Finance and Public Administration Committee
35th Meeting, 2024 (Session 6)
Tuesday 10 December 2024

Scottish Budget 2025-26 and Scottish Fiscal Commission's Economic and Fiscal Forecasts – December 2024

Purpose

1. The Committee is invited to take evidence from the following witnesses from the Scottish Fiscal Commission in relation to the Scottish Budget 2025-26 and the SFC's Economic and Fiscal Forecasts – December 2024—

   - Professor Graeme Roy, Chair,
   - Professor David Ulph, Commissioner,
   - John Ireland, Chief Executive, and
   - Claire Murdoch, Head of Fiscal Sustainability and Public Funding.

2. This paper sets out key points from the Committee's pre-budget 2025-26 report, the Scottish Budget 2025-26 and SFC's December 2024 Forecasts. Background information on the UK context to the Scottish Budget is provided at Annexe A. Annexe B provides further information on the Scottish Government's Tax Strategy: Building on our Tax Principles, published alongside the Scottish Budget 2025-26.

Pre-budget 2025-26 scrutiny

3. The Committee has agreed to focus its scrutiny of the Scottish Budget 2025-26 on the following three themes from its pre-budget 2025-26 report published on 7 November 2024, as follows—

   - the Scottish Government's Tax Strategy and tax policies for 2025-26,
   - growing the economy, including how capital expenditure should best be used to stimulate economic growth, innovation, and productivity, and
   - progress with the Scottish Government's public service reform programme.

4. The Committee also agreed to continue to consider, as part of its budget scrutiny, the Scottish Government's approach to public sector pay and how it has targeted its 2025-26 spending and tax policies towards meeting its four priorities of eradicating child poverty, growing the economy, tackling the climate emergency, and ensuring high quality and sustainable public services.[1]

[1] This follows the Committee's concerns that the Scottish Government's 2024-25 tax and spending policies did not always align with its key priorities at the time, and that its approach to public sector pay assumptions has lacked transparency.

5. In its pre-budget 2025-26 report, the Committee concluded that it—

> "… is deeply concerned about the Scottish Government's lack of strategic approach to managing Scotland's public finances. There is little evidence that medium- and long-term financial planning is taking place, and year-on-year budgeting has also become challenging, with significant emergency controls being required in each of the last three years. While we recognise that devolved administrations have fewer flexibilities to deal with 'shocks', many of the issues impacting the 2024-25 Budget … could have been foreseen and mitigated when [… it] was set last December. At the very least, scenario plans could have been put in place to allow spending commitments to be 'flexed' to adapt to fiscal strain."

6. Similar concerns were raised by the Auditor General for Scotland (AGS) in his Fiscal Sustainability and Report in Scotland, published on 21 November 2024. He highlighted that "the Scottish Government continues to take short-term decisions, reacting to events rather than making fundamental changes to how public money is spent" and suggested that the Scottish Government's reporting to Parliament and the public on the progress and implications of reform and fiscal sustainability has been insufficient.

7. The Committee suggested in its pre-budget 2025-26 report that "if key strategy documents looking beyond the year, such as the Medium-Term Financial Strategy (MTFS), Infrastructure Investment Plan (IiP) pipeline reset, Tax Strategy, and multi-year plans, had been published when originally committed to, they would have ensured the Scottish Government was considering the medium to longer term approach as part of its budget planning". It went on to say that "repeated publication delays until after the next fiscal event have unfortunately led to a perception of the Government being in a state of inertia".

8. The Fraser of Allander Institute (FAI) also noted, in its Scotland's Budget Report 2024 published on 28 November, that without the MTFS and accompanying full SFC Forecasts "we head into the Scottish Budget in a position of knowing less than we ideally would about next year's financial position, especially given (i) how long it has been since the last MTFS [in May 2023], and (ii) the significant changes to both spending and funding plans since then, both from the Scottish Government and UK Government". The Committee had also expressed concerns that "the absence of an MTFS this year has undermined our ability to consider how the priorities for the next Budget sit within [the] longer-term context". Similarly, the AGS reported that "the Scottish Government has not been transparent enough with the Scottish Parliament or the public about the medium-term risks it is facing", adding that the absence of the MTFS and infrastructure investment plans "makes scrutiny of the current uncertain financial situation more difficult".

9. The Cabinet Secretary has committed to publishing a fiscal sustainability delivery plan alongside the MTFS in 2025[2] which, the AGS has recommended, "should be fully transparent about the scale of the risks to the affordability of

[2] During a debate on Fiscal Sustainability on 29 October 2024.

public services and options for how the Scottish Government can manage them".

10. The Scottish Government published its Tax Strategy alongside the Scottish Budget 2025-26, with the MTFS, the new fiscal sustainability delivery plan, and IiP pipeline reset now expected after the UK Government's Spending Review (UKG SR), which will set out spending plans for a minimum of three years of the forecast period and is due to take place in late Spring 2025[3]. However, the Guardian reported on 28 November that the UKG SR would be delayed due to "drawn out and complex negotiations" and will now be published in June 2025. However, the same report states that UK Government officials have indicated there is no delay and it was always intended to be published between May and July.

11. In its pre-budget 2025-26 report, the Committee noted that a regular UKG SR provides an opportunity for the Scottish Government to carry out its own Scottish Spending Review (SSR) and to adopt multi-year budgets. It urged the Scottish Government to ensure that SRRs are undertaken with the same regularity from late Spring 2025 onward. In its response to the Committee's pre-budget report, the Scottish Government states that it "is currently reviewing its options for a Scottish Spending Review and will update the Committee in due course", adding this update "will set out a process for engaging with Parliament, its committees and the SFC".

12. Finally, the Committee noted in its report that the mandate letters issued to Cabinet Secretaries by the previous First Minister provide an opportunity for better accountability of decision-making and delivery of outcomes. It therefore sought "confirmation that the mandate letters will be updated to reflect the four new priorities and that the actions of Cabinet Secretaries in terms of delivering these priorities will be measured and publicly reported". The AGS further recommended in his recent report that the Scottish Government, by September 2025, reviews and updates the mandate letters it issued in September 2023, and use these to maximise the effect of portfolio spending towards reform and government priorities, adding "if the Scottish Government chooses not to publish mandate letters, then this information should be included in other publications". The Scottish Government points instead to the Programme for Government priorities being "affordable, impactful and deliverable and create the priorities [the First Minister] and his Cabinet will deliver".

13. The Committee also expects to receive an interim update from the Scottish Government this month on its public service reform programme, date to be confirmed, following the most recent update provided in late September 2024.

Economic and fiscal context

[3] The UK Autumn Budget 2024 confirmed that the UK Government would be carrying out a Spending Review to conclude in late Spring 2025.

