Office for
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Scottish tax forecasts

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Any queries regarding this publication should be sent to us at: obrenquiries@obr.gsi.gov.uk

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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 will 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.

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 Budget.

We published a methodology note in March 2012 which described how we planned 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 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

[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

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 carried out 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 March 11; and

- In the final week before the Budget, 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 Budget policy measures. Due to the confidentiality of Budget measures we were unable to involve the Scottish Government in this stage of the process.

Summary of March 2013 Scottish Forecasts

£ million	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Income Tax[1]	4330	4240	4246	4332	4649	4976	5308
Stamp Duty Land Tax	275	323	348	372	410	456	509
Landfill Tax	98	99	95	104	105	105	108
Aggregates Levy	52	49	48	49	51	53	56
Total	4755	4711	4737	4857	5215	5590	5981

[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; and
- aggregates levy

Income tax

Scottish rate of income tax

1.2 Under the Scotland Act, the existing basic, higher and additional rates of income taxes levied by the UK government will 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).

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.

Forecast methodology

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.

1.6 We then apply the Scottish share to this forecast and finally add on the Scottish element of Budget 2013 policy measures.

UK forecast

1.7 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 a March forecast which excludes the Autumn Statement 2012 measures. This shows reductions in each year from 2011-12 onwards compared with our forecast in December. The shortfall in the UK forecast for this definition is around £4½ billion in each year from 2013-14 onwards and reflects both receipts information since our last forecast and changes in economic determinants.

Table 1.1: UK forecast of tax liabilities on non-savings, non-dividend income (prior to Budget 2013 measures)

£ billion	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
March (post Autumn 12 measures)	141.7	142.7	140.9	147.5	152.0	162.4	173.4	185.2
March(pre Autumn 12 measures)	141.7	142.7	140.8	148.5	151.6	161.7	172.1	183.7
Autumn 12 (pre measures)	141.8	144.0	144.3	153.1	156.1	166.3	176.5	188.1
Change	0.0	-1.2	-3.5	-4.7	-4.5	-4.6	-4.4	-4.4

1.8 The UK forecast for all elements of income tax in 2012-13 was reduced by £3.4 billion in the March *EFO*. This reflects a shortfall of £2.1 billion in self assessment

(SA) income tax and a £1.5 billion shortfall in PAYE receipts. The payments of SA that were paid at the end of January related to the final payments for 2011-12 liabilities. As noted earlier, these will be accrued back to 2011-12 on the definition used for Scottish income tax. This explains the deterioration in 2011-12 in Table 1.1.

1.9 The lower-than-expected PAYE receipts, particularly in the non-financial sector help explain the larger shortfall in 2012-13 liabilities compared to December. In addition, we have revised down our assumption for SA liabilities for 2012-13 (which will be received in 2013-14). The weakness in SA receipts seems to reflect lower than anticipated income from those self-employed who pay tax at either the basic or higher rate. This is despite recent strong rises in self-employment. This indicates a fall in the effective tax rate on these incomes with many of the newly self-employed, as well as some of the existing self-employed, not earning sufficient incomes to pay much tax. We have assumed a further fall in the effective tax rate on 2012-13 liabilities.

1.10 There is also a downward effect on the UK forecast from lower earnings growth. Earnings growth has slowed in recent months and is likely to be the key factor behind the weakness in PAYE receipts since the December forecast. In light of the recent outturn and a weaker forecast for productivity, earnings growth is expected to remain subdued for longer.

Scottish Share

1.11 The Scottish share of income tax is currently based on the Survey of Personal Incomes (SPI), an annual HMRC survey based on a large sample of individuals drawn from their PAYE,SA and claims systems. This is only available with a long lag, with the 2010-11 data published in December 2012. In the run up to the devolution of income tax, HMRC will be able to identify each individual taxpayer as Scottish or not and flag them appropriately on their PAYE and SA systems.

1.12 Table 1.2 shows the Scottish share since 2000-01 has varied between 3.03 per cent and 3.23 per cent.

Table 1.2: Historical Scottish share of income tax

Per cent	00-01	01-02	02-03	03-04	04-05	05-06	06-07	07-08	08-09	09-10	10-11
Autumn	3.03	3.14	3.15	3.23	3.15	3.13	3.15	3.14	n/a	3.16	3.15

1.13 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, Scotland has a lower proportion of higher and additional rate taxpayers than the rest of the UK. In recent years, there have been a number of policies that target the top end of the income distribution such as the additional rate of income tax for incomes over £150,000, the withdrawal of personal allowances above £100,000, freezes in the basic rate limit and higher rate tax threshold and restrictions on pension tax relief.

1.14 HMRC modelling indicates that forestalling activity related to the introduction of the 50 per cent additional rate should have had an effect on the Scottish share in both 2009-10 and 2010-11. 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 December, we estimated that in the absence of forestalling, the Scottish share in 2009-10 would have been 3.21 per cent rather than 3.16 per cent. This higher underlying share was used as the basis for the December forecast.

