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The Role of Income Tax in Scotland's Budget

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Foreword by Cabinet Secretary for Finance and the Constitution

As we prepare to set Scotland's Budget for 2018-19, the time is right for a debate about how we finance our public services and grow our economy.

This Scottish Government has worked hard to protect individuals, public services and the economy from the impacts of austerity. We have supported our public service and protected our distinct social contract. Last year we prioritised investment in public services over giving a tax cut for our highest earners, and in the last few years we have invested hundreds of millions of pounds in mitigating the impacts of welfare reform.

However, we now face a critical challenge. The UK Government's apparent determination to continue with austerity, coupled with the real risk of a hard Brexit, puts our economy and public finances in jeopardy. By 2020, the Scottish budget will have faced a decade of cuts – a £2.9 billion cut in real terms since 2010 – coupled with cuts in the capital budget, and with further cuts expected in the coming years.

This means it is time for the Government, Parliament and Scotland's people to explore alternative approaches and, in particular, consider whether now is the time to use our limited tax powers differently.

Decisions on income tax are, and should be, passionately debated. They are one of the key responsibilities of any Government and Parliament.

The Scottish Government has always been clear that we must make these decisions in a principled and transparent way. A key principle, borne of Adam Smith, is that taxes should be proportionate to the ability to pay. In the present context, that means that we must ensure that those least able to pay are not shouldering the burden of austerity.

Another cornerstone of the Scottish approach to taxation is engagement with our people, communities and businesses. Taxes do not just support public services, they also allow the Government to support business and encourage growth through economic development, skills investment and major infrastructure. So everyone is a stakeholder. That is why we want to encourage debate, not just in Parliament but also in businesses and communities across Scotland.

Another key principle is one of certainty. With Brexit continuing to undermine confidence in the economy, we recognise the importance for people and businesses in Scotland of certainty over income tax and hope this debate can take a longer term approach.

We must also acknowledge our position as a minority Government. If all parties stick rigidly to manifesto positions it will not be possible to pass a budget. This means we must work together across Parliament to pursue consensus in the national interest.

The Government enters this debate with an open mind and with Scotland's people and our economy foremost in our considerations. I hope this paper will inform an open discussion on the direction of income tax in Scotland, and ensure that the decisions that Parliament makes enhance Scotland's reputation as an attractive place in which to grow up, live, work and do business.



Derek Mackay MSP

Cabinet Secretary for Finance and the Constitution

1 Introduction

Every country in the world faces a debate about the level of public service provision and how public services are funded. The discussion over the appropriate balance between funding public services through taxation as part of a social contract and leaving individuals to make their own spending decisions is centuries old and will no doubt continue.

In the present context of austerity imposed by the UK Government, the uncertainty and economic impact of Brexit and the legitimate expectation from the public of high quality service provision, we believe there are four key tests that any income tax decision must meet.

- Income tax policy should help maintain and promote the level of public services which people in Scotland expect
- The lowest earning taxpayers should not see their taxes increase
- Any tax changes should make the tax system more progressive and reduce inequality
- The changes we make along with our decisions on spending should support the economy.

We must also keep in mind Adam Smith's principles which underpin the Scottish approach to taxation:

Certainty: Certainty is important for households and businesses alike to ensure that financial decisions can be taken from an informed position on the path of future tax policy.

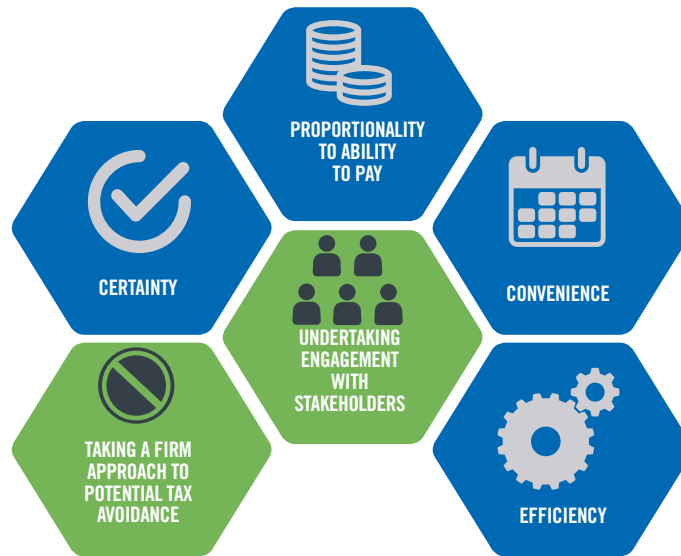
Convenience: The vast majority of income taxpayers pay their tax through Pay As You Earn (PAYE), which means there is little or no administrative impact on taxpayers. Decisions made in setting Scottish income tax rates and bands should not needlessly impact on the convenience of the current system.

Efficiency: The collection of Scottish income tax is administered by Her Majesty's Revenue and Customs (HMRC), but the cost of any collection activity that is 'wholly and exclusively' a consequence of Scottish tax policy falls on the Scottish Government. It is important therefore that policy is designed efficiently to minimise the cost of implementation.

Proportionality: Proportionality to the ability to pay (often referred to as progressivity) in taxation is vital. Everyone benefits from public services and all those who can contribute are expected to do so, but those with the broadest shoulders should bear the greatest burden. In considering this principle we also recognise that inequality damages not only the lives of the poorest in our society but also our economy.

As well as Adam Smith's founding principles, the Scottish Government's approach to tax is based on a **firm approach to tax avoidance**, although in the case of income tax avoidance our powers are more limited as this is the responsibility of the UK Government through HMRC; and a commitment to **engagement with stakeholders**. Transparency is key to effective engagement - it is vital that everyone understands what their money is spent on. As members of the Open Government Partnership (OGP), Scotland has committed to increasing financial transparency and this discussion paper supports our commitment within the 2017 OGP National Action Plan.

The Scottish approach to taxation



1.1 Outline of this paper

This paper aims to provide useful background to help inform the debate on the future use of our income tax powers. Chapters 1 to 3 cover matters such as the extent of our income tax powers, how the Scottish Government's final budget is set, the current make-up of income taxpayers in Scotland, the interaction with reserved areas of policy making and some international comparisons.

Chapter 4 explains what our taxes pay for and the choices available to us. We then set out the tests against which the Scottish Government believes any tax change should be judged. There is unlikely to be unanimity on the relative importance of these tests, but we believe that they are important to guide the discussion and our decisions.

Chapter 5 sets out the income tax proposals that the parties represented in the Scottish Parliament had in their 2016 manifestos and provides detailed analysis of these proposals. We also provide some simple tools which can be used to broadly assess the change in revenue arising from income tax proposals not included in this paper.

We then apply our policy tests to the parties' proposals in Chapter 6. Following on from this in Chapter 7 we provide a range of possible alternative income tax approaches. These alternatives do not represent fixed proposals but are included as a starting point for discussion. We also apply the four policy tests to those illustrative approaches to encourage a more open debate on how income tax powers can be used.

The analysis in Chapter 5 of how much parties' policy proposals would raise in revenue and their impact as well as the analysis in Chapter 7 of alternative approaches that could be adopted have been undertaken by the Scottish Government's Office of the Chief Economic Adviser and approved by the Scottish Government's Chief Economist.

Final revenue projections for the Scottish budget will be provided by the Scottish Fiscal Commission.

2 Funding in the Scottish budget

This chapter sets out how spending by the Scottish Parliament is funded following devolution of further tax powers. It also explains the agreement between the UK and Scottish Governments as to how the Scottish Government's overall budget is set.

2.1 How is Scotland's funding changing?

Until recently, Scottish Government revenue came almost exclusively via a Block Grant from the UK Government i.e. a budget which was set by the UK Government and Parliament based on spending decisions for England and Wales, which the Scottish Parliament could decide how to spend. The devolution of some tax powers in the Scotland Act 2016 means that decisions made in Scotland now have greater influence over the size of the Scottish Budget. However even when the full set of tax powers agreed in the Scotland Act 2016 are devolved, the Block Grant set by the UK Government will still make up around 50% of our budget.

WHERE THE SCOTTISH GOVERNMENT BUDGET COMES FROM

-  AIR PASSENGER DUTY
-  SCOTTISH RATE OF INCOME TAX / INCOME TAX
-  SCOTTISH LANDFILL TAX
-  LAND AND BUILDINGS TRANSACTION TAX
-  NON DOMESTIC RATES
-  VAT
-  BLOCK GRANT

TABLE PROVIDES ILLUSTRATIVE SHARE OF BUDGET IN YEARS BASED ON ESTIMATES FROM 2017-18 FIGURES. ACTUAL PERCENTAGES IN GIVEN YEARS WILL VARY.

IN ADDITION LOCAL AUTHORITIES SET AND RAISE COUNCIL TAX TO FUND LOCAL SERVICES, BUT THIS IS OUTWITH THE SCOTTISH BUDGET.



SCOTLAND ACT 1998

SCOTLAND ACT 2012

SCOTLAND ACT 2016

ESTIMATES ONCE ALL FISCAL POWERS HAVE BEEN DEVOLVED BY 2019-20

In the next financial year from April 2018 to March 2019:

- around 30% of our budget will come from income tax receipts in Scotland
- around 7% will come from other taxes set by the Scottish Parliament including Non-Domestic Rates, Scottish Landfill Tax, Air Departure Tax, Land and Buildings Transactions Tax and Aggregates Levy.

When the Scotland Act 2016 powers are fully devolved, a further 15% of our budget will be based on VAT revenues raised in Scotland, although the rate of VAT will continue to be set by the UK Government.

As a result, less than 40% of our spending power can be directly impacted by tax decisions made by the Scottish Government and Parliament, with income tax being by far the biggest of these. To give an example of what this limitation means in practice, increasing income tax receipts by 5% would raise around an additional £590 million per year, which is just 1.5% of our total budget.

2.2 The Fiscal Framework and the Scottish Government's budget

With the devolution of new tax powers in 2016, the UK and Scottish Governments agreed a "fiscal framework"¹ that sets the rules for determining the total Scottish Budget. Two of the key principles of that framework are that: i) the Scottish Government's Budget should benefit in full from policy decisions made by the Scottish Government that increase revenues or reduce expenditure and ii) there should be no detriment to either the Scottish Government or the UK Government budgets as a result of the decision to devolve powers and responsibilities.

To implement that agreement the UK Government will:

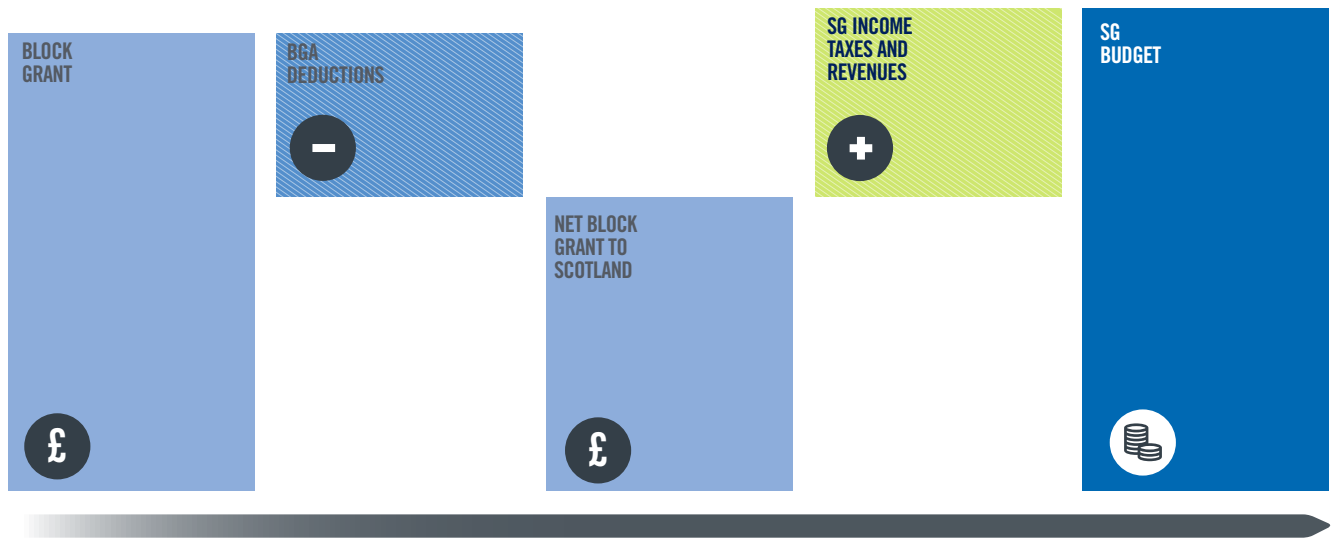
- continue to calculate the total Block Grant for the Scottish Government based on the Barnett formula (the formula that calculates how much Scotland should receive relative to UK Government spend in England)
- reduce that grant by an amount equivalent to how much tax per head was raised in Scotland under UK Government policy in the year prior to devolution (this is known as the Block Grant Adjustment (BGA)). Over time, this adjustment is increased in line with the growth in tax revenues per head raised from equivalent taxes in the rest of the UK.²

With new tax powers, how Scotland's economy performs and the Scottish Parliament's decisions on tax rates are fundamental in determining tax revenues and whether the Scottish budget is larger or smaller than it would have been without new powers. This approach applies to all recently devolved tax powers, including income tax.

1 *The Agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's fiscal framework*, February 2016.

2 It is effectively indexed by growth in corresponding per capita revenues in the rest of the UK.

THE INCOME TAX BLOCK GRANT ADJUSTMENT (BGA)



For the Scottish Government and Parliament to agree the Budget Bill each year, there needs to be an agreed overall financial envelope to work within. This depends on the Block Grant received from the UK Government, the forecasts for the BGA produced by the Office for Budget Responsibility (OBR), and the forecasts of tax revenues raised in Scotland produced by the Scottish Fiscal Commission (SFC). Put simply, whether the Scottish budget is higher or lower under the new tax powers will come down to the relative performance of tax receipts in Scotland and the UK, which will be heavily influenced by changes in tax policy.

It is inevitable that the forecasts will not exactly match the amounts actually raised in Scotland or the rest of the UK. As a result, when tax returns are finalised they will be compared with the original forecasts. In the case of income tax, the outturn data will become available 15 months after the end of the tax year and the next Scottish Government Budget will be adjusted accordingly.

2.3 The UK Budget in November

The interaction between decisions at UK level and Scottish decisions about tax is central to calculating the impact of the devolved taxes on Scotland's budget. It is important to note that the partial devolution of income tax and the indexation of the BGA mean, in effect, that whenever there is a change in the devolved tax in the rest of the UK, there is always an implication for Scotland, whether revenue is positive or negative.

The analysis in this paper assumes that in the UK Autumn Budget on 22 November 2017 the Chancellor will:

- raise the Higher Rate Threshold (HRT) (which applies in the rest of the UK) for income tax in line with the Conservative Party's manifesto commitment to £50,000 by 2020
- raise the Personal Allowance (PA) to £12,500 by 2020 in line with the Conservative Party's manifesto commitment.

3 Scale and scope of Scottish income tax powers

This chapter sets out the extent of the Scottish Parliament's income tax powers, the relevant tax base (i.e. where tax can be raised from) and the interactions with powers held by the UK Government and Westminster Parliament. It also provides comparative information on the tax systems of other countries.

