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## Finance and Public Administration Committee

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## Fiscal Framework Outturn Report 2022

### Introduction

The Fiscal Framework Outturn Report (FFOR) was published on 27 September 2022. This report is published annually following a recommendation made by the Budget Process Review Group (BPRG).

The purpose of the FFOR is to show how actual receipts collected for devolved/shared taxes and actual spend on social security compare with the forecasts made at the time the budget was set.

Across the range of these devolved powers, the document sets out the level of either positive or negative “reconciliation” to be applied to the upcoming budget.

The document sets out the provisional closing balance for 2021-22 in the Scotland Reserve (the Scotland Reserve is the account into which underspends or surplus tax receipts can be placed). Last year’s FFOR contained the latest planned drawdown and closing position for the current year at time of publication (2021-22). No such information for this year (2022-23) is provided in this year’s FFOR document – likely due to the ongoing uncertainties around funding for cost crisis interventions and improved public sector pay deals.

The FFOR also contains information on planned borrowing and overall borrowing levels relative to the borrowing limits set in the [Fiscal Framework](#).

The FFOR has a specific role to play in the pre-budget scrutiny process envisaged by the BPRG. Publication of this outturn information allows the Finance and Public Administration Committee the opportunity to question the Cabinet Secretary around how the Scottish Government intends to handle any negative or positive “reconciliations” in the upcoming Budget.

Writing to the Finance and Public Administration Committee, the Minister for Public Finance, Planning and Community Wealth noted that

“As the publication of the majority of final outturn data has been delayed until later this year, this report uses provisional Scottish outturn for 2021-22 Land and Buildings Transaction Tax (LBTT), Scottish Landfill Tax (SLfT) and Social Security expenditure. The equivalent BGA data is also on a provisional basis because the publication of the Office of National Statistics (ONS) mid-year population outturn data for 2021-22, which is used to calculate the final outturn BGAs, has been delayed until November 2022. However, the 2020-21 income tax revenue outturn and BGA can be considered final. An update will be sent to the Committee once the remaining data is finalised later in the year.”

## Summary of key points

The BPRG recommended that the FFOR is based on audited information as far as possible.

As mentioned in the above quote from the Minister, much of the information provided in this year’s FFOR is provisional. As such, the overall reconciliations applying to the 2023-24 Scottish budget are not final and will only be confirmed when the 2023-24 Scottish budget is published later this year.

Based on the provisional figures, the key points applying to the upcoming budget are as follows:

- **A total provisional positive reconciliation in the 2023-24 budget of £22.5 million.** This is the net figure across all the areas covered by the FFOR – namely, final reconciliations for 2020-21 Income tax revenue; BGA and provisional reconciliations of the BGAs for 2021-22 Land and Buildings Transaction Tax (LBTT), Scottish Landfill tax (SLfT), Social Security benefits expenditure and Fines, Forfeitures and Fixed Penalties.
- The document reports a provisional balance in the Scotland Reserve at the end of financial year 2021-22 of £650 million.
- Under current plans, the Scottish Government’s capital debt will be £2.1 billion by the end of 2023-24, which represents 71% of the overall £3 billion allowed for by the Fiscal Framework.
- In the current year (2022-23) there are plans to borrow £15 million in resource borrowing, a figure that is subject to change depending on movements of in-year reconciliations and the volatility of Social Security benefit spending.

## Tax revenues, BGA and net Budget position

As mentioned above, the key purpose of the FFOR is to report on outturn data for Scottish tax revenues, along with the outturn and final block grant adjustments (BGAs). This comparison of outturn revenue and BGAs with the forecasts made at the time of the budget allows the FFOR to identify the degree of 'reconciliation' that will be required in the subsequent budget.

For tax powers, Scottish budgets are now underpinned by two sets of forecasts.

- Forecasts for a block grant adjustment (BGA), which is an estimate of the revenue foregone by the UK in devolving tax powers to Scotland - these forecasts are undertaken by the Office for Budget Responsibility (OBR)
- Forecasts for the revenues to be raised by Scottish taxpayers based on Scottish Government policy decisions - these forecasts are undertaken by the Scottish Fiscal Commission (SFC).

