Kenneth Gibson MSP
Convener
Finance and Public Administration Committee
Scottish Parliament
Edinburgh
EH99 1SP

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Dear Convener

Final income tax outturn data for 2021-22 was published by HM Revenue & Customs (HMRC) today. The figures show Scottish income tax revenues were £13,724 million in 2021-22, growing by 14.9 per cent since 2020-21.

The Scottish Government and HM Treasury have agreed a provisional reconciliation figure for 2021-22 of -£390 million. While income tax outturn figures are final, the reconciliation is provisional because the underlying population figures used to calculate the Block Grant Adjustment (BGA) are not yet final. The Scottish Government and HM Treasury have issued a joint statement discussing the income tax outturn data and reconciliation here.

The provisional reconciliation figure of -£390 million is the largest negative reconciliation so far and exceeds the Scottish Government's borrowing powers. While it is smaller than the indicative estimate of -£712 million we provided in May 2023, the Scottish Government will still need to carefully consider how to handle it.

I thought there were some important issues to draw your attention to which are discussed below. We'll provide further analysis of this outturn data and the reconciliation in our Forecast Evaluation Report, due to be published on 29 August 2023.

Comparison to January 2021 budget setting forecasts

Figure 1 shows how the reconciliation figure came about.

Figure 1: Scottish income tax outturn and BGA compared to Budget setting forecasts

£ million	Budget setting	Outturn	Difference
SIT	12,263	13,724	1,461
BGA	-11,788	-13,639	-1,851
Net position	475	85	**-390**

Overall, both Scottish income tax revenues and the income tax BGA, based on income tax revenues in the rest of the UK, were substantially higher than the Budget setting forecasts published in January 2021 and November 2020 respectively. This was driven by a stronger than expected recovery from the pandemic in 2021-22, as well as rising inflation and nominal earnings growth across the UK.

Scottish income tax revenues in 2021-22 were £1,461 million higher than was forecast when the Scottish Budget was set in January 2021. In comparison, the provisional income tax BGA is £1,851 higher than expected when the Scottish Budget was set. These relative differences lead to a provisional reconciliation figure of -£390 million.

In January 2021 we stated that the high Budget setting net position of £475 million largely arose because of the significant uncertainty around COVID-19 and its effects on the data and judgements used in our and the OBR's forecasts, as well as issues with the timing of forecasts.[1] We did not expect Scottish tax revenues to perform significantly differently to the UK in 2021-22. We cautioned that a negative reconciliation was likely, suggesting a value of -£300 million if the net position was closer to the lower 2020-21 value.

[1] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link), see paragraphs 2.8 and 2.22 to 2.26

Scottish Fiscal Commission, The Governor's House
Regent Road, Edinburgh, EH1 3DE

For general enquiries:
info@fiscalcommission.scot

Comparison to May 2023 estimate

Alongside our May 2023 forecasts we published an indicative reconciliation figure of -£712 million, based on comparing ours and the OBR's latest forecasts.[2] Figure 2 shows how the reconciliation has changed since that indicative estimate.

Figure 2: Scottish income tax outturn and BGA compared to May 2023 forecast

£ million	Budget setting	May-23	Outturn	Change since May 2023
Revenues	12,263	13,387	13,724	337
BGA	-11,788	-13,624	-13,639	-15
Net position	475	-237	85	322
Reconciliation		-712	-390	322

The BGA is largely unchanged since the figure used in our May 2023 SEFF, which was based on OBR March 2023 forecasts. However, Scottish income tax revenues are £337 million, or 2.5 per cent, higher than we forecast, which has driven the shift in the reconciliation. The forecast error is largely down to unanticipated strong Scottish Self-Assessment (SA) revenue growth.

Most employees pay tax through HMRC's Pay-As-You-Earn (PAYE) system. PAYE is paid monthly, and HMRC's Real Time Information (RTI) statistics provide us with timely information on PAYE revenues, with a lag of just a couple of months. Around 90 per cent of Scottish tax revenues are collected through PAYE. The self-employed and those with earnings over £100,000 need to complete an SA tax return. This process is far less timely, with most 2021-22 SA tax returns only submitted in January 2023. The SA element of income tax can be a lot more volatile because of the nature of the incomes of those who pay it. In addition, for 2021-22, the Self-Employment Income Support Scheme (SEISS) added another layer of uncertainty.

We largely align our forecast of total income tax revenues with RTI data, implicitly assuming that growth in SA revenue will be similar to growth in PAYE revenue. When we published our May 2023 forecast, we had complete RTI income tax revenue data available for 2021-22, suggesting growth in income tax revenues of 11.6 per cent. After some further minor adjustments, we forecast growth in income tax revenues in 2021-22 of 12.0 per cent.

Outturn data shows income tax revenues growing by 14.9 per cent in 2021-22. This includes growth in income tax collected through PAYE growing by 13.8 per cent, and growth in income

[2] Scottish Fiscal Commission (2023) Scotland's Economic and Fiscal Forecasts – May 2023 (link)

tax revenue paid through SA of 20.1 per cent. In comparison, UK SA income tax revenue growth was only 11.6 per cent.

RTI is the only timely source of data on income tax revenues in Scotland. However, RTI is an imperfect tool for predicting growth in income tax revenues, as it doesn't include SA.

The Scottish component of the indicative reconciliation estimates we present have been largely driven by RTI since January 2021. However, in this instance, the unanticipated strong growth in SA revenue means there was a significant overestimate of the indicative reconciliation. We'll consider how we present indicative reconciliation figures and if there are ways to improve the estimates.

I'd be more than happy to discuss any of the issues above with you when we next appear at the Committee after the publication of our Forecast Evaluation Report.

Yours sincerely

Graeme Roy

Professor Graeme Roy

Scottish Fiscal Commission, The Governor's House
Regent Road, Edinburgh, EH1 3DE

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