

# **Scottish Government Fifth Annual Report on the Implementation and Operation of Part 3 (Financial Provisions) of the Scotland Act 2012**

**Report on the Implementation  
of the Scotland Act 2016**

**April 2017**



**Scottish Government**  
Riaghaltas na h-Alba  
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**Scottish Government  
Fifth Annual Report on  
the Implementation and  
Operation of Part 3  
(Financial Provisions)  
of the Scotland Act 2012**

**Report on the  
Implementation of the  
Scotland Act 2016**

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## Foreword



This is the Scottish Government's fifth annual report to the Scottish Parliament on progress with implementing the financial provisions of the Scotland Act 2012. The report has also been extended to include progress on implementing the fiscal framework and the Scotland Act 2016.

Considerable progress has been made throughout the year towards implementing the fiscal framework which underpins the Scotland Act 2016 and the significant powers that Act devolves to the Scottish Parliament. The Scottish Government will use these new powers responsibly, in order to give certainty and stability at a time of economic and political challenge.

Indeed, the Scottish Government is already putting its newly-devolved income tax powers to good use. Earlier this year, the Scottish Parliament passed its second Scottish Rate Resolution, and – historically - the first one to set Scottish rates and bands. For 2017-18, rates have been frozen and the threshold at which people start paying the higher tax rate will remain at £43,000. This continues to protect low and middle income taxpayers while at the same time generating extra revenue to invest in key public services. The Scottish Government has also continued to engage well with HMRC and DWP to deliver the Scottish income tax powers.

Preparations are also underway to ensure the smooth transition of the remaining financial powers, including the Scottish Parliament's current consideration of the Air Departure Tax Bill.

I am grateful to the Scottish Fiscal Commission for the work it has done to scrutinise and provide assurance of the Scottish Government's tax forecasts.

I also welcome the Scottish Parliament's continuing scrutiny of and interest in the programme of work to complete the implementation of the financial provisions of the Scotland Act 2016.



**DEREK MACKAY**

## Chapter 1 - Fully Devolved Taxes and Assigned Revenues

### Scotland Act 2012

#### Legislation

1. Over the year, the Scottish Government has laid a number of proposals for changes to devolved tax legislation before the Scottish Parliament.

#### Land and Buildings Transaction Tax - supplement on additional homes

2. The Land and Buildings Transaction Tax (Amendment) (Scotland) Act 2016 which introduced an LBTT supplement on purchases of additional residential properties – the Additional Dwellings Supplement, commenced on 1 April 2016.

#### Scottish Landfill Tax (SLfT) – Qualifying Materials Order

3. Scottish Ministers committed to introduce a statutory loss on ignition testing regime for fine material following the first year of operation of SLfT. Following a consultation in November and December 2015, Scottish Ministers laid a replacement Qualifying Material Order before the Scottish Parliament on 11 February 2016 which received parliamentary approval on 9 March 2016. This introduced a statutory testing regime with effect from 1 October 2016.

#### Tax Tribunals

4. Work is ongoing regarding the integration of the Scottish Tax Tribunals into the new Scottish Tribunal system under the Tribunal (Scotland) Act 2014. The necessary subordinate legislation has completed the parliamentary process and will be in effect from 24 April 2017.

#### Devolved tax rates and bands

5. Proposed rates and bands for LBTT and SLfT were published in *Scotland's Budget: Draft Budget 2017-18* on 15 December 2016.<sup>1</sup> On the same day, the Scottish Government published the *Draft Budget 2017-18 Devolved Taxes Methodology Report* which described the methodology underlying the five-year tax revenue forecasts for the period 2017-18 to 2021-22.<sup>2</sup> The forecasts and forecast methodologies were scrutinised and challenged over the course of 2016 and endorsed as reasonable by the Scottish Fiscal Commission in their *Report on the Draft Budget 2017-18*.<sup>3</sup>
6. A new rate-setting Order for SLfT was laid before the Scottish Parliament on 21 February 2017 and approved by the Scottish Parliament's Finance

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<sup>1</sup> <http://www.gov.scot/Publications/2016/12/6610/0>

<sup>2</sup> <http://www.gov.scot/Publications/2016/12/6669/0>

<sup>3</sup> [http://fiscal.scot/media/media\\_505786\\_en.pdf](http://fiscal.scot/media/media_505786_en.pdf)

Committee on 11 March 2017. LBTT rates and bands set by Order in 2015 will remain in force for 2017-18.