14. The SFC states in its December 2024 Economic and Fiscal Forecasts that “the outlook for the Scottish economy is higher GDP growth in 2025-26 than in 2024-25, in part as a result of the UK Government fiscal expansion, and inflation is also expected to be slightly higher in 2025-26 than in 2024-25” It goes on to explain that although UK decisions have resulted in additional funding for the Scottish Government through the Block Grant in both 2024-25 and 2025-26, “… the working of the fiscal framework and larger upward revisions to UK income tax revenue forecasts than our Scottish forecasts mean the income tax net position used to set the Scottish Budget has reduced funding by £575 million between 2024-25 and 2025-26. It adds “this means that the overall changes in the Scottish Budget are more modest”. The SFC further notes that—

- Over the past year, “the Scottish economy and labour market have performed slightly better than we expected in December 2023, but broadly on track with our last forecast”.
- GDP has increased marginally after being flat since early 2022, and “nominal earnings growth has remained relatively strong in a still tight labour market”. Its Forecasts shows GDP growth rising to 1.6% in 2025-26, before returning to its trend rate of 1.4% by 2027-28, “which reflects our higher migration and population assumption”.
- Stronger earnings growth, combined with lower inflation than expected a year ago, has resulted in living standards recovering more rapidly from their fall in 2022-23.
- Consumer Price Index (CPI) inflation is expected to rise to 2.6% across the UK in 2025-26, revised up from 1.6% in the SFC’s last forecast, which “feeds through to higher nominal earnings growth in both Scotland and the UK in 2025-26”.
- The SFC’s view is that the labour market in Scotland is still tighter than in the UK, consistent with regional data on job vacancies and worker shortages. This, it suggests, implies faster earnings growth in Scotland compared to the UK in 2025-26. In addition, it expects “the extra demand from the fiscal expansion will have a greater effect on earnings in Scotland, providing a small additional boost to Scottish earnings growth in 2025-26”.

15. In relation to funding for the Scottish Government, the SFC highlights that—

- Overall funding for 2025-26 is now £58,772 million, a real terms increase of 2.1% on 2024-25 (ABR figures). Resource funding is forecast to be £51,429 million in 2025-26, a real terms increase of 0.8%.
- Capital funding in 2025-26 is forecast to be £7,344 million, a 12% increase in real terms on 2024-25. The Scottish Government plans to borrow the maximum possible amount in 2025-26 of £472m, and use £326m of ScotWind proceeds to support capital investment on green projects for the first time.
- While UK Government capital spending is set to rise in the next two years before flattening off at a higher level, Scottish Government capital funding peaks in 2025-26 before falling in 2026-27 and then broadly staying flat. The SFC explains the reason for this is that the Scottish

Government plans to borrow less in 2026-27 than in 2025-26, and there is no planned use of ScotWind proceeds in 2026-27.

- As resource funding accounts for 88% of the Scottish Budget, the change in total funding is "most influenced by resource funding".
- The tax net position positively contributes to 2025-26 funding but less so than it did in 2024-25, and less so than expected in December 2023, when the SFC last forecast funding in 2025-26. The tax net position for 2025-26 is £1,175 million which is £549 million or 32% lower than in 2024-25. This, the SFC explains, is mostly because of improved forecasts of UK income tax revenues.

16. The SFC further notes that "unlike previous budgets, the Scottish Government is now comparing the 2025-26 Budget to the 2024-25 position at the ABR […, which] is an improvement from previous practice, where the comparison was to the previous Budget as initially presented to the Scottish Parliament". However, the SFC "would ideally want to compare to the latest position for both funding and spending, and to have information on how the Scottish Government plans to allocate the funding which has emerged since the ABR, because it is a more accurate reflection of changes year on year".

Scottish taxation and spending plans

Background

17. The Scottish Government's Scottish Budget 2025-26 and the SFC's accompanying Economic and Fiscal Forecasts – December 2024 were published on 4 December.

18. In its December 2024 Forecasts, the SFC explains that the Scottish Government has seen some large increases in funding as a result of the UK Autumn Budget 2024, "in particular there is more capital funding in real terms in 2025-26 than in previous years". However, it goes on to state that "after accounting for the working of the fiscal framework the increase is more modest for day-to-day (resource) spending which is the majority of the budget". It goes on to say that "existing and new social security commitments mean funding for other areas is lower in real terms in 2025-26 than in 2024-25".

19. Published prior to the Scottish Budget 2025-26 on 29 November, the Fraser of Allander Institute's (FAI's) Scotland's Budget Report 2024 includes "an analysis of what Scotland spends its money on, to understand more about the discretionary power the [Scottish] Government has to prioritise its budgetary decisions". This analysis "highlights the fact that health spending, all other pay, social security and grants to local government makes up £7 in every £8 the Scottish Government spends day-to-day, which seriously limits their room for manoeuvre in changing the overall shape of the Budget". It further finds that spending on reducing child poverty, a key priority of the Scottish Government, has grown significantly since 2018-19, "… it would not be fair to say that it has become a large part of the Scottish Budget". The FAI goes on to say that it remains under 3% of all discretionary resource funding and capital spending

through the provision of affordable housing and urban regeneration has fallen by 13% in real terms since 2019-20.

20. The Cabinet Secretary for Finance and Local Government explained in her Foreword to the Scottish Budget 2025-26 that “this is a Budget by Scotland, for Scotland”, suggesting that decisions are informed by views gathered through widespread engagement, including with opposition members. The Scottish Government states that “we can only build a more productive and innovative economy if we invest in infrastructure that delivers high quality public services, build more affordable homes for the families of children living below the poverty line and make decarbonisation a reality”. It goes on to say that the Budget therefore “prioritises major investment in the foundations of our economy, such as housing, transport, digital connectivity, and delivering critical infrastructure for a green and growing economy”.

Taxation

21. The Scottish Government states in the Scottish Budget 2025-26 that “our policy decisions at this budget will continue to deliver our progressive approach in Scotland, while raising substantial revenue to support the delivery of our public services”, adding “this means we are asking those with the broadest shoulders to contribute more”. Key tax decisions in the Scottish Budget 2025-26 include—

    - **A commitment not to increase the number of bands, or rates, of Scottish income tax for the remainder of this parliamentary session**[4]. The SFC forecasts that, in 2025-26, this measure will raise £76 million in revenues, rising to £244m at the end of the forecast period. The SFC estimates that the behavioural response reduces the overall yield of this policy by £10m in 2025-26, reaching £31m by 2029-30.

    - **Increasing the basic and immediate thresholds for income tax in 2025-26**. The SFC forecasts that these “above inflation” increases to thresholds will lower revenue by £24 million (m) in 2025-26, and that there is minimal expected behavioural response from the policy.
      The SFC states that income tax policy decisions taken together will raise additional revenue of £52m in 2025-26. It further estimates that “because of decisions on Scottish tax rates and thresholds, an additional £1,676m income tax will be raised in 2025-26 than would be the case if tax rates and thresholds from the rest of the UK were applied in Scotland”. However, it explains that the income tax net position is only expected to be £838m, largely because of slower economy growth in Scotland since income tax was devolved. It notes, therefore, in return for Scottish income taxpayers paying £1,676 million more in income tax, the Scottish Budget is only benefitting by £838 million. The SFC describe this as an “economic performance gap”.

