Extract of briefings and documents within scope of the request

Document 1: Extract from Additional Q&A Lines, January 2018

Q. You claim that your income tax policy is progressive but taxpayers earning more than £24,000 face a 1p rise in their marginal rate – the same as someone earning more than £150,000. Why did you choose not increase the top rate of income tax to 50p?

- We are proposing a Top Rate of tax at a level which will generate the most income, with the least risk of losing revenues next year and damaging the economy.
- Had we gone further our modelling indicates that once behavioral effects and forestalling are considered, a higher rate could actually reduce income tax revenue next year. That is not a decision any sensible Government would take.
    - For example, our own modelling shows that a 5p rise in the Top rate would reduce revenue in 2018-19 by £65 million (= +3 million - £68 million due to forestalling in 2018-19).
- This is largely due to taxpayers bringing income forward into 2017-18. Due to the way the Fiscal Framework operates, the Scottish Budget would see the full loss in income tax receipts from forestalling in 2018-19 but would not receive any potential uplift in 2017-18 until reconciliation occurred in Autumn 2019.

	One- off Forestalling Effects			Post behavioural Costing (SFC TIEs)	Revenue in 2018-19 (A+B)
Increase in Top Rate from 45 pence (pence)	Gain in tax liabilities in 2017-18 (£m)	**(A) Loss in tax liabilities in 2018-19 (£m)**	Net loss from forestalling (£m)	**(B) Gain in 2018-19 (£m)**	**Gain (+) or Loss (-) in 2018-19 (£m)**
1	0	0	0	3	**+3**
2	19	-20	-1	4	**-16**
3	38	-41	-3	5	**-36**
4	57	-62	-5	4	**-58**
5	61	-68	-7	3	**-65**

Document 2: Internal briefing on Revenue Impact of Incremental changes to the Additional rate

REVENUE IMPACT OF INCREMENTAL CHANGES TO THE ADDITIONAL RATE

Key points

- The SFC's assumptions about taxpayers' behaviour **and** potential forestalling mean that revenues in 2018-19 can be maximised with a 46p Top rate of income tax. Every 1p increase in the Top rate above that level would reduce revenues by an increasing amount (see final column of the table below).
    - For example, a 5p rise in the Top rate would reduce revenue in 2018-19 by £65 million (= +3 million - £68 million due to forestalling in 2018-19).
- This is largely due to taxpayers shifting income across years. Due to the way the Fiscal Framework operates, the Scottish Budget would see the full loss in income tax receipts from forestalling in 2018-19 but would not receive any potential uplift in 2017-18 until reconciliation occurred in Autumn 2019.
    - Since forestalling largely moves tax receipts across years, the net loss to the Scottish Budget is fairly limited (column 3) and amounts to £7 million for a 5p rise in the Top rate. However, even after reconciliation, a 4p or 5p rise in the Top rate may result in a loss to the Scottish Budget.
- Disregarding the one-off impact of forestalling in 2017-18 and 2018-19, the revenue raised from any changes in the Top Rate are broadly similar and close to zero, regardless of the scale of the increase.
- **This element of the Scottish Government's income tax policy therefore improves the progressivity of the tax system but raises very little additional revenue.**
- The SFC's assumptions about taxpayers' responsiveness to policy changes are broadly consistent with the advice obtained from the Council of Economic Advisers (CEA), however, the CEA's analysis does not specifically model forestalling.
- Finally, the extent of any behavioural response remains highly uncertain and the SFC will keep their assumptions under review as new information and research becomes available.

	One- off Forestalling Effects			**Post behavioural Costing (SFC TIEs)**	**Revenue in 2018-19 (A+B)**
Increase in Top Rate from 45 pence (pence)	**Gain in tax liabilities in 2017-18 (£m)**	**(A) Loss in tax liabilities in 2018-19 (£m)**	**Net loss from forestalling (£m)**	**(B) Gain in 2018-19 (£m)**	**Gain (+) or Loss (-) in 2018-19 (£m)**
1	0	0	0	3	**+3**
2	19	-20	-1	4	**-16**
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Source: Internal SG analysis using SFC forecasts and models

Document 3: Extracts from Briefing pack for 13/12/2017 Debate

Annex H - CEA paper

- The latest advice from the CEA on increasing the Additional Rate of income tax to 50p was published in the form of a paper by the Scottish Government prior to the Scottish Budget (12th December).
- The CEA have provided ongoing advice to the Scottish Government on the Additional Rate of income tax. The minutes of their meeting on 26 January 2017 note their discussion along and their agreement to discuss further in conference calls (these subsequently took place on several occasions this year).

Top Lines

- I sought advice from the Council of Economic Advisers (CEA) on the potential revenue risk of a divergence in the Additional Rate of Income Tax between Scotland and rUK.
- The CEAs carefully considered view is that there is a revenue risk from a substantial divergence in the Additional Rate (AR) of income tax between Scotland and the rest of the UK.
- However, the analysis highlights that these risks could be alleviated if the AR is increased by less than 5 pence.
- The CEAs advice continues to be invaluable and was considered by Scottish Government Ministers in advance of today's Draft Budget announcement.

The CEAs carefully considered view is that there is a revenue risk from a substantial divergence in the AR between Scotland and rUK

- The AR taxpayers are more likely to change their behaviour in ways that result in lower income tax revenue in Scotland.
- This is because AR taxpayers tend to be more mobile, have more opportunities to reduce their tax bill (reducing hours worked, incorporating as a business or moving their main place of residence outside of Scotland).
- There is therefore a revenue risk to Scottish income tax receipts from a substantial (5 pence) divergence in the AR between Scotland and rUK.

Smaller increases in the AR could alleviate the revenue risk

- Changes in the AR of less than 5 pence will result in a proportionately lower behavioural response and lower risk to Scottish income tax receipts.
- These risks could therefore be alleviated if the AR is increased by less than 5 pence.

<u>Increasing the AR is not in itself economically damaging. It is the divergence from rUK which is key</u>

- Recent research by the IMF makes clear that there is no strong evidence that increasing the progressivity of the tax system will reduce economic growth
- They conclude that "*there would appear to be scope for increasing the progressivity of income taxation without significantly hurting growth for countries wishing to enhance income redistribution*". IMF Fiscal Monitor, October 2017.
- However, for Scotland we need to be mindful of the impact that a large divergence in the AR with the rest of the UK could have, given how easily people can move within the UK.