3.1 The scope of income tax powers and their interactions with reserved matters

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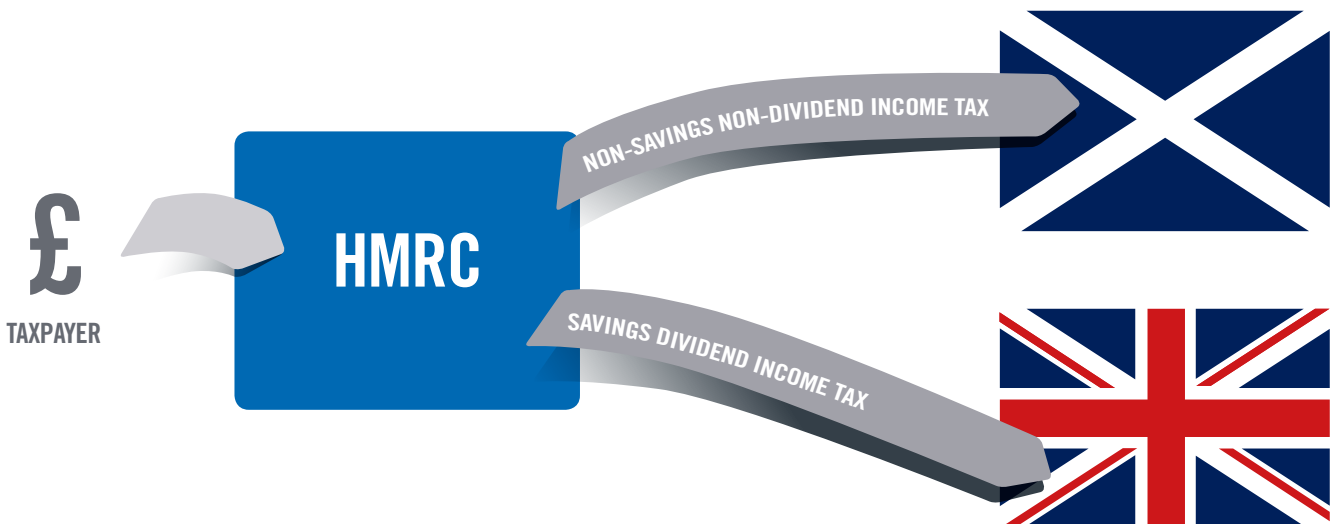
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Scottish income tax cannot be considered in isolation because the powers are only partly devolved. The tax is intricately interwoven with UK taxes, and the Scottish Parliament has only a limited number of pieces of the jigsaw.³

The Scottish Parliament does not have a full set of policy options available when it comes to taxation. Given the current fiscal settlement, there are a number of interactions with reserved systems that affect tax policy options in Scotland.

Non-Savings, Non-Dividend Income Tax

The Scottish Parliament has the power to set rates and bands for non-savings, non-dividend income tax only. This is largely earned income (e.g. from employment and pensions) and so for any income people get from savings or dividends the rates are still set by the UK Government and that money goes to HM Treasury and forms part of the UK budget.³



³ This money is then partly re-distributed to Scotland via the Barnett formula.

As a result, there are flexibilities that the UK Government can exercise over income tax that are not available to the Scottish Parliament. For example, the Scottish Parliament cannot use income tax to incentivise savings or equity investments in new companies. Any changes could also raise the risk of tax avoidance if people were able to switch income from salary to dividends or vice versa. This would both reduce the amount of tax paid overall and also mean payments are made to the UK Government as opposed to the Scottish Government.

Allowances and reliefs

The PA is the amount that taxpayers are able to earn before they pay income tax. It is determined by the UK Government. The Scottish Government can set a zero rate of tax, but unlike for the PA, we cannot easily remove the benefit of this policy from the very highest earners.⁴

The power to create new tax allowances and reliefs remains reserved. Again, this limits the fiscal levers available to the Scottish Parliament. So, for example, the Scottish Parliament could not provide further income tax relief for individuals who wish to invest in enterprise (such as via HM Treasury's Enterprise Investment Scheme) and the Scottish Government bears the risk of any lost revenue from reliefs if they impact on Scottish taxpayers more than in the rest of the UK.

National Insurance and social security

Income tax is inextricably linked with National Insurance and social security.

National Insurance (NI) is a tax payable by employees, employers and the self-employed on earnings and profits. It is entirely reserved to the UK Government. As a result, any changes in Scottish income tax rates and thresholds could lead to unintended anomalies for taxpayers when considered alongside the NI thresholds set by the UK Government. For example, the threshold for the 2% rate of NICs has historically tracked the HRT of income tax, but since 2017-18 the HRT in Scotland has differed from the rest of the UK. This means that some Higher Rate taxpayers in Scotland continue to pay the Higher Rate of NI. The way to avoid this impact would be for the Scottish Government to also have control over NI rates.

There are also interactions between income tax and reserved social security powers. In particular, under UK tax legislation, income from certain social security payments, including the State Pension, is liable to income tax. An increase in income tax, therefore, could result in a decrease in net income for some social security recipients. And in other cases, such as Universal Credit, entitlement is determined by net (i.e. after-tax) income. As a result, in making income tax decisions, the Scottish Government and Parliament must be mindful of any unintended impacts on the income of people in receipt of those payments, as the Scottish Parliament does not have powers to legislate to mitigate them.

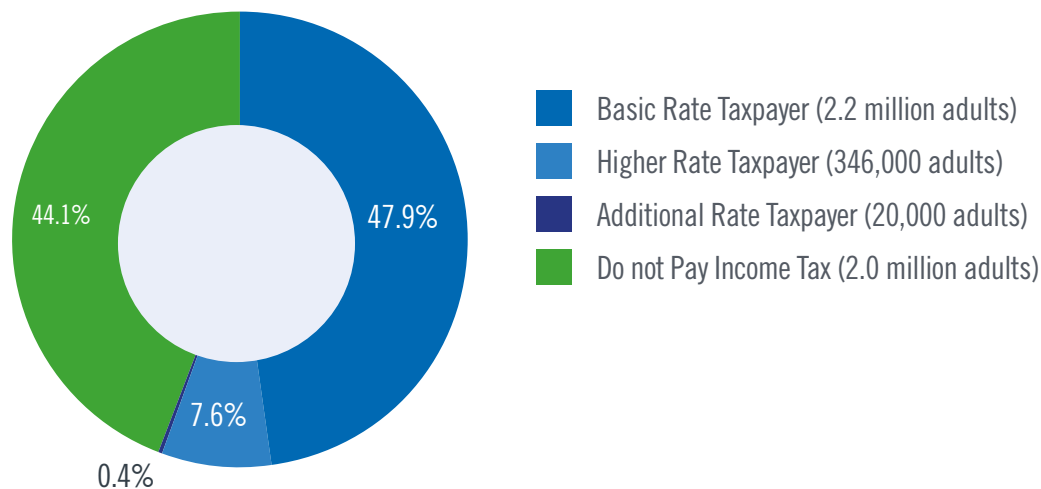
⁴ The tax-free PA tapers off for those with income above £100,000. As soon as earnings exceed £100,000, the UK Government starts to withdraw the tax-free PA by £1 for every £2 of income above the £100,000 limit. This means the allowance is zero if income is £123,000 or above (2017-18 figures).

3.2 The Scottish income tax base

There are projected to be 4.5 million adults in Scotland in 2018-19 and 2.5 million income taxpayers. Around 2 million adults, or 44% of the total number of adults, will not pay income tax as they will earn less than the PA.

As illustrated in Chart 1⁵ the large majority of taxpayers, around 2.2 million individuals, will pay the Basic 20p rate of income tax. Around 346,000 individuals, 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.

CHART 1: NUMBER AND PROPORTION OF ADULTS IN SCOTLAND BY THEIR MARGINAL RATE OF INCOME TAX, 2018-19



Further key facts on Scottish taxpayers are shown in Box A.⁶

⁵ Refers to non-savings, non-dividend income tax

⁶ [Information on UK taxpayers.](#)

Box A: Key Facts on Scottish Taxpayers

The median income of taxpayers in Scotland is expected to be around £24,000 in 2018-19

Looking across all Scottish taxpayers, i.e. those with taxable earnings above the Personal Allowance, and including employees, pensioners and the self-employed, the median income is estimated to reach around £24,000 in 2018-19. This means that half of all taxpayers in Scotland earn below this level. The highest income groups can be set out as follows:

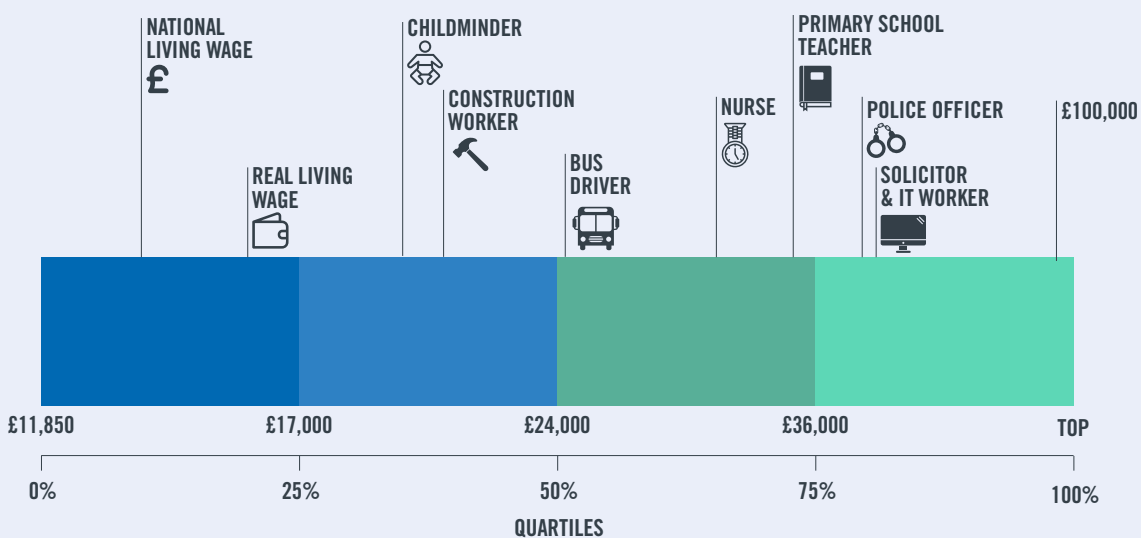
Highest income groups	Starting income
Top 25%	£36,000
Top 10%	£53,000
Top 5%	£70,000
Top 1%	£144,000

By comparison, the lowest income groups can be set out below. For example, 10% of income tax payers in Scotland earn less than £14,000, with 5% earning less than £13,000.

Lowest income groups	Have income less than
Bottom 25%	£17,000
Bottom 10%	£14,000
Bottom 5%	£13,000
Bottom 1%	£12,000

Chart 2 shows the estimated income distribution of Scottish taxpayers for 2018-19, split into quarters. This shows, for example, that someone earning between £11,850 (the expected level of the Personal Allowance next year) and £17,000 would be amongst the lowest earning 25% of taxpayers in Scotland. For illustrative purposes, various salary points are presented along this scale too.

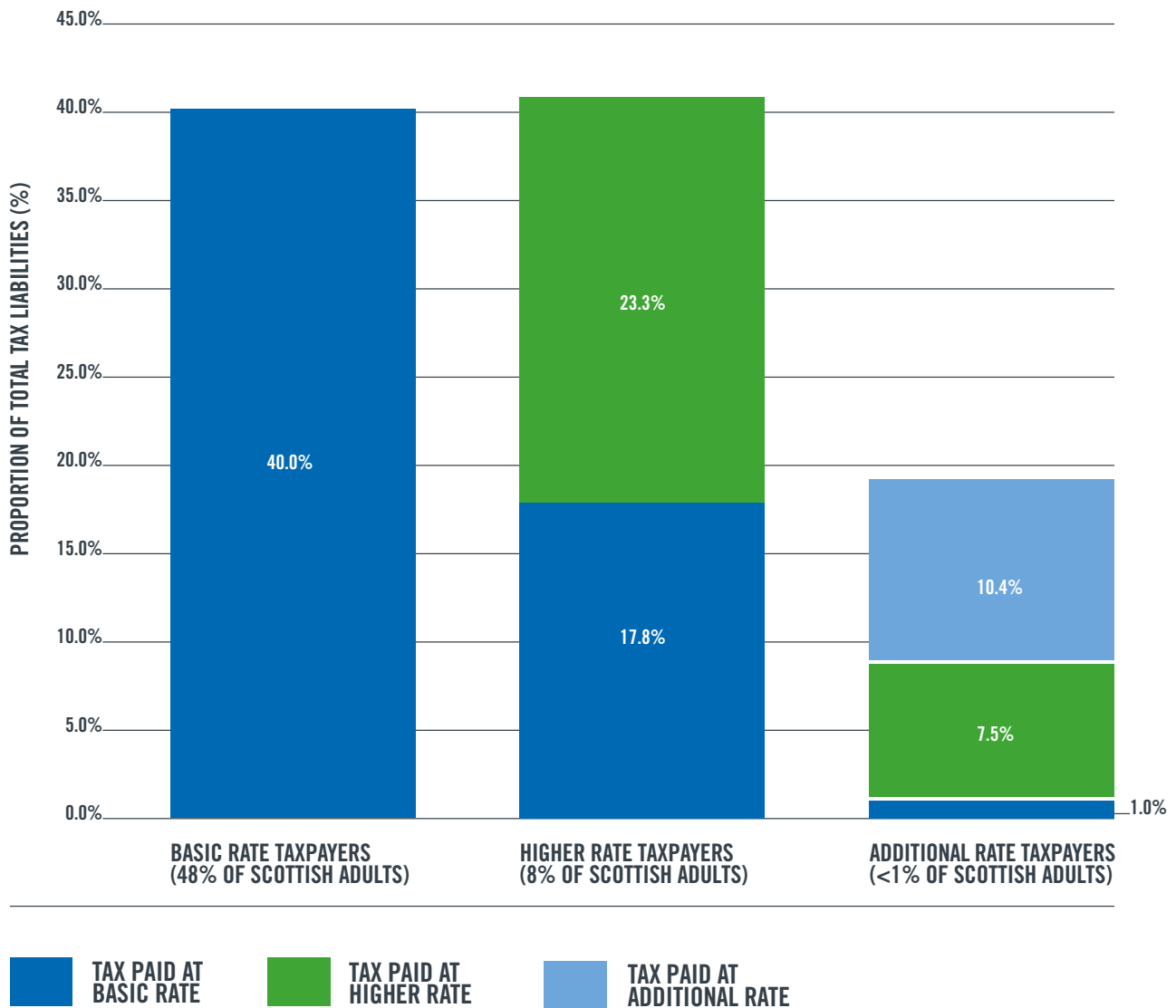
CHART 2: ESTIMATED INCOME DISTRIBUTION OF SCOTTISH TAXPAYERS, 2018-19



Higher and Additional Rate taxpayers account for nearly 60% of all income tax paid

Chart 3 groups Scottish taxpayers according to the highest rate of tax they pay and also shows the proportion of total income tax revenue that each group accounts for. This highlights how, despite making up less than 10% of adults, Higher and Additional Rate taxpayers account for 60% of all income tax paid.

