Office for
Budget Responsibility

Economic and fiscal outlook

Scottish tax forecasts

December 2013

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 that 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 notionally assigns 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 will not vary as tax receipts vary until the devolution of these taxes is fully implemented.

We publish our forecasts for these taxes alongside each *EFO*, consistent with the main UK forecast it contains. As with our main UK forecasts these are five-year forecasts. In this *EFO*, they extend to 2018-19. They are based on current Government policy, including the policies announced in the Autumn Statement.

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 replicate the methodology we use to produce the UK forecasts directly. In particular, the macroeconomic data that we would need to produce a Scottish macroeconomic forecast and economic determinants are generally not available at a Scottish level or are 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 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 continue at its recent average level in the future.

We will consider the case for making ad-hoc adjustments if there is robust evidence of specific factors that 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.

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/69803/Scotland_Bill_Command_Paper.pdf
[2] http://budgetresponsibility.org.uk/wordpress/docs/Forecasting-Scottish-taxes.pdf

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 judgements that underpin them.

We consider these methodologies work-in-progress. The OBR's role in forecasting 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 bill for the Land and Buildings Transaction Tax has received Royal Assent, while the bill for the Scottish landfill tax is currently being discussed in the Scottish Parliament. Once decisions (e.g. on tax rates and bands) 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 21 November; 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 the measures we were unable to involve the Scottish Government in this stage of the process.

Summary of December 2013 Scottish tax forecasts

	£ million							
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Income tax[1]	4,310	4,275	4,250	4,377	4,652	4,918	5,218	5,551
Stamp duty land tax	275	283	361	432	491	539	589	648
Landfill tax	95	99	96	99	104	104	108	110
Aggregates levy	47	43	44	47	47	48	49	50
Total	**4,727**	**4,700**	**4,752**	**4,955**	**5,294**	**5,609**	**5,964**	**6,359**

[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 tax 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, 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 that 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. We have assumed a 10p rate is levied 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 the receipts forecasts published in our *EFO*. The key components of the UK forecast are:

- total pay-as-you-earn (PAYE) liabilities;
- 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 repayments and repayments to pension providers, as included in our income tax repayments forecast.

1.6 We then apply the Scottish share to the net totals of these forecast components and finally add on the Scottish element of policy measures announced at Autumn Statement 2013.

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 December forecast which excludes the Budget 2013 measures. The UK forecast is higher between 2012-13 and 2015-16. Thereafter, the revised forecast is lower than the March forecast.

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

	£ billion							
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Autumn Statement 13:								
Post Budget 13 measures	142.1	142.1	147.8	151.9	162.2	171.8	182.4	194.3
Pre Budget 13 measures (a)	142.1	142.0	147.6	152.8	162.9	172.7	183.4	195.5
Budget 13 (pre-measures) (b)	142.7	140.9	147.5	152.0	162.4	173.4	185.2	
Change (a-b)	-0.7	1.1	0.1	0.8	0.5	-0.7	-1.8	

Sources: HMRC, OBR

1.8 The PAYE element of the UK forecast is stronger than expected in the early years of the forecast. Both bonuses and underlying non-bonus receipts in the final two months of 2012-13 were higher than we forecast in March. These stronger receipts have been pushed through the forecast. Labour market data so far this year have indicated stronger employment outturns but weak earnings growth. In light of these developments, we have revised our employment forecast up, while we expect earnings growth to remain subdued for longer. By 2017-18, the combined effect of these revisions is to reduce the UK PAYE forecast.

1.9 An analysis of SA tax returns has indicated that UK non-savings, non-dividend liabilities for 2011-12 were £0.6 billion lower than assumed in the March forecast. The lower starting point is a key reason for the SA element of the UK forecast being weaker in most years compared with March. The UK forecast for total SA receipts was boosted by stronger dividend and savings income, reflecting stronger profits and a higher path for interest rates than in March. Neither of these factors will affect the SA forecast for non-savings and non-dividend liabilities. Repayments are also expected to be around £0.3 billion to £0.4 billion higher than in our March forecast.

Scottish share

1.10 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. An estimate for 2011-12 will be available for Budget 2014. 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.