### Revenue Scotland Operations

7. The following paragraphs summarise the progress and performance of Revenue Scotland in its first year of collecting devolved taxes; comments on projected revenue outturn against forecasts; and notes the tax legislation changes made by the Scottish Parliament during the year.
8. Revenue Scotland completed its first full operational year in April 2016, collecting a total of £572m - £425m of Land and Building Transaction Tax and £147m of Scottish Landfill Tax. The organisation operated efficiently and effectively, with running costs in the first year of less than 1% of the total tax collected.
9. At the end of the 2015-16 financial year, 99.8% of all tax returns submitted had been paid either within the financial year or within five days of the year end.
10. During the period of the report, Revenue Scotland successfully implemented the LBTT Additional Dwelling Supplement, ensuring the systems and processes required from 1 April 2016 for purchases of second homes and buy-to-let properties in Scotland were in place.
11. The organisation used digital innovation to establish the Scottish Electronic Tax System (SETS), enabling 98.1% of returns to be submitted electronically in the first year of operation. This exceeded an initial target of 90% set through comparisons with the online payment levels for Stamp Duty Land Tax at UK level.
12. In terms of customer service, average call waiting times to Revenue Scotland's support desk in the first 12 months was 10 seconds. Of the written communication initiated by taxpayers and agents, 96% were responded to within 10 working days.
13. The organisation places a strong emphasis on effective stakeholder engagement and consultation. In its first operational year, the Devolved Tax Collaborative provided a forum for engagement on a range of tax issues. LBTT and SLfT forums enabled stakeholders to exchange information and views on technical, tax-specific issues.
14. Collaboration has also been a key part of Revenue Scotland's work to prepare for the introduction of Air Departure Tax. Although the bill to establish the tax in Scotland is subject to consideration by the Scottish Parliament, Revenue Scotland has been involved in regular engagement with key airline industry stakeholders to support work to develop systems and processes for the tax being introduced from 1 April 2018.

## **Scotland Act 2016**

### **VAT Assignment**

15. The Scotland Act 2016 allows for receipts from the first 10p of the standard rate of VAT and the first 2.5p of the reduced rate of VAT in Scotland to be assigned to the Scottish Government. As long as the standard and reduced rates of VAT remain 20% and 5% respectively, half of VAT receipts from Scotland will be assigned to the Scottish Government.
16. The power to set VAT rates will remain reserved to the UK Government. As such, the Scottish and UK Governments have agreed that requiring businesses to report their VAT separately for Scotland and the UK would impose an unwanted administrative burden, and have agreed that VAT raised in Scotland will instead be estimated.
17. Assignment of VAT to Scotland will begin in 2019-20. As per the Fiscal Framework agreement<sup>4</sup> there will be a transitional period during which VAT assignment will be forecast and calculated each year, but with no impact for the Scottish Government. The effectiveness of the methodology will be reviewed in the final year of the transition period.
18. The Scottish Government is working with HMRC and HM Treasury to produce a model of VAT liabilities in Scotland. This consists of producing a regional version of HMRC's VAT Theoretical Tax Liability (VTTL) model.
19. 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. The Scottish Government and HMRC agreed the governance arrangements for the allocation and payment of these costs in February 2017. Costs related to this work in 2016-17, up to Q3, totalled £0.13m, and were split equally between the organisations.
20. The VAT assignment working group expects to produce its first estimate of VAT receipts in Scotland by September 2017. It is intended that it will include an estimate of VAT associated with both international and domestic tourism. The estimate will relate to outturn VAT. The Joint Exchequer Committee (JEC) will agree arrangements for the production of VAT revenue forecasts at a future date.

