Office for
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Scottish tax forecasts

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Introduction

The Office for Budget Responsibility (OBR) was established in 2010 to provide independent and authoritative analysis of the UK's public finances. Twice a year, at the Budget and in the autumn, we produce forecasts for the UK economy and the public finances, which we publish in our *Economic and fiscal outlook* (EFO) publication. The Government has also asked us to forecast Scottish receipts from a number of taxes, which the Government intends to devolve to the Scottish Parliament from April 2015 onwards. This request arises from the Scotland Act, which received Royal Assent on 1 May 2012.

The Scotland Act gave new powers to the Scottish Parliament relating to taxation and borrowing. From April 2015, stamp duty land tax and landfill tax will be fully devolved to Scotland. From April 2016, the Scottish Parliament will be asked to set a Scottish rate of income tax, to replace a 10p reduction from each band of income tax.

The Command Paper which was published alongside the Scotland Bill set out our role in providing forecasts of Scottish income tax, landfill tax, stamp duty land tax and aggregates levy receipts.[1] At this stage, HM Treasury will notionally assign these forecast receipts to the Scottish Budget to show how much of what is currently grant funding would be replaced by tax, although the Scottish Budget would not vary as tax receipts vary until the devolution of these taxes is fully implemented.

This is our second publication of Scottish tax forecasts. We will publish our forecasts for these taxes alongside each *Economic and fiscal outlook* (EFO), consistent with the main UK forecast it contains. As with our main UK forecasts these are five-year forecasts to 2017-18. They are based on current Government policy including the policies announced in the Autumn Statement.

We published a methodology note in March this year which described how we intend to forecast these Scottish tax receipts.[2] It explained that it is not possible to directly replicate the methodology we use to produce the UK forecasts. In

[1] http://www.scotlandoffice.gov.uk/scotlandoffice/files/Scotland_Bill_Command_Paper.pdf

[2] http://budgetresponsibility.independent.gov.uk/wordpress/docs/Forecasting-Scottish-taxes.pdf

particular the macroeconomic data that we would need to produce a Scottish macroeconomic forecast and economic determinants is generally not available at a Scottish level or is only available with a long lag. We are therefore not able to produce a Scottish macroeconomic forecast to drive the Scottish tax forecast. Instead the methodologies we intend to use, described in more detail in the methodology document, are generally based on Scotland's historic share of the relevant UK tax stream. We then generally assume that this share will be maintained at the recent average level in the future.

We will consider the case for making ad-hoc adjustments if there is robust evidence of specific factors which may affect the Scottish share of the tax in the future, for example if a newly announced policy can be expected to have a disproportionate impact on the Scottish share.

As with our UK forecasts, the methodology and the forecasts represent the collective view of the three independent members of the OBR's Budget Responsibility Committee (BRC). The Committee takes full responsibility for the judgments that underpin them.

We consider these methodologies work-in-progress. The OBR's role in forecasting has started three years ahead of the initial devolution of the taxes. This allows us to develop and improve forecasts in the light of experience and the availability of new information sources. The forecasts in this document implicitly assume unchanged policy in both the UK and Scotland. The Scottish Government has announced consultations on replacement taxes for stamp duty land tax and landfill tax and intends to legislate during the 2012-13 session of the Scottish Parliament. Once final decisions have been made on these new taxes, we will produce forecasts based on the new tax regimes.

Producing the forecasts

The process for producing the Scottish tax forecasts has been as follows:

- HMRC officials produced draft Scottish tax forecasts using a near-final pre-measures UK economic forecast. The BRC and OBR staff discussed these forecasts with HMRC and Scottish Government officials on November 20; and

- In the final week before the Autumn Statement, HMRC officials provided us with a final set of Scottish forecasts using our final post-measures UK economic forecast and taking into account the effect of Autumn Statement policy measures. Due to the confidentiality of Autumn Statement measures we were unable to involve the Scottish Government in this stage of the process.

