

# **Budget 2021-22: Supporting the COVID-19 Recovery**

## **Scotland's Taxes and Fiscal Framework**

September 2020

## **Overview**

In advance of the Scottish Budget 2021-22, the Scottish Government is seeking views on the role of Scotland's devolved taxes and Fiscal Framework in supporting the COVID-19 economic recovery.

## **Why we are consulting**

The COVID-19 pandemic has triggered twin health and economic crises on a global scale. The Scottish Government has taken unprecedented steps to support the people and businesses of Scotland and we will continue to do so. We also remain committed to being an open and consultative government, which values and encourages accountability. The pandemic has underlined the importance of providing timely information about the decisions we are taking to support public understanding and provide opportunities for the public and stakeholders to participate in those decisions.

In the [Programme for Government 2020-21](#), we committed to building on our strong track record of taking a consultative approach to tax policy by launching an open representations process in advance of Budget 2021-22. This process will seek views on the role of our devolved taxes and the Fiscal Framework in the COVID-19 economic recovery, and to inform the decisions we take at the upcoming Budget.

The Scottish Government considers this to be a crucial time to seek wide-ranging views on how we can best deploy our limited tax, borrowing and reserve powers to support the recovery, and how we can seek to address any deficiencies in our current devolved fiscal arrangements exposed by the crisis, in order to build stronger fiscal foundations for Scotland's future.

We welcome responses from organisations and individuals on these issues in line with the Call for Evidence below (page 12).

## **Responding to this Consultation**

We are inviting responses to this consultation by 8 October 2020.

Please respond to this consultation using the Scottish Government's consultation hub, Citizen Space (<http://consult.gov.scot>). You can access and respond to this consultation online at <https://consult.gov.scot/financial-strategy/budget-2021-22-supporting-covid-19-recovery/>. You can save and return to your responses while the consultation is still open.

Please ensure that consultation responses are submitted before the closing date of 8 October 2020.

If you are unable to respond using our consultation hub, please complete the Respondent Information Form at the end of the document and send it to:

Covid-19 Recovery Consultation  
3-D North  
Victoria Quay  
Edinburgh  
EH6 6QQ

### **What happens next**

Following the closing date, all responses will be analysed and considered along with any other available evidence. The Scottish Government will publish responses, where respondents have given permission for their response to be made public, and an analysis report will also be made available.

Responses to the consultation will inform policy development in relation to the Scottish Budget 2021-22, and longer term, with final tax policy decisions being set out within the Budget documentation.

## Ministerial Foreword



I am delighted to be launching this consultation to seek views on the role of our devolved taxes and the Fiscal Framework in the COVID-19 economic recovery, which will help inform the decisions we take at the upcoming Scottish Budget 2021-22 and longer term.

The COVID-19 pandemic has created a challenge on a scale not seen in our lifetimes. The Scottish Government has taken unprecedented steps to support people and businesses in Scotland and we will continue to do so.

Scotland's public finances were already facing challenges this year due to the uncertainty caused by Brexit. We are now witnessing an unprecedented health and economic crisis, and the fiscal policy response will be central to our recovery. I have engaged extensively with stakeholders over the past few months, and have discussed ideas and views on our economic and fiscal recovery with many organisations and individuals. As we move towards the Scottish Budget 2021-22, I want to ensure I hear the widest possible range of views on how to aid the recovery and deliver a fairer and greener economy that puts wellbeing at its core, while ensuring sustainable public finances. This consultation is a crucial component of that.

The Scottish budget remains highly dependent on UK tax and spending decisions. We continue to invest to protect and create jobs, support businesses and strengthen communities, but our ability to do that is constrained by our limited borrowing powers. I will therefore continue to press for the Scottish Government to be granted additional financial powers to enable us to tailor a response that meets Scotland's needs. With greater fiscal powers we would have the ability to make different choices, with different economic and budgetary results.

I want to hear views from across Scotland about how we can best use our existing powers, and where our powers need to be expanded, to support Scotland's recovery. This will inform the Scottish Budget 2021-22 and the actions we take longer term, including as part of the review of the Fiscal Framework due to take place after the Scottish Parliament elections in 2021.

Everyone has a stake in tax and fiscal policy and, notwithstanding the limitations of the devolved settlement, the decisions we take in Scotland now have a greater impact on the size of the Scottish Budget. I want Scotland to be a country where we speak openly and frankly about tax; they are your taxes and they pay for your public services. This consultation provides you with the opportunity to help shape the way the Scottish Government uses its fiscal powers to support the COVID-19 recovery, and I very much look forward to receiving your views. I would like to thank you in advance for taking the time to respond to this consultation.