[4] This is in line with the Scottish Government’s Tax Strategy published alongside the Scottish Budget 2025-26.

- **A commitment to work with businesses across Scotland "to understand the cumulative impacts of tax on competitiveness".**
- **Maintaining current residential and non-residential rates and bands of Land and Buildings Transaction Tax (LBTT) at current levels**, while continuing first-time buyer reliefs. Additional Dwelling Supplement (ADS) rates will increase from 6 to 8% from 5 December 2024, which the SFC forecasts will raise £32m in additional revenue in 2025-26. In total, LBTT is forecast to raise £1,019m in 2025-26.
- **Increasing Scottish Landfill Tax (SLfT) rates in line with those in the rest of the UK**, to £126.15 per tonne for the standard rate, and £4.05 per tonne for the lower rate. Revenues from SLfT are forecast to reduce after the biodegradable municipal waste ban is introduced at the end of 2025, from £54 million in 2024-25 to £40 million in 2025-26.
- **Non-Domestic Rates (NDR) policy changes include freezing the Basic Property Rate and extending hospitality reliefs**. This includes maintaining the100% relief for hospitality premises on islands which was introduced in 2024-25, along with a new 40% relief which will be available for "the 92% of hospitality premises liable for the Basic Property Rate, capped at £110,000 per business", as well as for grassroots music venues with a capacity of below 1500. The SFC estimates that this new 40% relief will cost £22m in 2025-26, in addition to the £5m cost of extending the islands hospitality relief.
- **No cap on how much local authorities can raise council tax by next year**, although the Cabinet Secretary indicated there is "no reason for large increases".

22. The SFC forecasts that, after taking account of behavioural changes, the combined effect of all the Scottish Government's tax policies raises an extra £54 million in 2025-26 and that devolved Scottish taxes will raise a total of £24.6 billion in revenues in 2025-26.

Spending policies

23. The Scottish Government states in the Scottish Budget 2025-26 that it will focus resources across its four priorities, delivering "almost £64 billion of funding in 2025-26 towards these and to ensuring that we continue to protect the policies at the heart of our social contract[5], including delivering funding for a universal Pension Age Winter Heating Payment". Key spending decisions include—

- A "record investment" of £21 billion in health and social care, including an increase in capital spending of £139 million from 2024-25, to increase capacity and access to primary care "to shift the balance of care to preventative and community-based support and substantially reduce delayed discharge".
- A "record" £15 billion in funding for local government,

[5] The Scottish Budget 2025-26 states that the Scottish Government will "protect the social contract at the heart of this Government's approach: continuing free prescriptions; ensuring that no Scotland student pays tuition fees; access to free bus travel for almost 2.3 million people".

- Providing £768 million for affordable homes, “enabling over 8000 new properties for social rent, mid-market rent and low-cost home ownership to be built this coming year”.
- Restoring a universal winter heating payment to all pensioners. The SFC estimates this new policy will cost £69 million more than associated funding from the UK Government in 2025-26.
- Developing systems necessary to “effectively scrap the impact of the two-child cap in 2026” (further details below).
- Uprating all benefits in line with September 2024 CPI inflation and investing in a package of benefits and payments only available in Scotland totalling £644 million in 2025-26. The SFC explains that social security spending is forecast to account for 13.5% of day-to-day spending in 2025-26, £1,334m higher than the corresponding funding provided by the UK Government[6].
- Allocating £25 million to increase the number of jobs available in the green energy supply chain.
- Providing £3 million for a Bright Start Breakfasts pilot, while continuing to invest in early learning, and
- Delivering a £34 million uplift to the culture budget.

24. The Budget document notes that “as a result of the progress made to reach a balanced budget in 2024-25, this total investment will include over £300 million of ScotWind revenues in 2025-26 … on a range of projects for longer term benefits for Scotland – to deliver our ambitions to tackle climate change, invest in growing the economy and to create jobs, and to drive forward reform”. It also confirms that the forecast requirement for ScotWind in 2024-25 has now been reduced to £160 million from a possible £424 million prior to the UK Autumn Budget.

25. On public service reform, the Scottish Government indicates that it will deliver an Invest to Save fund in 2025-26 of up to £30 million of funding, “recognising the need to catalyse efficiency, effectiveness and productivity projects as part of the public service reform programme”. It also notes that progress on public service reform will be integrated into the forthcoming Fiscal Delivery Plan.

Two-child limit

26. As noted above, the Scottish Budget 2025-26 sets out the Scottish Government’s intention to “develop the systems necessary to effectively scrap the impact of the two-child cap in 2026”, which “prevents parents from claiming child tax credit or universal credit for more than two children”. The Scottish Government explains that “successful delivery is contingent on key departments in the UK Government, principally the Department of Work and Pensions, providing the necessary agreement and co-operation”, adding that the new support could be worth over £3,500 per year to families hit by the cap and could help to “lift thousands of children out of poverty in Scotland”.

[6] The SFC notes that this has grown significantly since 2022-23 when social security accounted for 9.7 per cent of day-to-day spending and was £481 million above UK funding.

27. In its December 2024 Forecasts, the SFC explains that—

> "On 28 November the Government provided us with a third additional policy relating to the mitigation of the Universal Credit two child limit. This was very late in the Budget process and a week and a day after the deadline for final policy measures. At this point it was too late for us to produce a full costing that took account of behavioural responses and other factors. Our forecast and spending tables **do not** include the cost of this policy."

28. It went on to say that this policy is a significant commitment to additional spending from 2026-27 onwards, adding "we will publish a report outlining the implications of this policy announcement for the Scottish Budget in due course".

Public Sector Pay Policy

29. In addition to the Budget document and Tax Strategy, the Scottish Government published its Public Sector Pay Policy which sets "pay metrics that are fair, sustainable and realistic within a multi-year pay envelope of 9% over 2025-26, 2026-27 and 2027-28 set against an expected inflation forecast of 7%, ensuring a level of pay restoration". Flexibility is being provided for employers to configure three-year proposals within the 9% pay envelope, "provided they have a fiscally sustainable approach". Any employer that does not agree a three-year pay deal will be restricted to a maximum 3% pay uplift for 2025-26.

30. The SFC states that "although the Scottish Government has been clearer this year in setting out its pay policy, risks remain that paybill growth may be larger than planned either as a result of pay pressures or workforce changes". It went on to say that—

> "There may also be other factors which affect pay pressures such as pay progression within pay-bands, changes in the structure of grades within the public sector, vacancies and turnover which will also need to be accommodated by portfolios within their allocations as the Scottish Government has not made provision for increases in the paybill other than the 3 per cent pay award. The size of the workforce is also an important lever to manage the paybill. The Scottish Government has indicated that it will set out further detail on what this means for the public sector in Scotland as part of a Fiscal Sustainability Delivery Plan published alongside the MTFS, noting protection for frontline staffing, such as in the NHS."

