Fourth Annual Report on the Implementation of the Scotland Act 2016

Eighth Annual Report on the Implementation and Operation of Part 3 (Financial Provisions) of the Scotland Act 2012

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Contents

1. Introduction

1.1.1 This is the eighth annual report on the implementation and operation of Part 3 (Financial Provisions) of the Scotland Act 2012 and the fourth report on the implementation of the Scotland Act 2016.

1.1.2 It is intended to inform Parliament of the implementation work that has been carried out on fiscal powers in the Scotland Acts 2012 and 2016 as required by Section 33 of the Scotland Act 2012 and paragraph 107 of the Fiscal Framework. The UK Government produces a separate report on the implementation work they have carried out.

1.1.3 The Scotland Act 2012 was granted Royal Assent in May 2012 and represented the first transfer of fiscal powers from Westminster to the Scottish Parliament following devolution. These included:

- The creation of a new Scottish rate of income tax;
- The disapplication of UK Stamp Duty Land Tax in Scotland and provision for the introduction of a new Scottish tax on land transactions;
- The disapplication of UK Landfill Tax in Scotland and provision for the introduction of a new Scottish tax on disposals to landfill;
- Provision for capital borrowing by Scottish Ministers; and
- The power to create new devolved taxes.

1.1.4 The Scotland Act 2016 received Royal Assent in March 2016 and devolved a range of further powers to the Scottish Parliament. These included:

- Further income tax powers including the power to set rates and bands income;
- Assignment of VAT;
- Certain social security benefits;
- Air passenger duty;
- Aggregates levy; and
- Fines, forfeitures and fixed penalties.

1.1.5 This report provides an update on these sections, as well as non-legislative elements in the Fiscal Framework including: [1]

- Block grant adjustments;
- Administration and implementation costs;
- Spillover effects;
- Borrowing; and
- Scotland Reserve.

[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/503481/fiscal_framework_agreement_25_feb_16_2.pdf

1.1.6 The report provides an update on all legislative, policy and implementation work that has been carried out since the previous report on 24 April 2019 and outlines any forecast administration and implementation costs incurred in 2019-20.

1.1.7 Administration costs are the ongoing costs incurred in supporting the delivery of the Scottish Government's responsibilities under the Scotland Acts 2012 and 2016. Implementation costs are one-off costs associated with the initial investment to set up all the necessary systems and other elements required for the delivery of the powers under the Scotland Acts 2012 and 2016, whether through setting up a body or a service, implementing IT systems.

1.1.8 The next report will be published in 2021.

2. Fully Devolved Taxes

2.1 Costs

£m	2017-2018	2018-2019	2019-2020 (forecast)
Administration	**5.5**	**7.8**	**6.9**
Implementation	**0.2**	**0.0**	**1.8**

2.1.1 The above table reflects Revenue Scotland's costs to administer and implement Land and Buildings Transaction Tax (LBTT), Scottish Landfill Tax (SLfT), Air Departure Tax (ADT) and Aggregates Levy (AL).

2.2 Land and Buildings Transaction Tax

The Scotland Act 2012 provided for devolution of powers to introduce a tax on transactions involving interests in land. Land and Buildings Transaction Tax subsequently replaced UK Stamp Duty Land Tax in Scotland from 1 April 2015. LBTT is a tax applied to residential and commercial land and buildings transactions (including commercial leases) where a chargeable interest is acquired.

Key Developments

- Introduction from 7 February 2020 of a new 2% tax band for LBTT non-residential leases.
- Amendment of Section 161 of the Revenue Scotland and Tax Powers Act 2014 to provide that a daily penalty related to LBTT returns can be charged by Revenue Scotland through a single Penalty Assessment Notice.

Outturn

2.2.1 Revenue Scotland reported that 2018-19 LBTT receipts were £554 million in its Annual Devolved Taxes Accounts on 2 October 2019.

Rates and bands

2.2.2 In the 2019-20 Scottish Budget, residential and non-residential LBTT rates and bands were amended, these are outlined in table 2.1.

Table 2.1 [2]

Residential transactions	Non-residential transactions	Non-residential leases			
Purchase price	**LBTT rate**	**Purchase price**	**LBTT rate**	**Net present value of rent payable**	**LBTT rate**
Up to £145,000	0%	Up to £150,000	0%	Up to £150,000	0%
£145,001 to £250,000	2%	£150,001 to £250,000	1%	Over £150,000	1%
£250,001 to £325,000	5%	Over £250,000	5%		
£325,001 to £750,000	10%				
Over £750,000	12%				

2.2.3 The Scottish Budget 2020-21 announced that all rates and bands relating to residential and non-residential conveyances for 2019-20 would remain in place in 2020-21, providing certainty for the vast majority of taxpayers.

2.2.4 Provisional affirmative legislation to introduce (from 7 February 2020) a third tax band on non-residential leases where the Net Present Value (NPV) of rental income is above £2 million was approved by the Finance and Constitution Committee of the Scottish Parliament on 26 February 2020 and confirmed by a vote in the Scottish Parliament on 4 March 2020.