1.11 The Scottish income tax share proved to be very stable between 2000-01 and 2010-11 averaging 3.14 per cent (with a range between 3.03 per cent and 3.23 per cent). The Scottish share could be affected if there were different Scottish economic trends or if policy measures had different exchequer effects between Scotland and the UK as a whole. We have not adjusted the Scottish share for different Scottish economic trends but have made adjustments for the asymmetric effect of policy measures.

1.12 Scotland has a lower proportion of higher and additional rate taxpayers than the UK as a whole. In recent years, revenue-raising policies have generally targeted 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 anti-avoidance measures. In contrast, tax reductions such as raising the personal allowance to £10,000 from 2014-15 would have a larger proportional effect on Scotland. Both these effects would lower the Scottish share.

1.13 UK liabilities for both PAYE and SA have been affected by forestalling activity related to the additional rate of income tax. The introduction of the 50p rate led high-income earners to bring forward income to minimise tax, while the reduction to 45p has led to shifting income into the future. We have allowed for an effect on the Scottish share from this forestalling behaviour. With a smaller proportion of additional rate taxpayers in Scotland, such behaviour will affect the Scottish share.

1.14 Table 1.2 shows our latest estimates of the Scottish share of income tax. These are little changed from our March estimates.

Table 1.2: Scottish share of income tax

	Fiscal Year; %							
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
March 2013	3.03	3.01	2.87	2.89	2.88	2.88	2.88	
December 2013	3.03	3.01	2.88	2.88	2.87	2.87	2.87	2.87

Sources: HMRC, OBR

Forecast of Scottish income tax liabilities from Scottish rate

1.15 Table 1.3 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 1.3: Scottish income tax forecast

	£ million							
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Scottish income tax liabilities (pre-measures)	4,310	4,275	4,250	4,370	4,656	4,936	5,242	5,581
Autumn Statement 2013 measures	0	0	0	7	-3	-18	-23	-30
Scottish income tax liabilities (post-measures)	4,310	4,275	4,250	4,377	4,652	4,918	5,218	5,551

Sources: HMRC, OBR

1.16 The main measures affecting income tax in Autumn Statement 2013 were:

- the transferable marriage allowance; and
- HMRC anti-avoidance measures (e.g. accelerated payments in anti-avoidance cases and confirming the extension of the partnerships measure to Alternative Investment Funds).

1.17 The overall effect from Autumn Statement measures is to lower Scottish receipts. This is mainly due to the tax reduction from the introduction of the transferable marriage allowance. With this allowance limited to basic rate taxpayers, we have assumed that the measure has a greater proportional effect on Scottish income tax. Many of the revenue-raising anti-avoidance measures are aimed primarily at the top end of the income distribution and we have assumed that they would have a smaller effect on Scotland than for the UK as a whole.

1.18 Table 1.4 provides a breakdown of the change in the Scottish income tax forecast since March. The change in the UK forecast is the main driver of higher Scottish receipts between 2012-13 and 2014-15. Thereafter, receipts are lower than in our March forecast reflecting both the change in the UK forecast and the effect of the Autumn Statement measures. We have modified how we incorporate policy measures from previous Budgets and Autumn Statements to ensure that such measures are not double-counted. This also lowers the Scottish forecast.

Table 1.4: Changes in Scottish income tax since March

	£ million						
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
March 2013	4,330	4,240	4,246	4,332	4,649	4,976	5,308
December 2013	4,310	4,275	4,250	4,377	4,652	4,918	5,218
Change in income tax	-20	35	4	46	4	-58	-90
of which:							
Scottish share	0	1	2	2	2	2	2
Previous measures	0	1	-1	14	-8	-21	-17
Autumn Statement 2013 measures	0	0	0	7	-3	-18	-23
UK forecast	-20	33	3	23	13	-20	-52

Sources: HMRC, OBR

1.19 A pick up in Scottish income tax receipts in 2014-15 will only bring the level of receipts back to their 2011-12 level. Thereafter, we expect more rapid growth in receipts. This reflects stronger growth in average earnings and rises in employment as the economy recovers. In addition, after 2014-15, the forecast assumes that tax thresholds and allowances are uprated with inflation. Above-inflation earnings growth then lifts receipts via 'fiscal drag', as people find more of their income taxed at higher rates.