CHART 3: CONTRIBUTION TO INCOME TAX LIABILITIES BY TAXPAYERS AND BAND, 2018-19



3.3 International comparisons

International comparisons of tax systems are undertaken using information compiled by the Organisation for Economic Co-operation and Development (OECD)⁷ (see Box B).

Box B: What do other income tax systems look like?

Countries have made different choices about the number of tax bands, tax rates and the progressivity of their tax systems.

There is significant variation in how countries design their income tax systems. Broadly speaking, the more tax bands a system has the more progressive it is, as tax is more closely linked to ability to pay. Scotland currently has three bands. The majority of OECD countries have more tax bands. For example, New Zealand and the Netherlands have four, Belgium and Norway have five and Japan and the US have seven bands.

However, the number of bands is not a definitive measure of the relative progressivity of a tax system. For example, Denmark and Sweden have only two bands at the central government level, but are still seen as broadly progressive. This is partly because Denmark and Sweden apply their top marginal rates (55.8% and 60.1% respectively) including local taxation on a relatively large proportion of higher earners.

A few countries have flat rate systems where everyone pays the same tax rate - this is not progressive (although the overall system could be progressive depending on how spending is targeted).

When considering income tax as a proportion of Gross Domestic Product (GDP), the corresponding level of public spending is also important.

Tax is only one side of the equation, as taxpayers also benefit from public services. Generally, lower tax countries, such as the US, also have lower public spending as a proportion of GDP and vice versa for higher tax countries. Therefore, people with the same level of income but facing different tax rates may still achieve the same quality of life if the higher tax country uses these extra tax revenues to fund public services rather than expecting the individual to meet their own costs. In this context it is important to note that Scotland has a much greater level of universal provision of services than the UK as a whole.

Scotland's overall tax as a proportion of GDP is below the OECD average.

If we look at tax as a proportion of GDP⁸ across 31 OECD countries in 2014, OECD figures show that the overall tax take in Scotland as a proportion of GDP (including oil and gas) is below the OECD average. Looking at income tax as a proportion of GDP, Scotland's figure (7.2%) is lower than the UK's (8.6%), partly due to the concentration of high income earners in London and the South East of England.⁹

⁷ OECD's *Taxing Wages*. Note that the latest available data used in this analysis are for 2014 and that the OECD average is unweighted. Government Expenditure and Revenue Scotland (GERS) figures are used to calculate Scotland's proportions.

⁸ Includes income tax, social security contributions, such as National Insurance in the UK, and all other taxes, such as Corporation Tax or VAT.

⁹ The overall tax on labour income is important as some countries may have low share of income tax but a higher share of other labour taxes.

4 Tax and spending policy choices

This chapter highlights what our taxes pay for and the choices that our Parliament faces in agreeing a budget. In doing so, it sets out the benefits of government spending for the economy as a whole, for public services and for individuals.

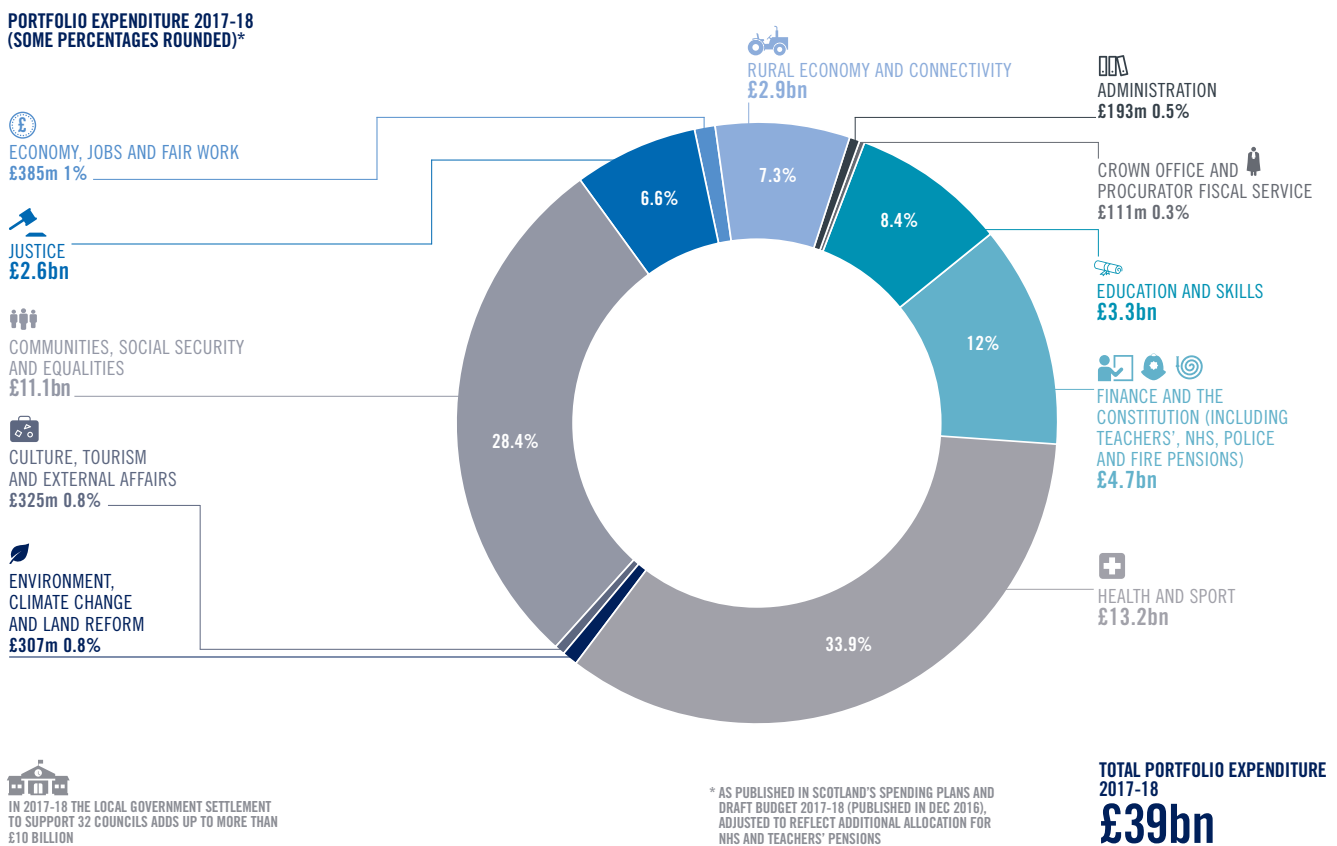
In discussing income tax policy we also have to consider the policy tests against which any changes should be assessed. This chapter therefore sets out the policy tests which the Scottish Government believes should be applied before any decision is made to change income tax.

4.1 What do taxes pay for?

The international comparisons in the previous chapter highlight that we cannot consider income tax policy in isolation from public spending choices.

The Scottish Government’s tax and spending decisions support our pledge to build a more sustainable economy, protect the quality of our public services and promote an inclusive vision for Scotland’s communities. Our spending plans for 2017-18 are shown in Chart 4. It is important to note that spending on, for example, health and education also supports our economy through improving the health, education and skills of the workforce.

CHART 4: SCOTTISH GOVERNMENT PORTFOLIO EXPENDITURE, 2017-18



With the Scottish budget facing unprecedented cuts and demand for public services continuing to rise, some of the alternatives to changing tax policy would be:

- to reduce or charge for some universal services
- to reduce mitigation of UK welfare reforms
- to reduce the provision of public services.

It is our view that it is in the context of these alternative options, which the Scottish Government does not favour, that a discussion about changes to income tax is essential.

Support for the economy, public services and individuals

In key areas this Government has chosen to invest more than elsewhere in the UK to secure better results. For example in the following areas:

Economic development: Public sector spending per person on economic development in Scotland is nearly double the level than that of the rest of the UK. This has allowed us to secure more Foreign Direct Investment in the last 5 years than any other part of the UK outside London and to reduce the productivity gap between Scotland and the UK.

Transport and Housing: Infrastructure investment is key to economic development. We have invested over £7.7 billion in rail since 2007 – spending twice as much on rail per person than in England. We have also delivered major road projects, such as the M8 improvements and the new Queensferry Crossing. This infrastructure investment supports Scotland's economy. For example, the Borders region has seen a 27% rise in hotel and bed and breakfast stays and an 8% rise in tourism-related employment since the Borders railway opened. In addition, since 2007 we have built more homes per head of population than England and Wales - delivering 48,000 more homes than would have been delivered had we matched England's lower per capita rate.

Health: Health spending will increase by £2 billion by the end of this parliament to support rising demand as our population ages. We are increasing the share of the frontline NHS budget dedicated to mental health and to primary, community and social care. Health spending per person in Scotland is 7.2% higher than in England. That means health spending in Scotland is £800 million higher than it would be at England's per head spending levels.

The Scottish Government has chosen to mitigate UK Government's cuts to social security spending in order to limit the number of people being pushed into poverty. For example:

- Since 2013-14 we have invested over £350 million to mitigate UK Government welfare reforms and to support low income families. This has included full mitigation of the Bedroom Tax
- We have helped 241,000 individual households - a third of which include children - through the Scottish Welfare Fund
- We have also invested over £1 billion in the Council Tax Reduction Scheme since 2013-14, assisting almost half a million households each year to meet their Council Tax and preventing people from falling into debt and rent arrears.

The Social Contract

The spending choices that the Scottish Government has made over the last ten years have also helped to deliver a social contract that underpins our society and economy. The social contract ensures that all those who pay into our public finances have the opportunity to benefit from their contribution. The social contract reduces costs for individuals by providing for services collectively.

In considering proposals to change income tax, it is appropriate to consider the value of the social contract against any change in tax policy and the impact that might have on individuals.

With our current income tax policy, we opted to freeze the HRT last year rather than following the UK Government in giving a £400 tax cut to the highest earning 10% of Scottish adults, as was done in the rest of the UK. The income forgone by Higher Rate taxpayers equates to £7.70 per week. This money contributes to Scotland's social contract.

The services provided under the social contract and their value to individuals and households are set out in Box C.

Box C: Value of Scotland's Social Contract

Tuition Fees: The abolition of tuition fees saves undergraduate students living in Scotland up to £27,000 as compared with the cost of studying in England. As a result, Scottish domiciled students graduate with less debt and are able to begin their working lives in a stronger position.

Care for older people: Around 77,000 older people benefit from free personal care in Scotland saving self-funders in residential care, or their families, £8,892 per year.

Childcare: Our current entitlement of 600 hours free childcare for all three and four year olds saves families up to a total of £2,500 per child per year, and our expansion to 1,140 hours over the course of this Parliament will save families over £4,500 per child per year.

School meals for all Primary 1 to 3 children: The provision of a nutritious school meal saves families around £380 per child per year and supports learning and development by ensuring young people are not hungry or stigmatised in school.

Prescription charges: Scottish patients who need a prescription save £8.60 per item as compared to England. This saves those with long term medical conditions hundreds of pounds a year and reduces administration costs when compared to providing free prescriptions only to those with specific conditions.

NHS eye exams: Patients are entitled to a primary eye examination every two years, or annually for some groups.¹⁰ Nearly 2.1 million eye examinations took place in 2016-17 at an average cost of £36 per test.

Concessionary travel for older and disabled persons: Around 1.3 million cardholders benefit by an average of around £250 each year.

¹⁰ Under 16s, those aged 60 and over, those with certain eye conditions, or those who fall into certain specific categories (e.g. patients aged 40 or over with a close family history of glaucoma).

In the course of this Parliament we are also committed to expanding free personal care to include care for those under 65 who need it, including ensuring that those diagnosed with a terminal illness receive the personal care they require. We are also consulting on the extension of concessionary travel to modern apprentices and are committed to increasing the provision of nursery education by doubling the number of hours available. We will also extend superfast broadband to 100% of business and residential premises and increase investment in business research and development. We will further support business by establishing a new National Manufacturing Institute and a Scottish Investment Bank. And we are determined to ensure fair and affordable pay rises for our public sector workers.

This Government believes that our investment in the economy, public services and the social contract – which goes significantly beyond what is provided in other parts of the UK – delivers benefits for all taxpayers and makes a significant contribution to making Scotland the best place in which to live, work, study and invest. The value of Scotland's social contract, and our investment in public services and support for the economy outweighs that of the any possible tax changes set out in Chapter 7.

4.2 Our Policy Tests

If, in order to protect and support our economy and our public services, we choose to change tax rates or bands, it is important to consider the policy tests against which the Scottish Government believes any tax change should be judged. There is unlikely to be unanimity on the relative importance of these tests but they are an important guide to our discussions and decisions.

We do not underestimate the impact that changes to taxation can have on individuals, public services and the economy and will always take decisions in a careful, considered and responsible way. Any changes to income tax, therefore, need to be rigorously assessed to ensure that they are informed and evidence based.

In light of current economic conditions, and the pressure that the UK Government's austerity programme places on Scottish public services, the Scottish Government believes that any income tax change in 2018-19 must be assessed against the following four tests. Tax changes must:

- **Mitigate UK Government spending cuts and maintain and promote the level of public services:** Income tax policy should help maintain the provision of, and promote the level of, public services which people in Scotland expect
- **Make the tax system more progressive:** Any tax changes should make the tax system more progressive and reduce inequality
- **Protect lower earners:** The lowest earning taxpayers should not see their taxes increase
- **Support economic growth:** Income tax changes, and the accompanying change in public spending, should support the economy.

Revenue Test

Recent analysis from the Fraser of Allander Institute¹¹ shows that the Scottish budget has faced unprecedented cuts over recent years. In real terms, the Scottish budget will be cut by £2.9 billion over the decade to 2020. These cuts have put significant pressure on Scotland's public services and have constrained the Scottish Government's ability to invest in our infrastructure and public services.

11 Fraser of Allander Institute. *Scotland's Budget 2017*. September 2017

We believe that any income tax changes in 2018-19 should raise additional revenue, over and above the current policy, to help protect public services in Scotland and support the social contract.

Progressivity Test

A progressive tax regime taxes people according to their ability to pay, with higher earners paying proportionately more in tax than those on lower incomes. The income tax system in Scotland is already progressive. For example, based on continuing rates and bands, someone earning £24,000 would pay £2,430 in income tax in 2018-19 (10% of their gross income), whilst someone earning £90,000 would pay around £24,800 in 2018-19 (28% of their gross income).

We are able to measure the progressivity of income tax policies and their impact on inequality by reporting the change in the Gini co-efficient, an internationally recognised measure of how equally income is distributed across the population. A reduction in the Gini co-efficient would reduce income inequality and would therefore mean that the income tax policy is more progressive.¹²

We believe that any changes to the income tax system should increase the progressivity of the tax system and reduce income inequality.

Protecting Lower Earners Test

Many families have already seen their incomes squeezed over recent years as a result of the UK Government's reforms to the social security and tax credit system. Rising inflation is also now putting pressure on living standards.

In 2017-18, the Scottish Government took the decision to protect lower paid income taxpayers, whilst asking those highest earners to forgo the tax cut made by the UK Government, and with the additional revenue support public services.

The median income for all income taxpayers in Scotland is estimated to be approximately £24,000 in 2018-19. This means that half of all taxpayers in Scotland earn below this level.

We believe that at a time when living costs are also rising, taxpayers in lower income brackets should not pay more tax.