2.2.5 The Additional Dwelling Supplement (ADS) remains at 4 per cent of the total price of the property for all relevant transactions above £40,000, and will be charged in addition to the residential conveyance rates and bands.

Legislation

2.2.6 In January 2020, the Scottish Government laid legislation in the Scottish Parliament, amending Section 161 of the Revenue Scotland and Tax Powers Act 2014 (RSTPA) to provide that a daily penalty related to LBTT returns can be charged by Revenue Scotland through a single Penalty Assessment Notice. The legislation took account of a decision by the Upper Tribunal for Scotland published on 4 July 2019 regarding the application of daily penalties for late LBTT returns in

[2] https://www.gov.scot/publications/scottish-budget-2019-20/pages/4/

circumstances where Revenue Scotland is not aware that a return is due until it is submitted.

2.2.7 The Regulations brings Section 161 into line with other penalty provisions in Sections 162 and 163 of the RSTPA, which deal with LBTT returns filed 6 and 12 months late respectively.

2.3 Scottish Landfill Tax

The Scotland Act 2012 provided for devolution of the power to introduce a tax on disposals to landfill. Scottish Landfill Tax was subsequently introduced on 1 April 2015, replacing UK Landfill Tax. It is a tax on the disposal of waste to landfill, charged by weight on the basis of two rates: a standard rate, and a lower rate for less polluting materials.

Key Development

- Increase in the standard and lower rate of SLfT, with effect from 1 April 2019, and the introduction of legislation to provide for further increase from 1 April 2020.

Outturn

2.3.1 Revenue Scotland reported that 2018-19 SLfT receipts were £149 million in its Annual Accounts on 2 October 2019.

Rates

2.3.2 SLfT rates have risen in line with inflation and continue to match the corresponding landfill tax rates in the rest of the UK. The rates for 2019-20 were £91.35 per tonne for standard rated waste and £2.90 per tonne for lower rated waste with the credit rate for the Scottish Landfill Communities Fund (SLCF) marginally higher than the rest of the UK equivalent at 5.6% as set out in Chapter 2 of the Scottish Budget 2019-20.[3]

2.3.3 The Scottish Landfill Tax (Standard Rate and Lower Rate) Order 2020 was laid before the Scottish Parliament on 4 March 2020 to provide for SLfT rates for 2020-21. The planned increase will again provide for consistency across the UK.

2.3.4 The Cabinet Secretary for Environment, Climate Change and Land Reform announced in September 2019 that full enforcement of the ban on the landfilling of biodegradable municipal waste (BMW) should be delayed until 2025 for both local authorities and commercial operators managing waste covered by the ban. Work is currently underway to explore the role that SLfT could play during this transitional period and a further announcement will be made in 2020-2021. Whilst a transitional period has been agreed, the Scottish Government remains committed to ending the practice of sending BMW to landfill, in order to contribute to climate change targets and ensure Scotland's waste is managed in a sustainable way.

[3] https://www.gov.scot/publications/scottish-budget-2019-20/pages/4/

2.4 Air Departure Tax

Air Departure Tax is Scotland's planned replacement for Air Passenger Duty, which was devolved by the Scotland Act 2016. The UK and Scottish governments have agreed that introduction of Air Departure Tax will be deferred beyond April 2020 to ensure it is not devolved in a defective state.

Key Development

- On 23 April 2019, the Minister for Public Finance and Digital Economy informed Parliament that introduction of ADT would be deferred beyond April 2020.

2.4.1 The introduction of ADT in Scotland has been deferred to allow the issues raised in relation to the exemption for flights departing from the Highlands and Islands to be resolved.

2.4.2 The UK Government will maintain the application of Air Passenger Duty in Scotland in the interim and the Scottish Government continues to work with the UK Government to find a solution.

2.5 Aggregates Levy

Aggregates Levy is a tax paid on the commercial exploitation of aggregates i.e. sand, gravel and rock. The Scotland Act 2016 gave the Scottish Parliament the power to legislate for a tax to replace the Aggregates Levy in Scotland.

Key Development

- Engagement with the UK Government on its review of the UK Aggregates Levy and progress on research to support the process of devolution.

2.5.1 Since the passage of the Scotland Act 2016, the devolution of Aggregates Levy had been prevented by ongoing European and domestic legal questions regarding aspects of the UK levy.

2.5.2 Following an announcement that these questions had been resolved, the UK Government published a discussion document outlining plans for a review of the UK levy on 13 March 2019. The Scottish and UK Governments have maintained regular engagement throughout 2019-20 to discuss the progress of the review and its relevance for devolution.

2.5.3 In preparation for the eventual devolution of the levy, the Scottish Government appointed the environmental consultancy Eunomia to review, model and analyse options for a Scottish-specific Aggregate Levy. Progress was made on this research and a report will be published in due course.