Summary of Autumn 2012 Scottish Forecasts

£ million	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Income Tax[1]	4480	4462	4472	4602	4918	5242	5587
Stamp Duty Land Tax	275	296	328	368	416	464	516
Landfill Tax	98	97	96	105	107	107	110
Aggregates Levy	52	50	51	53	55	57	59
Total	4905	4905	4947	5128	5496	5870	6272

[1] Scottish income tax liabilities from Scottish rate

1 Scottish tax forecasts

1.1 In this section we set out forecasts for the following Scottish taxes:

- Income tax
- Stamp duty land tax
- Landfill tax
- Aggregates levy

Income tax

1.2 Under the Scotland Act, the existing basic, higher and additional rates of income taxes levied by the UK government would be reduced by 10 pence in the pound for those individuals defined as Scottish taxpayers from April 2016. The Scottish Parliament will then levy a new Scottish rate of income tax, which will apply equally to Scottish taxpayers in all of the main UK bands. The new Scottish income tax rate will need to be set every year by the Scottish Parliament. The block grant from the UK government to Scotland will then be reduced to reflect the fiscal impact of the devolution of these tax-raising powers.

1.3 The Scottish rate of income tax will be paid by Scottish taxpayers, where a Scottish taxpayer is defined as a UK taxpayer either resident in Scotland or whose closest connection is with Scotland. It will be levied on non-savings, non-dividend income (i.e. earnings from employment, self-employment, pension income, taxable benefits and income from property). Tax liabilities for a particular year would include both PAYE (largely paid in the same year as the activity which created the tax liability) and self assessment (which is usually paid in the year after the activity that took place to create the tax liability). We have excluded the High Income Child Benefit Charge from our calculations. This recovers child benefit from families with a taxpayer with an income of over £50,000 through the income tax system.

1.4 We take a Scottish share of UK tax liabilities on non-savings, non-dividend income. References to a Scottish share are for liabilities specifically for the Scottish rate and we have assumed a 10p rate is levied for the basic, higher and additional rates in each year.

1.5 We build a UK forecast for non-savings, non-dividend income from the projections that are included in our receipts forecasts published in our EFO. The key steps in calculating the UK forecast are:

- include PAYE liabilities;
- include self assessment (SA) liabilities on non-savings, non-dividend income. The forecast for SA in the EFO is on a receipts basis (i.e. when the cash is received). This is adjusted to be on a liabilities basis and further adapted to exclude the savings and dividend elements of SA; and
- PAYE, the SA liabilities on non-savings, non-dividend income and a forecast of PAYE and pension provider repayments are then added together to get a UK forecast for this definition.

Table 1.1: UK forecast of tax liabilities on non-savings, non-dividend income (prior to Autumn Statement 2012 measures)

£ billion	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Autumn (post BUD12 measures)	141.8	144.0	144.3	153.1	156.1	166.3	176.5	188.1
Autumn (pre BUD12 measures)	141.8	144.0	144.3	155.8	158.6	168.3	178.3	189.1
BUD12 (pre measures)	140.8	144.1	148.2	157.2	168.7	181.6	194.1	
Change	0.9	-0.1	-3.9	-1.4	-10.2	-13.3	-15.8	

1.6 Table 1.1 shows the UK forecast of tax liabilities on non-savings, non-dividend income. To aid comparison with the previous forecast, we have constructed an Autumn forecast which excludes the Budget 2012 measures. This shows a substantial reduction in our forecast since Budget. The lower UK forecast is primarily due to our lower projection for earnings growth throughout the forecast, Earnings growth is expected to remain subdued for longer given the weaker pick up in the real economy and our lower assumption for growth in the GDP deflator. Table 1.2 shows the projections for earnings growth in the Budget and Autumn forecasts.

Table 1.2: UK forecast of earnings growth

Per cent	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Autumn	2.6	2.6	2.2	3.0	3.9	4.0	4.0
BUD12	2.1	2.4	3.5	4.4	4.5	4.6	
Change	0.5	0.2	-1.3	-1.3	-0.6	-0.6	

1.7 We then apply the Scottish share to this forecast and finally add on the Scottish element of Autumn Statement 2012 policy measures.