Economic Growth Test

A recent report from the IMF suggests that there is no strong evidence that increasing the progressivity of the tax system will reduce economic growth.¹³ The economic implications of a change in income tax, and an accompanying change in public spending, will depend on a number of factors including:

- The scale of the tax change
- The response of individuals and businesses to the change
- Where the change in public spending is directed.

12 The Gini co-efficient is a measure of how equally income is distributed across the population. It takes a value between 0 and 100 where 0 represents perfect equality. In 2015-16, the Gini co-efficient for Scotland was 34. World Bank figures show these range from around 60 (South Africa) to around 25 (Norway).

13 International Monetary Fund. *Fiscal Monitor: Tackling Inequality*. October 2017. See section on Progressive Income Tax (pages 10 or 13).

In the short term, an increase in income tax can affect the economy through two channels as summarised below. A reduction in income tax would have the opposite effect.

- An increase in income tax could reduce consumer spending and/or lower households' savings. This would have the effect of lowering consumption. Tax rises which impact on lower income households are more likely to reduce consumption in the short term, as such households generally spend a larger proportion of their income, rather than save it
- The corresponding increase in Government spending provided by a tax rise can support employment, higher wages and economic activity in the economy and can therefore counteract any fall in consumer spending.

In the longer term, the implications of a tax change will depend on the response of individuals and businesses and the extent to which the corresponding change in Government spending impacts on the economy. The impact of a tax rise is discussed below. A tax cut would have broadly the opposite effect.

- If the additional spending is used to boost the country's long term productivity, for example by investing in education or infrastructure, or increasing public sector pay, this could increase growth in the long term, benefitting the economy and boosting revenues in the future
- If, on the other hand, businesses believe that these improvements are not sufficient to offset the direct increase in costs the tax changes impose on them, they may reduce investment in Scotland
- For individuals, tax rises may change their perceptions and their behaviours, including the amount of hours they are willing to work. Tax can also be a factor individuals consider when deciding where to live and work, alongside other factors including public service provision, access to universal services and the cost of housing.

While this test can only fully be assessed once both taxation and spending decisions have been made at the completion of the budget process, it is important to consider the scale and the response in terms of changing perceptions and behaviours in order to assess the potential economic impact of any proposed changes. **We believe that changes in income tax policy, and the accompanying change in public spending, must support the economy.**

5 Income tax proposals in the 2016 manifestos of parties in the Scottish Parliament

This chapter is split into two parts. The first part provides a range of tools to estimate the revenue implications of various changes to the income tax system. The second part estimates the revenue implications of the income tax proposals which were put forward by each political party in the Scottish Parliament in the 2016 election.

5.1 Analysing the proposals

Income tax can be changed using a number of different building blocks such as changing existing tax rates, changing the number of tax bands and changing the thresholds at which different tax rates are paid. Box D shows how income tax proposals can be built up in different ways and provides a tool (a ready reckoner) which can be used to estimate what a particular proposal might raise in revenue.

For both the ready reckoner and for the manifesto proposals from each of the parties, the revenue implications are compared against the income tax rates and bands shown in Table 1 - these are the rates and bands that apply in 2018-19 if no changes were made. It is assumed that the PA and the HRT both increased in line with inflation from 2017-18 levels.¹⁴

TABLE 1: RATES AND BANDS ASSUMED IN 2018-19

Gross income	Rates	Estimated number of people in band
£11,850 to £44,290	20%	2,165,000
£44,291 to £150,000	40%	346,000
Above £150,000	45%	20,000

In analysing all the proposals, the same model, data sets and underlying assumptions are used to ensure consistency (further information is in Annex A).

A key part of the analysis is to consider how individual taxpayers might respond to tax changes. Evidence shows that some people do change their behaviour in response to a tax change. For example, they may choose to change the number of hours they work or re-locate. The extent of any behavioural response is uncertain. However, it is vital to consider it in making revenue forecasts - not least because the Scottish Fiscal Commission (SFC) will do so when making the forecasts that we must rely on in our Budget. The analysis therefore applies a range with low and high levels of responsiveness assumed.¹⁵

¹⁴ UK Consumer Price Inflation (CPI) of 3% in September 2017 is used throughout the analysis.

¹⁵ See the *Devolved Taxes Methodology Report* published at the Draft Budget 2017-18.

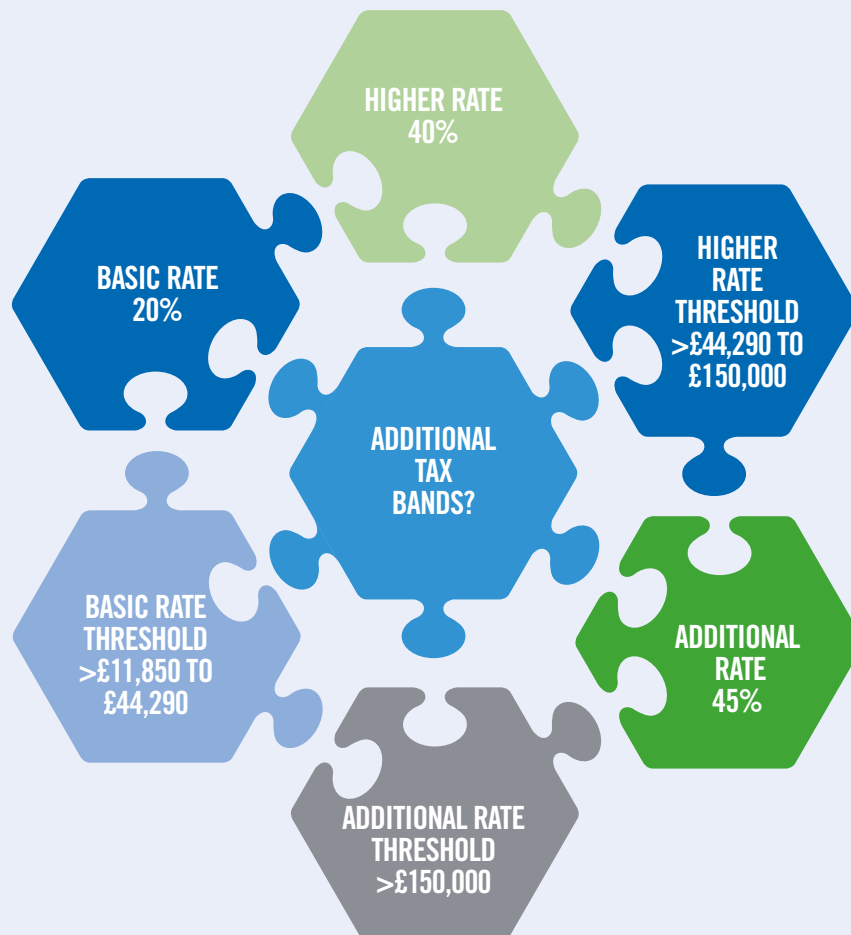
It is important to remember that the responsibility for producing the final income tax forecasts now sits with the SFC and its Commissioners may reach different views about responsiveness to tax changes than the ones included here. The analysis in this chapter has been undertaken by the Scottish Government and informed by advice from the Council of Economic Advisers.¹⁶

BOX D: INCOME TAX POLICY BUILDING BLOCKS

The income tax policy choices available to the Scottish Parliament include:

- the number of tax bands
- the tax rates that apply to these bands
- the thresholds where bands begin and end.

These elements can be combined in various ways as shown below.



Different combinations of these building blocks raise (or reduce) revenue. To give a general idea of how much revenue can be raised over existing policy, ready reckoners can be used. The table shows the additional revenue (or cost) assuming low and high behavioural responses of taxpayers to policies.

¹⁶ The Council of Economic Advisers continue to provide advice to the Scottish Government on analysis of revenue risks and possible mitigating actions associated with differential additional rates of income tax between Scotland and the rest of the UK.

Income Tax Option in 2018-19	Additional Revenue (+) or Cost (-) of Policy, in £ million		
	No behavioural response	Low behavioural response	High behavioural response
Income Tax Rates			
Only change Basic Rate by 1p	370	360	–
Only change Higher Rate by 1p	100	80	–
Only change Additional Rate by 1p	30	12	-2
Only change Additional Rate by 5p	150	53	-24
Income Tax Thresholds			
Reduce HRT by approx. £1,300	100	90	–
Increase HRT by approx. £2,200 (to UK levels) ¹⁸	-150	-140	–
Reduce ART to £125,000	30	10	–

The revenue implications of any combination of building blocks can be calculated by adding up the impact of each change.¹⁸

For example consider a policy which:

- increases the Higher Rate by 1p (an extra £80 million)
- increases the Additional Rate by 5p (which may raise receipts by £53 million or lower them by £24 million depending on the behavioural response).

Such a policy would generate between £56 million (£80 million minus £24 million) and £133 million (£80 million plus £53 million) in revenues for the Scottish Budget.

¹⁷ It is assumed that the UK HRT of £45,000 rises in line with inflation, as per UK legislation. The decrease in tax revenues, relative to the counterfactual, could be greater if the Chancellor instead decided to increase the HRT by more than inflation.

¹⁸ However, if a rate change is combined with a change in the corresponding income tax threshold, the impact may be higher, or lower, than what is calculated by simply adding up the ready reckoners. This is because there are interactions between rate and threshold changes.

All political parties in the Scottish Parliament have advocated changes to the income tax system and have done so using different approaches.

The Cabinet Secretary for Finance and the Constitution wrote to the leaders of each of the opposition parties in the Scottish Parliament asking them to confirm their current policy in sufficient time to allow it to be considered by the Office of the Chief Economic Adviser for inclusion in this paper.¹⁹ Replies were received from the Scottish Liberal Democrats, Scottish Greens and Scottish Labour. No reply was received from the Scottish Conservatives. The reply from Scottish Labour did not include details of tax rates and bands. The policies for these parties are therefore based on their manifestos for the 2016 Scottish Parliament election. The SNP policy is based on its manifesto for the 2016 Scottish Parliament election. Table 2 summarises the parties' proposals with further details presented in the remainder of this section.

TABLE 2: SUMMARY OF PARTIES' PROPOSALS ON INCOME TAX

Component	Scottish Conservatives	Scottish Greens	Scottish Labour	Scottish Liberal Democrats	SNP
Basic Rate	No change	Lower basic rate by 2p up to £19k and increase by 2p above £19k	Add 1p	Add 1p	No change
Higher Rate	No change	Add 3p	Add 1p	Add 1p	No change
Additional Rate	No change	Add 15p	Add 5p	Add 1p	No change
Tax thresholds	Raise HRT to match rUK	Raise HRT by inflation (assumed)	Freeze HRT in cash terms at 2015-16 levels	Raise HRT by inflation	Raise HRT by a maximum of inflation until 2021-22
Tax bands	Retain 3 bands	Increase to 4 bands by splitting basic rate in two	Retain 3 bands	Retain 3 bands	Retain 3 bands

¹⁹ A letter was issued on 14/09/2017 to each of the four opposition parties represented in Parliament stating that the Scottish Government planned to model their manifesto proposals, and asking them to notify us of any changes. Wherever possible, their responses are reflected in the modelling assumptions.

5.2 Tax rates and bands proposed

This section summarises the tax systems proposed by each party.

The Scottish Conservatives policy is shown in Table 3 and would see no change in income tax rates but changes in the HRT above which people start paying the 40p rate.

The Scottish Conservative manifesto from the May 2016 Scottish Parliament election stated that “*income tax should not be any higher than the rest of the UK in Scotland, and lower when affordable*”.²⁰ It is therefore assumed that the Conservatives would increase the HRT in Scotland to match the rest of the UK. This is assumed to be at £46,450, an inflationary increase from its current level, but will not be confirmed until the UK Budget in November.

TABLE 3: RATES AND BANDS (SCOTTISH CONSERVATIVES)

Gross income	Tax rate	Number of people in band
£11,850 to £46,450	20%	2,209,000
£46,451 to £150,000	40%	302,000
Above £150,000	45%	20,000

In response to the Cabinet Secretary’s letter, the Scottish Greens replied: “*It will clearly be impossible for a coherent tax policy to emerge, or even for annual rate resolutions to pass, if all political parties stick doggedly to 2016 manifesto positions and refuse to explore common ground. However, as a starting point I would remind you of the Scottish Green Party’s proposals.*” In their manifesto from May 2016, the Scottish Greens proposed a four band system.²¹ It has been assumed that the HRT is uprated with inflation in 2018-19, as set out in Table 4.

TABLE 4: RATES AND BANDS (SCOTTISH GREENS)

Gross income	Tax rate	Number of people in band
£11,850 to £19,000	18%	813,000
£19,001 to £44,290	22%	1,352,000
£44,291 to £150,000	43%	346,000
Above £150,000	60%	20,000

20 [The Scottish Conservative manifesto](#)

21 [The Scottish Greens manifesto](#)

The Scottish Labour manifesto from May 2016 states that Labour would “set the basic and higher rates of income tax just one penny higher” and that the HRT will be set at £42,385, the same level as in 2015-16.²² In addition, Labour would implement “a higher 50p rate for the top 1%, who earn over £150,000 a year”.²³ Scottish Labour propose to vary income tax rates across all bands and their proposals are shown in Table 5.

TABLE 5: RATES AND BANDS (SCOTTISH LABOUR)

Gross income	Tax rate	Number of people in band
£11,850 to £42,385	21%	2,122,000
£42,386 to £150,000	41%	389,000
Above £150,000	50%	20,000

In response to the Cabinet Secretary's letter, the Scottish Liberal Democrats set out their position as an increase of 1p on each rate of income tax and stated that they propose to index the HRT with inflation as shown in Table 6.

TABLE 6: RATES AND BANDS (SCOTTISH LIBERAL DEMOCRATS)

Gross income	Tax rate	Number of people in band
£11,850 to £44,290	21%	2,165,000
£44,291 to £150,000	41%	346,000
Above £150,000	46%	20,000

The Scottish National Party proposal is shown in Table 7. The SNP's manifesto from May 2016 committed to increase the HRT by no more than the rate of inflation in 2018-19. Table 7 uses a scenario where the HRT is frozen in cash terms at £43,000 (this shows the maximum revenue that could be raised from this position).

TABLE 7: RATES AND BANDS (SNP)

Gross income	Tax rate	Number of people in band
£11,850 to £43,000	20%	2,136,000
£43,001 to £150,000	40%	375,000
Above £150,000	45%	20,000

²² See page 14 of the *Scottish Labour Manifesto*

²³ *The Scottish Labour Manifesto*

There are estimated to be around 2.5 million income taxpayers in Scotland in 2018-19. Table 8 compares the impact of the parties' proposals on these individuals by comparing the tax they would pay in 2018-19 under the new policy with that under the current tax regime. As set out in section 5.1, the current tax regime assumes that in the absence of any changes, the HRT and PA are uprated in line with inflation.²⁴

TABLE 8: IMPACT ON SCOTTISH TAXPAYERS OF CHANGES TO RATES/THRESHOLDS (RELATIVE TO CURRENT REGIME IN 2018-19)

Proposal	Taxpayers (million)	Percentage of Scottish taxpayers who pay		
		same tax	more tax	less tax
Scottish Conservatives	2.53	86%	-	14%
Scottish Greens	2.53	-	45%	55%
Scottish Labour	2.53	-	100%	-
Scottish Liberal Democrats	2.53	-	100%	-
SNP	2.53	84%	16%	-

Table 8 shows that the Scottish Conservatives proposal would reduce tax for around 366,000 individuals, or 14% of taxpayers. Under the Scottish Greens proposal, 55% of taxpayers, or 1.4 million individuals with incomes up to £26,150, would pay less income tax in 2018-19 than under the current regime. The Scottish Labour and Scottish Liberal Democrat proposals would increase income tax for all taxpayers relative to the current regime. The SNP proposal would raise income tax for 16% of taxpayers.

