22 income tax will reduce the 2024/25 Scottish budget by £390 million. This is the largest adjustment to the budget resulting from the budget reconciliation to date. Reconciliations correct for the difference between forecasted tax receipts used in the Scottish budget and the actual outturn which is known later. Forecast assumptions about the path of Covid-19, unexpected extensions to the furlough scheme and relatively weaker economic performance compared the rest of the UK contributed towards this difference.

- HMRC's provisional estimate of Scottish income tax for 2022/23 is £14.996 billion. The provisional estimate is provided for financial reporting purposes and does not affect the Scottish budget. The C&AG concludes that HMRC's approach to establishing the provisional estimate is reasonable. Given continuing economic uncertainty and tax policy divergence, the Scottish Government and HMRC should keep methodologies under review

[1] Scotland Act 1998, section 80HA as amended by the Finance Act 2014, section 297.
[2] 1st Report, 2014 (Session 4): Framework for auditing the Scottish rate of income tax, Public Audit Committee, 2014.

as more data becomes available to ensure provisional estimates are as accurate as possible.

- The Scottish Government and HMRC should keep governance and assurance arrangements under continual review. I have previously reported that the Scottish Government and HMRC should consider if more frequent checks or further actions are required to provide further assurance over the accuracy of HMRC's address records. I am aware that the Scottish Income Tax Board has agreed to review the frequency of the third-party data checks.
- HMRC applies the same risk-based compliance approach to collect income tax in Scotland as it does in the rest of the UK. This is based on its assessment that compliance risk in Scotland is consistent with the rest of the UK. The C&AG concludes that, with tax policy diverging further from 2023/24 there is a risk that HMRC's assessment may not be sustainable in the longer term. The Scottish Government should regularly consider the costs and benefits of commissioning further compliance activity in Scotland. I am aware that the Scottish Income Tax Board has commissioned an update to its Compliance Plan to further consider how HMRC's Scottish income tax compliance activity fits into its wider work to administer Scottish income tax.
- HMRC's compliance activity typically applies to tax liabilities from two years previous, therefore any compliance risk from the further divergence in tax policy between Scotland and the rest of the UK from 2023/24 is unlikely to be apparent through compliance cases until at least 2025/26. There is therefore a risk that the Scottish Government are not able to make fully informed decisions on the future divergence of Scottish income tax policy.
- HMRC together with the Scottish Government has produced a dataset tracking the behaviour of taxpayers over time in response to any income tax changes between Scotland and the rest of the UK. The analysis of this dataset is under way, but it is not yet clear when or whether the results will be published. Publicly available better-quality data about taxpayer behaviour will help inform future tax policy decisions and enable more informed scrutiny.

Background

4. HMRC collects and administers Scottish income tax on behalf of the Scottish Government as part of the UK's overall income tax system. This includes separately identifying the amounts that relate to Scottish taxpayers. The Scottish Government is responsible for:

- reimbursing HMRC for the cost of implementing Scottish income tax
- ensuring that the cost of implementing Scottish income tax represents value for money
- seeking assurances that the system collects the correct amount of tax
- discussing and agreeing with HMRC aspects of the approach to the administration of Scottish income tax as set out in a Service Level Agreement.

5. The amount of Scottish income tax collected each year is identified separately in HMRC's annual accounts. HMRC's annual accounts for 2022/23 were published in July 2023. This report relates to 2022/23, including the final outturn calculation of Scottish income tax for the 2021/22 tax year. This amount is used to calculate the reconciliation applied to the Scottish Budget for 2024/25.

The 2021/22 Scottish income tax outturn is reconciled through the 2024/25 budget.

6. In 2021/22, income tax receipts across the UK increased markedly due to factors such as recovery from Covid-19 and increases in inflation. Total Scottish NSND income tax revenues rose by 14.9 per cent between 2020/21 and 2021/22, compared to an increase of 15.5 per cent in NSND income tax revenues across England and Northern Ireland. Between 2019/20 and 2020/21, Scottish income tax revenues rose by 1 per cent compared to a rise of 2 per cent across England and Northern Ireland.[3]

7. The report also covers HMRC's provisional estimate of Scottish income tax receipts for 2022/23. This provisional estimate does not affect the Scottish budget. The final outturn for 2022/23 is expected to be reported in summer 2024.