31. The SFC has therefore, in addition to the 3% basic pay award, assumed that "the other factors such as pay progress add, based on historical data, an additional 1.5 percentage points to average pay growth, summing to 4.5% average pay growth in total in 2025-26".

Update on borrowing policy

32. The Scottish Government further published an update on its borrowing policy and progress towards a future bond issuance on 4 December, the next stage of which will be to determine the specific conditions, and policy parameters, "which will frame a *successful* Scottish Government Bond issuance". This document also notes that the Scottish Government "will ensure the SFC, as the independent fiscal institution for Scotland, plays its role in assessing the plans for bond issuance as the due diligence work is developed further". The document further sets out guidelines to assess any capital borrowing decision, in light of the 2023 update to the fiscal framework. The SFC explains that—

> "In the short term the Scottish Government has revised down planned borrowing in 2024-25 to £300 million and plans on borrowing the maximum possible, £472 million in 2025-26. The Scottish Government has assumed £300 million of capital borrowing for each subsequent year, which it may amend to meet in-year requirements. The Scottish Government's plans will see it reaching 93% of its overall borrowing cap in 2029-30. The policy states that the Scottish Government will ensure at least £1.5 billion can be borrowed over the subsequent parliamentary term. The duration of the loans will be decided each year".

33. The SFC goes on to state that "when the Scottish Government publishes its MTFS in spring 2025, we will be looking for clarity on its borrowing plans over the 5 years of the MTFS, including both the sources and costs of borrowing".

Equality and Fairer Scotland Budget Statement

34. As usual, the Scottish Government also published alongside the Scottish Budget 2025-26 an Equality and Fairer Budget Statement, which considers the impacts that decisions made in the Scottish Budget are likely to have on different groups of people in Scotland. This year, the Statement includes new analysis showing the distributional impact of public services spending and illustrates the impact of a number of selected key decisions. Key findings include-

- "The overall distribution of public spending on health, schools, transport and funded early learning and childcare is similar in cash terms across income groups. Although when considered with the progressivity of the tax system, the overall tax and spending system is redistributive.
- Increases to the Basic and Intermediate rate thresholds have a small positive impact in the bottom half of the income distribution. The negative impact of frozen thresholds principally falls on the highest earning 20 per cent of households, with the top 10 per cent paying an average of 0.1 per cent of their income (around £130) more.
- Scottish Child Payment is the largest single contributor to the improved financial resources of low-income households relative to the rest of the UK, while the impact on higher income households is driven by changes to the Income Tax system."

Block Grant Adjustments

35. The Cabinet Secretary wrote to the Committee on 3 December setting out the Block Grant Adjustments (BGAs) for income tax, land and buildings transaction tax (LBTT), Scottish Landfill Tax (SLfT), and the devolved social security benefits, which reflect the latest Office for Budget Responsibility's (OBR) Forecasts published on 30 October 2024. She explained that the BGAs "only provide a partial view" as the full impact on Scotland's Budget will not be known until the SFC published its Forecasts on 4 December.

36. The letter includes the total provisional reconciliation requirement for the Scottish Budget 2025-26 of +£499.9 million (m), including +£450.6 m for income tax (2022-23), +£7.7 m for LBTT (2023-24), +£7.5 m for SLfT (2023-24), and +£34.1 for social security (2023-24). Final social security figures published on 21 November would have seen this figure reduced to £492.7 million, however, given this change "being less than two weeks from publication of the Scottish Budget 2025-26", the Cabinet Secretary has opted to defer the -£7.2 million negative impact to the Scottish Budget 2026-27.

37. The Cabinet Secretary's letter sets out a total in-year reconciliation to the 2024-25 Budget of -£54 m, however, "SFC forecasts alongside the 2025-26 Scottish Budget will allow a rounded picture of the net position". The UK Government's decision to target the winter fuel payment reduced the funding provided to the Scottish Budget by £146 m. The Cabinet Secretary confirms that the Scottish Government has "not elected to defer the impact of the in-year reconciliation and the reduction to funding will be reflected in the funding position for the Scottish Budget 2024-25".

Immediate responses to the Scottish Budget 2025-26

38. Immediate responses to the Scottish Budget 2025-26 were published by FAI, the Institute for Fiscal Studies (IFS), and SPICe, and are available at the links below—

    - In its blog, Budget with an eye on the election but storing up risks, the FAI highlights that the expected shortfall in funding for employer national insurance contributions in the public sector remains unaccounted for in the Scottish Government's budget. This, it argues "is an extremely risky approach and one which sets up a possible need for further emergency measures during the course of the next financial year – leaving us wondering whether any lessons have been learned from going into a new year without fully setting aside budget cover for what are known costs, as highlighted by the recent Audit Scotland report". The FAI further highlights that "there are some difficult news on the income tax forecast as well [with] the Scottish Government … looking at a £700m negative reconciliation in 2027-28, largely due to a much larger deduction to the block grant related to 2024-25 than that which was built into that year's budget".

- The Institute for Fiscal Studies (IFS) in An initial response to the Scottish Budget notes that “the Scottish Budget 2025-26 excludes £1.3 billion of funding that Budget documentation implies that the Scottish Government still has to allocate to services this year”. Accounting for this, the IFS suggests, would leave day-to-day spending on public services next year essentially flat in real terms between this year and next, falling by 0.3%”. It goes on to say that “the £1.3 billion still to allocate is less than the additional funding that has become available over the last 2 months”. This means, “despite previously suggesting it had already accounted for the top-up to its funding announced in the UK Budget in its financial planning for the current financial year, the Scottish Government is, in effect, planning to carry forward £400 million for use in future years”.
- SPICe, in its Initial Reaction blog suggests that “the clear Scottish Government choice in this Budget [is] to support low earners, pensioners and tackle child poverty, but it has the effect of squeezing other areas”. It further highlights the SFC’s statement that budget constraint is compounded by growth in staff costs across the devolved public sector, including uncertainty regarding the level of funding that can be expected from the Scottish Government to cover employer national insurance contributions in the public sector. SPICe further notes that the change in presentation of the Budget “has had the effect of distorting some budget lines as portfolio budgets for 2025-26 have not been adjusted to reflect certain in-year transfers that are known to take place each year”, with the effect of making the increase in health artificially high and the change in local government artificially low.

Next steps

39. The Committee will continue taking evidence in relation to the Scottish Budget 2025-26 on 17 December 2024

Committee Clerking Team
December 2024

ANNEXE A

Background to the Scottish Budget 2025-26

UK Government's public spending audit 2024-25

1) The UK Government published the outcomes of HM Treasury's Fixing the foundations: public spending audit 2024-25 on 29 July 2024, which "shows that the forecast overspend on departmental spending is expected to be £21.9 billion above the resource departmental expenditure limit totals set by HM Treasury in the Spring Budget 2024". The document set out "savings that have been identified [which …] together … will deliver £5.5 billion savings in 2024-25 rising to £8.1 billion in 2025-26", including departments absorbing public sector pay pressures and reducing consultancy and marketing spend. In addition, winter fuel payments would be targeted from this year.