An alternative calculation would be to compare people's tax liability across years, i.e. between 2017-18 and 2018-19. Although this would take into account any changes in the PA, this is outwith the Scottish Parliament's control and the impact cannot be confirmed until the UK Autumn Budget.²⁵ Moreover, comparing tax paid across years does not take into account the fact that over time tax allowances and thresholds are generally uprated in line with inflation as a matter of course to ensure that their real value is not eroded.

5.3 Revenue implications and impact

This section reports the revenue implications of each proposal along with analysis of the impact on an individual's take-home pay and household income.

Revenue implications

The headline revenue figures take account of behaviour change and are therefore described as 'post-behavioural' estimates. For transparency, Table A1 in Annex A presents the revenue figures with and without behaviour change assumptions and Chart 5 also shows the revenue figures if taxpayer behaviour did not change. Given, however, that some change in taxpayer behaviour is likely, the remainder of the analysis focuses on the post-behavioural revenue figures.

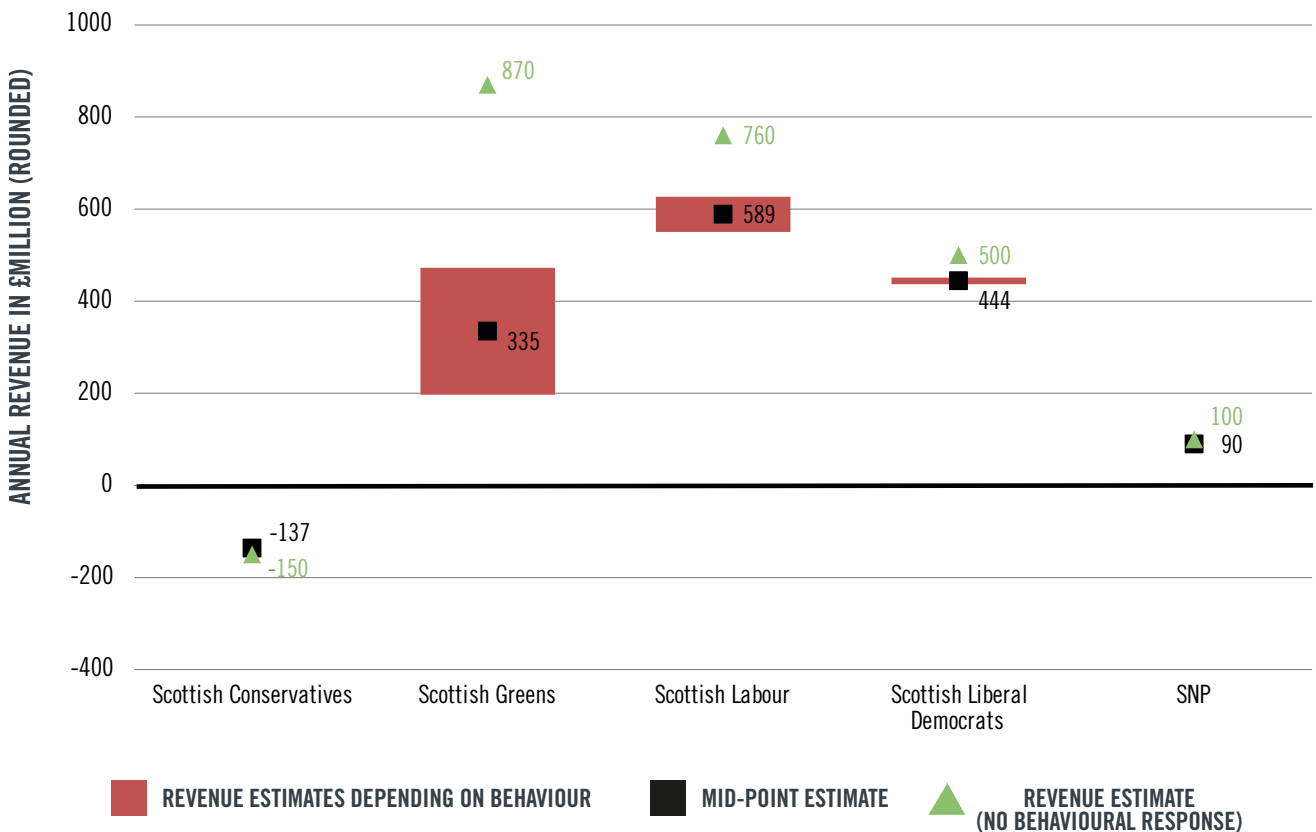
²⁴ The PA is therefore the same in all policy scenarios and the counterfactual (current regime in 2018-19).

²⁵ For example, the UK Government could decide to raise the PA in line with inflation by £350, resulting in a saving of £70 for all Basic Rate taxpayers. This means that, under the Scottish Labour and Liberal Democrat proposals, individuals earning up to £18,800, around 30% of taxpayers, would not pay any more tax in 2018-19 than they did last year. However, it would also mean that a relatively greater proportion of individuals would benefit from the rise in the PA and hence pay less tax under the other parties' proposals.

Chart 5 illustrates the impact on revenues of each party's proposals in 2018-19. All the proposals, with the exception of the Scottish Conservatives, would raise extra revenue for the Scottish budget, albeit to different degrees.

Chart 5 shows the mid-point of the revenue estimates (the range is shown in the bar and represents the low and high behaviour change assumptions). Chart 5 highlights that the revenue raised by the Scottish Greens' proposal is the most uncertain. This reflects the fact that their proposal would represent the largest rise in tax for the highest earners and because this group is the most mobile, individuals in this group are most likely to adjust their behaviour in response to a tax change.

CHART 5: REVENUE IMPLICATIONS OF PARTIES' PROPOSALS (POST-BEHAVIOURAL ESTIMATES)



Impacts on individual taxpayers and households

For each of the proposals, the impact on take-home pay (post-tax income) is calculated. Chart 6 shows the impact on an individual's take-home pay for the 95% of Scottish adults who earn up to £55,000 with a further chart (Chart 7) showing the impact on an individual's take-home pay for those earning above £55,000 (the top 5% of highest earning Scottish adults).

CHART 6: IMPACT ON AN INDIVIDUAL'S TAKE-HOME PAY BY PROPOSAL (FOR INCOMES UP TO £55,000)

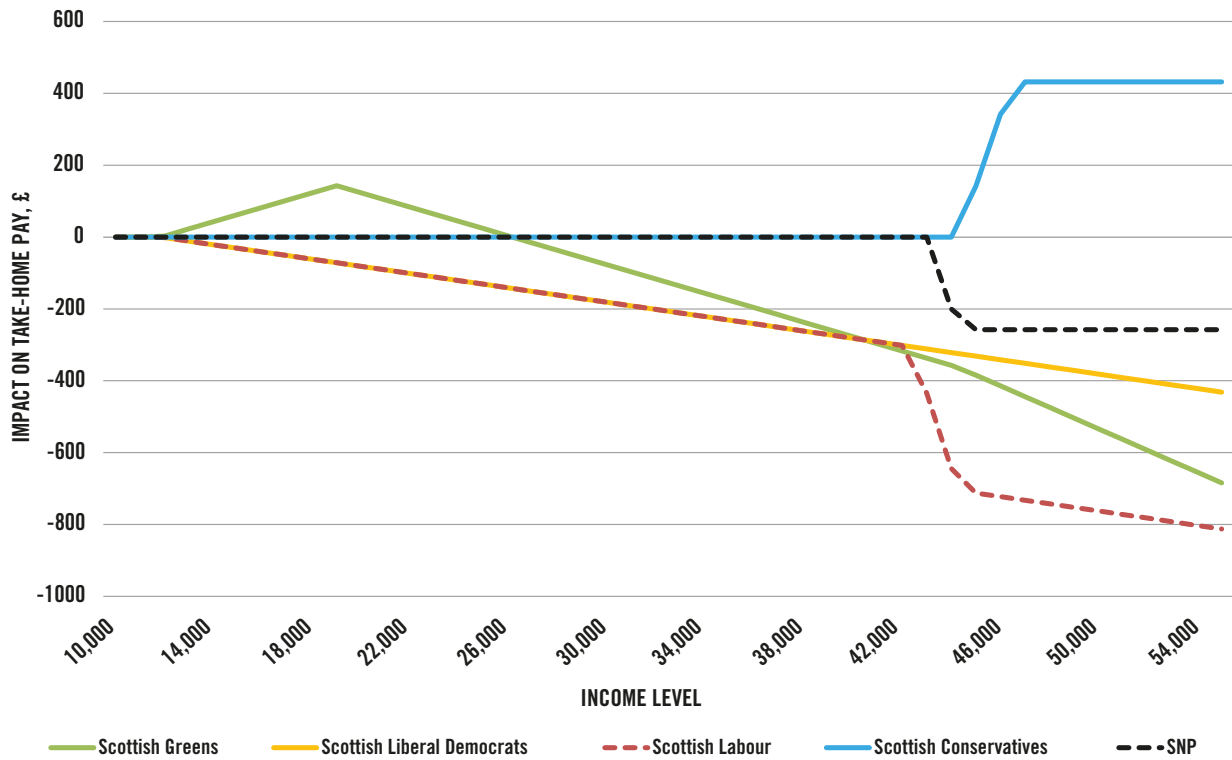
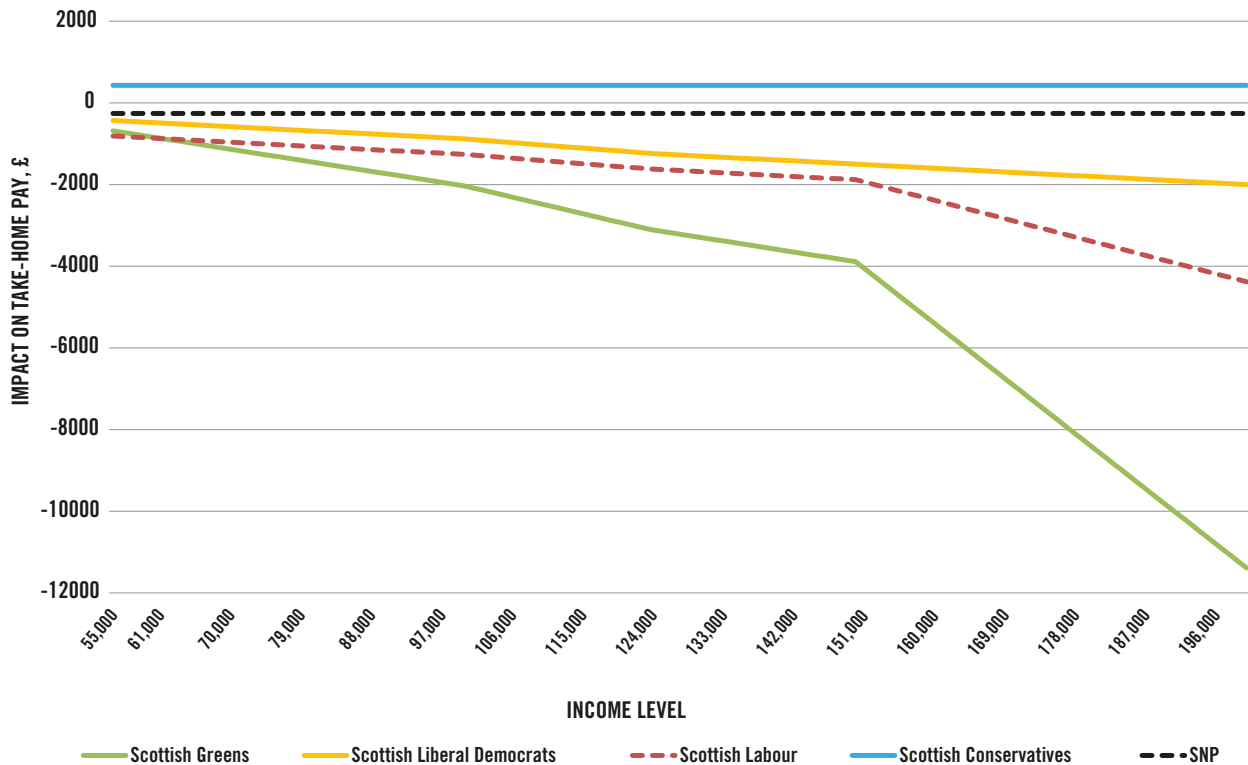


CHART 7: IMPACT ON AN INDIVIDUAL'S TAKE-HOME PAY AS A PROPORTION OF INCOME BY PROPOSAL (FOR INCOMES OVER £55,000)



The impact on the take-home pay of different occupations of each party's proposal are shown in Table 9.

TABLE 9: IMPACT ON ANNUAL TAKE-HOME PAY BY OCCUPATION AND PROPOSAL

Example gross income (annual)	Scottish Conservatives	Scottish Greens	Scottish Labour	Scottish Liberal Democrats	SNP	Occupations (average across profession)
£20,000	£0	+£123	-£82	-£82	£0	Nursing Assistant, Childminder
£25,000	£0	+£23	-£132	-£132	£0	Local Government administrative occupation, Bank and Post Office Clerk
£30,000	£0	-£77	-£182	-£182	£0	Nurse
£35,000	£0	-£177	-£232	-£232	£0	Primary School Teacher, Social Worker, Paramedic
£40,000	£0	-£277	-£282	-£282	£0	Solicitor, Police Officer, Secondary School Teacher, Chartered Accountant
£50,000	+£432	-£534	-£763	-£382	-£258	Head Teacher (primary school), Train Driver, Financial Institution Manager & Director
£60,000	+£432	-£834	-£863	-£482	-£258	Senior Police Officer, MSP
£70,000	+£432	-£1,134	-£963	-£582	-£258	Marketing & Sales Director, Medical Practitioner (GP or Surgeon)
£80,000	+£432	-£1,434	-£1,063	-£682	-£258	Air Traffic Controller, Senior Manager and Director (above median)
£90,000	+£432	-£1,734	-£1,163	-£782	-£258	Chief Executive, Airline Pilot
£120,000	+£432	-£2,934	-£1,563	-£1,182	-£258	Partner in some professional services firms, Chief Executive of larger organisations

Source: Based on ASHE 2016, Table 14.7a. Median incomes by occupation for the UK as a whole. Income rounded to nearest £5,000 or £10,000

For each of the proposals, the impact on household income is also calculated. This is because household income differs from individual earnings since households may have more than one earner and more than one source of income.²⁶ The analysis therefore calculates the impact of proposals on household incomes after tax and social security payments, accounting for the number of people in the household.

Box E presents the impacts on household income by income decile. This approach divides the population into ten equal groups, with decile 1 representing the 10% of households with the lowest incomes and decile 10, the 10% of households with the highest incomes. Box E shows the average change in household income by income decile for each of the party's proposals.

