The Scottish Parliament's Finance and Constitution Committee recommended as part of their Pre-budget scrutiny report 2020-21[1] that a document jointly agreed by HM Treasury and the Scottish Government should be published setting out the Income Tax reconciliation process.

This joint statement delivers on the Committee's recommendation and shows the Governments' continued ambition to ensure full transparency around the Fiscal Framework and specifically the reconciliation process. The recommendations are set out in full in Annex A.

Reconciliation for 2018-19 Income Tax

2018-19 outturn data for Income Tax has now been published[2]. This allows the reconciliation applying to the 2021-22 Scottish Government budget to be calculated.

Calculating the reconciliation requires comparing the forecast and outturn figures for the Scottish Government's Income Tax revenues and for the Block Grant Adjustment. The difference between the forecasts and the outturns is applied to the Scottish Government's funding in 2021-22. Further background is set out below, after the calculations.

The two reconciliation components will have the following effects, as summarised in the table below[3]:

- Block Grant Adjustment: The outturn is lower than was forecast at the time of the 2018-19 Scottish Budget so this will reduce the Block Grant Adjustment (and by implication increase the Scottish Government's block grant) by £312m in 2021-22.
- Scottish Income Tax: The outturn is lower than was forecast at the time of the 2018-19 Scottish Budget so this will reduce Scottish Government self-funding by £621m in 2021-22.

The net reconciliation effect is a £309m reduction in the Scottish Government's funding for 2021-22.

[1] https://digitalpublications.parliament.scot/Committees/Report/FCC/2019/11/12/Pre-budget-scrutiny-2020-21#

[2] https://www.gov.uk/government/statistics/scottish-income-tax-outturn-statistics-2018-to-2019

[3] The difference between forecast and outturn figures for 2018-19 revenue and BGAs for income tax is in part related to the fact that, at the time of the 2018-19 Scottish Budget, they were informed by a forecast 2016-17 baseline. Ultimately, income tax outturn data for 2016-17 (and therefore the baseline) was £495 million lower than the 2016-17 forecast used at the 2018-19 Scottish Budget.

Final Reconciliation for 2018-19 Income Tax which will impact the 2021-22 Budget

2018-19 Income Tax	Revenues	BGA	Net Budget Position
Forecasts as of Scottish Government Budget 2018-19	12,177	11,749	+428
Outturn	11,556	11,437	+119
Change/reconciliation	-621	+312	-309

Background

The Scotland Act 2016 devolved additional tax powers to the Scottish Government. In April 2017, the Scottish Government gained the power to set the rates and bands for non-savings and non-dividends (NSND) Income Tax in Scotland however HMRC is still responsible for the collection of Scottish Income Tax.

The Scottish Government is partly funded by the UK government block grant, and partly self-funded through raising revenue from devolved taxes and borrowing. The block grant is determined by the longstanding Barnett Formula.

The block grant is now adjusted to reflect the impact of the transfer of greater fiscal powers to the Scottish Government. These Block Grant Adjustments (BGAs) are deductions for tax powers and additions for social security benefits. Alongside this, the Scottish Government retains all revenues from devolved taxes and has capital and resource borrowing powers with agreed limits.

Initially, the Scottish Government's Income Tax revenues are forecast by the Scottish Fiscal Commission and the Income Tax block grant deduction is based on Office for Budget Responsibility Income Tax forecasts for the rest of the UK. Once the forecast revenue is determined and the corresponding BGA is made, there are no changes in the Scottish Government's funding until outturn data is available.

As set out in the Scottish Government's fiscal framework, Income Tax outturn published in HMRC's Annual Report and Accounts, which is normally published around 16 months after the end of the financial year[4], will then be used to determine the Scottish Government's funding for the following financial year through a reconciliation process.

Under this process, a reconciliation for 2018-19 Income Tax will be applied to the 2021-22 Scottish Budget. The reconciliation covers both Income Tax revenues and the block grant adjustment.

[4] This was delayed this year due to the impact of COVID.

Annex A - Finance Committee Pre-budget scrutiny report 2020-21 Recommendations

The Committee recommends that HM Treasury and the Scottish Government work together to agree an approach to the reconciliation process which is transparent and which will increase public understanding of the Fiscal Framework. The Committee recommends that consideration should be given to the following:

- A document jointly agreed by HM Treasury and the Scottish Government should be published annually setting out the Income Tax reconciliation process including a detailed explanation of the reconciliation figure;
- This document should be published and sent to the Committee in early June and provide a provisional reconciliation figure based on the most recent set of OBR and SFC forecasts so as to allow Scottish Parliament scrutiny prior to our summer recess;
- Any adjustments to the final reconciliation figure following HMRC's publication of the audited outturn figures can be provided in writing to the Committee.

Note

In relation to the second of these points, the Scottish Government's response to the Pre-Budget scrutiny report highlighted that the forecast income tax reconciliation is set out clearly in the annual Medium Term Financial Strategy in May, and is then confirmed in July on the basis of published outturn figures. On that basis, the response suggested that the proposed early June timing did not seem appropriate.