3. Scottish Income Tax and VAT Assignment

Since 6 April 2017, the Scottish Parliament has had the power to set the income tax rates and limits applicable to Scottish taxpayers on their non-savings and non-dividend income. The rates and limits will be set each year in its Scottish Rate Resolution.

Key Developments

- Income tax outturn data for 2017-18 were published by Her Majesty's Revenue and Customs (HMRC) in July 2019. This was the first outturn that encompassed the Scottish rates and bands of income tax, and provided the first reconciliation of Scottish income tax revenue to forecasts.
- HMRC published a new experimental statistical document containing comparisons of Scottish income tax with the rest of the UK, with data tables for liabilities, non-savings non-dividend (NSND) income and by method of collection.
- A National Audit Office (NAO) report confirmed that HMRC has implemented adequate processes for the administration of Scottish income tax and that the outturn of income tax for 2017-18 was fairly stated. Audit Scotland endorsed this approach in a report published in January 2020. [4]

Costs

£m	2017-2018	2018-2019	2019-2020 (forecast)
HMRC Operating Costs	0.4	0.8	1.0
HMRC Implementation Costs	4.5	2.0	0.6

3.1.1 The Scottish Government has continued to work with HMRC on the final elements of the implementation work to support the devolution of the further income tax powers in the Scotland Act 2016 and the ongoing operation of Scottish income tax. This includes programme management arrangements and close monitoring of costs.

3.1.2 For the financial year 2019-20 to Quarter 3, the Scottish Government has been invoiced implementation and running costs of £1 million for Scottish income tax. HMRC has forecast a total 2019-20 cost of £1.6 million.

3.1.3 HMRC has estimated the lifetime cost for the implementation of Scottish income tax as £24.3 million.

[4] https://www.audit-scotland.gov.uk/uploads/docs/um/srit_200108.pdf

Assurance

3.1.4 The NAO published its fourth report on the implementation of Scottish income tax on 8 January 2020.[5] It reported that "we are satisfied that HMRC has adequate rules and procedures to ensure the proper assessment and collection of Scottish income tax and that they are being complied with". Audit Scotland reviewed the approach taken by the NAO and endorsed it in its own report published in January 2020.

Scottish Taxpayer Identification

3.1.5 The Scottish Government and HMRC have always agreed that a robust process for the identification of Scottish taxpayers is not only critical to the successful implementation of the Scottish income tax powers, but that it will also be a key on-going exercise. Therefore, during 2019-20, the Scottish Government has worked closely with HMRC as it continues to refine and update its processes for identifying Scottish taxpayers, which are based on live data. HMRC estimates that there are around 2.5 million Scottish taxpayers.

Outturn

3.1.6 HMRC published experimental statistics on Scottish Income Tax in July 2019, showing that the receipts from Scottish income tax were £10.9 billion in 2017-18.[6]

Rates

3.1.7 Scottish income tax rates and bands for 2019-2020 are as follows:

Table 3.1 Scottish income tax rates and bands for 2019-2020

Income in Range	Name	Rate
Over £12,500* - £14,549	Starter Rate	19%
Over £14,549 - £24,944	Scottish Basic Rate	20%
Over £24,944 - £43,430	Intermediate Rate	21%
Over £43,430 - £150,000**	Higher Rate	41%
Above £150,000**	Top rate	46%

*Assumes individuals are in receipt of the Standard UK Personal Allowance.
**Those earning more than £100,000 will see their Personal Allowance reduced by £1 for every £2 earned over £100,000.

3.1.8 The Scottish Government's proposed income tax rates and bands for 2020-2021 are summarised below. They were approved through the Scottish Government's Scottish Rate Resolution for 2020-2021 on 4 March 2020.

[5] https://www.nao.org.uk/wp-content/uploads/2020/01/Administration-of-Scottish-Income-Tax-2018-19.pdf

[6] https://www.gov.uk/government/statistics/scottish-income-tax-outturn-statistics

Table 3.2 Scottish income tax rates and bands for 2020-2021

Income in Range	Name	Rate
Over £12,500* - £14,585	Starter Rate	19%
Over £14,585 - £25,158	Scottish Basic Rate	20%
Over £25,158 - £43,430	Intermediate Rate	21%
Over £43,430 - £150,000**	Higher Rate	41%
Above £150,000**	Top rate	46%

*Assumes individuals are in receipt of the Standard UK Personal Allowance.
**Those earning more than £100,000 will see their Personal Allowance reduced by £1 for every £2 earned over £100,000.

3.2 VAT Assignment

The Scotland Act 2016 provided for the first 10 pence of the Standard Rate of Value Added Tax (VAT), and the first 2.5 pence of the Reduced Rate, to be assigned to the Scottish Government. The assignment of VAT will be based on a model that will estimate expenditure in Scotland on goods and services that are liable for VAT.

