Third Annual Report on the Implementation of the Scotland Act 2016

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

April 2019

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

Presented to Parliament pursuant to Section 33(2)(c) of the Scotland Act 2012

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Foreword by the Cabinet Secretary for Finance, Economy and Fair Work

This report demonstrates the continuing progress made over the past year in operationalising the Fiscal Framework and implementing the wide range of powers devolved under the Scotland Acts 2012 and 2016. Once all Scotland Act 2016 tax powers are implemented, it is expected that around half of the Scottish Government’s budget will come from devolved or assigned revenues.

We have used these powers to make significant changes, particularly with regard to Scottish income tax with the introduction of two new bands and a change to some rates. I have committed to maintaining the new structure of income tax for the remainder of the Parliament. As such, the 2019-20 Scottish Budget made no changes to rates, and did not introduce or remove any bands. This ensures that 55% of Scottish taxpayers continue to pay less than they would if they lived elsewhere in the UK, and Scotland continues to be the fairest taxed part of the UK.

Preparations continue to ensure the smooth transition of social security and employability powers. The Scottish Government is committed to using these powers to create a Scottish social security system based on dignity, fairness and respect which will help to support those who need it, when they need it. Our top priority is to ensure the safe and secure transition of the 11 social security payments for the 1.4 million people who rely on them.

The Social Security (Scotland) Act 2018 received Royal Assent on 1 June 2018 and Social Security Scotland was established in September 2018 as an Executive Agency of the Scottish Government. The Agency’s first payments of Carer’s Allowance Supplement were made in September 2018 and the Best Start Pregnancy and Baby Payment was launched on 10 December.

I welcome the Scottish Parliament's continuing scrutiny of and interest in the range of work to implement these powers.

DEREK MACKAY MSP

Chapter One - Introduction

1.1.1 This is the seventh annual report on the implementation and operation of Part 3 (Financial Provisions) of the Scotland Act 2012 and the third 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;
- 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[1] including:

- block grant adjustments;
- administration and implementation costs;
- spillover effects;

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

- borrowing; and
- Scotland Reserve.

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 26 April 2018 and outlines any forecast administration and implementation costs incurred in 2018-19.

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 before 1 May 2020 in accordance with Section 33(3)(b) of the Scotland Act 2012.

Chapter Two – Fully Devolved Taxes

2.1 Costs

£m	2016-17	2017-18	2018-19 forecast
Administration	4.5	5.5	7.8
Implementation	0	0.2	0

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 (LBTT)

Land and Buildings Transaction Tax (LBTT) 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

- Amendment of LBTT legislation to introduce a first-time buyers relief and amend group relief provisions
- Amendment of the rates and bands for non-residential LBTT and an increase from 3% to 4% for the LBTT Additional Dwelling Supplement
- Introduction of legislation to enable Revenue Scotland to share protected taxpayer information with the Welsh Revenue Authority (WRA)

Outturn

2.2.1 Revenue Scotland reported that 2017-18 LBTT receipts were £557 million in its Annual Accounts on 2 October 2018.

Rates

2.2.2 In 2018-19, residential and non-residential rates and bands were maintained at 2017-18 levels and are summarised in the following table.

Table 2.1 LBTT Rates and Bands for Residential and Non-residential Property Transactions in 2018-19

Residential transactions		Non-residential transactions		Non-residential leases	
Purchase Price	**LBTT Rate**	**Purchase Price**	**LBTT Rate**	**Purchase Price**	**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 £350,000	3%	Over £150,000	1%
£250,001 to £325,000	5%	Over £350,000	4.5%		
£325,001 to £750,000	10%				
Over £750,000	12%				

The Additional Dwelling Supplement (ADS) is 3 per cent of the total price of the property for all relevant transactions above £40,000, and will be charged in addition to the rates set out in Table 2.1.

2.2.3 The 2019-20 residential and non-residential rates and bands announced at the Scottish Government's Budget on 14 December 2019 are summarised below. Legislation to amend the rates and bands for non-residential LBTT and to increase the amount of the Additional Dwelling Supplement (ADS) to 4% was approved in January 2019. The changes, which came into effect from 25 January, are as follows:

- Reduction in the lower rate of non-residential LBTT from 3 per cent to 1 per cent, increase in the upper rate from 4.5 per cent to 5 per cent, and reduction in the starting threshold of the upper rate from £350,000 to £250,000.
- Increase in the ADS rate from 3 per cent to 4 per cent.

Table 2.2 LBTT Rates and Bands for Residential and Non-residential Property Transactions in 2019-20

Residential transactions		Non-residential transactions		Non-residential leases	
Purchase Price	**LBTT Rate**	**Purchase Price**	**LBTT Rate**	**Purchase Price**	**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%				

The new ADS rate of 4 per cent applies to the total price of the property for all relevant transactions above £40,000, and will be charged in addition to the rates set out in Table 2.2.