2) The Chancellor of the Exchequer further announced that a multi-year Spending Review will conclude in Spring 2025[7] which will set spending plans for a minimum of three years of the five-year forecast period and "departmental expenditure limits for 2025-26 will be set out alongside the Budget in October, which will also confirm control totals for 2024-25". The Guardian reported on 28 November that the Spending Review would be delayed due to "drawn out and complex negotiations" and will now be published in June 2025. However, the same report states that Government officials have indicated there is no delay and the Review was always intended to be published between May and July.

3) The Cabinet Secretary for Finance and Local Government, Shona Robison MSP, confirmed in a letter to the Committee on 23 August 2024 that "… additional measures are now necessary following the UK Treasury's recent audit of public spending and lack of clarity over whether their decision to deliver Pay Review Body recommendations will be fully funded".[9] She advised that the Scottish Government has "introduced a set of spending controls with the intention of further reducing spend in 2024-25" and that it will replicate in Scotland the UK Government's decision to target winter fuel payments. In her fiscal statement to the Scottish Parliament on 3 September, the Cabinet Secretary outlined up to £500 million of further savings measures including resuming peak train fares and not progressing the concessionary fares extension to the asylum seekers' pilot. At that time, she was also planning on using up to £460 million of ScotWind money to plug funding gaps.

4) The Committee took evidence from the Minister for Public Finance on 12 November 2024 in relation to the Autumn Budget Revision which includes some of these changes to spending plans for 2024-25.

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[7] The UK Autumn Budget 2024 confirmed that the UK Government would be carrying out a Spending Review to conclude in **late** Spring 2025.

UK Autumn Budget 2024

5) In the UK Autumn Budget 2024 published on 30 October 2024, the Chancellor announced significant increases in public spending, financed by a combination of tax rises and higher borrowing. Public spending is set to increase by £70 billion per year over the next five years, with two-thirds going to day-to-day resource spending, and one-third to capital spend, such as transport, housing and research and development. The Chancellor suggested that this rise in capital spending will “keep public investment broadly flat at around 2.5% of GDP over the next five years, rather than dropping to the 1.7% assumed in the previous Government’s plans”[8]. The national minimum wage will increase to £12.24 an hour from April 2025 (an increase of 6.7%); the rate for 18–20-year-olds will increase from £8.60 to £10 per hour and the minimum wage for apprentices will rise from £6.40 to £7.55 per hour. In addition, extra funds have been allocated for the infected blood and Post Office horizon compensation schemes.

6) Key tax measures announced by the Chancellor include—

- Employer **National Insurance Contributions** (NICs) will rise by 1.2% to 15% from 6 April 2025. The level at which employers will start paying NICs for each employee is to fall from £9,100 to £5,000. This measure is expected to raise a forecasted £25.7 billion per year by 2029-30.
- **Capital gains tax** will rise on disposals made on or after 30 October 2024 (the lower rate from 10% to 18%, and the higher rate from 20% to 24%).
- The freezing of **inheritance tax** thresholds will be extended to 2030[9]. From April 2026, inheritance tax relief for business and agricultural assets will be capped at £1million, with a new reduced rate of 20% being charged on assets above that.
- **Value-added Tax** (VAT) will be charged on private school fees across the UK.
- The temporary 5p cut in **fuel duty** announced by the previous Government will be extended for one year to 2025-26.
- The freeze in **income tax** thresholds will end in 2028-29, at which point thresholds will increase in line with inflation. (England only)

7) The Chancellor also announced increases in borrowing, averaging around £32 billion per annum higher than the previous Government’s plans over the forecast period. To allow space for this extra borrowing, the Chancellor changed the definition of debt in her fiscal rules. The Office for Budget Responsibility (OBR) has explained that the UK Government intends “to target Public Sector Net Financial Liabilities (PSNFL) as the main balance sheet aggregate in its fiscal rules”. PSNFL is a wider measure of debt which includes financial assets and liabilities (such as the Student Loan Book and funded

[8] Autumn budget 2024: Key announcements and analysis - House of Lords Library
[9] The previous UK Government had announced that this freeze would continue until 2028.

public sector pension schemes) meaning interest rates may take longer to fall[10].

8) Decisions in the UK Autumn Budget have led to additional consequential funding for the Scottish Budget, with £1.5 billion added to this year's budget[11] (2024-25), rising to £3.4 billion for 2025-26[12]. During evidence to the Committee on the Autumn Budget Revision on 12 November 2024, the Minister for Public Finance said that "we welcome the additional funding, but that funding is necessary to correct for persistent underinvestment in public services and to address the cost pressures that we face". He went on to explain that "the amounts provided by way of consequentials arising from the UK autumn budget are broadly consistent with what has been factored into our planning and we are therefore not in a position to reverse the savings that were previously announced".[13]

9) While public sector employers are expected to be compensated by HM Treasury for higher costs resulting from the NICs increase, it has yet to be confirmed what level of compensation will apply to Scotland, which has a larger proportion of its working population employed in the public sector than in England. In October 2024, the Scottish Government has estimated that the UK Government's increase in NICs would add £500 million to Scottish public sector costs.[14]

10) On 20 November 2024, the **Scottish Government published the indicative costs of the policy** to the Scottish public sector based on newly collected data, gathered by the Scottish Government **between 8 November and 15 November 2024 from estimates provided by portfolios and organisations**. Key findings include that "the static increase in employer NICs might cost between £520 million and £580 million in financial year 2025 to 2026 for directly employed public sector employees in Scotland's devolved public sector, with a central estimate of £550 million". The Scottish Government also notes the latest estimates on potential Barnett consequentials of up to £380 million, suggesting a potential shortfall of around £140 million to £200 million. However, it adds, that this estimate of up to £380 million is subject to a high degree of uncertainty and could be much lower if, for example, some of the additional funding does not generate consequentials, or be higher if HM Treasury chooses to increase the overall sum available outside the normal operation of the Barnett formula.

11) The OBR observes in its October 2024 Economic and Fiscal Outlook that "the cancellation of the SFC's May forecast due to the announcement of the General Election means that its most recent forecast was published in

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[10] Report on Pre-Budget Scrutiny 2025-26 - Managing Scotland's Public Finances: A Strategic Approach

[11] The Scottish Budget 2024-25 approved by Parliament earlier this year amounted to approximately £60 billion.

[12] £1.5 billion baselined into the 2024-25 Budget, and an additional £1.9 billion added for 2025-26, totals £3.4 billion.