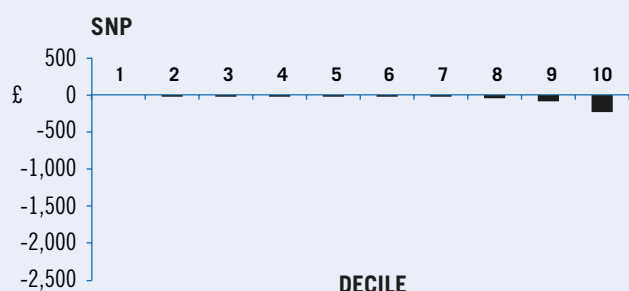
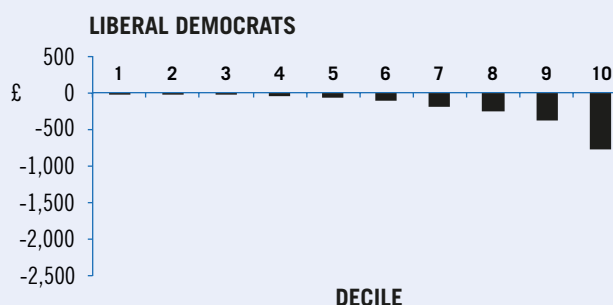
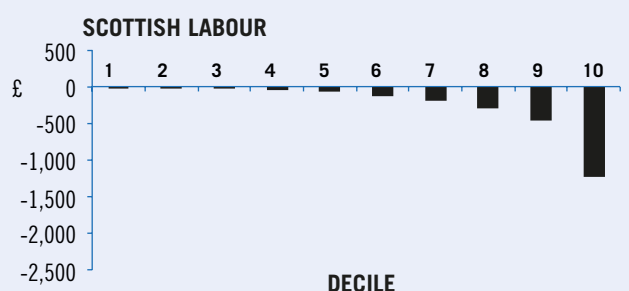
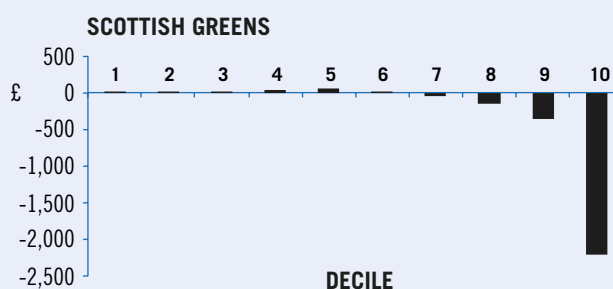
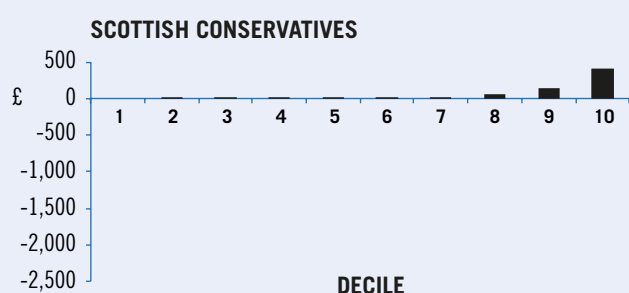
²⁶ Household income also takes into account the number of people in a household through a process called equivalisation. This uses the common sense notion that for larger households, income has to be spread further than for households with fewer people. The change in equivalised annual income is shown at a household level. The analysis does not include the impact from Universal Credit since the rollout is still in its early stages.

Box E: Average change in household income by income decile and proposal

The charts highlight that the Scottish Conservatives' proposal leads to the largest increases in income for those households at the top of the income distribution.

All the other proposals lead to lower incomes for those households at the top of the income distribution, as a result of them paying more tax.

The Scottish Greens' proposal leads to the bottom six deciles having slightly higher incomes as a result of paying less tax.



6 Comparing the parties' proposals against the policy tests

We now comment on how the parties' proposals perform against the tests set out in Chapter 4.

Revenue Test

Any income tax changes in 2018-19 should provide an increase in funding to mitigate the additional cuts we face next year. In 2018-19, the income tax policies outlined in Chapter 5 are estimated to raise the following amounts after behaviour is accounted for:

- The Scottish Conservatives' proposal is estimated to reduce the Scottish Budget by around £140 million (£150 million without behaviour change)
- The Scottish Greens' proposal is estimated to increase the Scottish Budget by between £200 million and £470 million (£870 million without behaviour change)
- The Scottish Labour proposal is estimated to increase the Scottish Budget by between £550 million and £630 million (£760 million without behaviour change)
- The Scottish Liberal Democrats' proposal is estimated to increase the Scottish Budget by between £440 million and £450 million (£500 million without behaviour change)
- The SNP proposal is estimated to increase the Scottish Budget by around £90 million (£100 million without behaviour change).

Progressivity Test

Chapter 5 presented the relative progressivity of each of the proposals by showing who pays more or less tax.

The Scottish Conservatives' proposal does not improve the progressivity of the current system. This is because it reduces the tax paid by higher rate taxpayers, the top 8% of highest earning adults in Scotland, by up to £432 while leaving taxes unchanged for those on lower incomes.

The Scottish Greens' proposal is progressive as tax rises are largely concentrated amongst the top earners. At the same time, taxpayers on incomes below £19,000 would pay a lower rate.

Both the Scottish Labour and Scottish Liberal Democrats' proposals would increase tax rates across all three income tax bands and therefore improve progressivity.

The SNP proposal would also improve the progressivity of the tax system.

Looking at income inequality, as measured by the Gini co-efficient (where the current value of the Gini co-efficient for Scotland is 34, as explained in section 4.2), the Scottish Conservatives' proposal would result in an increase in the Gini co-efficient (0.1). The Scottish Greens' proposal would result in the greatest reduction in the Gini co-efficient with it falling by 0.6. The reductions would be smaller under the Scottish Labour (0.3), Scottish Liberal Democrats (0.2) and SNP proposals (around 0.1), respectively.

Protecting Lower Earners Test

Under the Scottish Conservatives' proposal, taxpayers earning below the median income of £24,000 in 2018-19 would not see any increases in their tax liability.

Under the Scottish Greens' proposal taxpayers earning below the median income in 2018-19 would not see any increases in their tax liability. Reducing the Basic Rate up to £19,000 would benefit those earning less than £26,150.

The proposals put forward by Scottish Labour and the Scottish Liberal Democrats would increase the income tax paid by everyone earning more than the PA, compared to the current regime. As such, taxpayers earning below the median income in 2018-19 would not be protected from the tax rise. However, compared to the previous tax year 2017-18, the PA rises by £350, resulting in a tax saving of £70 for each Basic Rate taxpayer. This means that all taxpayers earning up to £18,800 would pay no more tax under these proposals than they did last year - however, they would not receive the full net benefit of the increase in the PA.

Under the SNP proposal, taxpayers earning below the median income of £24,000 in 2018-19 would not see any changes in their tax liability.

As highlighted in Chapter 3, tax changes can have an interaction with the social security system, in particular Universal Credit. The Scottish Greens' proposal, by lowering tax liabilities for the lower deciles, could have the effect of increasing post-tax income and therefore reducing Universal Credit payments to those individuals. We will discuss this issue with the UK Government to ensure, in line with the fiscal framework, that this does not reduce incomes or increase complexity for individuals.

Economic Growth Test

As we note earlier in this paper, it is not possible to reach a conclusive opinion on the economic impact of any of the proposals without a fuller understanding of the spending plans that would go with the changes. It is possible, however, to make the following high-level observations.

Small changes in income tax, such as those proposed by the Scottish Conservatives, would change income tax revenues by around 1% and are unlikely to have a measurable impact on the Scottish economy. However, the Scottish Conservatives' proposal would reduce the amount of revenue available for investment in public services and the economy.

The Scottish Greens' proposal would increase income tax revenues by between 2% to 4%, depending on the scale of the behavioural response. Since their proposal protects lower earners, the impact on consumer spending may be less immediate and therefore less likely to have a negative impact on growth in the short term. However, the Scottish Greens' proposal to increase the Additional Rate to 60p could discourage high earners from moving to or remaining in Scotland given the large increase they would see in their taxes. Over time, this would have a negative impact on economic growth as individuals and companies adjust their behaviour. As with the other party proposals which also raise revenue for investment in public services and the economy, spending choices might generate economic benefits in the long term, particularly if the proposal raised revenue at the higher end of the estimated range.

The scale of tax increases in the Scottish Labour and Scottish Liberal Democrats' proposals is larger as these would increase income tax revenues by 4% to 5% respectively. In the short term, these proposals could have a negative impact on growth because some of the tax rises would be borne by lower earners who are most likely to reduce consumption in response to a tax rise as they generally spend a larger proportion of their income. However, as noted above, the increase in Government spending accompanying the tax rise could offset any fall in consumer spending in the short-term and could have a positive impact in the longer term.

The Scottish Labour proposal would also increase the Additional Rate of income tax from 45p to 50p. As with the Scottish Greens' proposals, this introduces a risk that some high earners change their behaviour in ways that impact on the economy. However, the scale of the tax rise high earners would face under the Scottish Labour proposals is smaller than under the Scottish Greens' proposal, which in turn reduces the risk that high earners would change their behaviour.

Under the Scottish Liberal Democrats' proposal, the Additional Rate of income tax would be increased from 45p to 46p. An increase of this scale is unlikely to have a measurable impact on the economy.

The SNP proposal would change income tax revenues by around 1% and is unlikely to have a measurable impact on the Scottish economy. However, it would raise additional revenue for investment in public services and the economy.

7 Alternative approaches

The chapter is split into two sections. Section 7.1 describes a set of alternative and illustrative approaches. Section 7.2 estimates the revenue implications and impact of the approaches.

7.1 Four alternative approaches

In the light of the above, while all of the parties' proposals have interesting features, in order to develop the debate, we set out four alternative approaches that we believe could better meet the four tests. These do not constitute firm policy proposals - the Scottish Government's tax policy will be set out in our Draft Budget but they are intended to provide illustrative examples as a basis on which all parties can begin the discussion.

These alternative approaches are primarily based around tax regimes with different numbers of bands and are set out in more detail below. Within each alternative, there are ways to vary them that might raise more revenue, such as adding an additional penny to a rate or changing bands. A further variation, which could be applied to any of the approaches, would be not to increase the HRT by inflation (an inflationary increase is currently assumed) but either to freeze the HRT in cash terms or to vary it on a scale between a cash freeze and an inflationary increase. This latter variation would increase the revenue raised by up to £90 million (see Box D).

Many countries successfully operate tax systems with more than three income tax bands.²⁷ We acknowledge that if proposals to change tax bands are brought forward it will be important to engage extensively with HMRC to minimise any change in the administrative burden on self-assessment taxpayers and on business. The efficiency of the tax system is, therefore, something which we will consider in the upcoming debate.

Approach 1: A tax regime with three bands

Approach 1 (see Table 10) would keep the three existing income tax bands but add one penny on both the higher and additional rates of income tax. The basic rate would be left unchanged at 20p. The HRT would increase in line with inflation.

TABLE 10: APPROACH 1

Gross Income	Tax Rate	Number of people in band
£11,850 to £44,290	20%	2,165,000
£44,291 to £150,000	41%	346,000
above £150,000	46%	20,000

27

10 out of 35 OECD countries currently have 5 bands, including Canada, Belgium, Norway and Spain

This approach would increase income tax rates for the highest earning 8% of Scottish adults. As a result, 2.2 million Basic Rate taxpayers would pay no more tax than they do under the current system.

While this approach adds 1p to the Additional Rate, a variation of this approach would be to increase the Additional Rate by 3p or up to 5p instead. Estimates assuming increases in the Additional Rate of 3p and 5p are included under Approach 2.

Approach 2: A tax regime with four bands

Approach 2 (see Table 11) would introduce a new income tax band for low earners based around the median income, resulting in four income tax bands as opposed to the current three. Earnings between £11,850 and £24,000 would continue to be taxed at 20p. Earnings between £24,001 and £44,290 would be taxed at 21p and earnings between £44,291 and £150,000 would be taxed at 41p.

In taking this approach, the Additional Rate is increased firstly by 3p to 48p (Approach 2A) and then by 5p to 50p (Approach 2B).

TABLE 11: APPROACH 2

Approach 2A			Approach 2B		
Gross income	Tax Rate	Number of people in band	Gross income	Tax Rate	Number of people in band
£11,850 to £24,000	20%	1,267,000	£11,850 to £24,000	20%	1,267,000
£24,001 to £44,290	21%	898,000	£24,001 to £44,290	21%	898,000
£44,291 to £150,000	41%	346,000	£44,291 to £150,000	41%	346,000
Above £150,000	48%	20,000	Above £150,000	50%	20,000

Under Approaches 2A and 2B, around 1.3 million Basic Rate taxpayers - more than half - would not pay any more tax than they would under the current system.

Approach 3: A tax regime with five bands

As has been suggested in the context of the UK income tax system, it would be possible to split the higher rate band. Approach 3 (see Table 12) would split the current higher rate band at £75,000, further increasing the tax liability for the top 4% of Scottish income taxpayers.

Earnings of between £44,291 and £75,000 would be taxed at an extra 1p compared to the current system. Earnings between £75,001 and £150,000 would be taxed at an extra 2p at a rate of 42p. The HRT would increase in line with inflation.

TABLE 12: APPROACH 3

Gross income	Tax Rate	Number of people in band
£11,850 to £24,000	20%	1,267,000
£24,001 to £44,290	21%	898,000
£44,291 to £75,000	41%	266,000
£75,001 to £150,000	42%	79,000
Above £150,000	50%	20,000

As above, 1.3 million taxpayers, more than half of Basic Rate taxpayers, would pay no more tax than under the current system.

Approach 4: A tax regime with six bands

Approach 4 (see Table 13) would increase the number of income tax bands from three to six. Earnings of between £11,850 and £15,000²⁸ would be taxed at 19p, as opposed to 20p at present. Earnings between £15,001 and £24,000 would be taxed at the 20p rate as they are now. The other rates and bands are essentially the same as under Approach 3.

TABLE 13: APPROACH 4

Gross income	Tax Rate	Number of people in band
£11,850 to £15,000	19%	386,000
£15,001 to £24,000	20%	881,000
£24,001 to £44,290	21%	898,000
£44,291 to £75,000	41%	266,000
£75,001 to £150,000	42%	79,000
Above £150,000	50%	20,000

This means that 1.4 million taxpayers earning below £27,000 would pay less tax than they do now.

Table 14 compares the impact of the alternative approaches on the 2.5 million income taxpayers in Scotland by comparing the tax they would pay in 2018-19 with that under the current tax regime.²⁹

28 These are the households most likely to be affected by the benefit freeze.

29 As before, a different approach would be to compare people's tax liability across different years to account for any savings from the rise in the PA. This would increase the share of taxpayers who would pay less tax.

Under Approach 1, around 2.2 million Basic Rate taxpayers, or 86% of taxpayers, would pay no more tax than they do under the current system. Approaches 2 and 3 would result in half of all Scottish taxpayers seeing no change in their tax liability and half paying more. Under Approach 4, around 57% of Scottish taxpayers, i.e. all individuals earning less than £27,000, would pay less tax than they do under the current regime. The remaining 43% of taxpayers would pay more.

