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Mary Gregory, Deputy Director for Regulation

Tom Orford
Head of Profession for Statistics
HM Treasury
(by email)

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Dear Tom

As you are aware, the Office for Statistics Regulation was contacted about the use of HMRC statistics on Scottish Income tax receipts in 2017-18 in an article by Liz Truss MP, in the Scottish Daily Mail on 19 July. This article followed the publication of income tax reconciliations for Scotland, which were published by HMRC for the first time on 18 July.

The basis of the article was HM Treasury's press release "Scottish Income tax shortfall offset by UK funding"[1]. The press release states that "Scotland's economy grew more slowly than the rest of the UK, hitting tax receipts and leaving the Scottish Government with a shortfall in funding".

While it is correct that Scotland's economy grew more slowly than the rest of the UK it is incorrect to suggest this is the primary reason for reduced Scottish income tax revenues and therefore the main reason for the adjustment to the block grant funded by UK Government. The main causes are the availability of more accurate figures on the income tax base in Scotland and divergences in the forecasted income tax revenues between the Rest of the UK and those for Scotland.

While the joint fiscal framework is a relatively complex, multi-stage process of transfers and balancing, the principal reasons for changes to Scottish income tax revenues and Block Grant Adjustment revisions after reconciliations are amenable to clear and unambiguous explanation. We recommend that future HM Treasury press statements based on these statistics provide better explanations of the causes of changes to the Scottish income tax revenues and the associated Block Grant Adjustment. This will reduce the risk that users draw misleading conclusions from the statistics and the statements that draw on them.

We recognise that this is the first time that HMRC has published these statistics and been subject to associated media scrutiny. While it is likely future reconciliations will not be as large, we consider that to fully inform the public it would be helpful to present this framework in line with our Code of Practice for Statistics, considering how the statistics can be best presented in a clear and unambiguous way.

I am copying this letter to Sean Whellams, Head of Profession for Statistics at HMRC, and Alyson Stafford, Director General at the Scottish Exchequer.

Yours sincerely

M. Gregory

Mary Gregory
Deputy Director for Regulation

[1] https://www.gov.uk/government/news/scottish-income-tax-shortfall-offset-by-uk-funding

Annex: Scottish income tax revenues and the Scottish Block Grant Adjustment July 2019

The £941 million change in Scottish income tax and the £737million change in the block grant adjustment (BGA) were the culmination of a multi stage process. While the Scottish Government now retains all non-saving non-dividends income tax in Scotland, the block grant adjustment (BGA) is the amount deducted from the Scottish Government block grant to reflect the UK government no longer has control over these revenues, as these powers were devolved in 2016.

During this process Scottish income tax and the BGA are both forecast prior to each financial year, then the outturn Scottish income tax and BGA are calculated using real data around 15 months after the end of each financial year.

The BGA is based on 2 calculations: The revenue raised from income tax in Scotland during the year prior to devolution and a forecast of income tax receipts throughout the rest of the UK in subsequent years. This indexation mechanism therefore works by linking the BGA to income tax growth rates in the rest of the UK: if income tax revenue growth slows in the rest of the UK, the BGA will grow more slowly, and vice versa. This is similar to the way in which the block grant is linked to spending growth in the rest of the UK through the Barnett formula.

The initial estimates for Scotland's income tax and BGA in 2017/18 were £11,857 million and £11,750 million respectively.

However, the income tax and BGA outturn figures, based on real data, were £10,916 million and £11,013 million respectively, £941 million and £737 million lower than the forecasts. These figures were lower than originally forecast for two main reasons:

1) There was better tax data from HMRC, Scotland's tax base in the baseline line (2016-17) is now estimated to be £500 million smaller than previously thought. This reduced both the Scottish income tax and the BGA in 2017-18

2) UK income tax revenues grew faster in 2017-18 than forecast and Scottish income tax revenues grew more slowly than forecast, hence the outturn Scottish income tax for 2017-18 (£10,916 million) is smaller than the outturn BGA (£11,013 million).