The forecasts are reconciled with outturn data when that becomes available, so that the funding available to the Scottish Government ultimately corresponds to the actual revenues and BGAs.

As outturn data is available on different timescales for each of the taxes, there are different processes in place for how income tax is reconciled compared with the fully devolved taxes. For the fully devolved taxes, outturn data is usually available approximately 6 months after the end of the financial year. For income tax, outturn data is available around 16 months after the end of the financial year. This longer lag time for income tax relates to the self-assessment income taxpayers having around 10 months after the end of the financial year to pay income tax dues.

## Income tax

Final outturn data for 2020-21 Income tax was published by HMRC on 7 July 2022.

Table 1 below shows that at the time the Budget for 2020-21 was set, the net effect on the Budget from Scottish Government policy was forecast to be +£46.1 million – ie forecast revenues were £46.1 million higher than the BGA.

However, the outturn net effect on the Budget was actually +£96.4 million, meaning that the Scottish Budget was better off by £96.4 million as a result of income tax being devolved. Because the Budget was set with forecasts assuming the Budget would be £46.1 million better off (but was actually £96.4 million better off), there is a requirement for a positive reconciliation of £50.4 million to be made in respect of Income Tax to the Scottish Budget next year based on these provisional outturn figures.

Table 1: Final Income tax reconciliation to 2023-24 Budget, £ million

2020-21 Income tax	Revenues	BGA	Net effect on Budget
Forecasts – Budget Act 2020	12,365.4	-12,319.3	+46.1
Outturn	11,948.0	-11,851.5	+96.4
Outturn against forecast	-417.4	+467.8	+50.4

This is the first year since the devolution of Income tax powers where there has been a positive reconciliation for the Scottish budget. The FFOR notes that “reconciliations to correct for forecast error should not be interpreted as a reflection of the underlying performance of the Scottish or equivalent UK tax base.”

The FFOR also presents the latest forecast error reconciliations for 2021-22 Income tax (to be applied to the 2024-25 Budget) and the 2022-23 Income tax (to be applied to the 2025-26 Budget). These stand at -£817.3 million (table 3 of FFOR) and -£237.5 million (table 4 of FFOR) respectively. However, the document notes:

“Historically, indicative reconciliations have varied considerably between forecasting rounds. Even small asymmetries between the SFC’s and OBR’s relative forecast error can substantially change the size of any future reconciliations. Hence, a strong degree of caution should be used when interpreting these numbers – they are indicative only and not outturn data.”

## Historic errors in classification of taxpayers

The FFOR highlights the discovery of an error in the classification of some taxpayers following a National Audit Office (NAO) annual audit of Scottish Income tax.

“These taxpayers had Scottish residency flags in HMRC’s records and were thus identified as Scottish taxpayers for the purpose of the outturn data. However, they have subsequently been identified as non-resident for tax purposes so are not classified as Scottish taxpayers. No taxpayers have paid the incorrect tax. The process of producing the outturn figures has been corrected for the 2020-21 outturn. The figures from the previous outturn years (2016-17 to 2019-20) have been corrected in HMRC’s 2020-21 statistical release.”

The impact of this classification error meant that the Scottish budget had to manage a larger negative reconciliation in previous years to the tune of around £7 million per annum over the three year period 2017-18 to 2019-20 (£21 million in total).

In terms of how the Scottish budget will be compensated to correct this shortfall, the FFOR notes that “both governments are in ongoing discussions on addressing the historic implications of this issue.” The FFOR continues:

“The NAO and Audit Scotland consider the system for administering Scottish Income Tax to be functioning effectively and as intended. We continue to scrutinise the administration of the system through our Service Level Agreement, working collaboratively with HMRC to ensure the efficient identification of Scottish taxpayers and compliance activity.”

The Service Level Agreement for the administration of Scottish Income Tax is currently under review.