1.8 The methodology note we published in March showed that the Scottish income tax share was very stable between 2000-01 and 2009-10. On this basis we project forward the latest outturn (2009-10) for the Scottish share. The outturn is currently based on the Survey of Personal Incomes which is only available with a long lag. An estimate for 2010-11 will be available for Budget 2013.

1.9 The Scottish share could be affected if there were differential Scottish economic trends or if policy measures had differential exchequer effects between Scotland and the UK as a whole. In particular, there have been a number of policies such as the introduction of the additional rate of income tax for incomes over £150,000, the withdrawal of personal allowances above £100,000 and freezes in the basic rate limit and higher rate tax threshold coming into effect after 2009-10. These policies affect the top end of the income distribution and Scotland has a lower proportion of higher and additional rate taxpayers than the rest of the UK. Conversely, increases in the personal allowance will have a larger proportional impact on Scotland.

1.10 HMRC modelling indicates that these policies are expected to have reduced the Scottish share of income tax. We have adjusted the Scottish share to allow for these asymmetric effects between Scotland and the UK as a whole from policy measures. Table 1.3 shows the Scottish share from both the Autumn and Budget forecasts. This has been adjusted for:

- as in the Budget 2012 forecast, we have adjusted the share for policies introduced in 2010-11 and 2011-12 and already announced policies coming into effect in 2012-13 and 2013-14;
- the Budget 2012 measures have now been incorporated into the share calculation;
- we have also now adjusted the share for the effect that forestalling ahead of the introduction of the 50 per cent additional rate had on the Scottish share in 2009-10. High-income individuals shifted substantial amounts of income that would have been taxed in future years into 2009-10 so that it would be taxed at 40 per cent rather than 50 per cent. With a lower proportion of additional rate taxpayers in Scotland, this would have boosted UK liabilities by more than Scotland, reducing the Scottish share. In the absence of forestalling, we have estimated that the Scottish share in 2009-10 would have been 3.21 per cent rather than 3.16 per cent. This higher underlying share has been pushed through the forecast; and

- furthermore, projections of the Scottish share in 2010-11 and later years are further adjusted to take account of the counterpart of incomes brought forward to 2009-10, and also for further forestalling effects expected in 2012-13 and 2013-14 due to the reduction in the additional rate.

1.11 We have not adjusted the Scottish share for differential economic trends between Scotland and the UK as a whole. While there has been volatility in Scottish and UK data, the trends in the Scottish and UK labour markets have been broadly similar.

Table 1.3: Scottish share of income tax

Per cent	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Autumn	3.16	3.23	3.11	3.09	2.96	2.99	2.99	2.98	2.98
Budget	3.16	3.12	3.04	2.99	2.97	2.97	2.97	2.96	

1.12 Table 1.4 provides a forecast for Scottish income tax liabilities on non-savings, non-dividend income. As noted earlier, these are income tax liabilities specifically for the Scottish rate. Prior to a decision in the Scottish Parliament on the new Scottish income tax rate for the 2016-17 tax year, the forecast assumes that a 10p Scottish rate would be levied.

Table 1.4: Scottish income tax forecast

£ million	10-11	11-12	12-13	13-14	14-15	15-16	16-17	17-18
Scottish income tax liabilities (pre-measures)	4581	4480	4461	4525	4664	4970	5266	5613
Autumn 2012 measures	0	0	1	-53	-62	-52	-24	-26
Scottish income tax liabilities (post-measures)	4581	4480	4462	4472	4602	4918	5242	5587

1.13 The main measures affecting income tax in Autumn Statement 2012 were:

- the increase in the personal allowance by £235 to £9440 in 2013-14;
- the indexation of the higher rate threshold by 1 per cent for two years from 2014-15;
- the restriction of pensions tax relief by reducing the lifetime allowance from £1.5 million to £1.25 million and the reduction in the annual allowance from £50,000 to £40,000; and
- HMRC anti-avoidance measures.

