



Scotland's devolved taxation

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Preface

- It is worth emphasising that I have supported devolved taxes in the context of a devolved Scottish legislature [since 1976](#). I have not changed my mind on this, but experience of the almost quarter century since 1999 is disheartening
- Some of the failings are consequences of UK government policies which impose either legal constraints or political constraints on what Scottish governments can do. Notwithstanding the Mirrlees Review (2011) the UK tax system is unreformable due to inertia, lack of public understanding, and political cowardice
- Some of the failings are the fault of successive Scottish governments, with the paralysis at the UK level infecting Scotland. The fact that everything in Scotland is interpreted through the lens of its constitutional future has made serious political debate of taxation options impossible
- Rather than having a coherent direction for tax policy, fiscal drag is now the main policy instrument of the UK Government, with the Scottish Government using it as well
- The Scottish Fiscal Commission (2023) has warned that Scotland's public finances are unsustainable, just as the Office for Budget Responsibility has been doing for the UK as a whole for many years. This never seems to register in political debate

What devolved taxation is supposed to achieve

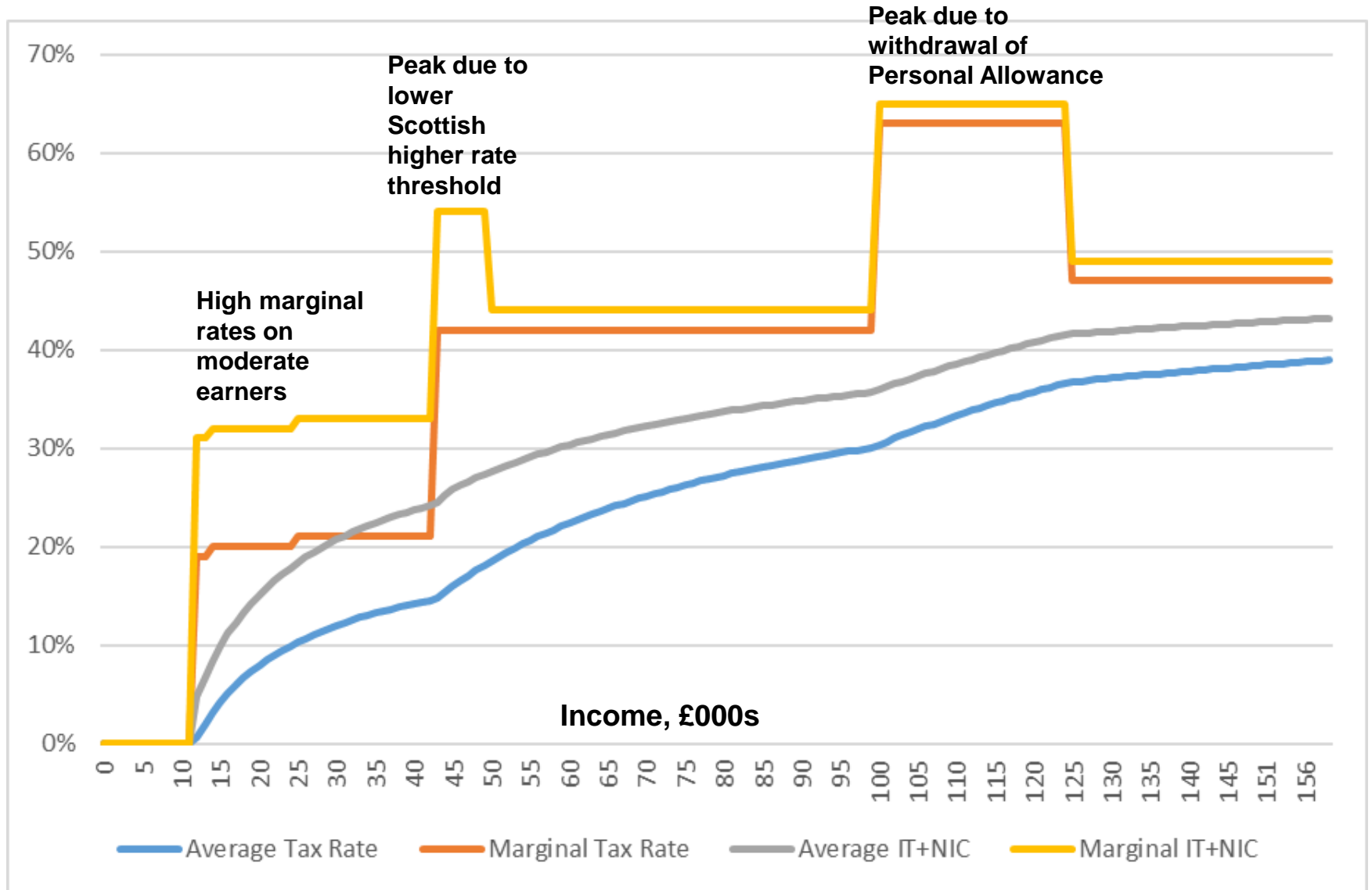
McIntyre et al (2022) identify three logics that have framed calls for greater Scottish tax devolution.