### **Air Departure Tax**

21. In March 2016 the Scottish Government published a consultation<sup>5</sup> seeking views on how a tax to replace Air Passenger Duty (APD) in Scotland should be structured and operated. Following the devolution of powers over APD to the Scottish Parliament under the Scotland Act 2016, and as confirmed in the

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<sup>4</sup> <http://www.gov.scot/Publications/2016/02/3623/0>

<sup>5</sup> The consultation paper, analysis and responses received can be found on the Scottish Government's Citizen Space online consultation platform: <https://consult.scotland.gov.uk/fiscal-responsibility/air-passenger-duty/>

2016-17 Programme for Government<sup>6</sup> published on 6 September 2016, the Scottish Government introduced the Air Departure Tax (Scotland) Bill<sup>7</sup> to the Scottish Parliament on 19 December 2016.

22. Assuming the Bill successfully completes its Parliamentary passage, and under terms agreed between the Scottish and UK Governments in the fiscal framework<sup>8</sup>, Air Departure Tax will replace APD in Scotland from 1 April 2018.

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<sup>6</sup> <http://www.gov.scot/programme2016>

<sup>7</sup> <http://www.parliament.scot/parliamentarybusiness/Bills/102778.aspx>

<sup>8</sup> Paragraph 26 of the Scottish Government's fiscal framework sets out the 1 April 2018 date:  
<http://www.gov.scot/Publications/2016/02/3623>

## Chapter 2 - The Scottish Rate of Income Tax (SRIT) and Scottish Income Tax

23. Over this year, the Scottish Government has continued to work with HMRC and DWP on both the remaining implementation work for the Scottish Rate of Income Tax (SRIT), including the solution that will allow pension providers to claim relief at source at the correct rate from next year, and also the implementation work to support the devolution of the further income tax powers in the Scotland Act 2016 (the 2016 Act).
24. The Scottish Parliament's Finance and Constitution Committee took evidence on HMRC's collection and management of SRIT and implementation of Scottish Income Tax from Jim Harra, HMRC's Additional Accountable Officer for Scottish income tax, and Sarah Walker, Deputy Director Devolution, on the 14 December 2016<sup>9</sup>.
25. The National Audit Office (NAO) published its second report on the Administration of SRIT on the 19 December 2016<sup>10</sup>. Audit Scotland also reviewed and endorsed the approach taken by the NAO in its own report<sup>11</sup> on the same day. Caroline Gardner, Auditor General for Scotland and Steven Corbishley, Director, NAO gave evidence on their respective reports to the Scottish Parliament's Public Audit and Post-Legislative Scrutiny Committee on 23 March 2017. The on-going work within the Scottish Government on the Scottish income tax powers was also considered by Audit Scotland as part of its separate report, *Managing Financial Powers – An Update*, published on 23 March 2017.<sup>12</sup>
26. These reports and evidence sessions have provided additional assurance to the Scottish Government on HMRC's administration of SRIT in 2015-16 and the work undertaken for the introduction of the further powers in April 2017.

### **Scotland Act 2012**

27. The Scottish Parliament set SRIT at 10% on 11 February 2016<sup>13</sup>, and from 6 April 2016, HMRC has been collecting it from Scottish taxpayers. The Office of Budget Responsibility forecast that SRIT would raise £4,900m in 2016-17 and this is the amount that has flowed from HM Treasury into the Scottish Government's Consolidated Fund during the course of this financial year. As part of the transitional arrangements agreed for SRIT, there will be no adjustment to the Scottish Government's block grant if the outturn data for 2016-17 differs from this forecast when it becomes available in 2018.
28. Due to lower costs incurred this year than forecast, HMRC has reduced its lifetime cost estimates for implementing SRIT to £20m - £25m, which it has split between non-IT costs of £7m, and IT costs of £13m – £17m. To date, the Scottish Government has been invoiced for £13.8m.