Relief for first-time buyers

2.2.4 In June 2018, the zero rate tax threshold for first-time buyers was effectively raised from £145,000 to £175,000. This was achieved by the Scottish Parliament approving the Land and Buildings Transaction Tax (First-

Time Buyer Relief) (Scotland) Order 2018[2], which introduced a new Schedule 4A to the Land and Buildings Transaction Tax (Scotland) Act 2013. First-time buyers buying a property above £175,000 will also benefit from the relief on the portion of the price below the threshold.

Provisions for group relief

2.2.5 In June 2018, the Scottish Parliament approved the 'Land and Buildings Transaction Tax (Group Relief Modification) (Scotland) Order 2018'. The order amended Schedule 10 of the LBTT Act to make it clear that group relief would be available where there is a transfer of properties between companies within the same corporate group structure and there is a 'Share Pledge' or similar security arrangement in place, provided by a lender outside of the group structure. The Relief will be withdrawn where an event results in the lender exercising its relevant security rights within a three year period.

Inter-Tax Authority Data Sharing

2.2.6 In December 2018, Parliamentary approval of 'The Revenue Scotland and Tax Powers Act 2014 (Ancillary Provision) Order 2018' allowed Revenue Scotland to share protected taxpayer information with the Welsh Revenue Authority under Section 15 of the Revenue Scotland and Tax Powers Act 2014 (RSTPA). This enables Revenue Scotland, the Welsh Revenue Authority and Her Majesty's Revenue and Customs (HMRC) to engage in tripartite discussions regarding tax compliance and replicates the arrangements in place between HMRC and Revenue Scotland, and HMRC and the Welsh Revenue Authority.

2.3 Scottish Landfill Tax (SLfT)

Scottish Landfill Tax (SLfT) was 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

- Amendment of the rates and bands for SLfT from 1 April 2019

[2] https://www.legislation.gov.uk/ssi/2018/221/contents/made

Outturn

2.3.1 Revenue Scotland reported that 2017-18 SLfT receipts were £149 million in its Annual Accounts on 2 October 2018.

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. A rate-setting Order for SLfT was laid before the Scottish Parliament on 20 February 2019, and these rates are now in place for 2019-20.

Table 2.3 SLfT Rates 2018-19 & 2019-20

	2018-19	2019-20
Standard Rate of SLfT	£88.95 per tonne	£91.35 per tonne
Lower Rate of SLfT	£2.80 per tonne	£2.90 per tonne
Credit Rate for Scottish Landfill Communities Fund	5.60%	5.60%

2.4 Air Departure Tax (ADT)

The Scotland Act 2016 provides for Air Passenger Duty to be devolved. The UK and Scottish Governments agreed in November 2017 to delay Air Passenger Duty devolution, and the introduction of the Scottish Government's replacement Air Departure Tax.

Key Development

- On 1 June 2018, the Cabinet Secretary for Finance, Economy and Fair Work informed Parliament that introduction of ADT would be deferred beyond April 2019.

2.4.1 The introduction of ADT in Scotland has now been deferred beyond April 2019 to allow the issues raised in relation to the exemption for flights departing from the Highlands and Islands (H&I) 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. A new H&I Working Group has been convened from organisations with expert knowledge of the H&I economy to help explore options.

2.4.3 Revenue Scotland will be responsible for collecting and managing Air Departure Tax. They have communicated a high-level 'start-up' plan to the Scottish Government to help inform plans for introduction in the future.

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

- Completion of research commissioned to review, model and analyse options for a Scottish specific Aggregate Levy in order to support the process of devolution.

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

2.5.2 However, the UK Government has recently announced that these questions have been resolved and subsequently published a discussion document outlining plans for a review of the UK levy on 13 March. The Scottish and UK Governments will be discussing the review and its implications for the timing of devolution.

2.5.3 In preparation for the eventual devolution of the levy, the Scottish Government appointed the environmental consultancy Eunomia in 2018 to review, model and analyse options for a Scottish specific Aggregate Levy. Work on this report has been undertaken throughout 2018-19 and a final report was submitted in March 2019.

Chapter Three – Scottish Income Tax

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

- A new five band Scottish income tax system was implemented in 2018-19 with the introduction of two new bands (a Starter Rate and an Intermediate Rate).
- A National Audit Office (NAO) report confirmed that Her Majesty's Revenue and Customs (HMRC) has implemented adequate processes for the administration of Scottish income tax and that the outturn of income tax for 2016-17 was fairly stated.
- Income tax outturn data for Scotland for 2016-17 was published by HMRC in July 2018 and the baseline value for the income tax Block Grant Adjustment (BGA) was adjusted accordingly.