Audit and assurance

8. The C&AG made his ninth annual report to the Scottish Parliament on 19 January 2024. His report relates to 2022/23 and considers:

- HMRC's calculation of the 2021/22 income tax revenue attributable to Scotland and provides assurance on the correctness of the amounts brought to account
- HMRC's estimation of the 2022/23 income tax revenue attributable to Scotland and his view on the methodology used to estimate the amount
- key controls operated by HMRC to assess and collect Scottish income tax

[3] Scottish Income Tax Outturn Statistics: 2021 to 2022, HM Revenue & Customs, July 2023.

- HMRC's approach to assessing and mitigating the risk of non-compliance with Scottish tax requirements
- the cost of administering Scottish income tax and provides assurance on whether the amounts are accurate and fair in the context of the agreement between HMRC and the Scottish Government.

9. Audit Scotland considered:

- the NAO's approach to identifying the key risks to the successful administration of Scottish income tax
- the NAO's audit working files, with focus on the audit evidence underpinning the key findings and conclusions in its report
- the NAO's arrangements for ensuring the quality of the audit work and reporting.

10. Audit Scotland's review was limited to consideration of the NAO's audit work; it did not directly review evidence obtained from HMRC or discuss any matters relating to Scottish income tax directly with HMRC. The judgements and conclusions set out in the report of the C&AG are his alone, based on the audit work undertaken by the NAO on his behalf.

11. Based on Audit Scotland's review, I am satisfied that the NAO's approach was reasonable and that its audit work covered the key audit risks. I am also satisfied that the findings and conclusions in the C&AG's report are reasonably based.

Correctness of the sums brought to account

12. HMRC's 2022/23 Annual Report and Accounts included Scottish income tax outturn figures relating to the 2021/22 year. Scottish income tax in 2021/22 was £13.724 billion.[4]

13. For the 2022/23 tax year, HMRC provided a provisional estimate that Scottish income tax revenue will be £14.996 billion. HMRC will publish the final Scottish income tax outturn for 2022/23 in its 2023/24 accounts, and an adjustment will be made to the 2025/26 Scottish Budget. The impact of tax outturns on the Scottish budget is explained in further detail at paragraphs 58-65 of this report.

2021/22 final outturn

14. The C&AG concludes that Scottish income tax revenue outturn for 2021/22 is fairly stated.

15. The 2021/22 outturn calculation of £13.724 billion is largely based on established tax liabilities, after the tax owed has been finalised and the taxpayer

[4] Administration of Scottish income tax 2022-23, National Audit Office, January 2024.

records have been reconciled. The remainder is based on estimated liabilities; including, HMRC's estimate of PAYE tax liabilities that have not yet been finalised and where tax liabilities are expected from future Self-Assessment returns or compliance activity. The calculated estimate is required because the income tax liability data is not available to identify the Scottish share of individual income tax liabilities, reliefs or other adjustments at the point the outturn is calculated.

16. The net effect of these estimation adjustments is to reduce the Scottish income tax outturn arising by £100 million (0.7 per cent of the outturn). The methodology used to arrive at these adjustments was agreed between the Scottish Government and HMRC at the Scottish Income Tax Board in May 2022. The C&AG notes that this methodology has remained broadly the same since the prior year.

17. Both income tax receipts and the number of people paying tax has increased markedly in 2021/22, in Scotland and in the rest of the UK. The C&AG notes that in Scotland, the outturn for 2021-22 represents an increase of 14.9 per cent compared with 2020-21 (£13.724 billion compared to £11.948 billion). The outturn for non-savings, non-dividend income tax for the whole of the UK increased by 15.4 per cent in 2021-22. HMRC and the Scottish Fiscal Commission have pointed towards economic recovery from the pandemic and tight labour market conditions in a period of inflation as contributing factors.

18. The Scottish Fiscal Commission has reported[5] on the reasons for an increase in the number of taxpayers in 2021/22, noting that,

> “There was a 5.1 per cent increase in taxpayers in 2021-22 compared to 2020-21. This was unexpected as outturn statistics from HMRC show that the number of taxpayers in Scotland remained steady between 2016-17 and 2020-21. HMRC noted in their accompanying report[6] that fiscal drag has resulted in the increases in the proportion of intermediate, higher, and top rate taxpayers in Scotland. There has also been a similar increase in England and Northern Ireland, with the number of taxpayers increasing by 5.2 per cent in 2021-22. This suggests that the reasons for the increase are UK-wide.”

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

Fiscal drag is the extra tax received when people's wages increase but tax rates and bands remain unchanged.