[13] Official Report

[14] What's in the UK Budget? Ask Reeves. – SPICe Spotlight | Solas air SPICe

December last year". It goes on to suggest that "the gap between this previous SFC forecast and ours means that making a detailed comparison and analysing differences between the forecasts is less informative than usual at this stage".

ANNEXE B

Scottish Budget 2025-26 – Scottish Government's Tax Strategy

Background

1. Since the devolution of tax powers in the Scotland Act 2012, the Scottish Government's approach to tax has been based around Adam Smith's four principles of taxation: Certainty, Proportionality, Convenience and Efficiency. The Scottish Government's Framework for Tax (2021) added two additional principles intended to guide the approach to tax policymaking: Engagement and Effectiveness.

2. The Scottish Government published Scotland's Tax Strategy: Building on our Tax Principles ("the Strategy") on 4 December 2024, alongside the Scottish Budget 2025-26. The 2025-26 Budget document explains that the Strategy is intended to expand on the Scottish Government's Framework for Tax sets out the Scottish Government's approach to tax over the medium term across the devolved and local tax system.

Pre-Budget Scrutiny 2025-26

3. As noted earlier in this paper, one of the themes of the Committee's Pre-Budget 2025-26 Scrutiny on Managing Scotland's Public Finances: A Strategic Approach was on the Scottish Government's approach to taxation[15]. During this scrutiny, witnesses expressed a range of views regarding what the Strategy should include. The Committee heard that the Strategy should move beyond the 'theory' set out in the 2021 Framework for Tax and should provide a clear direction on tax policy. The Committee also heard that the Strategy should focus on the main revenue raisers – Scottish income tax, non-domestic rates, and council tax.

4. In its Pre-Budget Scrutiny 2025-26 report, the Committee recommended that the Strategy should provide a framework within which tax policies are designed to contribute to the longer-term sustainability of Scotland's public finances. The report also recommended that the Strategy should specify that, when developing future tax policy, the Scottish Government should assess how individual rates and bands in Scotland would interact with the UK-wide tax system, to avoid issues associated with anomalies relating to marginal tax rates in Scotland arising.

[15] The other two themes were on how the Scottish Government is using its capital expenditure to achieve innovation, productivity, and growth, and progress with the Scottish Government's public service reform programme.

5. The report further noted the Committee's intention to examine, as part of Budget 2025-26 scrutiny, the Scottish Government's Tax Strategy.

The Tax Strategy

6. As noted above, the Scottish Government published Scotland's Tax Strategy: Building on our Tax Principles ("the Strategy") on 4 December 2024, alongside the Scottish Budget 2025-26.

7. In the Ministerial foreword to the Strategy, the Cabinet Secretary for Finance and Local Government explains that the Strategy is intended to set out "the steps that will underpin this government's approach to developing tax policy; ensure the tax system raises the revenue needed to achieve our priorities; and support our growing economy".

8. The Scottish Government explains that the Strategy sets out the Scottish Government's medium-term ambitions for how the tax system will develop to support the delivery of its four priorities: eradicating child poverty, growing the economy, tackling the climate emergency, and ensuring high quality and sustainable public services.

9. The Scottish Government's 2023 Medium Term Financial Strategy (MTFS) set out a three-pillar approach that the Government is taking to ensure that the public finances are on a sustainable trajectory. The Strategy, the Scottish Government explains, intends to deliver on the pillar, set out in the MTFS, "to maintain and develop our strategic approach to tax."

10. The Strategy outlines Scotland's fiscal and economic context, noting that, in recent years, "Scotland has faced significant economic and fiscal challenges which have also been seen across the UK and which have created lasting pressures on our public finances." It states that "the strategic, fiscal, and economic challenges that Scotland faces clearly go beyond a single budget cycle and require longer term policy responses."

11. The Strategy also states that the Scottish Government's priority is to support economic growth that "increases employment and earnings, lifts people out of poverty, and raises living standards. It notes that the Scottish Government is focused on interventions to support a more productive and competitive economy and that, as a result, it is taking action to grow Scotland's tax base by maximising potential Income Tax and other tax revenues.

12. The Scottish Government explains that the Strategy was informed by Scottish Government engagement with stakeholders, including businesses, think tanks, academics, civic society groups and tax professionals. It also undertook a pre-budget engagement event with stakeholders, the outcomes of which are

summarised in Scottish Budget 2025 to 2026: Public Attitudes to Tax, which was published alongside the Budget document on 4 December 2024.

Priorities

13. The Strategy outlines the Scottish Government's priorities for Scotland's existing tax system, setting out its intention not to introduce any new bands or increase the rates of Scottish Income Tax for the remainder of the Parliamentary session, explaining that "signalling a period of stability for our largest source of tax revenue will allow us to assess the impacts of recent policy changes, and support the conditions needed for a growing economy."

14. The Strategy also states that, for the remainder of the Parliamentary session, the Scottish Government will:

- Maintain its commitment that over half of Scottish taxpayers will pay less Income Tax than they do in the rest of the UK.
- Uprate the Starter and Basic rate bands by at least inflation.
- Maintain the Scottish Higher, Advanced and Top rate thresholds at current levels in nominal terms in light of the UK Government context of a freeze to UK Higher rate thresholds to 2027-28. This will be reviewed annually at the Budget.

15. These commitments are also set out in more detail in the Scottish Budget 2025-26 document.

16. The Strategy notes that the Scottish Government is committed to working in partnership with Local Government "to ensure that local taxes are fair and sustainable and to explore the creation of more revenue generating powers for local authorities." It states that, to do this, the Scottish Government will:

- "Begin the next phase of work of the Joint Working Group on Sources of Local Government Funding and Council Tax Reform (JWG) with a process of engagement in 2025 to build consensus on the way forward for Council Tax Reform." The outcome of this will be published by the end of this Parliamentary term.
- Support open dialogue and engagement through forums including the sub-group on Non-Domestic Rates (NDR) established under the New Deal for Business.
- Explore how NDR legislation might be consolidated and simplified.
- Consider the outcome of the UK Government's consultation on 'Transforming Business Rates', including its impact on the block grant for Scotland, and noting the differences in the NDR tax base between Scotland and England.

17. Another priority outlined in the Strategy is the completion of the devolution of the remaining taxes the Scottish Government has committed to delivering. It highlights the delivery of the Scottish Aggregates Tax and the Air Departure Tax as “a key strategic priority for the Scottish Government” and notes the Scottish Government’s intention to introduce a Scottish Building Safety Levy Bill within the current Parliamentary term.

18. To achieve its priority of completing the devolution of the remaining taxes the Scottish Government has committed to delivering, the Strategy explains that the Scottish Government intends to:

    - Introduce the necessary secondary legislation for the Scottish Aggregates Tax to the Scottish Parliament and work with the UK Government to ensure that the new tax can be introduced on 1 April 2026.
    - Work with the UK Government to resolve subsidy control issues with the current Highlands and Islands exemption to enable the implementation of Air Departure Tax.