Costs

£m	2016-17	2017-18	2018-19 forecast
Administration	0.2	0.4	0.8
Implementation	6.1	4.5	2.0
Department for Work and Pensions (DWP)	0.7	0	0

3.1.1 The Scottish Government has continued to work with HMRC on both the remaining implementation work for the Scottish Rate of Income Tax (SRIT), and the implementation work to support the devolution of the further income tax powers in the Scotland Act 2016. This includes programme management arrangements and close monitoring of costs.

3.1.2 For the financial year 2018-19 to Quarter 3, the Scottish Government has been invoiced implementation and running costs of £1.3 million for Scottish income tax, and HMRC has forecast a total 2018-19 cost of £2.8 million, split between a total non-IT cost of £0.9 million and a total IT cost of £1.9 million.

3.1.3 HMRC has estimated the lifetime cost for the implementation of Scottish income tax as £24.0 million.

3.1.4 The DWP SRIT implementation project completed its work and closed in 2016-17, and costs recharged to the Scottish Government in that year were £0.3m. To ensure that DWP's systems can deal with the implementation of the further income tax powers in Scotland Act 2016, costs recharged to Scottish Government in that year were £0.4m. This project was completed in early 2017-18.

Assurance

3.1.5 The Scottish Parliament's Finance and Constitution Committee took evidence on HMRC's delivery of changes and implementation of Scottish Income Tax from Jim Harra, HMRC's Tax Assurance Commissioner and Deputy Chief Executive and Second Permanent Secretary, on 3 October 2018.[3]

3.1.6 The National Audit Office (NAO) published its fourth report on the implementation of Scottish income tax on 30 November 2018[4]. It reported that "we are satisfied that HMRC has adequate rules and procedures to ensure the proper assessment and collection of Scottish income tax." Audit Scotland reviewed the approach taken by the NAO and endorsed it in its own report published in November 2018.[5]

Scottish Taxpayer Identification

3.1.7 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 2018-19, the Scottish Government has worked closely with HMRC as it continues to refine and update its processes for identifying Scottish taxpayers, which are now based on live data. HMRC estimates that there are around 2.5 million Scottish taxpayers.

Outturn

3.1.8 HMRC Accounts reported in a technical annex that receipts from the Scottish Rate of Income Tax were £4.35 billion in 2016-17.

3.1.9 The technical annex also calculated what the 2016-17 outturn would have been had the current (Scotland Act 2016) powers been in place with all Scottish non-savings and non-dividend income tax flowing to the Scottish Government. This figure is £10.7 billion.

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[3] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11715
[4] https://www.nao.org.uk/report/administration-of-scottish-income-tax-2017-18/
[5] http://www.audit-scotland.gov.uk/uploads/docs/um/srit_181130.pdf

3.1.10 This figure will be used from now on as the baseline value for the Scottish Government's income tax Block Grant Adjustment. For further information on this, please see chapter five.

Rates

3.1.11 Scottish income tax rates and bands for 2018-19 are as follows:

Table 3.1 Scottish Income Tax Rates and Bands 2018-19

Income in Range	Name	Rate
Over £11,850* – £13,850	Starter Rate	19%
Over £13,850 - £24,000	Scottish Basic Rate	20%
Over £24,000 - £44,273	Intermediate Rate	21%
Over £44,273 - £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.

3.1.12 The Scottish Government's proposed income tax rates and bands for 2019-20 are summarised below. They were approved through the Scottish Government's Scottish Rate Resolution for 2019-20 on 19 February 2019.

Table 3.2 Scottish Income Tax Rates and Bands 2019-20

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.

Chapter Four – 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

- The Scottish Fiscal Commission (SFC) has published its first forecasts of assigned VAT.
- Progress continues to be made on developing the model for assigned VAT.
- A draft model for assigned VAT was published on 22 November.

Costs

£m	2016-17	2017-18	2018-19 forecast
Implementation	0.1	0.2	0.2

4.1.1 As agreed in the Fiscal Framework, the Scottish Government and HMRC are sharing equally all costs wholly and necessarily incurred as a result of the implementation and administration of VAT assignment. The 2018-19 costs to the Scottish Government associated with the development of VAT assignment, up to Quarter 3, totalled £0.1 million and forecast overall 2018-19 costs are £0.2m.

Implementation

4.1.2 In 2018-19, the Scottish and UK Governments have worked together to develop a draft VAT assignment methodology to deliver the best model with currently available data. At present, the survey data that underpins elements of the methodology is being boosted to help with volatility concerns. This will increase the reliability and stability of survey data which will determine a significant component of future Scottish Budgets.

4.1.3 The draft model for calculating Scottish VAT receipts was published[6] on 22 November 2018 by HM Treasury, and on 28 March 2019 the Scottish and UK Governments held an event for interested stakeholders on the development of the draft model. Finalising the model will be discussed through the Joint Exchequer Committee in Spring 2019.