Key Developments

- UK and Scottish Governments have agreed to extend the transitional period for VAT assignment. An implementation date will be agreed once both Governments are assured that the assignment methodology is working effectively.
- Progress continues to be made on finalising the model for assigned VAT.
- Data on Scottish VAT assignment, up to 2017, was published by HMRC on 26 Feb 2020.[7]

Costs

3.2.1 As part of the Fiscal Framework Agreement, the Scottish and UK Governments agreed to share equally all costs incurred as a result of the implementation and administration of VAT assignment. In 2018-19 total costs incurred by HMRC and the Scottish Government were £0.4m, and in 2019-20, up to Q3, totalled £0.5m. These costs were split equally between HMRC and Scottish Government.

[7] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/868227/February_2020_VAT_Assignment_Experimental_Statistics_Publication_-_Published_version.pdf

Implementation

3.2.2 In 2019-20, the Scottish and UK governments have worked together to progress the draft VAT assignment methodology to deliver the best model with currently available data. The survey data that underpins elements of the methodology has been boosted to increase the reliability and stability of survey data. Finalising the model will be discussed at the Joint Exchequer Committee. Once both Governments are assured that the assignment methodology is working effectively, the Scottish Government's Budget will be determined by forecast and final estimated VAT receipts in Scotland and a corresponding block grant adjustment.

Scottish VAT Assignment Forecasts

3.2.3 The Scottish Fiscal Commission (SFC) has responsibility for producing forecasts of the VAT that will be assigned to Scotland. Their latest forecast of VAT revenue assigned to Scotland was published in February 2020.[8] This forecast has no impact on the Scottish Government's budget as this is a transitional period, where VAT assignment will be forecast and calculated, but with no impact on the Scottish Government's Budget.

[8] https://www.fiscalcommission.scot/wp-content/uploads/2020/02/Scotlands-Economic-and-Fiscal-Forecasts-February-2020.pdf

4. Block Grant Adjustments, Reconciliation & Indexation

The Fiscal Framework agreed that the Scottish Government's Block Grant would be adjusted to reflect the impact of the transfer of greater fiscal powers to the Scottish Government. Deductions are made to reflect the retention of devolved tax revenues and additions are made to provide funding for devolved social security benefits.

Key Developments

- The second Fiscal Framework Outturn Report was published on 26 September 2019 to report, amongst other things, on the operation of the Block Grant Adjustments (BGAs).[9]
- Outturn data for 2017-18 income tax was published on 18 July 2019 which determined the first income tax reconciliation which impacted the 2020-21 Scottish Budget.
- The Scottish outturn for Carer's Allowance was published for the first time in the Social Security Scotland Annual Accounts on 26 September 2019.

Fiscal Framework Outturn Report

4.1.1 As set out in the Written Agreement between the Scottish Government and the Finance and Constitution Committee, the Scottish Government published a Fiscal Framework Outturn Report on 26 September 2019 to report on the operation of the Fiscal Framework.[10] The Report made the following key point:

- A reconciliation of -£207 million would be made to the 2020-21 Budget, which is the net impact of the reconciliations for Income Tax from 2017-18, and for the fully devolved taxes, Fines, Forfeitures and Fixed Penalties, Proceeds of Crime Act revenues, and Carer's Allowance for 2018-19.

First Income Tax Reconciliation

4.1.2 Outturn data for income tax for 2017-18 was published by HMRC on 18 July 2019 and a reconciliation of -£204 million was applied to the 2020-21 Budget.[11] This was the first income tax reconciliation since the implementation of the Fiscal Framework. Further information on the reconciliation can be found in the Fiscal Framework Outturn Report.

Carer's Allowance Outturn

4.1.3 The 2018-19 Scottish outturn for Carer's Allowance was published for the first time in the Social Security Scotland Annual Accounts on 26 September 2019.[12] The DWP outturn for Carer's Allowance was published on 24 September 2019, which allowed the calculation for the final BGA reconciliation to be carried out.[13]

[9] https://www.gov.scot/publications/fiscal-framework-outturn-report-september-2019/pages/1/
[10] https://www.parliament.scot/S5_Finance/General%20Documents/20180517WA_with_SG.pdf
[11] https://www.gov.uk/government/statistics/scottish-income-tax-outturn-statistics
[12] https://www.socialsecurity.gov.scot/what-we-do/corporate-publications/annual-report-and-accounts
[13] https://www.gov.uk/government/publications/benefit-expenditure-and-caseload-tables-2019

4.1.4 As Carer's Allowance was transferred halfway through the financial year, the BGA was apportioned on a pro rata basis. As set out in Table 4.1, Carer's Allowance expenditure from September 2017 to March 2018 accounted for around 59% of DWP's expenditure in 2017-18; therefore the BGA for 2018-19 is 59% of the total year BGA. This proportion was also used to calculate the final BGA when outturn data became available and is shown in Table 4.2