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<sup>9</sup> <http://www.parliament.scot/parliamentarybusiness/report.aspx?r=10696>

<sup>10</sup> <https://www.nao.org.uk/report/the-administration-of-the-scottish-rate-of-income-tax-2015-16/>

<sup>11</sup> [http://www.audit-scotland.gov.uk/uploads/docs/um/srit\\_161219.pdf](http://www.audit-scotland.gov.uk/uploads/docs/um/srit_161219.pdf)

<sup>12</sup> <http://www.audit-scotland.gov.uk/report/managing-new-financial-powers-an-update>

<sup>13</sup> <http://www.parliament.scot/parliamentarybusiness/report.aspx?r=10794&mode=pdf>

29. In 2015-16, the Scottish Government paid HMRC £8.4m in SRIT implementation costs. In 2016-17, up to Q3, HMRC have invoiced the Scottish Government for £2.7m, with a forecast spend in Q4 of £1.9m expected.
30. The remaining implementation costs are expected to fall primarily in 2017-18, but extend into 2018-19. Provision has been made in the Scottish Government's budget for 2017-18 on the basis of HMRC's forecasts. Provision for the costs in 2018-19 will be set as part of the next spending review.
31. The SRIT powers commenced for the 2016-17 tax year. This is therefore the first instance of running costs being incurred which will be rechargeable to the Scottish Government. In 2016-17, up to Q3, HMRC have invoiced the Scottish Government for running costs of £0.03m. These are forecast to be around £0.2m in total for this year.
32. HMRC have previously estimated that 'business as usual' running costs for Scottish income tax will be around £1.5m per year. Work is underway, however, within HMRC to identify all the business as usual costs that would be rechargeable to the Scottish Government which, alongside experience of actual costs incurred, will refine this estimate for future years.
33. DWP has also reduced its lifetime cost estimates for implementing SRIT to £1.2m. In 2015-16, the Scottish Government paid DWP £0.9m for implementing SRIT. In 2016-17, up to Q3, DWP had invoiced the SG for £0.2m.

### **Scotland Act 2016**

34. The further Scottish income tax powers will take effect from the 2017-18 tax year.
35. The Memorandum of Understanding<sup>14</sup> between the Scottish Government and HMRC has been updated to take account of the work being done for the 2016 Act income tax provisions, and governing arrangements between the Scottish Government and the DWP were similarly updated in an Exchange of Letters.<sup>15</sup>
36. The Scottish Parliament agreed on the 21 February 2017<sup>16</sup> to maintain the income tax rates that apply in the UK, but to freeze the higher rate threshold in cash terms at £43,000 for the 2017-18 tax year. The Scottish Government has estimated that this will raise £11,857m which will be available to the Scottish Government to draw down from HM Treasury throughout that financial year. There will, however, be a reconciliation process against the final outturn figure once this is known in 2019, to determine the adjustment to the block grant. The Scottish Government's income tax forecast for 2017-18 was endorsed as reasonable by the Scottish Fiscal Commission.

<sup>14</sup> <https://beta.gov.scot/publications/scottish-income-tax-powers-memorandum-of-understanding/>

<sup>15</sup> <https://beta.gov.scot/publications/scottish-income-tax-arrangements-sg-dwp/>

<sup>16</sup> <http://www.parliament.scot/parliamentarybusiness/report.aspx?r=10365>