20. The impact on the Scottish budget, explored later in this paper, relates to per capita growth in receipts relative to the rest of the UK under the terms of the Fiscal Framework. The percentage growth in tax receipts does not result in a similar level of growth in the Scottish budget. It is therefore important that the Scottish Government continues to monitor and consider the impact of relative economic and tax policy change in the rest of the UK to the Scottish budget. This is particularly important given that the Scottish

[5] Forecast Evaluation Report, Scottish Fiscal Commission, August 2023.
[6] Scottish Income Tax Outturn Statistics: 2021 to 2022, HM Revenue & Customs, July 2023.

taxpayer base has a greater proportion of basic rate taxpayers and fewer higher rate taxpayers compared to the rest of the UK, meaning factors such as fiscal drag may affect Scotland differently. This is likely to remain the case for future budget years, potentially influencing budget growth from future tax policy decisions.

The impact of Covid-19 on 2021/22 outturns

21. HMRC estimates the amounts that are still expected from 2021/22 but have not yet been collected. In any given year, some taxes that are due will never be paid. Estimated liabilities therefore includes a deduction for taxes that may never be collected.

22. Covid-19 has not resulted in any substantial change to the overall collectability deductions to the Scottish outturn compared to previous years. The overall estimate of uncollectable revenue deducted by HMRC from the 2021/22 outturn was £94 million. This is £3 million lower than the figure deducted from the 2020/21 outturn for uncollectable amounts, and £5 million greater than the 2019/20 outturn, which covers the pre-pandemic period.

2022/23 provisional estimate

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

HMRC's estimated outturn for 2022/23 does not affect the Scottish budget.

24. Since 2018/19 the provisional estimate methodology is based on data from its Survey of Personal Incomes (SPI) and Personal Tax Model to give a Scottish percentage share of UK NSND tax income. HMRC compares this amount to the liabilities from the latest (2021/22) Scottish income tax outturns and adjusts its estimate accordingly. HMRC performs this calibration because, historically, actual tax outturns have been lower than the provisional estimates. The C&AG notes that the methodology is largely consistent with that used to calculate last year's 2021/22 estimate. However, the C&AG also outlines the continuing limitations described in previous reports in using SPI data.

25. HMRC identifies the key source of uncertainty in the 2022/23 provisional estimate as the accuracy with which it can identify the Scottish percentage share of UK NSND tax income. The C&AG notes that the estimated share that HMRC calculates is based on 2019/20 survey data. I understand that 2020/21 SPI data is available, but this has not been used to inform the 2022/23 estimate due to the impact of the pandemic on these figures.

26. The C&AG also notes that the outturn for 2021/22 was 3.2 per cent higher than HMRC had originally estimated, compared to the years between 2018-19 and 2020-21 where the outturn was approximately 1 per cent from HMRC's estimates.

27. HMRC estimates that Scottish income tax revenue will grow at a slightly higher rate than the UK overall in 2022/23. HMRC took account of this as part of its calibration adjustment.

28. The C&AG reports that the 2022/23 Scottish income tax estimate represents an increase of £1,273 million (9.3 per cent) against the 2021/22 outturn, compared to an 8.9 per cent increase for the UK overall against the 2021/22 outturn. The C&AG notes that these increases reflect continued inflationary rises in earnings, together with the freezing of the higher and top rates of income tax in Scotland and all income tax bands and thresholds in the rest of the UK, moving some taxpayers into higher tax brackets.

29. The C&AG also concludes that the impact of other external factors such as high interest rates and inflation, wage growth and high and volatile energy prices increased the level of uncertainty in HMRC's estimate of Scottish income tax revenue.

30. The risks to the budget caused by increasing uncertainty, complexity and volatility have never been higher, and it will be challenging to match spending to the available funding in the coming years. In my view, it is important that the Scottish Government and HMRC keep the estimation methodologies under review as more data becomes available to ensure they are as accurate as possible.

31. I note that the Scottish Fiscal Commission’s most recent forecast for 2022/23 Scottish income tax receipts is £15.309 billion which is around two per cent higher than HMRC’s provisional estimate.