Table 4.1 Carer's Allowance 2018-19 BGA Calculation

DWP's expenditure on Carer's Allowance in Scotland (April 2017 - March 2018)	£249.2m
DWP's expenditure on Carer's Allowance in Scotland (Sept 2017 - March 2018)	£145.9m
% of expenditure (Sept 2017 - March 2018)	59%
Autumn Budget 2018 - Forecast BGA (April 2018 - March 2019)	£266.9m
Autumn Budget 2018 - Forecast BGA (Sept 2018 - March 2019)	£157.3m

Table 4.2 Calculation for the final BGA reconciliation

Autumn Budget 2018 - Forecast BGA (Sept 2018 - March 2019)	£157.3m
Final BGA (April 2018 - March 2019)	£266.8m
% of expenditure (Sept 2017 - March 2018)	59%
Final BGA (Sept 2018 - March 2019)	£157.2m
Final BGA Reconciliation	-£0.1m

Proceeds of Crime

4.1.5 As set out in last year's report, the Scottish Government believes that the application of a BGA of £4m per annum breaches the Smith Commission's 'no detriment' principle. This is because the Scottish Government previously retained these proceeds (subject to a cap of £30m, which was never breached). The Scottish and UK Governments continue to discuss this matter through the official-level Joint Exchequer Committee. The BGA remains at £4m pending this further consideration.

5. Borrowing and Scotland Reserve

The Fiscal Framework Agreement and the Scotland Act 2016 increased the Scottish Government's capital borrowing limits to £3 billion. The annual limit on capital borrowing also increased to 15 per cent of the overall borrowing cap, £450 million per year.

Key Developments

- The Scottish Government’s Medium-Term Financial Strategy 2019 set out the principles and policies that guide the use of the Scottish Government’s borrowing and reserve powers.
- **Capital borrowing -** The Scottish Government has borrowed £405 million in 2019-20 to support capital expenditure, £45 million less than was assumed in the published 2019-2020 Scottish Budget. This borrowing was drawn down over three instalments, one in October 2019, and two in March 2020.
- **Resource borrowing -** In September 2019, the Cabinet Secretary for Finance, Economy, and Fair Work wrote to the Chief Secretary to the Treasury to request an increase to the Scottish Government’s borrowing and reserve limits due to their inadequacy compared to the scale of potential forecast errors.[14]
- No resource borrowing was undertaken in 2019-20. There are plans for £207 million of resource borrowing in 2020-21 to smooth the negative budget impact of forecast errors arising from tax and social security reconciliations.
- **Scotland Reserve -** The interim balance on the Scotland Reserve was reported to the Scottish Parliament as part of the Brief Guide to the Spring Budget issued on 6 March 2020.
- The Scottish Budget 2020-21 anticipated a drawdown of £168 million from the Scotland Reserve in 2020-21.[15]

5.1 Capital Borrowing

2019-20 Draw Down

5.1.1 The level of capital borrowing drawn down for 2019-20 is £405 million, £45 million less than was assumed in the published 2019-20 budget. The £405 million drawn down is what is required to support the 2019-20 financial position and to provide the capital carry forward necessary for 2020-21 published spending plans.

5.1.2 2019-20 borrowing is from the National Loans Fund (NLF). Repayments on NLF borrowing have an annuity structure. This means that semi-annual payments contain both interest and principal over the term of the loan.[16] The repayment periods and interest rates for each tranche in 2019-20 are as follows:

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[14] https://www.parliament.scot/S5_Finance/General%20Documents/18_October_2019.pdf

[15] This is £1m different than reported in the Brief Guide to the Spring Budget due to differences in rounding.

[16] https://www.gov.scot/publications/national-loans-fund-terms-of-borrowing/

- October Tranche: £200 million repaid over twenty years with an interest rate of 0.60%
- March Tranche 1: £190 million repaid over twenty five years with an interest rate of 0.56%
- March Tranche 2: £15 million repaid over twenty five years with an interest rate of 0.76%

5.1.3 Budget provision of £66 million has been made within the 2020-21 Scottish Budget to meet the expected fiscal resource costs of the capital borrowing being undertaken in 2019-20.

2020-21 Borrowing Plans

5.1.4 In recognition of the Climate Emergency, a decision has been taken to borrow the maximum of £450 million in capital borrowing to support infrastructure expenditure. This is £100m more than the £350m originally planned for in the 2019 MTFS.[17]

5.1.5 Final decisions on the specific borrowing arrangements for 2020-21 are taken over the course of the year, reflecting an on-going assessment of programme requirements and in line with the principles set out in the MTFS. Final borrowing levels may therefore differ from initial plans.

Capital Debt Stock

5.1.6 On the basis of existing and planned borrowing, the Scottish Government will have accumulated £1.99 billion in capital debt by the end of 2020-21, 66% of its overall limit. Details on previous borrowing can be found in the Fiscal Framework Outturn Report published on 26 September 2019.

5.2 Resource Borrowing

> Since 1 April 2017, the Scottish Government has had the power to borrow up to £600 million each year within a statutory overall limit for resource borrowing of £1.75 billion. The Fiscal Framework set out the conditions and limits for elements of resource borrowing: for in-year cash management, an annual limit of £500 million; for forecast errors, an annual limit of £300 million; for any observed or forecast shortfall where there is or is forecast to be a Scotland-specific economic shock, an annual limit of £600 million.