1.14 The increase in the personal allowance for 2013-14 has the largest negative effect on receipts. With a smaller proportion of high earners in Scotland, the restriction of pension tax relief will have less of a revenue-raising effect than for the UK as a whole.

1.15 Table 1.5 provides a breakdown of the change in the Scottish income tax forecast since March. Scottish income tax is forecast to be around £390 million less than assumed in March, with much of this effect from the downward revisions to the UK forecast. Despite this downward revision to the level of receipts in the later years, we still expect growth in receipts to pick up from 2014-15 onwards. This reflects stronger growth in average earnings and rises in employment as the economy improves. In addition, after 2013-14, the forecast assumes that tax thresholds and allowances are uprated with inflation. With earnings starting to rise faster than inflation, there will be a positive effect on receipts from 'fiscal drag' as people find more of their income taxed at higher rates.

Table 1.5: Changes in Scottish income tax since March

£ million	2012-13	2013-14	2014-15	2015-16	2016-17
Budget 2012	4417	4542	4874	5265	5633
Autumn 2012	4462	4472	4602	4918	5242
Change	45	-70	-272	-348	-390
Change from Scottish share	162	25	92	99	101
Change from Autumn 2012 measures	1	-53	-62	-52	-24
Change from UK forecast	-117	-42	-302	-394	-467

Stamp duty land tax

1.16 The Scotland Act provides for stamp duty land tax (SDLT) to be entirely devolved to Scotland in 2015. The Scottish Government carried out a consultation on their proposed Land and Building Transactions tax between June and August this year and their intention is to legislate for the new tax during the 2012-13 session of the Scottish Parliament.[1]

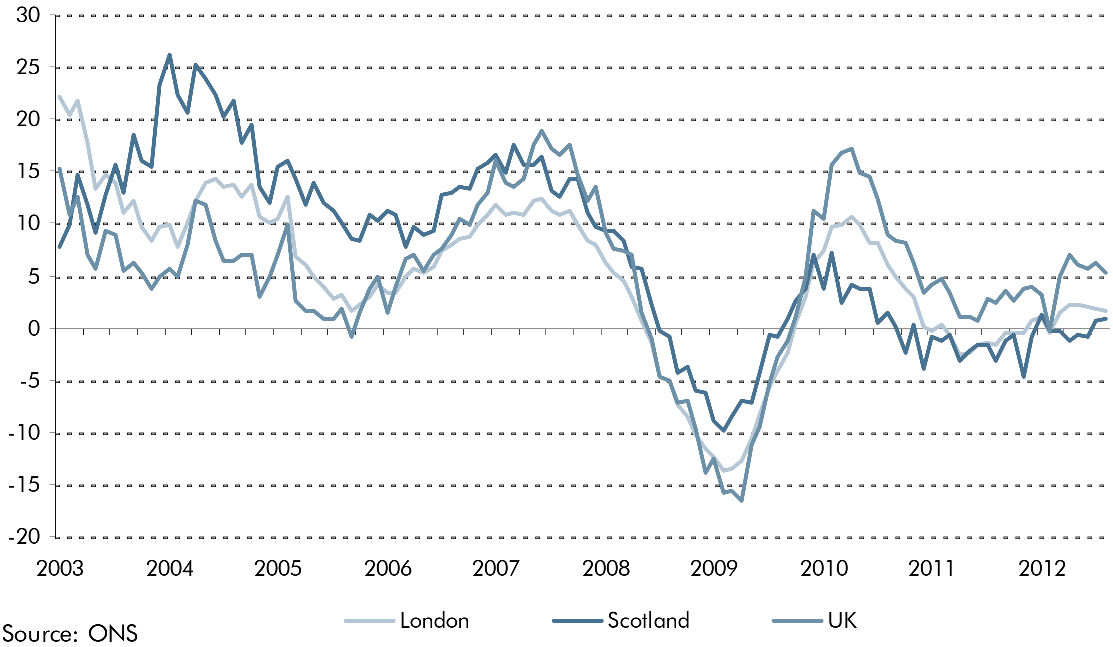
1.17 As final decisions on the proposed new tax have yet to be taken, our Scottish forecast effectively assumes that the current system of SDLT would remain after the tax is fully devolved in April 2015. Once firm details of the proposed new tax are available, we will generate forecasts for the new tax.