19. Regarding VAT assignment, the Strategy states that the Scottish Government “must protect the Scottish Budget from unnecessary levels of risk. This applies to the assignment of VAT, where concerns remain around the levels of uncertainty and volatility associated with the proposed assignment methodology, without appropriate fiscal or policy levers to help manage that risk.” The Strategy notes that, following the 2023 Fiscal Framework Review, and in light of these concerns, the Scottish and UK Government jointly agreed to consider the options for the future of VAT Assignment.

The economy and tax system

20. The Strategy states that the Scottish Government is “focused on creating the conditions for growth by bringing more people to Scotland, supporting our people into work, and raising wages for those working here. We also recognise the need for our tax environment to support private investment as well as to fund the public services which underpin a competitive economy.” The Scottish Government will “drive forward a renewed focus on expanding the tax base and tax revenues by progressing specific economic activities with the potential to grow the economy and get more people into work.” Actions the Scottish Government is taking to grow the economy are also outlined in the Strategy, including:

    - Measures to maximise the potential of Scotland’s workforce.
    - Provision of Employability Support.
    - Continuing to deliver Scotland’s Migration Service.

21. The Strategy explains that the Scottish Government intends to broaden its understanding on how the competitiveness and attractiveness of Scotland's economy is impacted by the tax environment by:

- Assessing the links between tax policy and the economy in greater detail through a programme of evidence development, initially focusing on income tax.
- Engaging with businesses and organisations to contribute to the assessment of the cumulative impacts of Scottish, UK and local tax policies on the competitiveness of the economy.

Administration of Scotland's taxes

22. The Strategy notes that the Scottish Government's intention is to deliver a "fair, efficient and effective tax system in Scotland", which will be guided by the Framework for Tax principles. To achieve this, the Strategy states that the Scottish Government will:

- Increase public understanding of tax in order to make it easier for Scottish taxpayers to understand and navigate the tax system.
- Strengthen its approach to compliance in collaboration with HMRC and Revenue Scotland.
- Work with tax administrators to ensure mechanisms for efficient tax collection, including increasing the digitalisation of the Scottish tax system.
- Renew considerations concerning changes to the legislative processes for the fully devolved taxes.

Evidence and evaluation

23. The Strategy sets out the Scottish Government's commitment to enhancing its evidence base to "inform tax policymaking and support evaluation of tax changes." This, it states, will "improve transparency around tax decisions and their impacts; provide evidence on cumulative effects across the whole tax system; and support debate on the existing tax system and future reform."

24. The Strategy outlines that the Scottish Government will:

- Publish its Areas of Research Interest (ARIs) on tax and set out the available exploratory funding to support the development of the ARIs. Figure 3 of the Strategy sets out the Scottish Government's key tax research areas for the next five years.
- Develop a "systematic and regular programme of appraisal and evaluation across the Scottish tax system."

25. The Strategy notes that the Scottish Government recognises "the need to build evaluation across the devolved and local tax system, ensuring that significant

policy decisions are transparently monitored and assessed as further data and evidence emerges.” It further states that, to achieve this, the Scottish Government intends to:

- Formally evaluate the impact of changes to income tax in 2023-24 and 2024-25 once outturn data is available, and “closely monitor behavioural impacts on different groups of taxpayers, business, and the economy using a range of economic evidence and stakeholder engagement.”
- Conduct its first five-year LBTT review by the end of the Parliamentary session in order to support an evaluation of key aspects of the tax legislation.

Future priorities

26. Regarding future priorities, the Strategy sets out that the Scottish Government will “explore the reforms needed to continue to deliver sustainable and growing tax revenues in the future.” It states that, guided by the principles outlined in the Framework for Tax, the Scottish Government will begin a programme of work focused on:

- Reserved tax powers (the Scottish Government will “consider the tax landscape in the round as we plan our next steps on tax devolution”).
- Balance of taxes across labour, income and wealth.
- Tax as a lever to encourage positive behavioural change.

27. The Strategy states that the Scottish Government will set out a detailed programme of work on future priorities alongside the next MTFS in 2025, and that an update on progress against the Strategy will be published in early 2026.

Initial reactions to the Strategy

28. On 4 December 2024, the Institute for Fiscal Studies (IFS) published an initial reaction to the Scottish Budget 2025-26 and the Tax Strategy. The IFS welcomed the intention set out in the Strategy not to introduce any new tax bands for the remainder of the Parliamentary session. However, it noted that, while the Strategy’s plan for income tax rates and thresholds for the remainder of the Parliamentary session provides helpful guidance to taxpayers, it will severely limit the Scottish Government’s options should additional revenue need to be raised.

29. The IFS also highlighted concerns about the depth of the Strategy’s content, stating that—

> “The Tax Strategy provides little sense of direction on tax policy beyond income tax. On council tax and business rates, for example, there is merely an intention to continue dialogue and engagement. It does not inspire confidence that much-needed reform will actually happen. There is

welcome recognition of the value of more systematic evaluation of the effects of tax policy, and plans to improve the administration of the tax system and taxpayers’ understanding of it. It remains to be seen what will be achieved in practice.”

30. On 5 December 2024, the Chartered Institute of Taxation (CIOT) provided written evidence to the Committee focusing on the Strategy and the tax policy outlined in the Scottish Budget 2025-26. This submission is attached at Annexe C.

ANNEXE C

Written Submission from the Chartered Institute of Taxation and its Low Incomes Tax Reform Group

1 Introduction

1.1 We welcome the opportunity to provide written evidence in advance of the Finance and Public Administration Committee's scrutiny of the Scottish Budget 2025-26. Our evidence focuses on the Tax Strategy and tax policy in Scotland. This evidence is provided by the Chartered Institute of Taxation (CIOT), with commentary from its Low Incomes Tax Reform Group (LITRG).

1.2 As this submission has been provided immediately following the Scottish Government's budget on 4 December, further time is required to digest all the Budget Day announcements and the final Tax Strategy. We would be pleased to provide further comment and evidence at a later date to the Committee if required.

1.3 Our evidence looks at taxation decisions only. We do not provide views on the required level of taxation, nor where the burden of taxation should fall. These are matters for politicians, who decide where and how taxation revenues are used.

1.4 The CIOT's stated objectives for the tax system include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

1.5 LITRG's seven principles for the tax system, set out in its paper 'A better deal for the low-income taxpayer',[16] are that it should be:

1. Clear and up to date
2. Simple
3. Equitable
4. Just
5. Accessible and responsive
6. Joined up
7. Inclusive

2 Tax Strategy – Tax policy-making timetable and process

2.1 While it is helpful to have a published Tax Strategy to provide greater certainty and a clearer direction, we consider that the Tax Strategy misses an opportunity to refer to the tax policy-making timetable and process. In theory, these are covered in the 2021 Framework for Tax, but there remains a lack of much-needed consistency in the approach to developing tax policy.