1.15 In 2010-11, the unwinding of the 50p forestalling should boost the Scottish share, since UK liabilities would be more depressed by such activity than Scottish liabilities. The SPI outturn share for 2010-11 is 3.15 per cent but we estimate that without forestalling the underlying share would be 3.10 per cent. This is used as the basis for our March forecast and is lower than the comparable figure of 3.23 per cent assumed in December.

1.16 As with our previous forecasts, we have made adjustments to the share for:

- policies introduced in 2011-12 and 2012-13 and already announced policies coming into effect from 2013-14 onwards. This includes Autumn Statement 2012 measures such as the rise in the personal allowance;
- other measures not included in the share calculation are added separately; and
- projections of the Scottish share have been further adjusted for forestalling effects expected in 2012-13 and 2013-14 due to the reduction in the additional rate.

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
December	3.16	3.23	3.11	3.09	2.96	2.99	2.99	2.98	2.98
March	3.16	3.15	3.03	3.01	2.87	2.89	2.88	2.88	2.88

1.17 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.

Forecast of Scottish income tax liabilities from Scottish rate

1.18 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)	4468	4330	4240	4240	4390	4677	4997	5340
Previous measures not in share calculation	0	0	1	6	-1	18	31	29
Budget 2013 measures	0	0	0	0	-57	-46	-52	-62
Scottish income tax liabilities (post-measures)	4468	4330	4240	4246	4332	4649	4976	5308

1.19 The main measures affecting income tax in Budget 2013 were:

- the increase in the personal allowance to £10,000 in 2014-15;
- the information exchange and disclosure facilities with the Isle of Man, Guernsey and Jersey; and
- HMRC anti-avoidance measures.

1.20 As was the case at both Budget 2012 and Autumn Statement 2012, the tax reduction through the rise in the personal allowance has a larger proportional effect on Scotland. The revenue-raising elements of recent packages are primarily aimed at the top end of the income distribution and have a smaller proportional effect on Scotland.

1.21 Table 1.5 provides a breakdown of the change in the Scottish income tax forecast since March. The lower than expected Scottish share for 2010-11 takes around £110 million off the estimate for that year, compared with our December estimate. The shortfall widens to between £200 million and £300 million in each year from 2012-13 onwards, reflecting the deterioration in the UK forecast and the Budget 2013 policy announcement that the personal allowance will reach £10,000 in 2014-15.

1.22 Despite the 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 2014-15, 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 December

£ million	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
December 2012	4581	4480	4462	4472	4602	4918	5242	5587
March 2013	4468	4330	4240	4246	4332	4649	4976	5308
Change	*-113*	*-150*	*-221*	*-226*	*-270*	*-269*	*-267*	*-280*
Change from Scottish share	-111	-112	-113	-88	-78	-85	-84	-87
Change from Budget 2013 measures	0	0	0	0	-57	-46	-52	-62
Change from UK forecast	-2	-38	-108	-138	-135	-138	-131	-130

Stamp duty land tax

1.23 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 last year. A Land and Building Transaction Tax (Scotland) Bill is currently being discussed in the Scottish Parliament.[1]

1.24 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.

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

1.26 We use a Scottish share of residential SDLT of 3.7 per cent, consistent with the 2011-12 outturn. With London accounting for almost 40 per cent of residential SDLT, the Scottish share is well below the Scottish share of UK GDP. We use a Scottish share of commercial SDLT of 7.4 per cent.

1.27 Table 1.6 shows the UK forecasts for SDLT from both residential and commercial property. We have revised up our UK forecast for SDLT receipts by £0.4 billion in 2012-13, in part because receipts from commercial property have held up better than expected. Higher commercial SDLT is expected to persist throughout the forecast period. However, by 2017-18, we expect UK SDLT receipts to be around £0.5 billion below the December forecast. This reflects that the recovery in residential property transactions is assumed to be slower than in our previous forecast.

Table 1.6: UK forecasts of Stamp duty land tax

£ million	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Residential SDLT	5001	5856	6451	7309	8284	9395
Commercial SDLT	1940	1892	1915	2016	2166	2343
Total SDLT	6941	7748	8366	9325	10450	11738
Residential SDLT (ex BUD 12 and BUD13 measures)	4819	5522	6104	6921	7856	8918

1.28 There were policy announcements on SDLT in both Budget 2012 and Budget 2013 which are likely to have an asymmetric effect between Scotland and the UK as a whole. Budget 2012 announced the 7 per cent SDLT rate on residential properties over £2 million and the measure to reduce avoidance on residential properties through enveloping. Budget 2013 announced amendments to the enveloping measure and an anti-avoidance measure related to the 'subsale' rules. All of these measures are likely to affect expensive properties which are concentrated in London and the South-East. Only 0.9 per cent of UK sales of residential property above £2 million take place in Scotland. To allow for the fact that these measures are likely to have only a very modest effect on Scottish SDLT receipts, we used the Scottish share of SDLT on UK residential property prior to these Budget 2012 and Budget 2013 measures as the basis for the forecast and then added the effects of the measures separately.