Logic	My assessment
Accumulate more competencies regardless of how such competencies are used	Those favouring Scottish independence have seen more tax powers as making Scotland seem closer to an independent state. The Smith Commission's proposal of partially assigned VAT was designed to take the self-financing percentage over 50%
Accumulate more competencies as a means of pursuing objectives that cannot be achieved or are inhibited by existing competencies	Given the economic, geographic and political configuration of the UK, there is a limit to how much Scotland can diverge from rUK while part of the Union. Politically, devolved social security benefits can never be less generous than UK counterparts, and are depriving public services of Barnett funding
Accumulate tax powers to balance the Parliament's powers to spend public money, thus bringing more fiscal responsibility and making decision making more accountable	I regard this as the decisive argument for having some devolved taxes. However, the complexities of Block Grant Adjustments have made Scotland's public finances even more unintelligible to most people. Scotland has taken on much more fiscal risk.

The financing of the Scottish Government

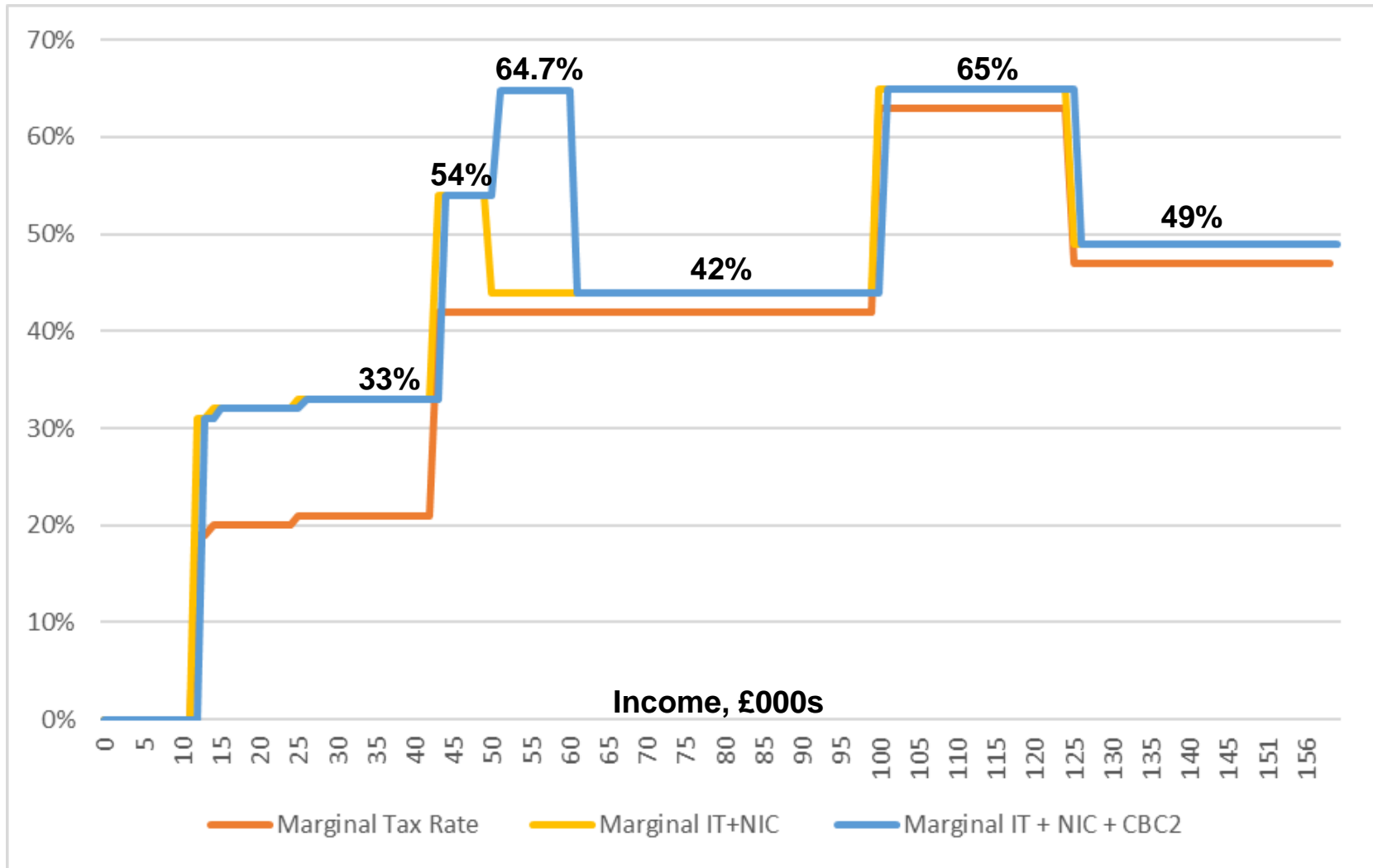
- Scottish Income Tax (as proposed by Lord Smith of Kelvin (2014)) finances £15,810 million (37%) of the 2023-24 Scottish budget's Fiscal Resource of £41,944 million, and is the focus of most of this presentation
- The other devolved taxes finance 2%. These have been smoothly administered by Revenue Scotland, but Land and Building Transactions Tax (like Stamp Duty Land Tax in England) discourages housing moves and damages labour mobility
- The Smith Commission's partial assignment of VAT revenues seems to have been quietly abandoned. I regard this proposal as misguided, but the lack of movement allows the UK government to say that the Scottish Parliament is not making use of available powers
- Council Tax and Business Rates are outside the Scottish budget but play a significant role in financing public expenditure in Scotland. I strongly support having a residential property tax but reliance on 1991 values is inefficient and inequitable. The Labour-Liberal Democrat Coalition's immediate rejection of the Burt Report (2006) recommendations was disastrous for reform possibilities. Economic change is undermining Business Rates. It appears impossible to address these issues unless there are similar moves at Westminster