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

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

33. The administration of Scottish income tax is governed by a Service Level Agreement (SLA) between HMRC and the Scottish Government.[7] This is updated every year to reflect HMRC’s planned work. The SLA sets out the requirements and performance measures for the operation of Scottish income tax. HMRC shares the results of assurance exercises and compliance activities with the Scottish Government throughout the year and publishes an annual summary of its performance against the requirements.[8]

34. The Scottish Income Tax Board meets quarterly as part of its annual cycle of governance and discusses the performance of HMRC procedures on Scottish taxpayer checks, PAYE (Pay As You Earn) reconciliations and compliance plans. The Scottish Government has told us this provides it with a high level of assurance over HMRC’s administration of Scottish income tax. From 2023/24

[7] HM Revenue & Customs, Service level agreement for operation of Scottish Income Tax by HMRC, 30 September 2022.
[8] Scottish Income Tax HMRC Annual Report 2022, HMRC, February 2023.

onwards, the Scottish Government and HMRC agreed to publish the minutes of the Scottish Income Tax Board.

35. The publication of the Scottish Income Tax Board minutes is an important step towards greater transparency in decision-making. Given ongoing economic uncertainty and volatility and increased divergence between Scottish and UK income tax policies, it will be important to keep performance against the SLA and governance arrangements under continual review.

Scottish Tax Base

36. Accurate identification of Scottish taxpayers remains fundamental to the effective operation of the Fiscal Framework, to the size of the Scottish budget and in ensuring that the right amount of tax is collected from individuals.

37. The C&AG reports that HMRC carries out several assurance activities to maintain the completeness and accuracy of the Scottish taxpayer population. This includes a series of checks on HMRC's records of Scottish taxpayers. The Scottish Government and HMRC agreed in October 2020 that third-party data checks (where taxpayer address records held by HMRC are compared with third-party data sources) should be run every two years. This comparison is the main source of assurance over HMRC's address information and is part of a wider suite of assurance activity detailed in Figure 9 of the C&AG's report.

38. The C&AG has reported that third-party data exercises continue to be run every two years. In my view, the Scottish Government should consider if more frequent checks or further actions should be requested to provide further assurance over the accuracy of HMRC's address records. I am aware that the Scottish Income Tax Board agreed in July 2023 to review the frequency of the third-party data clash scan following the conclusion of the 2023 to 2024 process.

39. The most recent exercise was completed in August 2023. The results of this exercise became available in December 2023, and the HMRC has not yet assessed reasons for trends in data.

40. While there are 2.7 million NSND Scottish taxpayers, HMRC holds 5.3 million taxpayer records, excluding duplicates, temporary numbers, deceased taxpayers and inactive records. The C&AG reports that overall, the residency status of taxpayers for 72.9 per cent of these records could be corroborated to third-party data with a Scottish address. This is a slight increase from 72.2 per cent of records corroborated in the previous third-party data exercise in 2021. The C&AG notes that this remains lower than the 78.7 per cent matched in HMRC's 2019 exercise, meaning there remains an increased reliance on internal HMRC records and other assurance activity compared to 2019. The C&AG notes that HMRC identified the impact of data protection regulations on third-party data sets, a higher death-rate due to the Covid-19 pandemic, the inclusion of 16- to 18-year-olds on the electoral roll and an increase in people changing address as potential reasons for records not matched to third-party data.

41. The C&AG also reports that system changes designed to remove the need to annually update parliamentarians' records were introduced in August 2020, and that HMRC did not identify any issues in relation to Scottish Parliamentarians' tax during 2022/23.

Compliance risks

42. HMRC continues to assess compliance risk for Scottish taxpayers in the same manner as it does for the entire UK taxpayer population; through its Strategic Picture of Risk (SPR). The Scottish SPR identifies risks for Scottish income tax by taking the Scottish share of UK NSND income tax.

43. The C&AG reports that HMRC generated an estimated additional £380 million in Scottish income tax through its compliance activities in 2021/22 through generating additional revenues or preventing revenue losses. Scotland's share of the estimated revenue lost in 2020/21 (the latest year for which data is available) from risks identified in the SPR, such as tax evasion and not declaring income, is £1.1 billion.

44. Both figures are calculated based on a proportion of the UK figure, rather than using Scotland-specific data to quantify the risks. The C&AG emphasises that HMRC has limited information on specific compliance activity undertaken in Scotland. Unlike the income tax system which can flag Scottish taxpayers, HMRC's compliance system cannot readily identify people living in Scotland.

45. The C&AG notes that, as in previous years, HMRC's compliance approach is based on its assumption that compliance risk in Scotland is consistent with the rest of the UK. This assumption is not tested by HMRC because of the methodological challenges and costs involved. The C&AG concludes that, with tax policy diverging further from 2023/24 there is a risk that HMRC's assessment may not be sustainable in the longer term.