**Kate Forbes**  
**Cabinet Secretary for Finance**

# Scotland's Fiscal Powers

## Funding the Scottish Budget

The Scottish Budget is funded through a number of component parts and is principally comprised of a Block Grant<sup>1</sup>, local tax revenues, net devolved tax revenues, and additional funding for devolved social security powers. The overall funding position depends in large part on the operation of the Fiscal Framework, as follows:



- Component One - Barnett formula-determined Block Grant – Barnett continues to determine the initial size of the Block Grant and block grant funding remains the largest component of the Scottish Budget.
- Component Two – Block Grant Adjustments (BGA) – the Block Grant is adjusted to reflect the devolution of tax and social security powers. The size of the adjustment is based upon the performance of the corresponding UK Government tax revenues and social security expenditure.
- Component Three – Devolved Tax Revenues – the revenues from devolved local and national taxes, which contribute to Scotland's funding.

Until recently, Scottish Government revenue came almost exclusively via a Block Grant from the UK Government. The devolution of further tax powers in the Scotland Acts 2012 and 2016 means that decisions made in Scotland now have greater influence over the size of the Scottish Budget, with around 40% of the Scottish Budget in 2020-21 being funded from revenue-raising powers devolved to the Scottish Parliament.

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<sup>1</sup> The devolved administrations in Scotland, Wales and Northern Ireland all receive a transfer, the 'block grant', from the UK Government that funds a substantial proportion of their spending. A system known as the Barnett funding formula calculates the annual increase or decrease in the block grant given to each country.

## **Borrowing and reserve powers**

The Fiscal Framework agreement extended the fiscal tools available to the Scottish Government to manage the increased budget risk and volatility associated with the devolution of new powers. The Scottish Government has the power to borrow up to £600m of resource borrowing each year, within a statutory overall limit of £1.75bn.

Resource borrowing can only be undertaken for the following reasons:

- For in-year cash management, with an annual limit of £500m.
- For forecast errors in relation to devolved and assigned taxes and social security expenditure, with an annual limit of £300m (increasing to £600m in the event of Scotland-specific economic shock).

The Scottish Government also has the ability to smooth expenditure, manage tax volatility and determine the timing of expenditure through building up funds in, and drawing down funds from, the Scotland Reserve. The Reserve is capped in aggregate at £700m and is split between resource and capital. Annual drawdowns are limited to £250m for resource, and £100m for capital. There are no annual limits for payments into the Scotland Reserve.

The Scotland Reserve also replaced the Budget Exchange Mechanism which allowed the Scottish Government to manage underspend between financial years. The Reserve is therefore also used to manage expenditure between years.

## **The Scottish Approach to Tax**

Taxes fund public services and allow the Scottish Government to encourage growth and support business through economic development, skills investment and major infrastructure projects. Taxes can support three important functions:

- To raise money to fund public services, investment and public goods (e.g. schools, health care and infrastructure).
- To promote a more equal society through objectives such as redistribution of income and wealth.
- To encourage people to change their behaviours, in order to promote societal benefits, in areas such as health or the environment.

Since the devolution of tax powers to Scotland, the Scottish Government's approach to tax policy has reflected Adam Smith's four principles of taxation:

- Certainty
- Proportionality to the ability to pay
- Convenience
- Efficiency

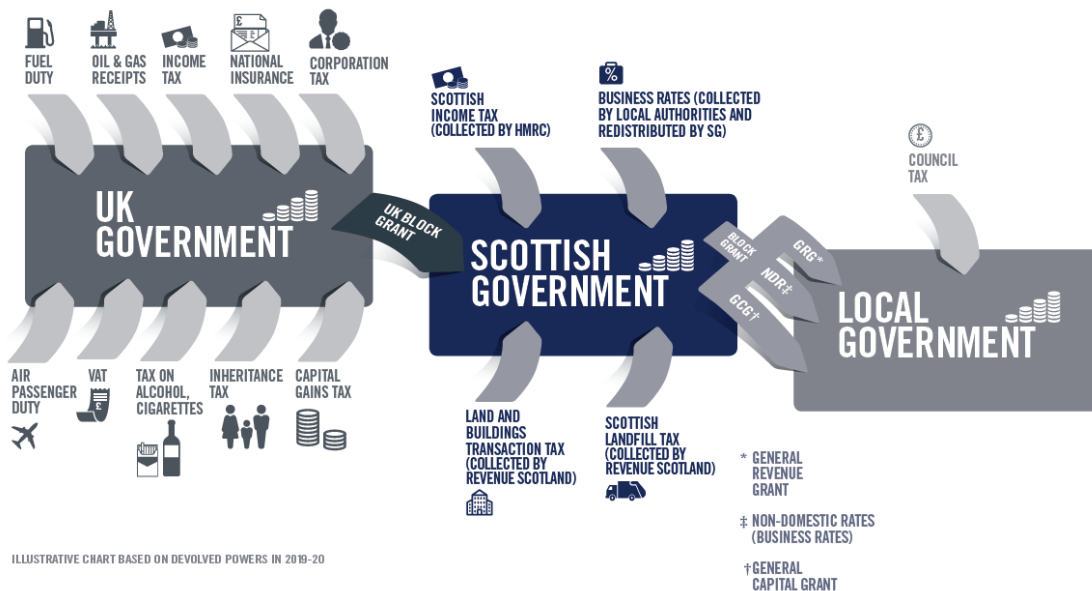


Our approach to tax is also based on a firm approach to tackling avoidance, where we have the power to do so, and a collaborative approach to tax policy development. We have a strong track record of taking an open and consultative approach to tax policy and using the powers we have to make taxation fairer and more progressive<sup>2</sup>.

### Devolved Tax Powers

The Scottish Parliament has limited powers when it comes to taxation. Under the current devolution settlement, the vast majority of tax powers remain reserved to the UK Government and Parliament (see figure 1). Decisions made on reserved taxes can sometimes generate unanticipated consequences as a result of interactions with devolved tax policy and other devolved policies.

**Figure 1: The Scottish tax landscape 2019-20**



<sup>2</sup> For example, the Scottish Government’s discussion paper and consultation process on the role of income tax in Scotland’s Budget: <https://www.gov.scot/publications/role-income-tax-scotlands-budget/>

The Scottish Parliament currently has devolved responsibilities in relation to five taxes:

- **Scottish Income Tax** is partially devolved – the Scottish Parliament is able to vary rates and bands for Scottish income taxpayers on non-savings and non-dividend income, e.g. earnings from employment, pension or property. The tax is administered by HMRC. The personal allowance, reliefs and the rates and bands for savings and dividend income all remain reserved to the UK Parliament.
- **Land and Buildings Transaction Tax**, the tax paid in relation to land and property transactions in Scotland, and **Scottish Landfill Tax**, a tax on the disposal of waste to landfill, are fully devolved national taxes and are collected by Revenue Scotland.
- The Scottish Parliament also has powers over local taxes for local expenditure, which were devolved in 1998. Currently, the two main local taxes are **Council Tax** and **Non-Domestic Rates** (also known as business rates), which are collected by local authorities.

In addition:

- The power to introduce two further taxes has been devolved to Scotland, but these have not yet been implemented and the relevant reserved taxes therefore continue to apply. These taxes are **Air Departure Tax**, a tax on all eligible passengers flying from Scottish airports, which will replace Air Passenger Duty when introduced, and the **Aggregates Levy**, a tax on the commercial exploitation of rock, gravel, or sand.
- A portion of VAT revenues generated in Scotland is due to be assigned to the Scottish Budget, referred to as **VAT Assignment**. This is not a power, as VAT policy remains reserved to the UK Government, and its implementation is dependent upon agreement between UK and Scottish ministers regarding the methodology for assigning VAT receipts.
- The Scottish Parliament has the power to create **new local taxes**. There is also a mechanism allowing the UK Parliament, with the consent of the Scottish Parliament, to devolve powers for **new national devolved taxes** to be created in Scotland.



# Scotland's finances in the aftermath of COVID-19

The outbreak of COVID-19 has shown that public services in Scotland can support the economy and public when faced with a profound and sudden challenge. However, it has also exposed a mismatch between the current devolved powers and the actions necessary to deliver a comprehensive response to the crisis, particularly with regards to the economic response and recovery.

To date, both the UK and Scottish Governments have provided unprecedented support to help protect jobs, support businesses and limit the longer-term damage to the economy.