Figure 1: Scottish Income Tax and UK National Insurance Contributions, 2023-24



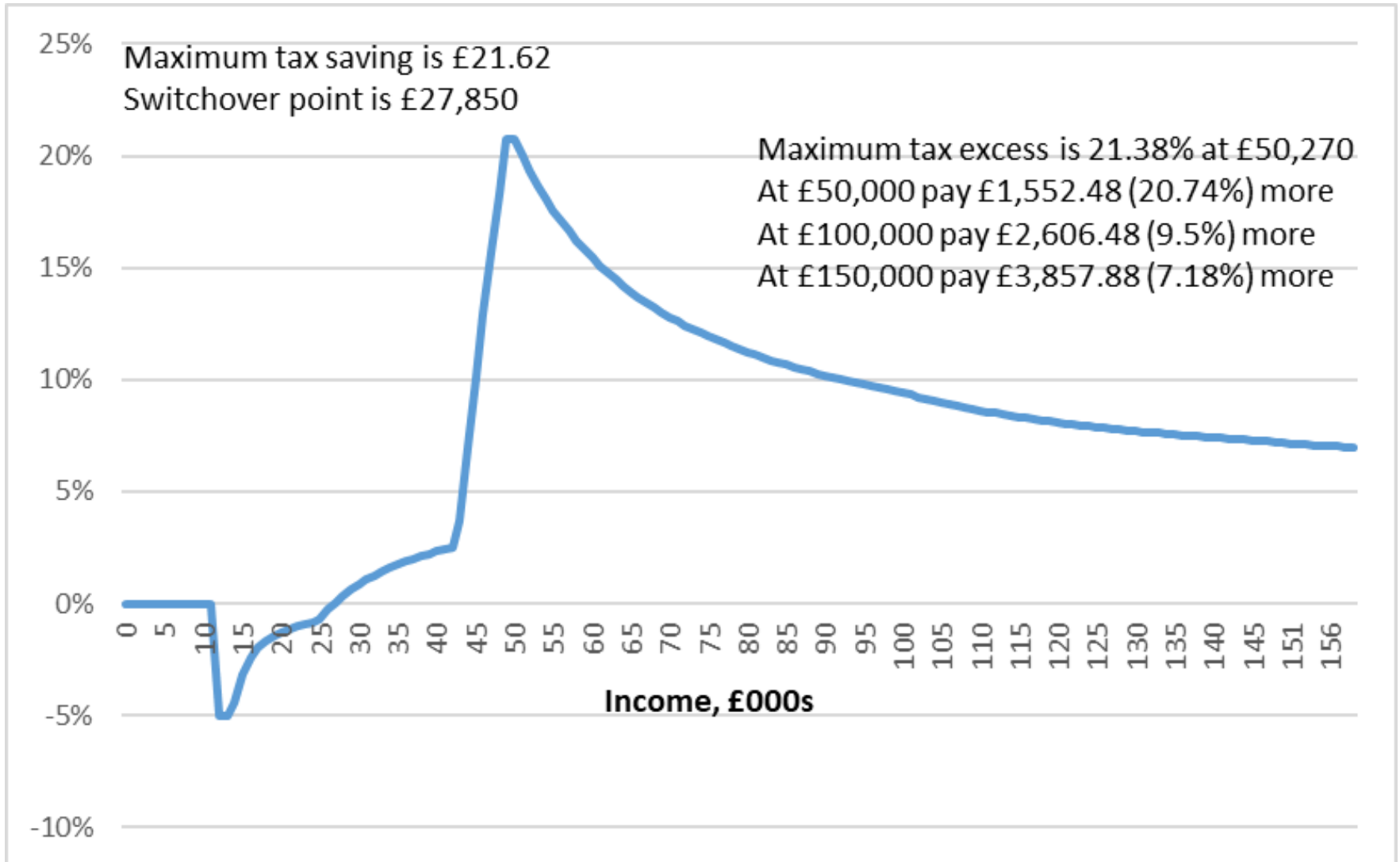
Source: Updated from Heald (2020, Figure 28.5).

Figure 2: Cumulative Marginal Rate of SIT + NIC + Child Benefit Charge (2 children, 2023-24)