2.2 Some policies follow lengthy and detailed consultation and engagement prior to the publication of legislation (for example, Part One of the Aggregates Tax and Devolved Taxes Administration (Scotland) Bill), while other tax policy changes have been announced without prior warning (such as last year's decision to pursue a council tax freeze) or consultation (such as Part Two of the Aggregates Tax Bill). Likewise, CIOT and LITRG welcomed the opportunity to contribute to the roundtables which took place during the drafting of the Tax Strategy. However it is unfortunate that various events prevented the sharing of the draft Tax Strategy with stakeholders before publication, as the availability of a draft document would have made it easier for stakeholders to assess the proposals, as well as offer constructive and practical feedback.

2.3 A process for designing tax policy should build in engagement with key stakeholders to inform the development of tax legislation, ensure it is fit for purpose and workable in practice, and avoid unintended consequences. It is important that there is adequate lead in time, and that consultation takes place throughout the process, and in particular when there is sufficient data available to inform discussions.

2.4 A process for designing tax policy should also give consideration to how Scottish taxes interact with the wider UK tax system. There can be complicated interactions with reserved tax policies and with welfare benefits (both devolved and reserved) that need to be considered so that any policy changes are effective in terms of their policy aims.

2.5 A clear process for making tax policy changes provides Scottish taxpayers and Scottish businesses with greater certainty and transparency, so that

[16] https://www.litrg.org.uk/latest-news/reports/201204-better-deal-low-income-taxpayer

they know when and how changes are being made and how they can plan and navigate these.

3 Tax Strategy – Legislative process

3.1 We welcome the commitment to renew consideration of changes to improve the legislative process for devolved taxes in Scotland.

3.2 CIOT remains of the view that an annual Finance Bill, or similar legislative process by which the Scottish Parliament could make necessary changes to devolved taxes in a transparent way and subject to appropriate scrutiny, would be beneficial. This could include the re-establishment of the Devolved Taxes Legislation Working Group to take this work forward.

4 Tax Strategy – Improved taxpayer communications and taxpayer engagement with Scottish Taxes

4.1 The Tax Strategy includes a clear commitment to increasing public awareness and understanding of Scottish taxes. Better public awareness and discussion about tax helps people understand how the tax system works, helping to build trust and engagement with the tax system.

4.2 Part of improving taxpayer understanding, and indeed compliance, is ensuring that there is good guidance available. LITRG has called for improved guidance to help Scottish taxpayers ensure they are claiming the correct tax relief, for example on pension contributions, Gift Aid donations and marriage allowance. We are disappointed that there is no explicit commitment to improve guidance in the Tax Strategy. LITRG has worked with the Scottish Government over the past few months, and this has resulted in some positive changes to the mygov.scot website. We hope that despite not being explicitly mentioned in the Tax Strategy, that there will be a process of continual improvement of tax guidance with sufficient capacity and investment allocated to this work, accompanied by a willingness to take feedback on board from key stakeholders. LITRG and CIOT would both welcome the opportunity to continue working collaboratively with the Scottish Government to improve guidance.

4.3 We look forward to the publication of the tax literacy framework in Spring 2025, and we have welcomed the opportunity to work with the Scottish Government on this.

5 Tax Strategy – Effective and efficient tax administration

5.1 We welcome the commitment to improving various aspects of tax administration, including compliance and future digitalisation.

6 Tax Strategy – Evidence gathering for impact assessments and post-implementation evaluation

6.1 It is important that the Scottish Government is accountable for its tax policy decisions. This means there must be strong decision-making processes and robust procedures for scrutiny. This includes processes for undertaking and publishing impact assessments before a tax policy decision is made. It also includes gathering evidence and evaluation post implementation of a tax policy. The inclusion in the Tax Strategy of commitments to publish Areas of Research Interest and develop a systematic programme of evaluation are therefore welcome. We recommend that tax policy assessments should include assessment of any post-implementation impacts which might need to be dealt with via consequential amendments. Ongoing evaluation of existing policy measures should consider whether they are still meeting their objectives. If not, consideration should be given as to whether the policy or the objectives need to change.

6.2 Greater information gathering helps inform decisions but we appreciate that there are challenges and time delays in gathering information. This is particularly the case when trying to understand the impact of income tax decisions. The data published to date suggests that income tax divergence is not having a material impact on migration from Scotland to the rest of the UK (although there have been some suggestions of a shift in behaviour among the very highest earners). Decisions on where a taxpayer chooses to locate are unlikely to be made on tax factors alone, but the impact of divergence is something that should continue to be monitored and fed into policy development, especially as the data relating to tax changes made in 2023/24 and 2024/25 starts to become available. We welcome the commitment to formally evaluate the impact of changes to Scottish income tax in 2023/24 and 2024/25. We welcome the inclusion of a commitment to explore how digitalisation of the Scottish tax system could help the Scottish Government gather data more promptly. Meanwhile we would also urge the Scottish Government to reach out more widely to Scottish businesses to try and understand whether income tax divergence is having a real impact, for example, on their ability to recruit and retain high earners which allow these businesses to grow and strengthen the Scottish income tax base?

7 Actioning the Tax Strategy

7.1 The 2021 Framework for Tax outlined the key principles of good tax policy making, but not all of these are reflected in practice. It is important that action is now taken to progress the key elements of the Tax Strategy, as well as to ensure the Scottish Government is delivering on the 2021 Framework for Tax. Some key recurring themes have emerged through the discussions on Tax Strategy – including the need for a Finance Bill (or other legislative mechanism to make changes to tax legislation) and a desire to explore changes to council tax. Stakeholders have been raising these points for several years and if the Tax Strategy helps to move them forward, then this would be very welcome.

8 The Scottish Budget

8.1 When considering changes to Scottish income tax, the Scottish Government needs to assess the benefits of this against other options such as using devolved social security powers or changes to council tax, in terms of their relative impacts on work incentives and the income and quality of life of the lowest paid. It is also necessary to consider the knock-on effects for and interactions with reserved income tax policies and welfare benefits policies (both devolved and reserved).

8.2 There have been few changes to council tax, despite several attempts to review and reform the system since the reestablishment of the Scottish Parliament in 1999. At the start of 2023, the CIOT commissioned a survey to look at attitudes to council tax reform in Scotland. Of those surveyed, the vast majority were in favour of an end to the present system. However, there has been and still is a lack of consensus about what should take its place. That being said, it is widely acknowledged that the current system is out of date, being based on property values from 1991. In the absence of wholesale reform, we continue to believe the right step is to move towards a full revaluation of all properties. Without this, the current system is inefficient, inequitable and not making full use of the tax's revenue potential. Proper reform, led by a full revaluation, could assist the Scottish Government with the achievement of its wider policy priorities. While we welcome the announcement of work to build consensus on the way forward, this is not the first time reform has been promised, and what is needed now is action rather than warm words.

The Chartered Institute of Taxation

The Low Incomes Tax Reform Group

5 December 2024