The Scottish Government has taken a series of unprecedented policy actions with significant fiscal implications in response to the crisis. These have included £2.3 billion of business support measures, as well as a £350 million community support package for those communities most affected by the pandemic. We have also announced a £230 million investment package to help stimulate Scotland's economy following the pandemic, covering construction, low carbon, digitisation, and business support. This is in addition to £200 million of new initiatives to support homebuyers and help people into work or to re-train.

In April the Scottish Government established the Advisory Group on Economic Recovery, and their report<sup>3</sup> validates our overall strategic approach to the economy. As set out in our response to the report<sup>4</sup>, the Scottish Government will seize the opportunity to build a greener, fairer and more equal society: a wellbeing economy. This ambition will also be at the heart of our fiscal response.

The crisis has brought to the fore the limitations of the centralised UK budgeting approach, which leaves little fiscal flexibility to the devolved administrations. Before the pandemic, deficiencies in the devolved settlement and our Fiscal Framework had already become apparent: Scottish budgets continue to be highly dependent on UK tax and spending decisions. There is very limited scope to take a different path from the UK where that is in Scotland's best interest. These deficiencies must now be addressed urgently to enable Scotland to respond comprehensively to this and any future challenges.

The Scottish Government has made the case to the UK Government for temporary additional borrowing flexibilities, within the parameters of our current overall budget. This would enable us to better support the COVID-19 response and recovery, and to plan and respond more effectively. This additional flexibility is important, given that the UK Government's overall fiscal stance remains a key factor in determining the Scottish Government budget – the largest proportion of the budget is still determined by the Block Grant received from the UK Government via the Barnett formula.

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<sup>3</sup> <https://www.gov.scot/publications/towards-robust-resilient-wellbeing-economy-scotland-report-advisory-group-economic-recovery/>

<sup>4</sup> <https://www.gov.scot/publications/economic-recovery-implementation-plan-scottish-government-response-to-the-advisory-group-on-economic-recovery/>

Furthermore, the Scottish Government cannot use borrowing in the same way that the UK Government can. For example, our limited borrowing powers cannot be used to support additional spending on day-to-day public services.

Even leaving aside the particular challenges caused by COVID-19, the Scottish Government's view is that its borrowing and reserve powers are insufficient to manage the volatility inherent in the Fiscal Framework. This is demonstrated clearly by the fact that the income tax reconciliation the Scottish Government will have to manage in 2021-22 is currently forecast to be larger than the combined total of our permitted borrowing and drawdown from the Scotland Reserve.

Where the Scottish Government does have the fiscal powers to act, we have done so quickly and decisively:

- We have taken swift and significant action on the **Land and Buildings Transaction Tax (LBTT)** to help homebuyers and support Scotland's housing market in response to the impact of Covid-19. The increase in the starting rate threshold for LBTT to £250,000 until the end of March 2021, means that an estimated eight of out ten homebuyers and an estimated nine out of ten first-time buyers will pay no LBTT. In addition, we have doubled the time available for taxpayers most affected by the impact of Covid-19 to sell a previous main residence and claim a repayment of the Additional Dwelling Supplement (ADS).
- In relation to **Non-Domestic Rates**, the Scottish Government responded swiftly to the emerging crisis by introducing additional rates relief within a comprehensive package of measures worth over £2.3 billion to sustain businesses during the coronavirus pandemic.

The fiscal response to the crisis will have profound consequences for the public finances. The Office for Budget Responsibility (OBR) expects the UK's fiscal deficit to reach between 15% and 23% of GDP in 2020-21, depending on the speed of the economic recovery – the highest peacetime deficit in 300 years. In July 2020, UK public sector net debt exceeded £2 trillion, or 100.5% of GDP. This is the highest debt to GDP ratio since 1960-61.

With the UK economy officially entering recession in Q2 2020, and the risk of a stark rise in unemployment in the autumn once the furlough schemes unwind, further support will be needed. This is why we will continue to call on the UK Government to go further and adopt our bold and practical proposals for a UK-wide £80 billion (4% of GDP) fiscal stimulus to regenerate the economy and reduce inequalities, as set out in our paper COVID-19: UK Fiscal Path – A New Approach<sup>5</sup>.

The Scottish Government must consider how best to use its limited fiscal levers to support the recovery, whilst ensuring that public finances are kept on a sustainable future path. Given the unprecedented scale of economic impacts, those decisions must be taken carefully, also being mindful of the end of the EU Exit transition period

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<sup>5</sup> <https://www.gov.scot/publications/coronavirus-covid-19-uk-fiscal-path-new-approach/>

on 31 December 2020 and the likely changes to Scotland's economic relationships thereafter.