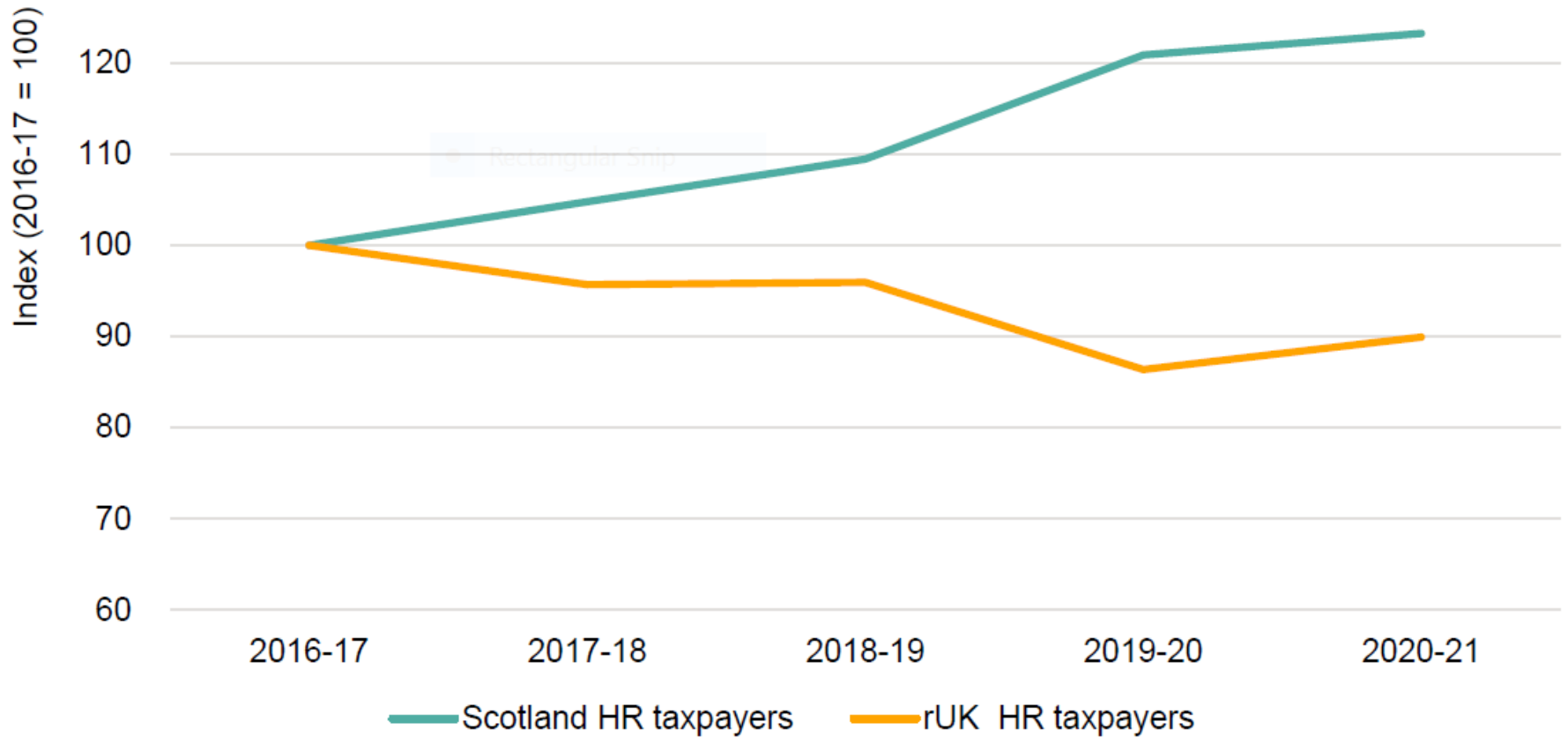
Source: Updated from Heald (2020, Figure 28.5).

Figure 3: Less/More Scottish tax as % of rUK tax paid, 2023-24



Source: Updated from Heald (2020, Figure 28.6).

Figure 4: Divergence in index of number of higher rate taxpayers



Note: The vertical axis begins at Index = 60.
Source: Scottish Fiscal Commission (2022, Figure 4.12).