Stamp duty land tax

1.20 The Scotland Act provides for stamp duty land tax (SDLT) to be entirely devolved to Scotland in April 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 (LBTT Bill) received Royal Assent on 31 July 2013.[3]

1.21 In April 2015, the LBTT will replace the current UK-wide stamp duty land tax within Scotland. The main changes are:

- modifications to the structure of the tax from a slab structure to a slice structure;
- a requirement to pay LBTT prior to registration of the title, intended to encourage prompt payment; and
- modifications to reliefs and exemptions, including the withdrawal of sub-sale relief arrangements.

1.22 The Scottish Government has not yet announced specific tax rates and bands, which are necessary for us to be able to produce a forecast of LBTT receipts. Therefore, our Scottish forecast effectively assumes that the current system of SDLT would remain after the tax is fully devolved. Once tax rates and bands are known, we will generate forecasts for the new tax.

[3] http://www.legislation.gov.uk/asp/2013/11/pdfs/asp_20130011_en.pdf

1.23 To produce our forecasts for Scottish SDLT, we typically make an assumption that receipts remain constant as a share of overall UK SDLT receipts. However, in this forecast we have also considered recent developments in regional house prices. Over the past year, the UK housing market has seen a significant pick-up in prices, but much of this has been concentrated in the South East of England. London accounted for over 40 per cent of residential SDLT in 2012-13, since more SDLT is paid on expensive properties and London has a disproportionate share of these. In the year to September 2013, house price growth, as measured by the ONS, was 9.4 per cent in London against a 1.1 per cent fall in Scotland. As a result, we have adjusted the Scottish share from 3.5 per cent in 2012-13 to 3.3 per cent in 2013-14. We then hold the share constant at 3.3 per cent over the rest of the forecast period, implicitly assuming that housing market developments are more evenly spread through the UK from 2014-15 onwards.

1.24 For commercial SDLT, we use a three-year average of the Scottish share and project this forward. A three-year average share should reduce the risk of a large error resulting from volatility due to changes in the mix of transactions between years. The outturn Scottish share was 5.6 per cent in 2012-13, lower than in the two previous years. The three-year average is 6.8 per cent and this share is used over the whole forecast period.

1.25 Table 1.5 shows the UK forecasts for SDLT from both residential and commercial property. Our forecast for SDLT receipts has been revised up by £1.1 billion in 2013-14 and by £3.5 billion by 2017-18. Much of the increase reflects a rise in receipts from residential property. Our forecast for UK house prices has been revised up substantially since March, broadly in line with external forecasts. The level of house prices is 10 per cent higher by 2017-18. Residential property transactions are also expected to pick up more quickly than assumed in our March forecast.

Table 1.5: UK forecasts of Stamp Duty Land Tax

	£ million						
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Residential SDLT	4,914	6,688	8,504	10,088	11,255	12,449	13,786
Commercial SDLT	1,994	2,171	2,338	2,450	2,605	2,787	2,981
Total SDLT	6,908	8,858	10,842	12,538	13,861	15,236	16,767
Residential SDLT (ex BUD 12 and BUD13 measures)	*4,916*	*6,338*	*8,105*	*9,639*	*10,762*	*11,904*	*13,195*

Sources: HMRC, OBR

1.26 The UK forecast for SDLT includes the effects from a number of measures from previous Budgets which will only affect the top end of the residential property market. These include the 7 per cent SDLT rate on residential properties over £2 million and measures to reduce avoidance on residential properties through enveloping and the 'subsale' rules. HMRC have estimated that 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 measures as the basis for the forecast and then added the effects of the measures separately. Table 1.6 shows the forecasts for Scottish SDLT.

Table 1.6: Forecasts of Scottish Stamp Duty Land Tax

	£ million						
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Residential SDLT	171	210	268	319	356	394	437
Commercial SDLT	112	148	160	167	178	190	204
Total SDLT (pre-measures)	283	358	428	487	534	585	640
BUD12 and BUD13 Measures[1]	0	3	3	4	4	5	5
Total SDLT (post-measures)	283	361	432	491	539	589	646

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

Sources: HMRC, OBR

1.27 Table 1.7 provides a breakdown of the changes in the Scottish SDLT forecast since our March forecast. Outturns for Scottish SDLT in 2012-13 for both residential and commercial properties were lower than we had assumed in March. The lower Scottish share has a negative effect in each year of the forecast. However, the upward revision to the UK forecast means that Scottish SDLT is higher from 2013-14 onwards. From 2015-16, Scottish SDLT is around £80 million higher.