[1] http://www.scotland.gov.uk/Resource/0039/00394544.pdf

1.18 The forecasts for Scottish stamp-duty land tax (SDLT) use a constant share of overall UK SDLT receipts. For residential SDLT, we use the outturn share in the latest year and project this forwards. For commercial SDLT, we use a three-year average of the Scottish share and project this forward. A three-year average share should lessen the risk of an error resulting from volatility due to changes in the mix of transactions between years.

1.19 Table 1.6 shows the latest Scottish shares for both residential and non-residential SDLT. The Scottish share of residential SDLT has fallen from 4.1 per cent in 2010-11 to 3.7 per cent in 2011-12. This is due to a 'London' effect on residential SDLT. London saw a rise in receipts of £295 million between 2010-11 and 2011-12, while all other regions of the UK saw flat or falling SDLT. The overall UK rise in receipts over this period was £180 million. London accounts for almost 40 per cent of residential SDLT and saw the strongest house price rises during 2011-12. The Scottish share of commercial SDLT fell back from 8.6 per cent to 6.3 per cent in 2011-12, lowering the three-year average from 7.7 per cent to 7.4 per cent.

Chart 1.1: UK and Scottish House Price Growth



Source: ONS

Table 1.6: Scottish share of SDLT

£ million	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Residential SDLT						
UK	6375	6680	2950	3290	4040	4220
Scotland	265	340	185	135	165	155
Scottish share	4.2%	5.1%	6.3%	4.1%	4.1%	3.7%
Commercial SDLT						
UK	3260	3280	1845	1595	1857	1910
Scotland	165	225	135	115	165	120
Scottish share (per cent)	5.1	6.9	7.3	7.2	8.6	6.3

1.20 Table 1.7 shows the UK forecasts for SDLT from both residential and commercial property. Our UK forecast for SDLT from residential property has been revised up since March to reflect modestly higher house prices this year and that transactions, although still well below their pre-crisis peak, have held up better than expected. We assume that transactions will be slightly higher throughout the forecast, helped in the next two years by the Funding for Lending scheme and other government schemes aimed at improving the supply of residential property. In contrast, SDLT from commercial property is lower reflecting the weaker projections for both prices and transactions in the sector and more than offsets the effect from residential property by the end of the forecast period.

Table 1.7: UK forecasts of Stamp duty land tax

£ million	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Residential SDLT	4220	4840	5860	6840	7850	8910	9990
Commercial SDLT	1910	1700	1680	1750	1880	2030	2220
Total SDLT	6130	6540	7540	8590	9730	10940	12210
Residential SDLT (ex Budget 12 measures)	4220	4657	5563	6510	7476	8490	9515

1.21 While there were no SDLT measures announced at the Autumn Statement which had a non-negligible effect on UK yield, there were two measures announced at Budget 2012 which are likely to have an asymmetric effect between Scotland and the UK as a whole. These are the 7 per cent SDLT rate on residential properties over £2 million and the measure to reduce avoidance on residential properties through enveloping. These measures are likely to affect expensive properties which are concentrated in London and the South-East. The proportion of sales of residential property above £2 million in Scotland is just 0.9 per cent. To allow for the fact that these measures are likely to have only a very modest effect on Scottish SDLT receipts, we took the Scottish share of SDLT on UK residential property prior to these Budget 2012 measures and then added them separately.