Figure 5: Tax policy making subordinated to political spin

Income tax decrease in additional rate threshold

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Static costing		33	35	37	40	43
Behavioural change of which:	4	-25	-22	-23	-25	-28
METR effect		-14	-15	-16	-17	-19
AETR effect		-6	-7	-7	-8	-8
Forestalling effect	4	-4				
Post-behavioural costing	4	8	13	14	15	16

Income tax increase in Additional rate to 47 pence

£ million	2023-24	2024-25	2025-26	2026-27	2027-28
Static costing	32	34	35	37	40
Behavioural change, of which:	-29	-31	-32	-34	-37
METR effect	-29	-31	-32	-34	-37
AETR effect	0	0	0	0	0
Post-behavioural costing	3	3	3	3	3

Notes: Figures may not add because of rounding. METR and AETR refer respectively to Marginal Effective Tax Rate and the Average Effective Tax Rate.

Source: Scottish Fiscal Commission (2022, Figures A.2 and A.3).

Figure 6: Scottish Fiscal Commission's analysis of 2023-24 tax changes

Contributions to income tax policy change

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Total policy	4	129	142	150	162	175
Top rate threshold reduction to £125,140	4	8	13	14	15	16
Basic rate band freeze		18	19	20	21	22
Starter rate band freeze		6	6	6	6	6
Top rate increased by 1p to 47p		3	3	3	3	3
Higher rate increased by 1p to 42p		92	98	104	114	125
RTI adjustment		3	3	3	4	4

Notes: Figures may not add because of rounding. RTI adjustment refers to HMRC's Real Time Information System
 Source: Scottish Fiscal Commission (2022, Figure 4.11).

As shown on the next slide, the SFC forecasts that 90% of the static costing yield of the increase in the Top rate will be immediately lost to behavioural effects.

By 2027-28, 63% of the static costing yield from the reduction in the Top rate threshold will be lost to behavioural effects.

No contribution from Higher rate threshold freeze because this was embedded in previous SFC forecast.

Reflections

- Demographic numbers for Scotland:
 - population at 2020 was 5,466,000, of whom 4,439,078 were over 18
 - registered electors in 2022 for Scottish Parliament and local authority elections were 4,243,800 (4,012,700 for UK Parliamentary elections)
 - Income tax payers in Scotland in 2019-20 were 2,580,000 (not all might have income taxable by the Scottish Parliament)
- Ignoring differences in dates, 47% of the Scottish population are income tax payers. Scottish taxpayers earning over £50,000 (12.3% of taxpayers) contribute 56.1% of total income tax paid to the Scottish and UK Governments. Taxpayers earning over £70,000 (5.2% of taxpayers) contribute 40.9% of that total
- The Scottish budget faces a pincer. Extracting more tax is difficult, as shown by static costings of £994 million more in 2023-24 from post-2016-17 tax changes whereas the Net Tax Position is forecast as much less and volatile (Scottish Fiscal Commission, 2022, Figure 4.5). By 2027-28, social security spend is forecast to be £1,416 million over what is funded by the UK Treasury via Block Grant Adjustments
- Smith (1996) highlighted the conflict between **neutrality** (as few economic distortions as possible, subject to desired revenue yield) and **subsidiarity** (holding sub-national governments accountable). When there is more than one level of government with tax-raising powers, then horizontal equity in terms of tax payments only occurs within each jurisdiction, not across jurisdictions. With a long history of fiscal centralism, there can co-exist public approval for devolved tax powers but disapproval of emerging differences

Anything positive to say about the historical record?

- The SNP Scottish Government deserves credit for using Scottish Income Tax powers, and not letting them atrophy as did the tartan tax
- The work of the Scottish Fiscal Commission has brought greater transparency to the way Scotland's public finances now operate, though underlying complexity hinders accessibility
- Perhaps there is now an opportunity to develop a cross-party political debate about:
 - Devoting more attention to the performance of the Scottish economy on which the Scottish budget now partly depends
 - Amending the nonsensical Marginal Rate Schedule shown on Slide 6
- It would be good to have something positive to say about local taxation but experience warns against that

References

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