1.28 The sharp rise in Scottish SDLT from 2013-14 onwards is primarily driven by receipts from residential property. This reflects a number of factors. Firstly, house price growth peaks at 7 per cent in 2015-16 and then grows broadly in line with earnings growth. Secondly, although property transactions have picked up recently, they remain well below their long-run trend, providing scope for additional growth. Finally, the combination of higher house prices and unchanged tax thresholds in the UK system will have a 'fiscal drag' effect with a higher proportion of transactions becoming subject to higher stamp duty bands.

Table 1.7: Changes in Scottish SDLT since March

	£ million					
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
March 2013	323	348	372	410	456	509
December 2013	283	361	432	491	539	589
Change in SDLT	-40	13	60	81	83	80
of which:						
Scottish share	-47	-38	-46	-53	-58	-63
UK forecast	6	51	106	133	140	144

Sources: HMRC, OBR

Landfill tax

1.29 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. The Landfill Tax (Scotland) Bill to the Scottish Parliament has recently completed Stage 2 scrutiny in Parliament but is yet to be passed by Parliament and receive Royal Assent.[4]

1.30 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.

1.31 Scottish landfill tax is forecast using a constant Scottish share of UK landfill tax based on an average of the last three years. A Scottish share is now available for 2011-12 and is 8.9 per cent. The three-year average is also 8.9 per cent. This is lower than the 9.1 per cent assumed in March.

1.32 The Scottish landfill tax is lower in 2014-15 by £5 million and £1 million thereafter compared to the March forecast. The effect of the lower Scottish share is largely offset by changes in the UK forecast in most years. The rise in receipts over the forecast period is the result of the pre-announced rises in the standard rate of landfill tax of £8 per tonne 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 1.8: UK and Scottish forecasts of landfill tax

	£ million						
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
UK forecast	1,116	1,085	1,120	1,167	1,172	1,211	1,242
Scottish forecast	99	96	99	104	104	108	110

Sources: HMRC, OBR

Table 1.9: Changes in the Scottish landfill tax since March

	£ million					
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
March 2013	99	95	104	105	105	108
December 2013	99	96	99	104	104	108
Change in landfill tax	0	1	-5	-1	-1	0
of which:						
Scottish share	-2	-2	-2	-3	-3	-3
UK forecast	3	4	-2	2	2	2

Sources: HMRC, OBR

[4] http://www.scottish.parliament.uk/S4_Bills/Landfill%20Tax%20Bill/b28as4-stage2-amend.pdf

Aggregates levy

1.33 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.

1.34 We forecast Scottish aggregates levy by using a Scottish share of the UK total, based on the latest outturn share. The Scottish share for 2011-12 is 16.6 per cent, which is lower than the 18.3 per cent assumed in March. The lower Scottish share largely reflects that the Northern Ireland share increased following the ending of a duty relief. With overall UK aggregate levy receipts remaining weak, this translates into a lower estimate for Scottish receipts for this levy.

1.35 Table 1.10 shows the UK and Scottish aggregates levy forecast. The Scottish forecast is £4 million lower than we assumed in March for 2013-14, with the revision rising to £7 million by the end of forecast. The weaker forecast is almost entirely due to the lower Scottish share.

1.36 We expect only marginal growth in the Scottish aggregates levy over the forecast period. Aggregates extraction is expected to decline modestly over the forecast period, in line with recent trends. This is offset by our assumption that duty rates are uprated with inflation, in the absence of announced policy.

Table 1.10: UK and Scottish forecasts of aggregates levy

	£ million						
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
UK forecast	261	268	281	285	289	295	301
Scottish forecast	43	44	47	47	48	49	50

Sources: HMRC, OBR

Table 1.11: Changes in the Scottish aggregates levy forecast since March

	£ million					
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
March 2013	49	48	49	51	53	56
December 2013	43	44	47	47	48	49
Change in aggregates levy	-6	-4	-2	-4	-5	-7
of which:						
Scottish share	-4	-5	-5	-5	-5	-5
UK forecast	-1	1	2	1	0	-2

Sources: HMRC, OBR