

Scottish Budget

Role of Income Tax

Introduction

The Scottish Government has published a discussion paper on the role of income tax in the forthcoming Scottish Budget. The purpose of this briefing is to highlight the issues in the paper and seek views from branches on this issue.

Context

The Scottish Budget used to be simply a matter of allocating the block grant from Westminster. Since the new fiscal framework, half of the budget is still allocated this way. The other half largely depends on the tax policy choices of the Scottish Government and the performance of devolved tax revenues relative to the rest of the UK.

By far the largest element of devolved revenues is from income tax, over £11.3bn. The Scottish Government can set the rates and bands, but not the tax base (excludes unearned income) or allowances. The discussion paper explains how this change in the way Scotland's budget is drawn up works, the Scottish tax base and four alternative approaches.

Principles

The government argues that tax policy should help maintain public services, not increase tax on the lowest earners, reduce inequality through progressivity, and support the economy.

Tax Base

There are projected to be 4.5 million adults in Scotland in 2018-19. Around 44% of the total number of adults, will not pay income tax as they will earn less than the Personal Allowance. The large majority of taxpayers, around 2.2 million, will pay the Basic 20p rate of income tax. Around 346,000, or 8% of Scottish adults, also pay the Higher 40p rate, and only 20,000 taxpayers (or 0.4%) in Scotland pay the 45p rate. This means that higher and additional rate taxpayers make up less than 10% of adults and account for 60% of all income tax paid.

Tax is only one consideration in terms of equality. Good public services reduce inequality by ensuring access to education, health services and public transport. Scotland's overall tax take as a proportion of GDP is also below the OECD average.

Spending

Around one third of the Scottish Budget goes on health. Just under a third on local government and the remainder on other services. The Scottish budget is under increasing pressure from austerity cuts (2.3% cut by 2020/21) and lower growth compared to the rest of the UK. Half the budget is protected (health, police, school attainment and childcare). This means other services, mostly councils, will have to be cut more, by around 9-14%. There are further budget risks from demographic change, new social security powers and Brexit.



POLICY BRIEFING

KEY POINTS:

- **Income tax plays an important part in new Scottish budget.**
- **Budget pressures mean increased revenue is required**
- **ScotGov paper sets out approaches to increase revenue from Income Tax.**
- **Branches asked to consider these and other options.**
- **Parliament decides in Budget Bill next year**



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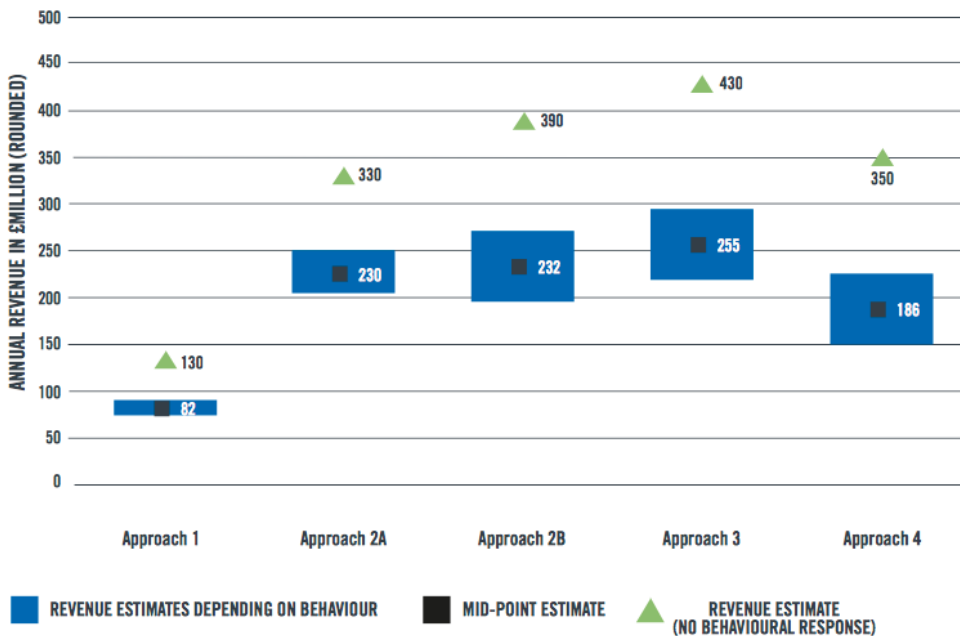
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Income Tax Options

The paper sets out the proposals of the main political parties at the last election and then proposes four alternative approaches based on 3, 4, 5 and 6 bands. The impact on taxpayers and the revenue implications of each approach is set out. The latter is a forecast because the actual revenue will depend on behavioural change, primarily the risk of tax flight of high income taxpayers.

This chart summarises the revenue implications of each option.

CHART 8: DIRECT AND POST-BEHAVIOURAL REVENUE ESTIMATES, 2018-19



All these options mean taxpayers below median earnings (£24,000) would be protected from a tax rise. However, they also generate fairly modest increases in revenue. For example, 1p on the current basic, higher and additional rates would generate £500m, double these options. In simple terms, major new revenues cannot be generated from higher income groups alone.

Other considerations

While income tax is the main tax raising power, the Scottish Government has other options available, even if they are politically challenging. There is limited scope left for further efficiency savings, but they could reduce universal benefits that only apply in Scotland - prescription charges, tuition fees etc. They can avoid cutting taxes like Air Departure Tax (deferred for now) and introduce new tax streams on wealth, tourists, paper cups etc.

If they could grow the Scottish economy faster than the rest of the UK including wages – even quite small differences generate significant revenue. However, there is no consensus on what stimulus would be needed to achieve this.

This debate has direct implications for public sector pay. Just over 55% of the budget is spent on pay and a 1% increase comes at a gross cost of £150m. However, the net cost is halved when the tax receipts and other economic benefits are taken into account. The Scottish Government also gets inflation linked payments from Westminster (GDP deflator) which have exceeded their pay policy in recent years. If the Chancellor allocates more for UK pay policy in the UK Budget this month, that also reduces the cost.

Action for Branches

Branches should discuss this issue and feedback views to Dave Watson.

Further info

ScotGov discussion paper.

<http://www.gov.scot/Resource/0052/00527052.pdf>

Fraser of Allander Institute budget paper <https://www.sbs.strath.ac.uk/economics/fraser/20170926/Scotlands-Budget-2017.pdf>

Impact of Austerity on Scotland – John Maclaren for UNISON <http://www.unison-scotland.org/2016/04/28/the-impact-of-austerity-on-scotland-damage-done-and-routes-to-recovery/>



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