[6] https://www.gov.uk/government/publications/scottish-vat-assignment-summary-of-vat-assignment-model

4.1.4 From 2020-21, provided 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

4.1.5 The SFC has responsibility for producing forecasts of the VAT that will be assigned to Scotland. They produced their first forecast of VAT revenue assigned to Scotland in December 2018[7]. This forecast has no impact on the Scottish Government's budget because 2019-20 will be a transitional year, where VAT assignment will be forecast and calculated, but with no impact on the Scottish Government's Budget.

[7] http://www.fiscalcommission.scot/publications/scotlands-economic-and-fiscal-forecasts/scotlands-economic-and-fiscal-forecasts-december-2018/

Chapter Five – 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 First Fiscal Framework Outturn Report was published on 20 September 2018 to report, amongst other things, on the operation of the Block Grant Adjustments (BGAs).
- A change has been agreed to the Income Tax Block Grant Adjustment to account for income tax devolution to Wales.
- The first Block Grant Adjustment for Social Security was operationalised following the transfer of Carer's Allowance to the Scottish Parliament.

5.1 Fiscal Framework Outturn Report

5.1.1 As recommended by the Budget Process Review Group, the Scottish Government published a Fiscal Framework Outturn Report on 20 September 2018 to report on the operation of the Fiscal Framework. The Report made the following key points regarding the operation of the Block Grant Adjustments in 2018-19:

- A downward reconciliation of £2 million was made to the 2019-20 Budget in relation to the fully devolved taxes.
- Only the baseline value was established for income tax and the 2020-21 Budget will be the first Scottish Budget in which an income tax reconciliation will have to be made, in regards to income tax for 2017-18.

5.2 Income Tax

BGA Baseline Reconciliation

5.2.1 Income tax outturn data for Scotland for 2016-17 was published on 12 July 2018 as part of HMRC's annual accounts and report process. The outturn figure of £10,719m will be used from now on as the baseline value for the income tax BGA.

5.2.2 This figure was £548m lower than the 2016-17 forecast used at Scotland's Fiscal Outlook (£11,267m) in May 2018. While this causes the income tax BGA and forecast Scottish Income Tax revenues for the 2019-20 Scottish Budget to be significantly lower, the 2016-17 outturn data has no direct impact on the Scottish Government's Budget. This is because the BGA deducted from the Budget and the forecast tax revenues added to the Budget have been revised down by the same amount to account for the new baseline value.

Change in the Income Tax BGA Indexation

5.2.3 From 2019-20, a proportion of income tax paid by taxpayers living in Wales will be transferred to the Welsh Government. This has required the Scottish Government's income tax BGA to be updated in line with paragraph C.16 of the Fiscal Framework:

"For revenues, "corresponding UK government receipts" are the revenues from the equivalent taxes or other revenue-raising powers collected by the UK government in the rest of the UK… The scope of the UK government receipts will be updated with any devolution of tax powers to other parts of the UK".

5.2.4 For 2019-20, the BGA will still be indexed using growth in receipts and population data for England, Wales and Northern Ireland. This is necessary because there will be no 2018-19 outturn figure for England and Northern Ireland (ENI) income tax receipts only. Without this figure, it is not possible to measure the growth between 2018-19 and 2019-20 ENI income tax receipts, which would be needed to operate the 2019-20 BGA based on ENI only.

5.2.5 From 2020-21 and onwards, the income tax BGA will be indexed using growth in receipts from England and Northern Ireland only.

5.3 VAT Assignment

5.3.1 Once VAT Assignment is fully implemented, a Block Grant Adjustment will be made to reflect the fact that more of the Scottish Government's spending power will be determined through assigned VAT.

5.3.2 As set out in paragraph A.5 of 'Scottish VAT Assignment: Summary of Assignment Model'[8], the two Governments have agreed that the Office for Budget Responsibility (OBR) will forecast comparable receipts in the rest of the UK to be used in calculations for the Block Grant Adjustment.

5.3.3 The Block Grant Adjustment for VAT Assignment will work in broadly the same way as the adjustments applied for Scottish Income Tax. Forecast

[8]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/758498/VAT_assignment_model_publication_final_1.pdf

assigned revenues and the Block Grant Adjustment will be added to and deducted from the Scottish Government's Block Grant. The revenues and BGA are then fixed until the Budget after outturn data is available.

5.4 Social Security

5.4.1 Block Grant Adjustments for Social Security work in a similar way to Fully Devolved Taxes, albeit they are additions to the Block Grant rather than deductions.

5.4.2 The first benefit to require a Block Grant Adjustment, Carers' Allowance, was devolved to the Scottish Government on 3 September 2018.[9] As the benefit was transferred halfway through the financial year, the BGA was apportioned on a pro rata basis. As set out in table 5.1, 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 will also be used to make the reconciliation after 2018-19 outturn data becomes available in Autumn 2019.

