

Scottish Income Tax shortfall offset by UK Funding

The Scottish Government raised £941 million less than expected in devolved income taxes in 2017/18, new figures from HMRC reveal today.

Scotland's economy grew more slowly than the rest of the UK, hitting tax receipts and leaving the Scottish Government with a shortfall in funding.

Because of the risk sharing mechanism in the jointly agreed fiscal framework, the shortfall will be offset by a £737 million increase to the block grant funded by the UK Government. It means the Scottish Government will have to manage a reduction in funding in 2020/21 of £204million.

Scottish ministers are responsible for deciding how to respond. They have powers to borrow up to £1.75billion and a £700million reserve to smooth funding pressures across financial years.

Chief Secretary to the Treasury Liz Truss said:

The 2016 Scotland Act was a major new act of devolution that helps make the Scottish Parliament one of the most powerful devolved parliaments in the world.

This helps to realise all the benefits of the Union as it provides Scottish ministers with substantial powers over taxes and spending for Scotland while still being supported by the broad shoulders of the UK.

But with those new powers, Scottish ministers should take responsibility and focus on the decisions necessary to get Scotland's economy growing faster to avoid shortfalls in tax receipts.

Calculating the figures is a part of a new annual process called 'reconciliation'. It was jointly agreed by the Scottish and UK Governments when a new fiscal framework was created alongside the Scotland Act 2016. 2017/18 is the first year in which powers over income tax rates and thresholds were fully devolved to the Scottish Government so this is the first time the reconciliation has operated.

The Scottish Fiscal Commission currently forecasts reconciliation over the first three years will see a c.£1 billion reduction in funding for the Scottish Government, although this is a much larger shortfall than the Office for Budget Responsibility currently expects of around £300million.

Alongside this, public spending statistics published today show spending in Scotland rose to £10,881 per head in 2017/18 from £10,606 the previous year.

This compares to the UK average in 2017/18 of £9,350 per head.

Notes to editors:

What is reconciliation?

As set out in the Scottish Government's fiscal framework, income tax outturn published in HMRC's Annual Report and Accounts for 2017-18 will be used to determine the Scottish Government's funding in 2020-21 through a reconciliation process.

Under this reconciliation process, the block grant will be increased by £737m and the Scottish Government's income tax revenues will be reduced by £941m.

What is income tax devolution?

The Scotland Act 2016 devolved additional tax powers to the Scottish Government. In April 2017, the Scottish Government gained the power to set the rates and bands for non-savings and non-dividends (NSND) Income Tax in Scotland.

How is the Scottish Government funded?

The Scottish Government is partly funded by the UK government block grant, and partly self-funded through raising revenue from devolved taxes and borrowing.

The block grant is determined by the longstanding Barnett Formula, block grant deductions in relation to tax devolution and block grant additions for welfare devolution. Alongside this, the Scottish Government retains all revenues from devolved taxes and sets borrowing levels within agreed limits.

What is the income tax reconciliation for 2017-18?

The reconciliation covers both income tax revenues and the block grant deduction.

Initially, the Scottish Government's income tax revenues are forecast by the Scottish Fiscal Commission and the income tax block grant deduction is based on Office for Budget Responsibility income tax forecasts for the rest of the UK.

Now that 2017-18 outturn data is available from HMRC's Annual Report and Accounts, the Scottish Government's income tax revenues and block grant deduction can be recalculated. The difference between the forecasts and the outturns are applied to the Scottish Government's funding in 2020-21.

The two reconciliation components will have the following effects, as summarised in the table below:

1. Block grant deduction: The outturn is lower than forecast so this will increase the Scottish Government's block grant by £737m in 2020-21.

2. Scottish income tax: The outturn is lower than forecast so this will reduce Scottish Government self-funding by £941m in 2020-21.

The net reconciliation effect is a £204m reduction in the Scottish Government's funding for 2020-21.

| — | 2017-18 (£m) |
|---|--------------|
| Block grant deduction: based on OBR forecast 2016 | -11,750 |
| Block grant deduction: based on HMRC outturn 2019 | -11,013 |
| Reconciliation effect | +737 |
| Scottish income tax: SFC forecast 2016 | 11,857 |
| Scottish income tax: HMRC outturn 2019 | 10,916 |
| Reconciliation effect | -941 |
| Net reconciliation effect | -204 |