Table 1.7: 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	178	204	226	256	291	330
Non-residential SDLT	120	144	140	142	149	160	173
Total SDLT (pre-measures)	275	322	344	368	405	451	503
Bud12 and BUD13 Measures[1]	0	2	4	4	5	5	5
Total SDLT (post-measures)	275	323	348	372	410	456	509

[1] Measures are all assumed to relate to residential SDLT

1.29 Reflecting the higher UK outturn for SDLT in 2012-13, the Scottish SDLT forecast is up by £27 million in 2012-13. The forecast remains higher than in December until 2014-15, helped by the higher Scottish share for SDLT on commercial property which as noted earlier, is higher throughout the forecast for the UK as a whole. Thereafter, the slower growth in residential property transactions, means that Scottish SDLT in 2017-18 is £7m lower than we previously forecast.

1.30 Although we have assumed a slower recovery in property transactions than in December, we still expect this to be the main driver behind the rise in SDLT over the forecast period. Transactions still remain close to historically low levels and we expect a recovery to a level consistent with the average historical duration of home ownership (with owner-occupiers moving every 19 years).

Table 1.8: Changes in Scottish SDLT since December

£ million	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
December 2012	296	328	368	416	464	516
March 2013	323	348	372	410	456	509
Change	27	20	4	-6	-8	-7
Change in Scottish share	0	0	0	0	0	0
Change in BUD12 measures	0	2	2	2	2	2
BUD 13 measures	0	0	0	0	0	0
Change in UK forecast	27	18	2	-8	-10	-9

Landfill tax

1.31 The Scotland Act provides for landfill tax to be entirely devolved to Scotland in April 2015. The Scottish Government carried out a consultation on a landfill tax for Scotland between October 2012 and January 2013 and intend to introduce a Landfill Tax (Scotland) Bill to the Scottish Parliament in Spring 2013.[2]

1.32 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 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.

1.33 Scottish landfill tax is forecast using a constant Scottish share of UK landfill tax based on an average of the last three years. With no new outturn information available on waste sent to landfill by region, we have continued to assume a 9.2 per cent Scottish share as in December.

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

1.34 The Scottish landfill tax is marginally lower by £1-2 million in each year from 2013-14, compared to the December forecast. With no change in the Scottish share, the lower Scottish forecast is due entirely to a lower projection for UK landfill tax receipts. The rise in receipts over the forecast period is the result of the pre-announced rises of £8 in the standard rate of landfill tax in both 2013-14 and 2014-15 and the assumption that tax rates will be uprated in line with inflation thereafter. This offsets the downward trend in waste sent to landfill. Tonnages charged at the standard rate have fallen markedly over the last decade and we assume that this decline will persist over the forecast period.

Table 1.9: 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	1084	1040	1139	1150	1153	1186
Scottish forecast	98	99	95	104	105	105	108

Table 1.10: Changes in the Scottish landfill tax since December

£ million	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
December 2012	97	96	105	107	107	110
March 2013	99	95	104	105	105	108
Change	1	-1	-1	-2	-2	-2
Change in Scottish share	0	0	0	0	0	0
Change in UK forecast	1	-1	-1	-2	-2	-2

Aggregates levy

1.35 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.

1.36 We forecast Scottish aggregates levy by using a Scottish share of the UK total, based on the latest outturn share. As in the December forecast, we continue to use a 2010 outturn for the Scottish share of 18.3 per cent. The trend in the Scottish share has been upwards in recent years with the share rising from 14 per cent in 2006-07.

1.37 Table 1.11 shows the UK and Scottish aggregates levy forecast. The Scottish forecast is £4 million lower than we assumed in December from 2014-15 onwards. The weaker forecast is mainly the result of the Budget announcement that the aggregates levy would be frozen in 2013-14. The Scottish share of this measure is around £3 million. The standard rate of aggregates levy has now been frozen since April 2009.

1.38 We expect modest growth in the aggregates levy over the forecast period. This reflects growth in aggregates extraction and that duty rates are expected to be uprated with inflation, in the absence of announced policy.

Table 1.11: 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	268	273	284	293	305	319
Scottish forecast	52	49	48	49	51	53	56

Table 1.12: Changes in the Scottish aggregates levy forecast since December

£ million	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
December 2012	50	51	53	55	57	59
March 2013	49	48	49	51	53	56
Overall Change	-1	-3	-4	-4	-4	-4
Change in Scottish share	0	0	0	0	0	0
Budget 2013 measures	0	-2	-3	-3	-3	-3
Change in UK forecast	-1	-1	-1	-1	-1	-1

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