TABLE 14: IMPACT ON SCOTTISH TAXPAYERS OF CHANGES TO RATES/THRESHOLDS

Approach	Taxpayers (million)	Percentage of Scottish taxpayers who pay		
		same tax	more tax	less tax
1	2.53	86%	14%	-
2A/2B	2.53	50%	50%	-
3	2.53	50%	50%	-
4	2.53	-	43%	57%

It is also important to remember that there are currently 2 million individuals, or 44% of adults in Scotland, who do not pay income tax as they earn less than the PA. These people would be unaffected by each of the approaches outlined above.

7.2 Revenue implications and impact of the proposals

The analysis of the alternative approaches uses the same model, data sets and underlying assumptions as set out in Chapter 5 in order to ensure consistency. All revenue figures are compared to the income tax rates and bands shown in 2017-18 with the PA and the HRT both increased in line with inflation.

Revenue implications

Chart 8 illustrates the impact on revenues of the alternative proposals in 2018-19. It shows the revenues both with and without estimated behavioural change. Further details are in Annex A. All the proposals would raise extra revenue for the Scottish Budget, albeit to different degrees:

- Approach 1 (three bands) would raise between £80 million and £90 million (£130 million without behaviour change)
- Approach 2A (four bands) would raise between £210 million and £250 million (£330 million without behaviour change) while Approach 2B (four bands) would raise between £190 million and £270 million (£390 million without behaviour change)
- Approach 3 (five bands) would raise between £220 million and £290 million (£430 million without behaviour change)
- Approach 4 (six bands) would raise between £150 and £220 million (£350 million without behaviour change).

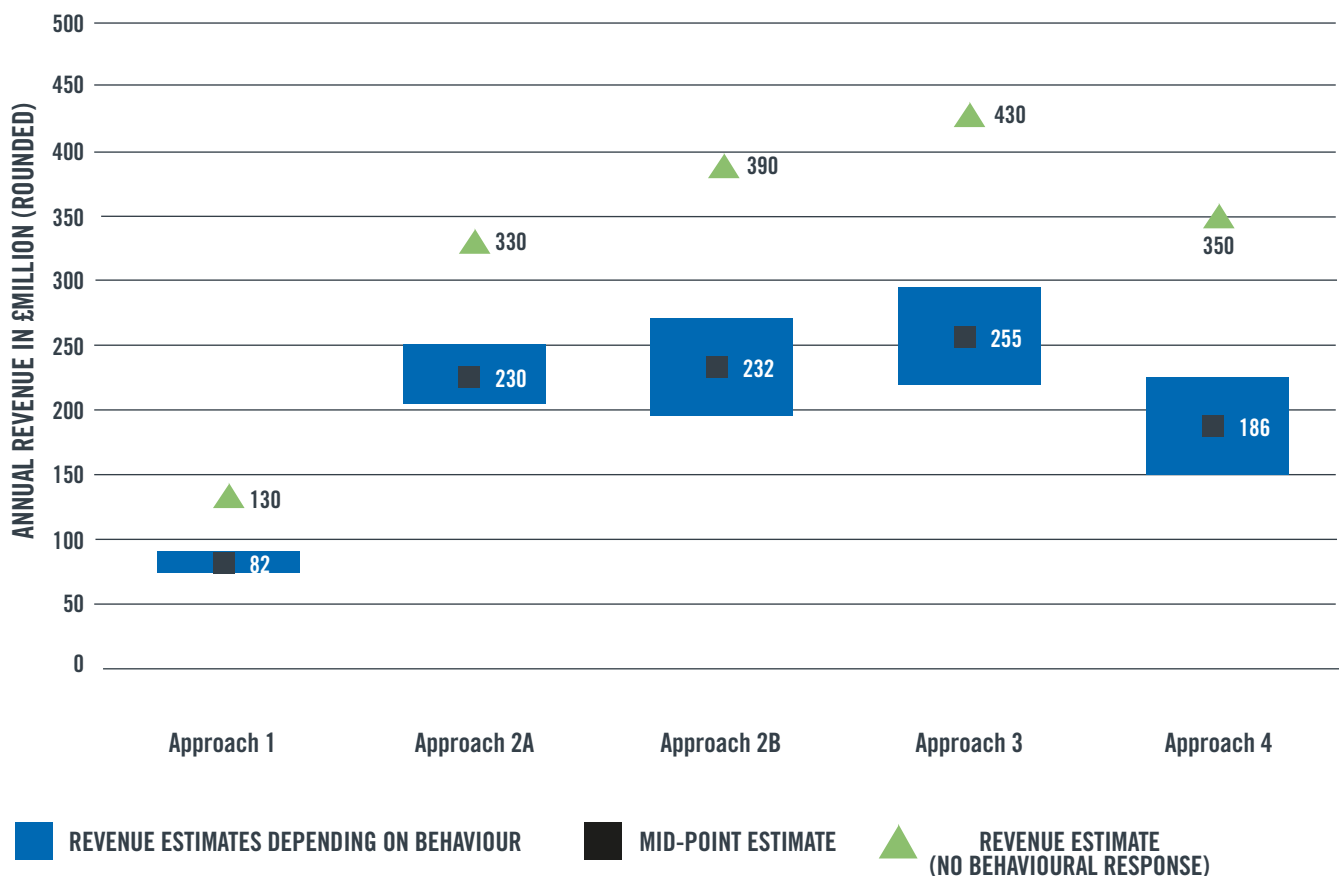
There are several variations that could be applied to the approaches. For each, a variation would be to freeze the HRT in cash terms at £43,000, as opposed to increasing it by inflation. This could raise around an extra £90 million under each approach.

A further variation in approach would be to adopt a 1p or 3p increase in the Additional Rate instead of a 5p increase. Table 15 below summarises the different revenue figures these different additional rates could raise.

TABLE 15: ADDITIONAL REVENUE FROM INCREASING THE ADDITIONAL RATE BY DIFFERENT AMOUNTS (£ MILLION)

Amount of increase in Additional Rate	No behavioural response	Low behavioural response	High behavioural response
1p	30	12	-2
3p	90	34	-10
5p	150	53	-24

For example, under a 3p rise as opposed to a 5p rise, revenues would be around £20 million lower if taxpayers' responsiveness is low. However, if taxpayers' responsiveness is high, a 3p increase would mitigate the revenue risk as the loss in receipts would be smaller.

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

Impacts on individual taxpayers and households

Chart 9 shows the impact of the four approaches on an individual's take home pay for the 95% of Scottish adults who earn up to £55,000 with a further chart (Chart 10) showing the impact on an individual's take-home pay for those earning above £55,000 (the 5% highest earning Scottish adults).

CHART 9: IMPACT ON AN INDIVIDUAL'S TAKE-HOME PAY BY PROPOSAL (FOR INCOMES UP TO £55,000)

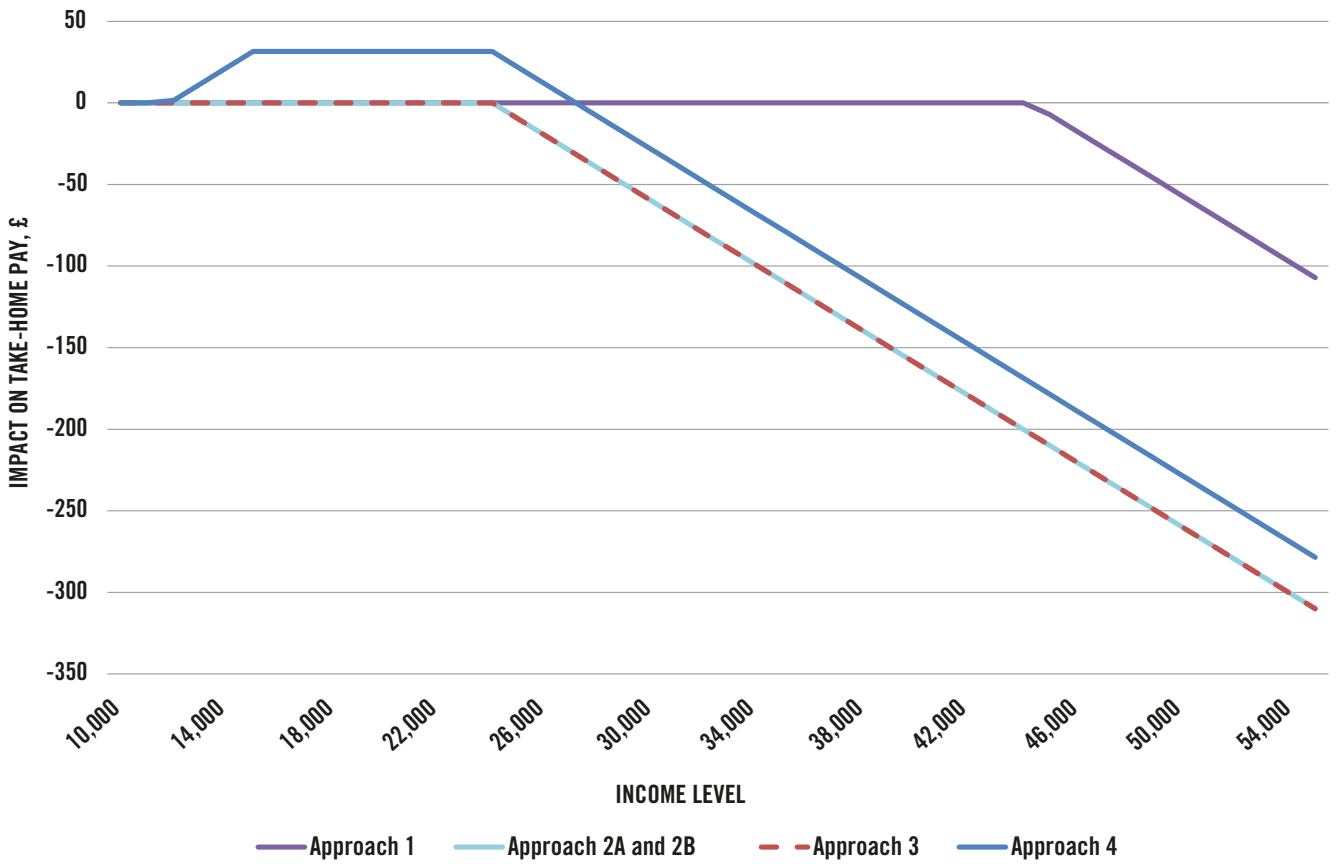


CHART 10: IMPACT ON AN INDIVIDUAL'S TAKE-HOME PAY BY PROPOSAL (FOR INCOMES MORE THAN £55,000)