Table 1.8: Forecasts of Scottish Stamp duty land tax

£ million	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Residential SDLT	155	171	204	239	275	312	349
Non-residential SDLT	120	125	124	129	138	150	164
Total SDLT (pre-measures)	275	296	328	368	413	461	513
Budget 2012 Measures	0	0	0	0	3	3	3
Total SDLT (post-measures)	275	296	328	368	416	464	516

1.22 The Scottish forecast is down by £32 million in 2012-13 relative to March, and the shortfall rises to £75 million by the end of the forecast period. Table 1.9 breaks down the change in the forecast since the March forecast. Around two-thirds is due to the changes in the Scottish share and around a third due to changes in the UK forecast. The latter is due to the higher proportion of commercial property in Scottish SDLT receipts, which is affected by the downward revisions in the UK forecast for that sector.

1.23 Despite the lower Scottish SDLT forecasts than in March, we still expect robust growth in receipts over the period to 2017-18. The main driver of this rise is the recovery in property transactions from historically low levels since the downturn to a level which is consistent with the average historical duration of home ownership (with owner-occupiers moving every 19 years).

Table 1.9: Changes in Scottish SDLT since March

£ million	2012-13	2013-14	2014-15	2015-16	2016-17
Budget 2012	328	369	426	480	536
Autumn 2012	296	328	368	416	464
Change	-32	-41	-58	-64	-72
Change in Scottish share	-26	-29	-34	-38	-43
Change in BUD12 measures	-2	-5	-7	-4	-4
Change in UK forecast	-4	-7	-17	-22	-25

Landfill tax

1.24 The Scotland Act provides for landfill tax to be entirely devolved to Scotland in April 2015. The Scottish Government are currently carrying out a consultation on a landfill tax for Scotland and intend to introduce a Landfill Tax (Scotland) Bill to the Scottish Parliament in Spring 2013.[2]

1.25 As with SDLT, until decisions have been made on the proposed new tax, the Scottish landfill tax forecast assumes that the current system of landfill tax remains

[2] http://www.scotland.gov.uk/Publications/2012/10/3524

after the tax is fully devolved in 2015. Once firm details of the proposed tax are available, we will generate forecasts based on the new tax.

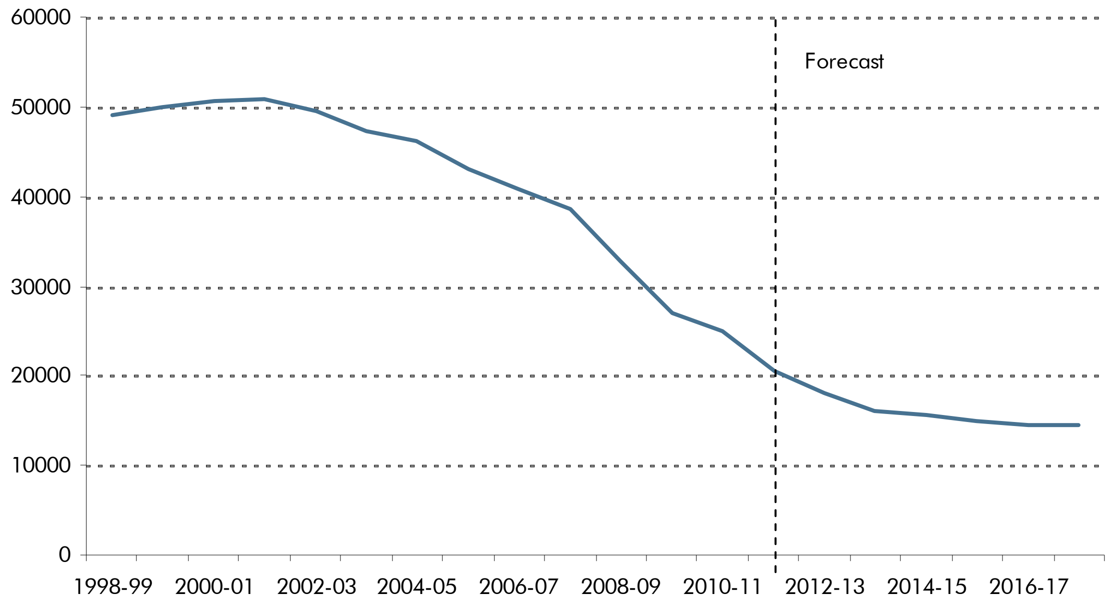
1.26 To forecast Scottish landfill tax we use an assumption of a constant Scottish share of UK landfill tax based on an average of the last three years. Table 1.10 shows the Scottish share of landfill tax in recent years. The latest three-year average is 9.1 per cent compared with the 9.2 per cent share assumed in the forecasts published alongside Budget 2012. There were no landfill tax measures in the Autumn Statement so the calculation is just the share multiplied by the UK forecast.