37. HMRC estimates that the implementation of the further income tax powers will cost £2.6m, split between a total non-IT cost of £1.3m and a total IT cost of £1.3m. For the implementation of the further income tax powers up to Q3 of 2016-17, HMRC has invoiced the Scottish Government for £0.6m, with a further £0.8m forecast for Q4.
38. Additional costs will also be recharged to the Scottish Government to reflect the work undertaken by HMRC to update the PAYE system to allow it to recognise the new rates and thresholds agreed by the Scottish Parliament in February for the start of the tax year.
39. 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 2016-17, 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. This has included HMRC putting in place a solution to ensure that a significant number of potential Scottish taxpayers who had not been identified during the initial identification scan in December 2015, were subsequently correctly identified within their systems by October 2016. HMRC did not recharge the Scottish Government for the costs of implementing this solution.
40. Further analysis of the degree to which - once identified within HMRC systems as Scottish taxpayers - the correct 'S' tax code has been applied to relevant PAYE returns has also been undertaken.
41. HMRC continues to estimate that there are around 2.6m Scottish taxpayers; figures on the actual total population will be available for the first time in 2018.
42. The Scottish Government has engaged with HMRC on the compliance processes and activity that will take place each year following the agreement of both the Scottish and UK Government's income tax rates and bands, and which will take account of the degree to which there is any consequent divergence. Overall, the Scottish Government will benefit from the compliance work that HMRC conducts to protect UK income tax yield as well as bespoke activity identified for Scottish income tax. In addition, the Scottish taxpayer identification work which HMRC conducts will also have an input to the enforcement and compliance work.
43. To reflect transition from solely implementation to live running of the Scottish income tax powers, HMRC and the Scottish Government are in the process of drafting a Service Level Agreement which will cover operational aspects.
44. The Scottish Government has also continued to work with the DWP to ensure that that DWP's systems can recognise and process information on Scottish taxpayers. DWP's implementation of the further income tax powers is

estimated to cost a total of £0.5m. The Scottish Government has been invoiced for £0.2m up to Q3 in 2016-17.

### **Chapter 3 – Block Grant Adjustments, Reconciliation and indexation**

45. Following the Fiscal Framework agreement, changes in the Scottish Government's block grant will continue to be determined via the operation of the Barnett Formula. The block grant to the Scottish Government will then be adjusted to reflect the retention in Scotland of devolved revenues. As agreed in the framework, the adjustments involve two elements: (i) an initial block grant baseline adjustment; and (ii) an indexation mechanism.
46. The general position as set out in the fiscal framework and the associated technical annex<sup>17</sup> is that the initial baseline adjustments for each tax will be equal to the UK Government's receipts from the relevant tax generated in Scotland in the year immediately prior to the transfer of the tax to Scotland (year 0). Indexation will then be applied to the year 0 baseline to determine the block grant adjustment (BGA) for each tax in the first year of devolution (year 1), and indexation of the BGA will be applied annually thereafter. The full indexation formulae and methodologies for BGAs can be found in part two of the fiscal framework technical annex.
47. Over the period to 2021-22 the BGAs for tax will be indexed using the Comparable Model (CM) and the results will then be adjusted to achieve the outcome delivered by Indexed Per Capita (IPC). The figures in this chapter refer to figures achieved by the IPC method. The BGAs based on both the CM and IPC mechanisms can be found on page 20 of the Scottish Government's Draft Budget for 2017-18.<sup>18</sup>

#### **Scotland Act 2012**

48. Implementing the financial provisions for the Scotland Act 2012 powers has required three BGAs – in respect of SRIT and in respect of LBTT and SLfT - the two fully devolved taxes.
49. Prior to the fiscal framework agreement, the BGA in respect of SRIT for 2016-17 was set equal to the forecast revenue raised in Scotland (£4,900m). The net effect of this BGA was zero because no change in rates was made in this year. The revenue added to the Scottish budget was therefore equal to the reduction in the block grant. There will be no reconciliation to this adjustment once outturn data becomes available because of the agreement that the UK Government bears forecasting risks in the initial transitional period. The Scottish Government's spending power in 2016-17 has therefore been unaffected by forecast or actual receipts from SRIT.
50. Prior to the fiscal framework agreement, for LBTT and SLfT, a specific one-year agreement was reached with the UK Government in January 2015 on the BGA for 2015-16. The combined figure agreed and applied was £494m. This figure will not be revisited and will not be treated as the baseline to which indexation will be applied to arrive at the BGAs for LBTT and SLfT in respect

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<sup>17</sup> <http://www.gov.scot/Publications/2016/02/3623/4>

<sup>18</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/503481/fiscal\\_framework\\_agreement\\_25\\_feb\\_16\\_2.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/503481/fiscal_framework_agreement_25_feb_16_2.pdf)

of 2016-17 onwards. For 2016-17, the Scottish and UK Governments agreed a provisional one-year BGA of £600m for LBTT and SLfT. This will be revisited now the Fiscal Framework has been agreed but to ensure budget certainty, any revision will not take place until outturn data is available after 2016-17.