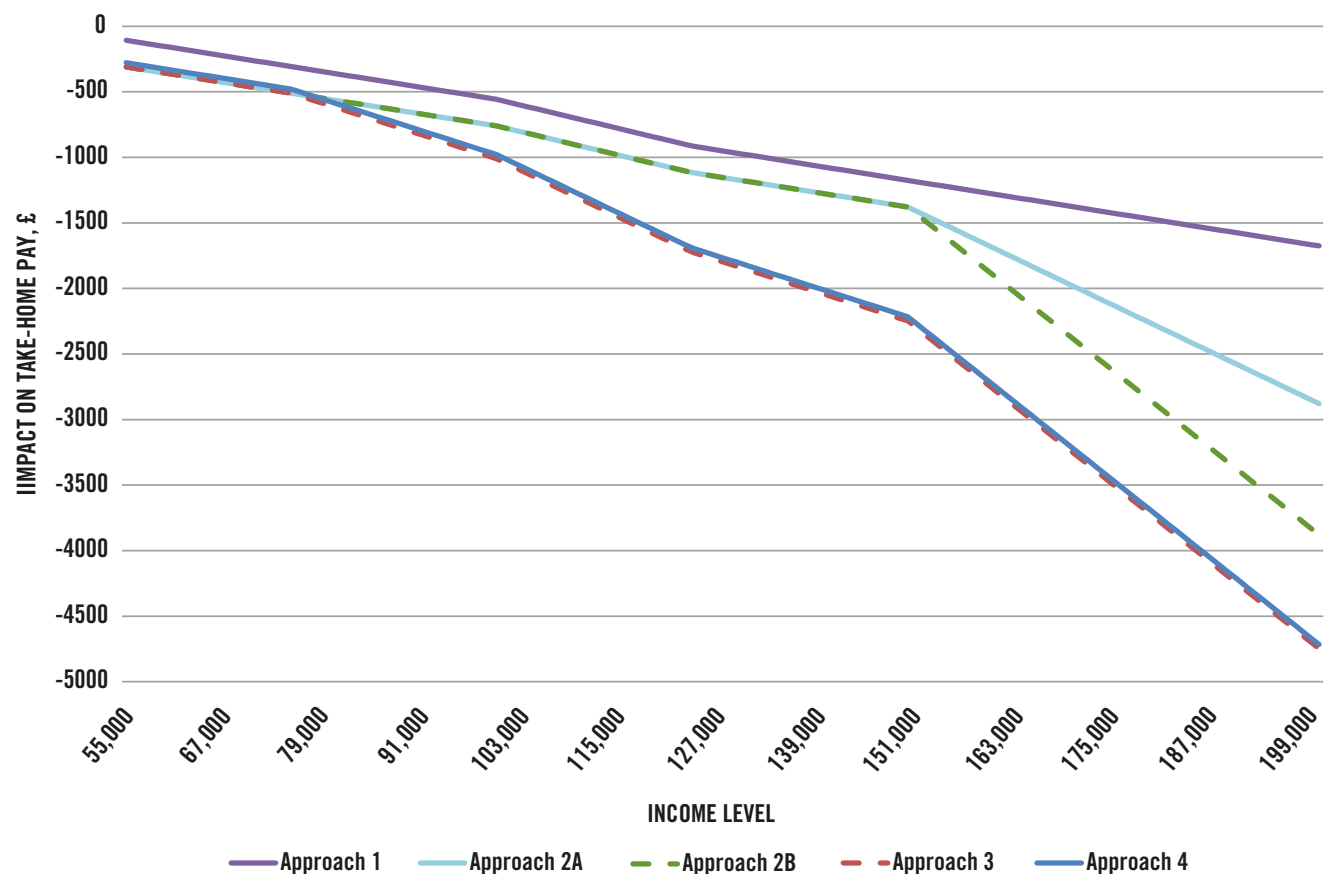


TABLE 16: IMPACT ON ANNUAL TAKE-HOME PAY BY OCCUPATION AND APPROACH

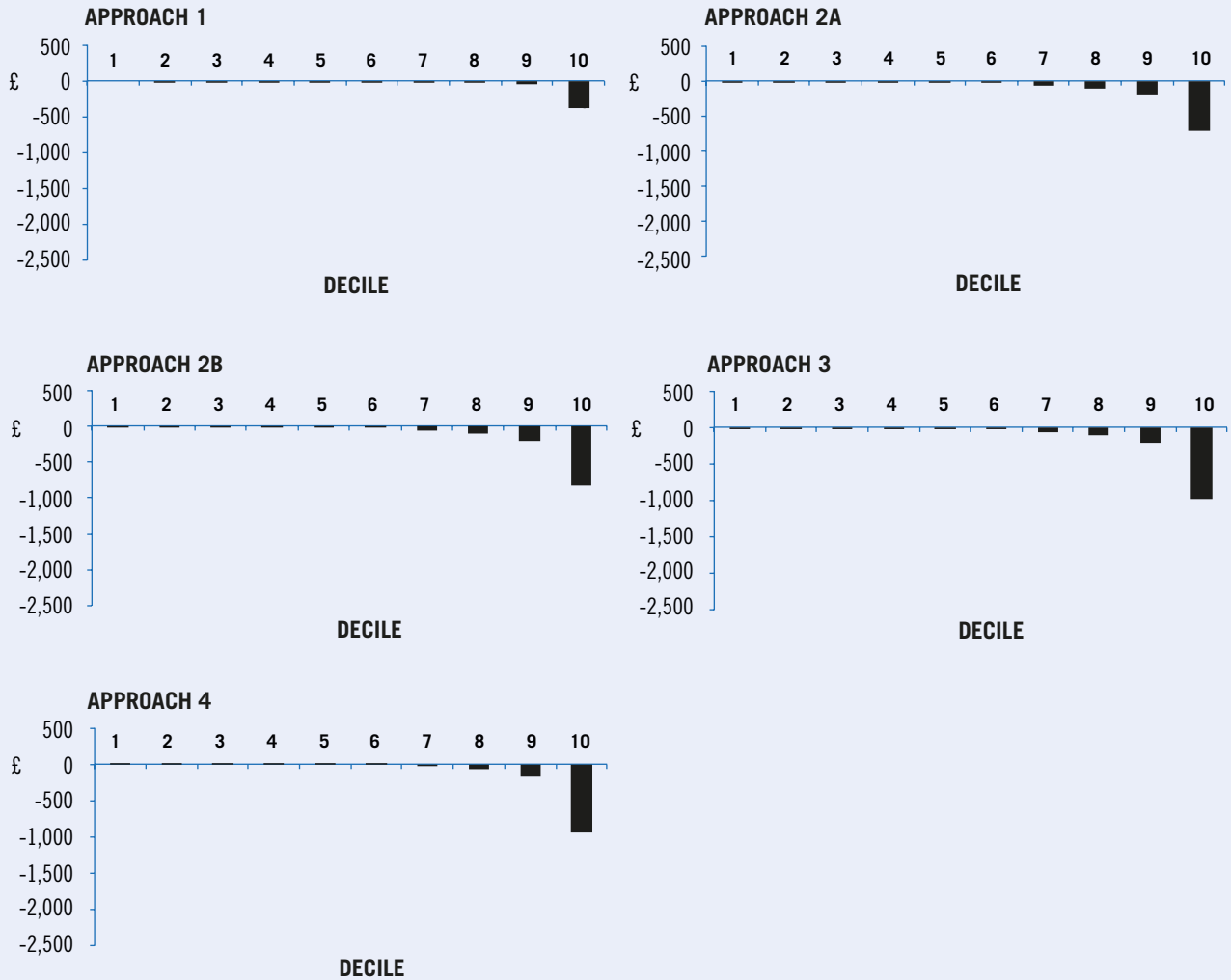
Example gross income (annual)	Approach 1 (three band)	Approach 2A/B (four band)	Approach 3 (five band)	Approach 4 (six band)	Occupations (average across profession)
£20,000	£0	£0	£0	+£32	Nursing Assistant, Childminder
£25,000	£0	-£10	-£10	+£22	Local Government administrative occupation, Bank and Post Office Clerk
£30,000	£0	-£60	-£60	-£29	Nurse
£35,000	£0	-£110	-£110	-£79	Primary School Teacher, Social Worker, Paramedic
£40,000	£0	-£160	-£160	-£129	Solicitor, Police Officer, Secondary School Teacher, Chartered Accountant
£50,000	-£57	-£260	-£260	-£229	Head Teacher (primary school), Train Driver, Financial Institution Manager & Director
£60,000	-£157	-£360	-£360	-£329	Senior Police Officer, MSP
£70,000	-£257	-£460	-£460	-£429	Marketing & Sales Director, Medical Practitioner (GP or Surgeon)
£80,000	-£357	-£560	-£610	-£579	Air Traffic Controller, Senior Manager and Director (above median)
£90,000	-£457	-£660	-£810	-£779	Chief Executive & Airline Pilot
£120,000	-£857	-£1,060	-£1,610	-£1,579	Partner in some professional services firms, Chief Executive of larger organisation

Source: Based on ASHE 2016, Table 14.7a. Median incomes by occupation for the UK as a whole. Income rounded to nearest £5,000 or £10,000

The implications of the alternative approaches for individuals on different incomes, and the types of occupations associated with each income, are shown in Table 16. Box F summarises the impact that each approach could have on household incomes.

Box F: Average change in household income by income decile and proposal

Under all alternative approaches outlined in this chapter, the richest 10% of households (decile 10) would see the largest impact on their income. Changes for households in lower deciles are considerably smaller and for households in the bottom half of the income distribution (deciles 1-5) changes are close to zero.



7.3 Comparing the alternative proposals against the policy tests

We believe that the approaches we have set out are not only useful as a starting point for discussion but that they better meet the policy tests set out in Chapter 5.

Revenue Test

In 2018-19, two of the four approaches are expected to raise at least £190 million in additional revenues for the Scottish Budget. Approaches 2 and 3 would raise the most revenue.

Variations within some of these approaches could raise further revenue. For example, for each approach a freeze in the HRT in cash terms at £43,000, as opposed to increasing it by inflation, could raise around an extra £90 million.

Progressivity Test

All four approaches would make the tax system more progressive, with the degree of progressivity increasing with the number of income tax bands. Approach 4 is the most progressive of the four approaches considered.

Looking at income inequality, as measured by the Gini co-efficient (where the current value of the Gini co-efficient for Scotland is 34, as explained in section 4.2), Approach 1 would result in the smallest reduction in income inequality in Scotland, with the Gini co-efficient falling by 0.1. The reductions would be larger under Approaches 2, 3 and 4 (between 0.18 and 0.25).

Protecting Lower Earners Test

Under all the alternative approaches, taxpayers earning below the median income (£24,000) would be protected from a tax rise.

This means that 1.3 million taxpayers would pay no more income tax than they would under the current tax regime.

Approach 4 goes further and reduces the tax liability through the introduction of a new 19p band. Each taxpayer, including those on higher incomes, would pay £32 less tax in 2018-19. However, this money is recouped for taxpayers on higher incomes by increasing tax rates in the top four bands. Under this approach, around 1.4 million Basic Rate taxpayers (those earning up to £27,000) would be better off than they are under the current tax system.

As with the Scottish Greens' proposal, lowering the tax liability for those on low incomes could trigger interactions with social security payments, in particular Universal Credit, which must be considered as part of this discussion.

Economic Growth Test

As with the proposals considered in Chapter 6, the economic impact of the alternative approaches can only be fully assessed once the corresponding spending package is considered in full.

Approach 1 would raise income tax revenues by less than 1% and is therefore unlikely to have a measurable impact on the Scottish economy. However, it would raise additional revenue for investment in public services and the economy.

Approaches 2 to 4 would increase income tax revenues by up to 2%. As these proposals are smaller in scale than some of the proposals considered in Chapter 6, the impact that they would have on economic growth would also be smaller.

Approaches 2 to 4 do not increase taxes on lower earners. Lower earners are most likely to adjust their spending in the short term in response to a tax rise. Therefore, the risk that these approaches would have a negative impact on short term consumer spending is reduced. Moreover, the increase in Government spending accompanying the tax rise - which all approaches would provide - could offset any reduction in consumer spending.

Approaches 2 to 4 would increase the Additional Rate of income tax from 45p to 48p (Approach 2A) and from 45p to 50p (Approaches 2B, 3 and 4). As with some of the proposals assessed in Chapter 6, an increase to 50p introduces a risk that some high earners would change their behaviour in ways that impact on the economy. However, the scale of the tax rise high earners would face under these approaches is significantly smaller than under the Scottish Greens' proposal, which in turn reduces the risk that high earners would change their behaviour.

Approaches 2 to 4 would raise additional revenue for investment in public services and the economy. Therefore in the long term, depending on where the additional public spending is directed, Approaches 2 to 4 could boost productivity and increase growth.

7.4 Conclusion

The Scottish Government has always been clear that we must make tax decisions in a principled and transparent way. That is why we use Adam Smith's principles to guide our tax policy making. In this discussion paper we have introduced four tests that we believe any changes to income tax should adhere to.

Given the scale of cuts by the UK Government which have been sustained over a number of years, it is becoming increasingly difficult for us to protect our vital public services. This, an ageing population, and all the uncertainty created by Brexit mean that now is the time to look more seriously at using our tax powers to help protect the services we all expect and deserve.

When considering changes, it is important to remember that tax is only one side of the equation and the role of public spending has to be considered alongside tax. The social contract is an important component of our society, and the public services we provide - with no charges for undergraduate tuition, eye examinations available to all and many more - need funding to ensure their long term future.

This paper has considered income tax proposals from across the political spectrum, offering impartial analysis on the revenues they are likely to raise to support our public services. We have also discussed how we consider the proposals measure up against our four tests.

We have set out four alternative approaches to provide a basis on which we can all begin this discussion. We hope that our alternative approaches will facilitate a debate about how our income tax powers can be used and how income tax policy can meet our policy tests.

We will be hosting roundtable discussions with business, the third sector and civic society to help progress this debate and inform our thinking on policy options ahead of the Draft Budget in December. This, as well as the vital discussions in Holyrood will help us to propose an income tax policy for Scotland that supports our public services, protects lowest earning taxpayers, advances progressivity and supports our economy.

Annex A: Further detail on analysis and economic modelling

Overview of the economic modelling

This Annex describes the approach to estimating the impact of different income tax policy proposals.

Estimating the direct (or “static”) impact of policies on revenues

The starting point for forecasting income tax - both under the status quo and under any policy proposal - is to project forward Scottish income tax revenue. This is done by combining data on Scotland's current income distribution³⁰ and income tax receipts with forecasts of growth in the number of taxpayers and their income.

The number of taxpayers is projected separately for different age bands to factor in demographic shifts in the Scottish population. This forecast is informed by the 2014-based Office for National Statistics (ONS) principal population projections, labour market data on participation and unemployment in Scotland and projections of future employment growth.³¹ The growth rates of different types of income, such as income from employment, pensions and property income, are also forecast separately. These forecasts take into account outturn data from the Survey of Personal Incomes and Annual Survey of Hours and Earnings where available. For simplicity, forecasts for earnings and employment growth are based on the OBR's latest Economic and Fiscal Outlook from March 2017.³² Further detail on the forecasting methodology can be found in the report published alongside the Draft Budget 2017-18.³³

By comparing the forecasts under each policy proposal with those under the current tax regime, we can estimate how much additional tax a policy proposal would raise. These estimates are also referred to as “static” or “direct” policy costings.

Estimating taxpayers' behavioural responses

Taxpayers will change their behaviour in response to a change in income tax, for example by changing the number of hours they work.

The scale of the behavioural response can be estimated by using taxable income elasticities (TIEs). These measure the percentage change in taxable income in response to a one per cent change in the net of tax rate: the higher the TIE, the greater is the behavioural response and the greater the resulting impact on tax receipts. To ensure consistency, the same set of TIEs was applied across all policy options. These were informed by discussions with a number of institutions and a review of the academic literature.³⁴

30 This is based on the Survey of Personal Incomes (SPI) for 2014-15, the latest year for which data are available. The SPI comprises a detailed sample of over 40,000 anonymised Scottish tax records, weighted to be representative of all Scottish taxpayers.

31 No new data releases were included after 25 October.

32 The Scottish Fiscal Commission will provide an updated set of economic determinants at the time of the Draft Budget 2018-19.

33 [The Draft Budget 2017-18](#)

34 Box 5 in the [Devolved Taxes Methodology Report](#) sets out the calculations in detail.

While there is a general consensus in the academic literature that TIEs are much higher for those on higher incomes, the exact magnitude of the behavioural response is uncertain. Therefore, the analysis assumes that TIEs are close to 0 for taxpayers on low incomes and increase as incomes rise. To highlight the degree of uncertainty, the analysis adopts a range of 0.35 to 0.75 for the TIEs of the very top earners, i.e. those earning more than £250,000, and slightly smaller ranges for taxpayers earning between £150,000 and £250,000. Since behavioural responses are much smaller at the lower end of the income range, a single TIE was applied to taxpayers earning up to £150,000.

These TIEs have been updated compared to what was set out in the Devolved Taxes Methodology Report to reflect recent research by the Institute for Fiscal Studies (IFS), which found that those just above the £150,000 Additional Rate threshold appear to be less responsive to tax changes than the Additional Rate taxpayer group as a whole.³⁵ Likewise, the International Monetary Fund (IMF) recently published new analysis showing that there is no evidence of an increase in income tax elasticities for top earners over time, despite cheaper access to international tax planning or increased mobility of taxpayers.³⁶

All TIEs are kept under regular review as new information on the behaviour of Scottish taxpayers becomes available. It is important to remember that the SFC may reach different views on taxpayer responsiveness as the responsibility for producing the final income tax forecasts now sits with the SFC and its Commissioners. The Scottish Government's assessment of behavioural responses continues to be informed by the advice by the Council of Economic Advisers on the revenue risks for raising the AR to 50p. Further advice is expected ahead of the Draft Budget.

Estimating impact on household income

As well as modelling the impact of a tax proposal on each individual's earnings, the impact on household income is also calculated. This is because household income differs from individual earnings since households may have more than one earner and more than one source of income. The analysis therefore calculates the impact of proposals on household incomes after tax and social security payments, accounting for the number of people in the household.

Household income distributional analysis is based on a static tax and benefit micro-simulation model developed by the Scottish Government. The model is based on 2015-16 Family Resources Survey (FRS) data.³⁷ It does not incorporate the impact of any behavioural response or secondary impacts, for example, employment impacts from the interaction between employment and social security income.

35 [Research by the Institute for Fiscal Studies \(IFS\)](#)

36 [The IMF Fiscal Monitor](#)

37 The Family Resources Survey (FRS) is collected annually by DWP. The FRS contains detailed information about household income and has a large Scottish sample (2,700 households in 2015-16) making it the best source of information on household income in Scotland.

In order to replicate the impact of the introduction of a policy in 2018-19, income tax parameters for each proposal were adjusted to 2015-16 levels.³⁸ In order for comparisons to be made with incomes in that year, the most recent for which data are available. The distributional impact of the policy is then demonstrated using equivalised household income deciles. This splits all households in Scotland into 10 equally sized groups by level of income. The 1st decile is the 10% of households with the lowest incomes, whilst the 10th decile is the 10% of households with the highest incomes. Equivalised income is used as it adjusts for the composition of different households.

Further detail of the impact of behavioural responses on revenue

TABLE A1: COMPARISON OF REVENUE IMPLICATIONS WITH AND WITHOUT BEHAVIOURAL RESPONSES BY PROPOSAL/ APPROACH (£MILLIONS IN 2018-19)

	Revenue implications (no behavioural response)	Revenue implications (post-behavioural response) Mid point	Revenue implications (post-behavioural response) Low	Revenue implications (post-behavioural response) High
Scottish Conservatives	-150	-137	-137	–
Scottish Greens	870	335	473	197
Scottish Labour	760	589	627	550
Scottish Liberal Democrats	500	444	451	437
SNP	100	90	90	–
Alternative approach 1	130	82	89	75
Alternative approach 2A	330	230	252	208
Alternative approach 2B	390	232	271	194
Alternative approach 3	430	255	294	217
Alternative approach 4	350	186	224	148

38 Using September CPI inflation.



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