Adviser Briefing on income tax outturn

Income tax outturn statistics for 2017/18 were published by HMRC on 19 July. These included the outturn Scottish income tax revenue, and the outturn rUK income tax revenue. The latter enables a calculation of the outturn income tax ‘block grant adjustment’ for 2017/18, which is deducted from the Scottish block grant.

The Scottish Government produced a useful summary of the outturn data, and the implications for reconciliation.

OUTTURN TAX AND BGA FOR 2017/18

- Outturn Scottish income tax revenue in 2017/18 was £10,916m
- The outturn income tax BGA was £11,013m. The BGA is an estimate of the revenues that the UK Government has foregone as a result of transferring income tax to Scotland. It is estimated by assuming that, if income tax had not been transferred, then income tax revenues in Scotland would have grown at the same per capita rate in Scotland between 2016/17 and 2017/18 as was observed in rUK.
- The difference between revenues and the BGA (known as the ‘net tax’ position) is -£97m. This means that the Scottish Budget in 2017/18 was £97m worse-off than it would have been if income tax had not been transferred. (This is despite the policy of the Scottish Government to set a lower threshold for the Higher Rate, which in principle should raise Scottish revenues relative to the BGA; without this policy change, the gap between Scottish revenues and the BGA would have been even larger).
- The fact that the BGA is higher than Scottish revenues implies that the income tax base grew slightly more quickly in rUK than in Scotland. In practice, it is largely explained by slightly faster growth in average earnings in rUK than Scotland.

RECONCILIATION

When the 2017/18 budget was set, these outturn figures were clearly not known with certainty. Instead, the Budget relied on forecasts of both Scottish revenues (produced by the Scottish Government and ‘signed-off’ by the SFC) and the BGA (based on OBR forecasts of rUK).

Now that outturn data is available, there needs to be a ‘reconciliation’ of the difference between the forecast net tax position and the outturn net tax position.

When the 2017/18 Budget was set, the net tax position was forecast to be £107m (i.e. revenues were forecast to be higher than the BGA).

The difference between the forecast £107m and outturn -£97m is -£204m. This means that the 2020/21 budget will be adjusted downwards (reconciled) by £204m. Effectively, the 2017/18 budget was planned on an assumption that the Scottish...
Government would have £204m more resources available to it than we now know to be the case.

Table 1: Forecast and outturn income tax revenues and BGA (£m)

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<tr>
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<th>Revenues</th>
<th>BGA</th>
<th>Net position</th>
</tr>
</thead>
<tbody>
<tr>
<td>Budget 2017/18</td>
<td>11,857</td>
<td>11,750</td>
<td>+107</td>
</tr>
<tr>
<td>Outturn</td>
<td>10,916</td>
<td>11,013</td>
<td>-97</td>
</tr>
<tr>
<td>Change</td>
<td>-941</td>
<td>-737</td>
<td>-204</td>
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EXPLANATIONS AND INTERPRETATION

The scale of the revisions reported in Table 1 do not come as a surprise as they are largely in line with the forecasts that were made in May this year. An adviser briefing note circulated in June this year (alongside the MTFS) discussed the explanations for these revisions. This can be summarised as follows:

- As can be seen from Table 1, both the outturn revenues and outturn BGA are substantially lower than was forecast at Budget 2017/18. The downward revision to revenues and BGA is largely the result of the publication of 2016/17 outturn data in summer 2018. The 2016/17 outturn for Scottish revenue was lower than had been anticipated. This obviously pushed down on income tax forecasts in subsequent years. But because it also meant that the UK Government had been collecting less income tax from Scotland than had been thought, it reduced the BGA by a similar magnitude. Implicitly, lower Scottish revenues in 2016/17 imply that the UK Government is foregoing less income than had been anticipated from transferring income tax to Scotland.

- But as well as this downward adjustment to both revenues and the BGA, two other things have happened. First, Scottish revenues grew slightly less quickly between 16/17 and 17/18 than had been forecast. Second, rUK income tax revenues grew more quickly between 16/17 and 17/18 than had been forecast.

In its press release, HM Treasury said that Scottish income tax revenues for 2017/18 were £941m lower than ‘expected’, implied that this shortfall was due to slower economic growth in Scotland, and stated that this shortfall would be ‘offset’ by increased UK Government funding of £737m as part of risk sharing mechanisms.

This interpretation is somewhat disingenuous on a number of counts. First, Scottish revenues were not £941m lower because of slower economic growth, but – as described above – largely reflected lower than anticipated outturn data for 2016/17. In
other words, most of the explanation for the lower than forecast outturn data reflects that revenues turned out to be lower than expected before income tax was transferred.

Secondly, the UK Government did not offset this lower outturn with increased funding to reflect some risk-sharing mechanism; rather, the block grant adjustment was lower than forecast (i.e. less was deducted from the block grant) reflecting the lower 2016/17 outturn – which meant that the UK Government had been collecting less income tax revenue from Scotland than had been thought, and as a result was implicitly foregoing less revenue by transferring income tax to Scotland. The Fiscal Framework contains no ‘risk-sharing mechanism’ that protects the Scottish budget from slower than rUK growth – the Scottish budget is exposed in full to any such divergence, which is why it bears the risk of its revenues being lower than the BGA.

Indeed, reflecting these points, the UK Statistics Authority upheld a complaint from Mr. Mackay that the UK Government’s interpretation of the reconciliation was ‘incorrect’.

The Scottish Government’s own press release puts a positive spin on the figures. For example, it argues that “the number of Scottish Higher and Additional Rate taxpayers combined, and the revenue paid by them, grew more quickly in Scotland than in the rest of the UK”, and that this “demonstrates that concerns taxpayers would relocate as a result of our tax policy choices were unfounded”.

Of course, we would expect the number of higher rate taxpayers to grow more quickly in Scotland than rUK, given that the higher rate threshold was frozen in Scotland but increased by more than inflation in rUK. Moreover this in itself tells us nothing about whether there was or wasn’t some taxpayer response to the tax changes.

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