5.2.1 No Resource borrowing was undertaken in 2019-2020.

5.2.2 There are plans for £207 million of resource borrowing in 2020-21 to smooth the negative budget impact of forecast errors arising from tax and social security reconciliations.

[17] https://www.gov.scot/publications/scotlands-fiscal-outlook-scottish-governments-medium-term-financial-strategy-2019/pages/5/

Request to increase resource borrowing limits

5.2.3 The previous Cabinet Secretary for Finance, Economy, and Fair Work wrote to the CST requesting resource borrowing and drawdown limits be extended to £900m. This request is to allow the Scottish Government to better manage volatility, as the current limits are inadequate given the potential scale of forecast errors the Scottish Government may face.

5.3 Scotland Reserve

The Scotland Reserve has applied since 1 April 2017. It replaces the previous Budget Exchange mechanism and enables the Scottish Government to manage volatility associated with its fiscal powers. The Scotland Reserve is capped in aggregate at £700 million, with annual drawdowns limited to £250 million for resource and £100 million for capital. There are no annual limits for payments into the Scotland Reserve.

2019-2020 Reserve position

5.3.1 The 2019-20 Reserve position, as reported to Parliament as part of the Spring Budget Revision process, is reproduced below. The Cabinet Secretary for Finance will provide an updated report on the Reserve position to the Scottish Parliament as part of the provisional outturn in June 2020.

Table 5.1 Mid-Year report on Underspend Reserve position

2019-20 Forecast Outturn at 28 February 2020	**HM Treasury Fiscal £million**	**Scottish Budget £million**
Budget	-34,707.8	44,203.3
Forecast Outturn	34,606.8	43,896.8
Forecast Underspend	**-101.0**	**-306.5**
2020-21 Scotland Reserve Forecast at 28 February 2020	**HM Treasury Fiscal £million**	**HM Treasury Fiscal £million**
2019-20 Opening Balance		**-605.0**
2019-20 Forecast Movements		
In-year Reserve Drawdown	431.0	
Forecast Underspends	-101.0	
		330.0
2019-20 Forecast Closing Balance		**-275.0**
2020-21 Expenditure Commitments		
Budget Bill		168.0
2020-21 Planned Reserve Drawdown		**168.0**
2020-21 Forecast Residual Balance		**-106.0**
Of Which		
Fiscal Resource		100.0
Capital		0.0
Financial Transactions		6.0
		106.0

Notes:

- The position for the Reserve reflects the 2020-2021 Budget Bill commitments;
- The 2019-2020 forecast figures are drawn from a wide range of income and expenditure activities, including a number of demand-led budgets where forecasts are difficult to estimate exactly, and the forecast will be updated regularly through to year-end; and
- The Scottish Parliament will be provided with a full breakdown of the 2019-2020 provisional outturn figures by portfolio in June, as is normal practice.

2020-2021 Reserve position

5.3.2 Table 5.1 also shows an anticipated drawdown of £168 million from the Reserve in 2020-2021. The drawdown on publication was expected to comprise £131 million of resource funding, £5 million of capital funding, and £32 million of financial transactions. The drawdown is to be funded from the anticipated balance on the reserve after allowing for the 2019-20 net drawdown. The final breakdown will not be known until after the end of the financial year, when we will have provisional outturn figures for 2019-20.

5.3.3 It is the Scottish Government's policy to build up the balance in the Scotland Reserve over time as resources allow, in order to have a financial cushion available. However, a reserve capped at £700 million with a maximum limit of £350 million for annual drawdowns severely limits the capacity for Scottish Ministers to plan for the impact of future fluctuations in tax receipts while also prudently managing any underspend across the financial year.

Request to increase Scotland Reserve limit

5.3.4 The letter from the previous Cabinet Secretary for Finance, Economy, and Fair Work to the CST also requested an increase in the Scotland Reserve to £1.75bn. This increase would bring the Reserve limit in line with the overall limit for borrowing.

6. Social Security

Part 3 of the Scotland Act 2016 contains 14 Sections relating to social security and employment support. The provisions in these Sections of the Act give the Scottish Parliament greater powers to ensure that social security in Scotland is tailored to the needs of Scottish citizens. Once transferred, the Scottish Parliament and the Scottish Government will be responsible for social security benefits ultimately worth over £4 billion of spending each year in Scotland.

Key Developments

- Social Security Scotland is now established and directly employs 560 people across its Dundee Headquarters, Glasgow site and communities across Scotland. It is forecast to deliver £343 million of payments across Scotland by end of 2019-20.
- The Best Start Grant Early Learning Payment and Best Start Grant School Age Payment were launched on April 2019 and June 2019, respectively.
- The Best Start Foods payment card was launched in August 2019 and replaced the UK Government's Healthy Start Vouchers.
- The first payments for Funeral Support Payment were made in September 2019.
- Social Security Scotland's new benefit to help support young carers, Young Carer Grant, was launched in October 2019.