46. The C&AG also reports that HMRC's consideration of compliance risk typically looks at tax liabilities from two years prior. Any compliance risk arising from further divergence in tax policy between Scotland and the rest of the UK from 2023/24 is therefore unlikely to be considered until at least 2025/26.

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

48. For example, the outturn for 2023/24 Scottish NSND income tax will be known in summer 2025, with the adjustment to the Scottish budget then being made to the 2026/27 budget. Therefore, reconciliations to the 2026/27 budget would be made before compliance risks arising from further tax divergence in 2023/24 are fully known.

49. The C&AG states that the Scottish Government did not request any specific compliance activity in 2021-22, over and above the work undertaken as part of HMRC's UK-wide compliance approach. In line with the SLA, further compliance activity can be undertaken by HMRC and paid for by the Scottish Government if such activity is requested by the Scottish Government and agreed by HMRC.

50. Each year, HMRC also monitors cross-border migration trends to identify potential instances of taxpayers erroneously changing their address to obtain a tax advantage. The C&AG reports that for 2022/23 states HMRC encountered difficulties with importing land and property transaction data into its systems. This has caused a delay in HMRC's plans for analysing these data, although HMRC expects the analysis to be complete by January 2024.

51. For 2023-24, the Scottish Government has commissioned HMRC to use more sources of information to corroborate the validity of taxpayers' movements where land and property transaction data are not suitable. This information could include electoral roll, credit reference and other available third-party information. This is intended to help establish a more reliable baseline of cross-border movements against which to monitor the impact of increased divergence in income tax rates from 2023/24.

52. In my view, the Scottish Government should regularly consider the costs and benefits of additional compliance activity in Scotland. We are aware that the Scottish Income Tax Board in July 2023 commissioned an update to the Compliance Plan to further consider how HMRC's Scottish Income Tax compliance activity fits into its wider work to administer Scottish income tax.

Taxpayer behaviour

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

- **Economic responses:** seeking work or increasing the number of hours worked or vice versa.
- **Cross-border mobility:** taxes could also affect migration, both into and out of Scotland.
- **Tax planning or avoidance:** shifting income into a more tax-efficient source, such as dividends; or artificially reducing one's tax liability.
- **Evasion:** where there is a deliberate (and illegal) attempt not to pay the tax which is due.

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

55. The C&AG has reported that HMRC has now produced an initial version of a dataset to enable a series of analyses, including examining the historical levels of migration across the Scottish and Welsh borders by age and income level. HMRC expects this work will enable it to analyse cross-border migration in response to any income tax changes between devolved administrations and the rest of the UK.

56. In my view, the development of a dataset to track taxpayer responses to income tax changes over time is a positive development. Obtaining better quality data will help inform future tax policy decisions. In my view, results of this first dataset analysis should be made publicly available as soon as is practicable.

The accuracy and fairness of the administrative expenses

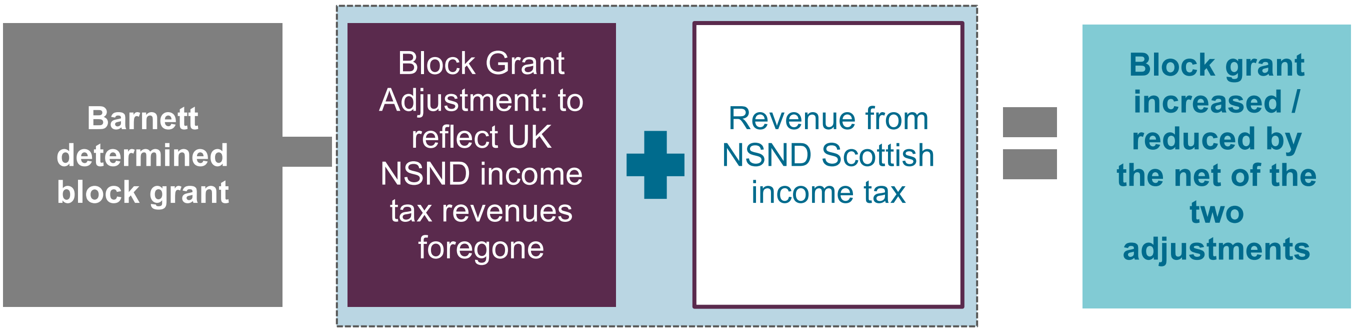
57. The C&AG notes that 'based on our audit work, we have concluded that the amount paid by the Scottish Government (for the year ended 31 March 2023) was accurate and fair in the context of the agreement between HMRC and the Scottish Government'. HMRC invoiced the Scottish Government for £0.6 million of costs relating to the administration of Scottish income tax in 2022/23 (£0.6 million in 2021/22).