51. Following the Fiscal Framework agreement, the baseline adjustments for LBTT and SLfT, to which the indexation factors will be applied to calculate the BGA in respect of 2016-17 and future years, will be set equal to estimated outturn receipts from the relevant UK taxes in Scotland in 2014/15. These figures are £468m for LBTT and £149m for SLfT. Using the indexation outcome delivered by Indexed Per Capita (IPC), the BGAs for LBTT and SLfT for 2017-18 are £545m and £119m respectively.
52. As per the framework, the BGAs are produced based on the latest available information at the time of the Draft Budget. Once the outturn data is available for the Scottish tax revenues and the BGA, a reconciliation will be carried out as per the timetable set out in the fiscal framework. For LBTT and SLfT, this is likely to be available six months after the end of the financial year.

### **Scotland Act 2016**

53. For 2017-18 and beyond, the Scottish income tax powers under the Scotland Act 2016 will apply. The baseline block grant adjustment for income tax has been calculated at £11,750m. This is based on OBR forecasts of total Non-Savings, Non-Dividend income tax receipts in Scotland under UKG income tax policy in 2016-17, and will be reconciled to outturn.
54. Taking into account the Scottish income tax rates and bands agreed by the Scottish Parliament on 21 February 2017, the Scottish Government's forecast figure for Scottish income tax receipts for 2017-18 is £11.857 billion. This is the sum that will be available to the Scottish Government to draw down from Treasury throughout that financial year. Until reconciliation to outturn, the net impact on the Scottish budget after the Block Grant Adjustment (BGA) relating to income tax is therefore £107m in additional revenue for 2017-18.
55. Once the outturn data is available for Scottish income tax, a reconciliation will be carried out as per the timetable set out in the fiscal framework. For Scottish income tax outturn data is likely to be available 15 months after the end of the financial year.

## **Chapter 4 – Fiscal Framework Implementation**

### **Scotland Act 2016**

56. The Fiscal Framework further determines in relation to the Scotland Act 2016 tax and spending powers: an agreed transfer of funding for administration and implementation costs; funding arrangements for all further spending powers other than social security; a commitment to update Audit and accountability arrangements, and principles to ensure no detriment as a result of UK government or Scottish Government policy decisions post-devolution.

### **Administration and Implementation Costs**

57. There are administration and implementation costs associated with the new powers and functions being devolved. The UK and Scottish Governments agreed in the Fiscal Framework that the UK Government will provide a one-off non-baselined transfer of £200m to the Scottish Government to support the implementation of the new powers and a baselined transfer of £66m to cover the ongoing administration costs associated with the new powers.
58. Within these totals, £100m for implementation costs and £22m administration costs will be transferred for 2017-18. The remaining transfer(s) will be agreed by both Governments in due course.

### **Funding Arrangements for Powers Other Than Social Security**

59. To reflect the new powers and functions being devolved from April 2017, the Scottish Government has agreed with HM Treasury funding transfers to reflect the additional costs incurred or revenue generated as a result of delivering these powers and functions.
60. These powers and functions are Consumer Protection (devolved in May 2016), the Coastal Communities Fund, the Crown Estate, Discretionary Housing Payments and Employment Support Services.

### **No Detriment as a Result of Policy Decisions Post-Devolution**

61. The Fiscal Framework includes provisions on 'policy spillovers' to implement the Smith Commission's conclusion that where either the UK or the Scottish Governments makes policy decisions that affect 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.
62. We are currently considering with UK Government officials the production of guidance setting out how the provisions on policy spillovers should be applied in practice. Final arrangements will be agreed by Scottish and UK Ministers at the Joint Exchequer Committee (JEC).