Table 5.1 Carer's Allowance 2018-19 BGA Calculation

DWP's expenditure on Carer's Allowance in Scotland (April 2017 - March 2018)	£249m
DWP's expenditure on Carer's Allowance in Scotland (Sept 2017 - March 2018)	£146m
% of expenditure (Sept 2017 - March 2018)	59%
Block Grant Adjustment (April 2018 - March 2019)	£267m
Block Grant Adjustment (Sept 2018 - March 2019)	£157m

5.5 Proceeds of Crime

5.5.1 The Scotland Act 2016 includes provision for sums raised under Proceeds of Crime legislation in Scotland to be devolved to the Scottish Government. This provision came into force at the beginning of 2017-18 financial year.

5.5.2 Prior to devolution, the Scottish Government had an agreement with the UK Government whereby it retained all sums from Proceeds of Crime under an administrative cap of £30m. This cap was never breached whilst it was in force, so the UK Government never benefitted from any sums from Proceeds of Crime raised in Scotland before 2017-18.

[9] Funding for three benefits is transferred into the block grant with no Block Grant Adjustment and subsequent reconciliation required. These are Discretionary Housing Payments, Best Start Grant and Funeral Expenses.

5.5.3 The no detriment principle is clear that neither government's budget should be larger or smaller simply as a result of the devolution of powers. Despite this, the UK Government has made a Block Grant Adjustment of £4m per year for Proceeds of Crime since 2017-18. This means that the Scottish Government's budget is now £4m worse off a year and the UK Government's budget is £4m larger as a result of devolution. This contravenes the no detriment principle.

5.5.4 This Block Grant Adjustment remains under active discussion through the Joint Exchequer Committee.

Chapter Six – Borrowing and Scotland Reserve

6.1 Capital Borrowing

The Fiscal Framework 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, i.e. £450 million per year.

Key Developments

- The Scottish Government has borrowed £250 million in 2018-19 to support capital expenditure. This is less than the £450 million originally planned, largely as a result of additional consequential capital funding received from the UK Government.

- In order to maximise its commitment to investing in infrastructure in 2019-20, the Scottish Government has announced plans to borrow the annual maximum of £450 million capital intended over a 25 year period.

- The Permanent Secretary has confirmed the aim to set out a more detailed approach on capital borrowing in the next Medium Term Financial Strategy document in Spring 2019.

2018-19 Draw Down

6.1.1 The level of capital borrowing drawn down for 2018-19 is £250 million, £200 million less than the £450 million assumed in the published 2018-19 budget. The £250 million drawn down is what is required to support the 2018-19 financial position and to provide the capital carry forward necessary for 2019-20 published spending plans.

6.1.2 This reduction from the £450 million originally planned is primarily due to the Scottish Government receiving additional consequential capital funding at the UK 2018 Autumn Budget (£112 million) and subsequently in respect of additional Crossrail funding (£45 million) with the balance of the reduction a result of a number of fiscal capital underspends emerging across portfolios.

6.1.3 2018-19 borrowing is from the National Loans Fund and will be repaid over a 10 year period.[10] The interest rate for 2018-19 borrowing is 0.95%. Budget provision of £49 million has been made within the

[10] The Scottish Government's capital loan facility agreement with UK Government can be found at the following link: https://www.gov.scot/publications/national-loans-fund-terms-of-borrowing/

2019-20 Scottish Budget to meet the expected fiscal resource costs of the capital borrowing being undertaken in 2018-19.

2019-20 Borrowing Plans

6.1.4 The Scottish Government has set out plans to make full use of the £450 million capital borrowing powers in 2019-20. An assumed annual interest rate of 2.5% for 2019-20 borrowing has been used in Scottish Government affordability modelling.

6.1.5 Final decisions on the specific borrowing arrangements for 2019-20 are taken over the course of the year, reflecting an on-going assessment of programme requirements and value for money assessment of the options available. Final borrowing levels may therefore be below initial estimates.

Capital Debt Stock

6.1.6 On the basis of existing and planned borrowing, the Scottish Government will have accumulated £1.662 billion in capital debt by the end of 2019-20, 55% of its overall limit. Details on previous borrowing can be found in the Fiscal Framework Outturn Report published on 20 September 2018.

Scottish Government Approach to Capital Borrowing

6.1.7 In November 2018, the Permanent Secretary confirmed to the Public Audit and Post-Legislative Scrutiny Committee that the Scottish Government had accepted the Auditor General for Scotland's recommendations to review and refine the Scottish Government's approach to capital borrowing. The Scottish Government aims to set out a more detailed approach to the level, type and timing of borrowing in the next Medium Term Financial Strategy document in spring 2019.