Costs

£m	2017-2018	2018-2019	2019-2020 (forecast)
Administration	2.3	24	17
Implementation	18.7	55	82

6.1.1 The costs above have been updated following last year's report and the forecast for 2019-2020 also included. As forecast by the Scottish Fiscal Commission, total benefit expenditure for 2020-21 is £3.4 billion.

6.1.2 By the end of 2019-20, the Scottish Government will have spent an estimated £82 million on implementing the social security programme. The Programme Business Case was published in February 2020 to provide the whole-life costs and benefits of the Programme over a 30-year timeframe to 2050.[18] The business case clearly explains the strategic context, rationale for change, socio-economic considerations, commercial considerations, and financial information and management structures necessary to deliver social security benefits for the people of Scotland. It covers short-term implementation and transition work as well as longer-term activity and measurable improvements resulting from the programme. The business case ensures decision making is robust and value for money assured.

[18] https://www.gov.scot/publications/social-security-programme-business-case-executive-summary/

Social Security (Scotland) Act

6.1.3 The Social Security (Scotland) Act 2018 sets out the over-arching legislative framework for the Scottish Government's social security powers. The Act sets out eight principles on which the Scottish social security system is based. The Act required the Scottish Government to develop a Social Security Charter, published in January 2019, which sets out how the Scottish Government and Social Security Scotland will deliver on the principles set out in the Act. The Charter also sets out what is required from individuals who apply for and receive assistance.

6.1.4 The Social Security (Scotland) Act 2018 established the Scottish Commission on Social Security (SCoSS), an independent advisory Non-Departmental Public Body. In its first year, SCoSS has provided scrutiny of a number of legislative proposals, including Funeral Expense Assistance, Young Carers' Grant, Uprating and Scottish Child Payment, to support Scottish Ministers in achieving a social security service that is human rights based, respects the dignity of individuals and contributes to reducing poverty in Scotland.

Social Security Scotland

6.1.5 Social Security Scotland delivers its services in accordance with the eight principles set out in the Social Security (Scotland) Act 2018 and the Social Security Charter. Once fully operational, Social Security Scotland will employ in excess of 1900 people across central and local functions. Foremost amongst these principles is the requirement that people be treated with dignity, fairness and respect.

6.1.6 Social Security Scotland provided £190 million in payments in the 2018-2019 financial year to more than 91,000 people across Scotland. In the financial year 2019-20 it expects to spend over £340 million. Once fully operational, Social Security Scotland will administer around £4.2 billion in payments per annum.

6.1.7 In the next 12 months Social Security Scotland's service will expand beyond the seven payments that it currently has on offer. The Agency will continue to build capacity this year in preparation for the launch of a range of disability benefits, which will become the major part of the Agency's operation in the future.

Benefits

6.1.8 The Best Start Grant Early Learning Payment and School Age Payment were introduced by the Scottish Government following the new powers introduced in the Social Security (Scotland) Act 2018. The Early Learning Payment commenced in April 2019 and provides £250 to low income families around the time a child can start nursery. The School Age Payment, which followed in June 2019, provides £250 to eligible families around the time a child can start school.

6.1.9 Funeral Support Payment, which replaces the UK Government's Funeral Expenses Payment, was launched in September 2019. This provides support to lower-income families struggling with funeral costs. In 2019-20 the flat rate payment was £700, which has been increased to £1000 in the 2020-21 Scottish Budget.

Social Security Scotland had received 950 applications for this payment as of October 2019.

6.1.10 The Young Carers' Grant gives £300 to carers who are aged 16-18 and provide an average of 16 hours of care per week. This was launched in October 2019 and is expected to have supported almost 2000 young carers by end 2019-20.

Scottish Welfare Fund and Discretionary Housing Payments

6.1.11 The Scottish Welfare Fund was established in April 2013 to provide a safety net to people on low incomes and in need. An estimated £220 million has been paid out to more than 357,000 households in need. In 2020-21, funding for the Scottish Welfare Fund is to be increased by almost 8%, from £38 million for 2019-20, to £41 million in 2020-21.

6.1.12 Responsibilty for Discretionary Housing Payments was devolved to the Scottish Government on 1 April 2017. The Scottish Government committed over £63 million to Discretionary Housing Payments in 2019-20, and this is to be increased to £73 million for 2020-21.

Scottish Child Payment

6.1.13 Work to implement the new Scottish Child Payment began in 2019-20. The Scottish Child Payment, a new benefit for low-income families with children aged under 16, will be a preventative measure to reduce levels of child poverty in Scotland.

6.1.14 The Scottish Government are using the powers to top up a reserved benefit contained in Section 79 of the Social Security (Scotland) Act 2018 to introduce Scottish Child Payment. Using secondary legislation allows the Scottish Government to make these payments quicker to families in need.