Table 1.10: Scottish share of landfill tax

£ million	2006-07	2007-08	2008-09	2009-10	2010-11
UK	825	897	863	944	1095
Scotland	78	90	82	85	97
Scottish Share	9.5%	10.0%	9.5%	9.0%	8.9%

1.27 The UK forecast has been marked down sharply since the Budget and Table 1.12 shows that almost all of the lower Scottish landfill tax forecast is due to the weaker UK forecast. This is primarily due to a reassessment of the landfill tax model. In particular, we expect that the decline in outturn standard rate tonnages for landfill recorded over the past decade to persist. Chart 1.2 shows the outturns for tonnages sent to landfill charged at the standard rate of landfill tax.

Chart 1.2: Outturn tonnages for landfill charged the standard rate



Source: ONS, OBR

Table 1.11: UK and Scottish forecasts of landfill tax

£ million	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
UK Forecast	1075	1069	1050	1155	1172	1176	1206
Scottish forecast	98	97	96	105	107	107	110

Table 1.12: Changes in the Scottish landfill tax since March

£ million	2012-13	2013-14	2014-15	2015-16	2016-17
Budget 2012	123	132	145	151	157
Autumn 2012	97	96	105	107	107
Change	-25	-36	-40	-44	-49
Change in Scottish share	-1	-1	-2	-2	-2
Change in UK forecast	-24	-35	-38	-42	-47

Aggregates levy

1.28 The Command Paper commits the Government to keeping the devolution of aggregates levy to Scotland under review and states the intention, subject to the resolution of a legal challenge in the European Courts, of devolving this tax in the future. In the interim, the Treasury will assign aggregates levy receipts to Scotland in the same way as the other three taxes that are forecast.

1.29 At Budget 2012, we forecast Scottish aggregates levy by using a Scottish share of the UK total, based on an average of the last three years. We now have a 2010 outturn for the Scottish share of 18.3 per cent, which continues the upward trend seen in the share of recent years. A three-year average would only partially pick up this trend, so we have moved to using the latest outturn share. This is higher than the 15.7 per cent share we used in Budget 2012.

Table 1.13: Scottish share of aggregates levy

£ million	2006-07	2007-08	2008-09	2009-10	2010-11
UK	324	339	321	276	292
Scotland	45	52	48	46	53
Scottish Share	14.0%	15.4%	15.1%	16.6%	18.3%

1.30 Table 1.13 shows the UK and Scottish aggregates levy forecast. There were no measures affecting the aggregates levy in the Autumn Statement. The forecast for Scottish aggregates levy is around £4 to £5 million higher in each year of the forecast than assumed in March. Table 1.14 shows the breakdown for the change in the forecast. The higher Scottish share more than offsets the effect from a lower UK forecast. The weaker UK forecast primarily reflects a lower estimate for 2012-13 which is then expected to persist through the forecast.

Table 1.14: UK and Scottish forecasts of aggregates levy

£ million	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
UK forecast	283	272	277	289	298	310	324
Scottish forecast	52	50	51	53	55	57	59

Table 1.15: Changes in the Scottish aggregates levy forecast since March

£ million	2012-13	2013-14	2014-15	2015-16	2016-17
Budget 2012	45	47	48	50	53
Autumn 2012	50	51	53	55	57
Overall Change	4	4	5	4	4
Change in Scottish share	8	8	8	8	9
Change in UK forecast	-3	-4	-3	-4	-5

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