6.2 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.

Key Developments

- No resource borrowing was undertaken in 2018-19 and there are no plans for resource borrowing in 2019-20.

6.2.1 Since the publication of the Implementation of the Scotland Act 2016 second report, Scottish Government and HM Treasury have agreed the terms of the resource borrowing loan facility agreement.[11]

6.3 Scotland Reserve

The Scotland Reserve has applied since 1 April 2017, 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. The Governments have agreed that annual drawdowns from the reserve is limited to £250 million for resource and £100 million for capital. There are no annual limits for payments into the Scotland Reserve.

Key Developments

- The interim balance on the Scotland Reserve was reported to the Scottish Parliament as part of the Spring Budget Revision process.
- The Scottish Budget 2019-20 anticipated a drawdown of £313 million from the Scotland Reserve in 2019-20.

2018-19 Reserve Position

6.3.1 The 2018-19 Reserve position as reported at Spring Budget Revision is reproduced below. The Cabinet Secretary for Finance, Economy and Fair Work will provide a report of the Reserve position as at 31 March 2019 to the Scottish Parliament in June.

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

Table 6.1 - 2018-19 Scotland Reserve Forecast at 31 January 2019	HM Treasury Fiscal £million	HM Treasury Fiscal £million
2018-19 Opening Balance		**(538.0)**
2018-19 Forecast Movements		
In-year Reserve Drawdown	250.0	
Forecast Underspends	(211.7)	
		38.3
2018-19 Forecast Closing Balance		**(499.7)**
2019-20 Expenditure Commitments		
Budget Bill		313.5
Budget Bill - Stage 2		94.0
		407.5
Less: Additional 2019-20 Funding		
Late budget consequentials carried forward through HMT Reserve	(148.0)	
QLTR Receipts deferred from 2018-19	(60.0)	
		(208.0)
2019-20 Planned Reserve Drawdown		**199.5**
2019-20 Forecast Residual Balance		**(300.2)**
Of Which		
Devolved Taxes Income		136.2
Financial Transactions		78.5
Balance set aside to fund spending commitments		85.5
		300.2

2019-20 Reserve Position

6.3.2 The Scottish Budget 2019-20 anticipated a drawdown of £313 million from the Reserve in 2019-20. The drawdown on publication was expected to comprise £220 million of resource funding, £46 million of capital funding and £47 million of financial transactions. The drawdown is to be funded through a mix of underspend from 2018-19 and the existing reserve balance. The final mix will not be known until after the end of the financial year, when we will have provisional outturn figures for 2018-19.

6.3.3 During the passage of the 2019-20 Budget Bill, stage 2 amendments committed a further £94 million in Resource spending, to be funded from additional consequentials of £148 million allocated to Scottish Government at the 2018-19 UK Supplementary Estimate, comprising £126 million of Resource and £22 million of Capital. Given the late allocation of this funding, HMT agreed an exceptional arrangement to separately carry forward this funding into 2019-20 outside of the Scotland Reserve arrangements. This preserves the flexibility of the agreed arrangements for operating the Scotland Reserve.

6.3.4 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 £700 million reserve with a maximum £350 million annual drawdown 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 financial years.

Chapter Seven – Social Security & Employability

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 around £3.3 billion of spending each year in Scotland.

7.1 Social Security

Key Developments

- The Social Security (Scotland) Act 2018 received Royal Assent on 1 June 2018 and we have started to deliver our first benefits.
- Social Security Scotland was established in September 2018 and now employs more than 350 people based at its interim headquarters in Dundee and a second site in Glasgow.
- The first payments of Carer's Allowance Supplement were made in September 2018.
- The Best Start Pregnancy and Baby Payment was launched on 10 December 2018 with payments of £2.7 million made to families across Scotland by 31 January 2019.

Costs

£m	2016-17	2017-18	2018-19 forecast
Administration	N/A	2.3	16.0
Implementation	5.0	18.7	59.6

7.1.1 During 2018-19 the Scottish Government spent £59.6 million on its social security programme. As in previous years, spend on the social security programme in 2018-19 continued to be funded from the centrally-held budget relating to Scotland Act 2016 non-tax implementation. This approach allowed Scottish Ministers to respond flexibly to the needs of a complicated policy area through the first years of implementation.

7.1.2 The Scottish Budget 2019-20 is the first year that sets out the Social Security budget in a separate budget line, providing more transparency to the Scottish Parliament and the public. Total social security assistance forecast expenditure is £435 million in 2019-20. Benefit expenditure is demand-led and budget allocations are based on Scottish Fiscal Commission forecasts. Scottish Government officials will monitor actual spend against forecasts closely and manage any variances in-year.