Welfare Foods

6.1.15 Section 27 of the Scotland Act 2016 came into force on 8 February 2019, devolving all functions relating to the subject matter of Section 13 of the Social Security Act 1988 (benefits under schemes for improving nutrition: pregnant women, mothers and children). These schemes are referred to as Welfare Foods (Best Start Foods) and replace the Healthy Start Voucher Scheme previously operated by UK Government.

6.1.16 Following Section 27 coming in to force, Scottish Ministers laid regulations using the power in Section 13 of the 1988 Act to make amendments to the Welfare Foods. The Best Start Foods payment card was launched in August 2019 and replaced the UK Government's Healthy Start Vouchers. The Scottish Government made changes to the scheme and implemented payment cards rather than vouchers, increased payments from £3.10 to £4.25 and expanded the range of foods available through the scheme.

7. Employability

The Scotland Act 2016 gave Scottish Ministers the opportunity to deliver employability support to help disabled people or those at risk of long-term unemployment to seek, obtain and retain employment.

Key Developments

- The Scottish Government continues to work closely with all parties to ensure that people continue to get the support required to help them in their journeys into and towards work, with over 16,000 people joining Fair Start Scotland (FSS) in the first 18 months of service.
- The Scottish Government proactively publishes information on our employability services, with statistics published quarterly on progress to date.
- The Scottish Government published the first annual report on the progress of Fair Start Scotland in June 2019, setting out its impact on people and communities.

Costs

£m	2017-2018	2018-2019	2019-2020 (forecast)
Administration	3.4	2.6	2.6
Implementation	2.2	0.6	0.0
Delivery	0.0	14.8	15.2

Fair Start Scotland

7.1.1 FSS provides tailored, person-centred support to people who need help to find and stay in work, and get the support needed to achieve their full potential. Unlike previous UK Government initiatives, participation in FSS is voluntary.

7.1.2 The Scottish Government has contracted service providers to deliver FSS services across nine contract package areas. The Scottish Government continues to work with service providers to implement and deliver support tailored to participants' individual needs.

7.1.3 The positive impact of FSS was outlined in the first annual report, which indicated that participants welcomed the support they received and that principles of dignity and respect were embedded in the service with participants also feeling they had some control over the support available.[19]

7.1.4 The Scottish Government will continue to work with a range of partners to support the wider ambition of alignment and integration of employability services as set out in our No One Left Behind strategy.[20] The Scottish Government continues to

[19] https://www.gov.scot/publications/fair-start-scotland-annual-report-year-1/pages/2/
[20] https://www.gov.scot/publications/one-left-behind-next-steps-integration-alignment-employability-support-scotland/

work closely with the DWP on delivering the FSS services, including increased joint partnership working to support key eligibility groups.

7.1.5 Scottish Ministers are committed to supporting the delivery of devolved employability services, with additional investment of up to £20 million per annum from 2018, significantly above funding transferred under the Fiscal Framework Agreement.

8. Fiscal Framework Implementation

This chapter covers further areas of Fiscal Framework implementation relevant to this Report: Policy Spillovers.

8.1 Progress on Policy Spillovers

Key Development

- The Scottish Government is continuing to pursue a spillover claim in relation to UK Government increases to the income tax Personal Allowance in 2018-19 and 2019-20, as set out in our previous report.

8.1.1 In correspondence from the then Chief Secretary to the Treasury, the UK Government accepted that above-inflation increases to the personal allowance do represent a policy change, in the context of the spillover provisions. The UK Government did not, however, accept that CPI-linked increases to the personal allowance constitute a policy change. The then Cabinet Secretary set out the Scottish Government's position that any increase in the personal allowance causes a spillover due to the differing income distributions of taxpayers in Scotland and the rest of the UK.

8.1.2 The UK Government agreed to consider the analysis presented at the official-level Joint Exchequer Committee, and, subject to agreement on the methodological approach, to estimate the effects of the policy changes for 2019-20 and 2020-21, as the basis for discussions to consider whether any transfer of funding (in either direction) is due for these years.

8.1.3 UK Government officials have since shared analysis with Scottish Government officials and officials will discuss progress and next steps at the next meeting of the official-level Joint Exchequer Committee.

8.2 Behavioural Spillovers

8.2.1 Through correspondence exchanged in February 2020, the Scottish and UK Governments have agreed that an increase in take-up of reserved benefits to which an individual is already entitled is outside the scope of the spillover provisions and the DWP will not seek to raise a spillover claim in this scenario.[21]

8.2.2 Detailed guidance on the scope and process for behavioural spillovers remains under discussion at the official-level Joint Exchequer Committee.

8.2.3 No behavioural spillovers have been raised to date. In the absence of more detailed guidance, the existing provisions in the Fiscal Framework Agreement will inform consideration of any behavioural spillover raised by either government.

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21 https://www.parliament.scot/S5_Social_Security/General%20Documents/20200310_CabSecSSOP_to_Convener_Spillover_and_Fiscal_Framework.pdf

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