## Fully devolved taxes

Revenue Scotland manages and collects the fully devolved taxes (LBTT and SLfT) and these revenue streams feed in to the Scottish Budget as they are collected. This means reconciliations for revenue are not necessary for these taxes. The Scottish Government manages any variance between forecast and actual revenues as part of its in-year budget management process.

However, the BGAs for these taxes do undergo reconciliations, which are undertaken in two stages. The first stage is an in-year reconciliation, which normally takes place within the same financial year, on the basis of updated OBR forecasts produced for the UK autumn fiscal event. Outturn data becomes available in the autumn following the end of each financial year. Using these outturn figures, a final reconciliation is applied to the Block Grant in the financial year two years after the original BGA was applied.

Table 6 of the FFOR shows that the difference between the BGA used to underpin the 2021-22 Scottish budget and the provisional BGA used at the time the Budget was set equates to a negative reconciliation of £164.2 million. £104.4 million of this was deducted as an in-year reconciliation in 2021-22 and a further provisional final reconciliation of -£59.8 million is now required to be made in the 2023-24 Budget.

For SLfT, table 9 of the FFOR shows the difference between the BGA used to underpin the 2021-22 Scottish budget and the provisional BGA used at the time the Budget was set equates to a negative reconciliation of £7 million. £5.4 million was added as an in-year positive reconciliation in 2021-22 meaning a further provisional final reconciliation of -£12.3 million is now required to be made in the 2023-24 Budget.

## Fines, Forfeitures and Fixed Penalties

There will be a +£0.4 million provisional BGA reconciliation added to the 2023-24 budget. This is shown in table 12 of the FFOR and stems from the provisional BGA outturn being slightly lower than forecast at the time of Budget Act 2021.

## Proceeds of Crime

The FFOR notes that

“Revenue seized under the Proceeds of Crime Act 2002 is subject to a BGA. The basis on which this is carried out is the subject of dispute between the Scottish and UK Governments and the BGA remains at negative £4 million while the dispute remains unresolved. The Scottish and UK Governments agreed to consider this issue as part of the review of the Fiscal Framework.”

And that:

“No reconciliation takes place while the BGA remains the subject of dispute between the Scottish and UK Governments.”

The Scottish and UK governments have been in dispute over this issue for some time now. It centres on how sums recovered under ‘proceeds of crime’ legislation (confiscation of money and assets that have been gained through criminal conduct) are budgeted for post-devolution.

Before sums raised from proceeds of crime legislation were officially devolved through Scotland Act 2016, the two governments had an agreement that the Scottish Government could retain sums raised through proceeds of crime in Scotland if these raised less than £30m in any year – which they always did. So HM Treasury never actually received any sums from proceeds of crime legislation in Scotland prior to their devolution.

But the devolution of proceeds of crime resulted in a formalised process by which the Scottish budget can be adjusted downwards to reflect the funding that the UK Government has ostensibly foregone as a result of devolving these funds.

Since 2018-19, rather than being able to retain revenue from proceeds of crime in Scotland – as would have happened pre-devolution – the Scottish Budget is having most of proceeds clawed back in the form of a reduced block grant.

The Scottish Government claims this breaches ‘no detriment’ principles. HM Treasury’s view is that this is what the two governments have signed up to.

## Social Security

For social security payments, forecasts are of spending rather than revenues and Block Grant Adjustments are therefore additions rather than deductions. Otherwise, the process of reconciling forecasts to outturn data functions in the same way as for the fully devolved taxes.

This paper does not go into the detail of these. The FFOR report sets out the position for each of the benefits. Some of these reconciliations are absorbed in-year (as with the devolved taxes), but there is a +£43.9 million reconciliation to be applied to the 2023-24 Block grant based on the latest provisional outturn information.

## Net reconciliation requirement

Combining all these reconciliations takes us to a net reconciliation figure to be applied to the 2023-24 Scottish budget of +£22.5 million.