The Scottish Budget 2021-22 therefore faces unprecedented challenges. In response, we are seeking the widest possible views from across Scotland on how we use our limited fiscal powers to support Scotland's recovery from COVID-19, both through the Scottish Budget 2021-22 and longer term, including as part of the review of the Fiscal Framework due to take place after the Scottish Parliament elections in 2021.

# Annex – Call for Evidence

## TAX POLICY

### **How should the Scottish Government use its devolved and local tax powers to support the COVID-19 recovery as part of Budget 2021-22?**

Your representation should contain policy proposals in relation to:

1. devolved and local taxes as part of the Covid-19 recovery, with a focus on Budget 2021-22; and
2. where applicable, any longer-term tax policy considerations for the Scottish Government.

Where possible, please consider the role of tax policy in the COVID-19 recovery, in particular balancing potential trade-offs between raising revenue to fund public services and COVID-19 support; stimulus for individuals and businesses most affected by the crisis; and supporting a greener, fairer and more equal society and economy.

### **Are there any further tax powers that should be devolved to the Scottish Parliament to facilitate our ability to support the economic recovery?**

You may wish to consider the list of reserved tax powers (*Figure 1, page 7*) and how or whether these could be used more effectively in a Scottish context. You may also wish to consider which tax policy and powers you think are better suited at a UK wide level.

### **Are there any new tax proposals you would like to see implemented by the Scottish Government?**

You may wish to express views on new tax ideas or proposals as part of the COVID-19 recovery. Please consider whether your proposals fall within the scope of current devolved powers, including suitability for devolution using the mechanism for new national devolved taxes under the Scotland Act [*page 8*].

## FISCAL FRAMEWORK

### **What particular fiscal challenges have been highlighted as a result of the Covid-19 emergency?**

Your response should contain any observations and evidence on how the devolved fiscal powers have or have not been sufficient to deal with this exceptional situation and what this reveals about the need for change.

## **What changes, if any, should be made to the scope of devolved fiscal powers under the Fiscal Framework?**

Your response should contain proposals for any changes to fiscal powers (e.g. borrowing, use of the Scotland Reserve). Where possible, explain the rationale for extending or limiting powers, including whether and what borrowing and Reserve limits should be changed or abolished?

## **What fiscal rules should the Scottish Government follow?**

Fiscal rules set out how a government uses its fiscal powers (e.g. self-imposed limits on borrowing). Your response should set out whether there are any rules that are of particular importance now, or in conjunction with a future extension in the scope of fiscal powers.

## **FACTORS TO CONSIDER IN YOUR RESPONSE**

In your response to the questions above, you may wish to consider the following factors and any potential trade-offs:

- likely effectiveness of the proposal
- revenue implications for the Scottish Government
- costs and whether the proposal represents value for money
- wider macroeconomic implications (for economic recovery and growth)
- sectoral impacts
- distributional impacts, e.g. how the proposal would impact different household types, income deciles, businesses, etc.
- administrative and compliance costs and issues
- inequality – does the proposal address, or could it exacerbate, inequalities?
- legislative and operational requirements
- environmental impacts and climate change



**Title:** Budget 2021-22: Supporting the COVID-19 Recovery – Scotland’s Taxes and Fiscal Framework

## RESPONDENT INFORMATION FORM

**Please Note** this form **must** be completed and returned with your response.

To find out how we handle your personal data, please see our privacy policy:  
<https://www.gov.scot/privacy/>

Are you responding as an individual or an organisation?

- Individual  
 Organisation

Full name or organisation’s name

Phone number

Address

Postcode

Email

The Scottish Government would like your permission to publish your consultation response. Please indicate your publishing preference:

- Publish response with name  
 Publish response only (without name)  
 Do not publish response

**Information for organisations:**

The option 'Publish response only (without name)' is available for individual respondents only. If this option is selected, the organisation name will still be published.

If you choose the option 'Do not publish response', your organisation name may still be listed as having responded to the consultation in, for example, the analysis report.

We will share your response internally with other Scottish Government policy teams who may be addressing the issues you discuss. They may wish to contact you again in the future, but we require your permission to do so. Are you content for Scottish Government to contact you again in relation to this consultation exercise?

Yes

No



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