Impact of tax outturns on the Scottish budget

58. The block grant received from the UK Government remains the main source of funding for the Scottish budget. Since NSND income tax was devolved to Scotland in 2017/18, the block grant is now adjusted to take account of actual Scottish income tax revenues raised in Scotland. These are known as block grant adjustments (BGAs).

59. For Scottish income tax, the block grant is reduced by the amount of income tax foregone by HM Treasury by devolving it. Scottish income tax receipts are then added to the block grant in its place (Exhibit 1).

Exhibit 1
The block grant is adjusted for NSND Scottish income tax



Source: Audit Scotland

60. 2021/22 budget figures for Scottish income tax were based on independent forecasts prepared by the Scottish Fiscal Commission (SFC) and the Office for Budget Responsibility (OBR). A budget adjustment (or 'reconciliation') is made in later years once outturn data is known.

61. The reconciliation resulting from 2021/22 outturn figures is a budget decrease of £390 million. This is the largest adjustment to the budget resulting from the budget reconciliation to date. This will be made through the 2024/25 Scottish budget. As part of the updated Fiscal Framework Review earlier in 2023, the reserve drawdown limits of £250 million for resource and £100 million for capital have been abolished. Resource borrowing limits have also been revised up to £600 million. Therefore, the Scottish Government could choose to cover this downward adjustment by using reserves or borrowing, or a combination of the two.

62. Forecasts originally used for the 2021/22 Scottish budget increased the budget by £475 million, the net difference between forecast tax foregone by HM Treasury and forecast Scottish income tax receipts. Outturns show that the actual increase was £85 million, £390 million less than the forecasted difference (Exhibit 2). While the Scottish Income Tax outturn was greater than forecasted by the SFC, the corresponding block grant adjustment was relatively higher, due to greater tax receipts in the rest of the UK. The SFC notes that it had to make several assumptions around the outlook for Covid-19 and its effects on the economy and tax base when setting its forecasts. For example, it expected the furlough scheme to end on 30 April 2021, but it was subsequently extended until 30 September 2021 which supported employment as the economy re-opened. It also notes that the Scottish economy itself was more resilient than was expected.

63. The SFC estimates that differential income tax policies implemented since 2017/18 have raised up to an additional £750 million from Scottish taxpayers in 2021/22, when compared with matching income tax policy in the rest of the UK. The SFC notes that relatively weaker economic performance alongside differences in the income distribution have largely offset this.

64. Because the 2021/22 Scottish Budget was set in December 2020 before the UK Budget in March 2021, the Scottish Government was able to choose after the UK budget whether to set its final budget based on the provisional BGA produced by the OBR as part of the UK Spending Review in November 2020, or to use the updated BGA based on the OBR's March 2021 forecasts. The Scottish Government chose to use the November 2020 BGA for its final budget. This gave a more favourable budget in the short term, but gave an increased risk of a negative reconciliation being required through the 2024/25 budget.

65. Had the Scottish Government used the March 2021 BGA forecasts in its 2021/22 budget instead, then this would have resulted in a lower budget decrease through the 2024/25 Scottish budget, of £342 million (Exhibit 2). I note however, that this is less than the £712 million negative reconciliation forecast by the Scottish Fiscal Commission in May 2023, which was factored into the Scottish Government's Medium-Term Financial Strategy (MTFS). The MTFS expects positive reconciliations in future years.

Exhibit 2

How the Scottish Income Tax outturn relates to the 2024/25 budget reconciliation

£ million	BGA – reflecting income tax foregone by HM Treasury	Revenue from NSND Scottish income tax	Net effect on budget
Forecasts used for the 2021/22 budget	-11,788	12,263	475
Final outturn	-13,639	13,724	85
Reconciliation required through the 2024/25 budget			**-390**
Alternative BGA forecast option not used for the 2021/22 budget	*-11,836*	12,263	*427*
Final outturn	-13,639	13,724	85
Reconciliation to the 2024/25 budget that would have resulted from application of alternative BGA forecast			***-342***

Source: Audit Scotland, based on Scotland's Economic and Fiscal Forecasts, Scottish Fiscal Commission, December 2023

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