Table 2: Total provisional reconciliation requirement for 2023-24 Budget

Power and year	Data	£ million
Income tax 2020-21	Outturn	+50.4
LBTT 2021-22 provisional BGA reconciliation	Provisional Outturn	-59.8

SLfT provisional BGA reconciliation	Provisional Outturn	-12.3
FFFP 2021-22 provisiona BGA reconciliation	Provisional Outturn	+0.4
Social Security 2021-22 provisional BGA reconciliation	Provisional Outturn	+43.9
<b>Total provisional reconciliation required</b>		<b>+22.5</b>

## Taxes yet to be introduced

The FFOR (p6) notes the taxes yet to be introduced – namely Assigned VAT, Air Passenger Duty and Aggregates levy. Assigned VAT is now wrapped up in the ongoing Fiscal Framework discussions between the Scottish and UK Governments. It is not clear from the document why the Highlands and Islands exemption continues to hold up the devolution of Air Passenger Duty. The FFOR notes that Aggregates Levy implementation is to be informed by a consultation and stakeholder engagement exercise in Autumn 2022.

## Borrowing

### Capital Borrowing

Table 19 of the FFOR shows the Scottish Government's Capital borrowing plans.

Key points are as follows:

- Under current plans, the Scottish Government will have accumulated Capital borrowing of just over £2.1 billion by the end of 2023-24, 71% of its overall £3 billion limit
- The Scottish Government borrowed £150 million in 2021-22 for capital spending, less than the £450 million originally planned for in the Budget. The borrowing in that year was drawn from the National Loans Fund in February 2022 and will be repaid over a 20 year period at an interest rate of 1.44%. No details are provided around the interest paid on the rest of the borrowing.
- Plans for this year (2022-23) onwards are to borrow £250 million per annum, but final decisions will be taken throughout the year.
- According to the table, in the current year (2022-23) repayments for Capital borrowing will total £83 million, rising to £100 million in 2023-24.

## Resource Borrowing

The FFOR notes that due to the triggering of the Scotland-specific economic shock provision of the Fiscal Framework, the annual borrowing limit for forecast error was raised to £600 million for the years 2021-22 up to and including 2023-24. However, the document makes the point that “although the conditions for an economic shock were met, it is not possible for the Scottish Government to apply resource borrowing to provide an economic stimulus – only to meet forecast error in relation to receipts or demand-led Social Security spending.”

The Scottish Government borrowed £319 million in 2021-22 to cover the negative reconciliations relating to 2018-19 Scottish Income tax and 2019-20 fully devolved taxes and social security spending.

“However, reconciliations and borrowing plans fluctuate throughout the year, reflecting revisions to forecasts of devolved tax receipts, demand-led Social Security expenditure and associated block grant adjustments. The Scottish Government must consider the overall budget management position and ensure the Scotland Reserve limits are not breached when finalising borrowing plans towards the end of the financial year.”

The FFOR confirms that £15 million in Resource borrowing is planned in the current financial year to “fully offset” the impact of negative reconciliations relating to 2019-20 Income tax and 2020-21 fully devolved taxes, FFFP and Social Security. However, the FFOR notes that “this borrowing has not yet been drawn down, as borrowing drawdowns are subject to the in-year financial position...” and that

“As the forecast reconciliation profile is itself subject to volatility, these plans are continually re-assessed.”

The FFOR section on Resource borrowing concludes that

“The outstanding debt from resource borrowing was £505 million at the end of 2021-22, over £1.2 billion below the cumulative Resource Borrowing limit of £1.75 billion. It is highly unlikely that the Scottish Government will ever approach this cumulative limit, given the combination of the Fiscal Framework annual restrictions and the low likelihood of the cash management borrowing power being required.”

## Scotland Reserve

The final section of the FFOR relates to the Scotland Reserve position at the start and end of financial year 2021-22.

This closing provisional balance at 2021-22 year end totalled £650 million, comprising £421 million in Resource, £183 million in Capital and £46 million in Financial transactions.

No details are provided around the latest Scotland Reserve position, although that’s perhaps not surprising given the uncertainties around plans for funding current “cost crisis” measures and improved public sector pay deals in light of high inflation.



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