Social Security (Scotland) Act

7.1.3 The Social Security (Scotland) Act 2018 received Royal Assent on 1 June 2018. The Act sets out the over-arching legislative framework for the Scottish Government's social security powers. The Act sets out 8 principles on which the Scottish social security system is based. The Act also requires the Scottish Government to develop a Social Security Charter which sets out what is expected of Ministers when developing and delivering devolved benefits. The Charter also sets out what is required from individuals who apply for and receive assistance.

7.1.4 The Social Security Charter was approved by Parliament on 6 February 2019. It has been designed by people with lived experience. Stakeholders such as the Scottish Human Rights Commission and Scottish Public Services Ombudsman have provided advice and guidance to the core group. The co-design is an innovative model of human rights based policymaking. It is intended to be a powerful and ambitious statement of how the human right to social security will be realised in practice by the new Scottish system.

7.1.5 The Social Security (Scotland) Act 2018 establishes the Scottish Commission on Social Security, an independent scrutiny body. Scottish Ministers have appointed Dr Sally Witcher OBE as Chair, along with Ms Sharon McIntyre, Ms Judith Paterson and Dr Mark Simpson as Board Members. They took up post on 23 January 2019.

Social Security Scotland

7.1.6 Social Security Scotland was established in September 2018, as an Executive Agency of the Scottish Government, and will deliver its services in accordance with the eight principles set out in the Social Security (Scotland) Act 2018 and the Social Security Charter. Foremost amongst these principles is the requirement that people be treated with dignity, fairness and respect.

7.1.7 Its interim Corporate Plan explains how it will do this by setting out its strategic objectives and linking them directly to the principles in the Act. The interim Corporate Plan is currently being consulted on, to ensure that it properly reflects our clients' and stakeholders' expectations of our service and an updated version will be published before the end of the year. Social Security Scotland will contribute to the Scottish Government's wider outcomes based approach, which is set out in the National Performance Framework. Social Security Scotland is providing advice and support to people applying for assistance and will ultimately make the payments for all the devolved benefits. In 2018-19, Social Security Scotland commenced delivery of the Carer's Allowance Supplement and the pregnancy and baby element of Best Start Grant.

Benefits

7.1.8 Carer's Allowance Supplement, our first benefit, was delivered from September 2018, putting £442 into the pockets of over 75,000 carers with two lump sum payments of £221, an investment of over £33 million. All payments were issued on time, using a communications approach co-designed with carers and the organisations who represent them.

7.1.9 The Best Start Pregnancy and Baby Payment was introduced on 10 December 2018 to replace the UK Government's Sure Start Maternity Grant. On 6 March Parliament approved regulations which create the Best Start Early Learning and School Age payments by summer 2019. Since opening for applications on Monday 10 December, Social Security Scotland has made payments to more than 7000 low income households. The support provided to families across Scotland, as of 31 January 2019, totals £2.7 million.

7.1.10 Funeral Expense Assistance is on course to be delivered in summer 2019, improving the support available to lower income families struggling with funeral costs. Funeral Expense Assistance will replace the current DWP Funeral Payment in Scotland. Funeral Expense Assistance regulations were laid in Parliament on 18 January 2019 and approved on 6 March 2019.

Scottish Welfare Fund and Discretionary Housing Payments

7.1.11 In addition to benefits devolved in 2018-19, funding for the Scottish Welfare Fund, Discretionary Housing Payments (which are delivered through local authorities), and flexibilities for Universal Credit (UC) continued. In 2018-19 there was a total investment of over £100 million in Discretionary Housing Payments and the Scottish Welfare Fund. Responsibility for Discretionary Housing Payments was devolved to the Scottish Government on 1 April 2017, making it the first social security scheme to be devolved to Scotland following the Scotland Act 2016.

7.1.12 The Scottish Welfare Fund is a vital lifeline for people across Scotland providing £38 million per annum to councils. From 1 April 2013 until 30 September 2018, 316,095 individual households in Scotland have been helped with awards totalling £181.6 million. 171,715 (54%) were single person households and 104,805 (33%) were families with children.

Universal Credit (Scottish choices)

7.1.13 The Scottish Government is using the limited powers devolved under the Scotland Act 2016 to try and make the delivery of Universal Credit (UC) better suited to the needs of those who claim it through the UC Scottish choices. Since 4 October 2017, people in Scotland have been given the choice to receive their UC award either monthly or twice monthly and have their housing costs paid directly to their landlord.

7.1.14 The Scottish Government is also committed to splitting payments of UC between members of a couple in a household to ensure that everyone has access to an independent income based on their individual circumstances, and to promote equality in the welfare system. We have now established two policy options which we think represent the most feasible ways to split payments of UC and have taken these to the DWP to carry out a formal impact assessment. This will allow the Scottish Government to progress with refining its split payments policy based on what is technically feasible within the Department for Work and Pensions' (DWP) IT systems, and to get a sense of cost and operational requirements for delivery.

Welfare Foods

7.1.15 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 and include the Healthy Start and Nursery Milk Schemes.

7.1.16 With section 27 coming into force, Scottish Ministers will be able to make and lay regulations using the power in section 13 of the 1988 Act to establish a replacement scheme in Scotland, called Best Start Foods.

7.1.17 Best Start Foods will come into place in Summer 2019 and will replace the Healthy Start Vouchers with a new smartcard, increase payments from £3.10 to £4.25 and expand the range of foods available through the scheme.

7.1.18 On the 8 February 2019, a section 93 Order also came into force, to enable the functions relating to Welfare Foods to be exercised via Agency Arrangement on behalf of Scottish Ministers by a Minister of the

Crown. This Agency Arrangement allows for the UK Government to continue to administer the Welfare Foods schemes whilst we transition to the Scottish replacement schemes.

7.1.19 The Scottish Government continues to work closely with the UK Government's Department of Health and Social Care on the transition of Welfare Foods.

7.2 Employability

Key Development

- Delivery of the Fair Start Scotland programme

Costs

£m	2016-17	2017-18	2018-19 forecast
Administration	1.5	3.4	3.4
Implementation	1.3	2.2	0.2

7.2.1 Fair Start Scotland (FSS) provides tailored, person centred support to people who need help to find and stay in work and get the support they need to achieve their full potential. FSS is different to previous UK Government provisions as participation is completely voluntary.

7.2.2 The Scottish Government contracted service providers to deliver this service across nine contract package areas and the Scottish Government are working with them to implement and deliver support tailored to participants' individual needs.

7.2.3 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.

7.2.4 The Scottish Government continues to work closely with the DWP on delivery of the FSS service, including budgeting and monitoring costs.

Chapter Eight – Fiscal Framework Implementation

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

8.1 Progress on Policy Spillovers

Key Development

- The Scottish Government has requested a spillover be considered in relation to the UK Government increases to the Personal Allowance in 2018-19 and 2019-20.

8.1.1 The Fiscal Framework agreed that “where either government makes a policy decision that affects the tax receipts or expenditure of the other, the decision-making government will either reimburse the other if there is an additional cost, or receive a transfer from the other if there is a saving.” These financial consequences of policy decisions are termed “spillover effects”.

8.1.2 The Fiscal Framework distinguishes between direct spillover effects and behavioural spillover effects. Direct effects occur directly and mechanically as a result of a policy change before any associated change in behaviours. Behavioural spillover effects occur as a result of people changing behaviour following a policy change.

8.1.3 As part of the Framework, the UK and Scottish Governments agreed to account for all direct spillover effects and behavioural spillover effects in material, demonstrable and exceptional circumstances. Any transfer for spillover effects must be jointly agreed by both Governments. The UK and Scottish Governments agreed guidance on how the process for direct effect spillovers would work in December 2017.[12]

8.1.4 As part of this process, the Scottish Government has asked that a spillover be considered regarding the UK Government’s decision to increase the Personal Allowance for 2018-19 and 2019-20. This is because UK Government’s decisions to increase the Personal Allowance for 2018-19 and 2019-20 have a relatively larger impact on Scottish income tax liabilities, because Scotland has proportionally more basic rate taxpayers than the rest of the UK. This means that these decisions reduce the Scottish income tax

[12] See Annex B - https://www.gov.scot/binaries/content/documents/govscot/publications/report/2018/04/scottish-government-sixth-annual-report-implementation-operation-part-3-financial/documents/00534618-pdf/00534618-pdf/govscot%3Adocument

base and income tax receipts proportionately more than the rest of the UK income tax base.

8.1.5 The Scottish Government and UK Governments will continue to discuss this matter through the Joint Exchequer Committee.

8.2 Audit and Accountability Framework

Key Development

- The Audit and Accountability Framework was agreed on 27 February 2019.

8.2.1 The Fiscal Framework contains high-level principles for how accountability to Parliaments and audit arrangements of devolved services should work. Scottish Government and UK Government officials agreed an Audit and Accountability Framework on 27 February 2019 to set out how these principles should be applied in practice.

8.2.2 This Framework contains clear and consistent principles that will allow UK and Scottish auditors to support their respective Parliaments in holding public bodies to account without unnecessary duplication, with clear and distinctive lines of accountability, and in a manner that respects and facilitates their status as independent bodies. Close attention has been paid to the Scottish Parliament and Audit Scotland's recommendations throughout the drafting process. UK Government officials have also shared the drafts with the National Audit Office and the UK Parliament and their feedback has also been taken into account.

8.2.3 The Framework will be examined in the course of the wider review of the Fiscal Framework, which will present the opportunity to revisit these issues with the benefit of experience of its operation in a real-world context.

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