## **Chapter 5 - Borrowing and Scotland Reserve**

### Borrowing

#### **Scotland Act 2012**

63. The Scotland Act 2012 allowed Scottish Ministers to undertake borrowing to fund capital expenditure subject to a statutory aggregate cap of £2.2 billion. HM Treasury has set out administrative rules, which limits borrowing in any one year to 10 per cent of the capital budget (Capital Departmental Expenditure Limit or CDEL).
64. The 2016-17 budget includes provision to borrow up to £333m to support capital investment under the Scotland Act 2012 powers. The Office of National Statistics classified the Aberdeen Western Peripheral Route Non Profit Distributing (NPD) project to the public sector in July 2015. As a result of this classification decision the Scottish Government is managing the budgetary impact of this and four other stand-alone projects in the NPD programme against capital budget limits. Although these projects now impact on the Scottish Government Capital Budgets there is no change to the contract position and therefore no cash requirement for that capital impact. The Scottish Government has therefore again exceptionally agreed a notional borrowing arrangement with HM Treasury which allows the Scottish Government to access the CDEL budget adjustment associated with borrowing (necessary to meet the budget impact of the publicly classified NPD projects) without having to make any cash drawdown. This notional borrowing will be recorded against the Scotland Act 2012 borrowing limit and notionally repaid over the lifetime of the associated projects (30 years). This is for budgeting purposes only. No actual drawdown of borrowing from the National Loans Fund or other sources is required for this amount in 2016-17. This has the advantage of minimising the interest costs in respect of the relevant projects.

#### **Scotland Act 2016**

65. The fiscal framework and the Scotland Act 2016 increase 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. £450m per year. The Scottish Government may borrow through the UK Government from the National Loans Fund, by way of a commercial loan or through the issue of bonds. The new limits came into effect from 1 April 2017.
66. The Scottish Government will continue to maximise investment within the capital limits imposed by HM Treasury, and intends to utilise the borrowing powers available through the Scotland Act 2016 up to a maximum of £450m in 2017-18. Given the variety of factors that impact on major projects, the capital programme will be proactively managed through the financial year.
67. Scottish Ministers will continue to evaluate the potential methods of borrowing available to them including borrowing from the National Loans Fund,

commercial loans and issuing bonds and will in due course take a decision on which method or combination of methods to use in 2017-18.

### Resource Borrowing

#### **Scotland Act 2012**

68. The Scotland Act 2012 extended Scotland Act 1998 powers regarding resource borrowing to enable the Scottish Government to borrow from the National Loans Fund across financial years when devolved tax revenues are lower than forecast. This form of borrowing was repayable within four years rather than in-year. An annual limit of £200m was set administratively within a statutory £500m overall limit.

#### **Scotland Act 2016**

69. From 1 April 2017, the Scottish Government has the power to borrow up to £600m 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 £500m; for forecast errors, an annual limit of £300m; for any observed or forecast shortfall where there is or is forecast to be a Scotland-specific economic shock, an annual limit of £600m.
70. Resource borrowing will continue to be from the National Loans Fund and the repayment period will be between three and five years, as determined at the time of borrowing. These borrowing powers replace those put in place under the Scotland Act 2012.
71. There are no plans to use resource borrowing powers in 2017-18.

### Scotland Reserve

72. The new Scotland Reserve applies from 2017-18 onwards and will enable the Scottish Government to manage tax volatility. The Scotland Reserve will be separated between resource and capital. Payments into the resource reserve may be made from the resource budget including tax receipts. Funds in the resource reserve may be used to fund resource or capital spending. Payments may be made into the capital reserve from the capital budget and capital reserve funds may only be used to fund capital spending. Detailed arrangements for reporting and repaying borrowing and the operation of the Scotland Reserve are being agreed with the UK Government.

## **Chapter 6 - Changes to Systems and Process and Audit and Accountability**

### Changes to Systems and Process

#### **Scotland Act 2012/Scotland Act 2016**

73. Within the Scottish Government, the Financial Management projects assessed the impact of each of the Scotland Act changes on each stage of the financial management cycle.
74. This was to ensure that the relevant processes are in place to accommodate these changes efficiently, making necessary adjustments to processes and systems and to ensure that processes are in place to support effective financial decision-making by Scottish Ministers at each stage of the financial cycle.
75. The 2017-18 Draft Budget process and documents set out the decisions made in respect of the first year of operation of new arrangements and the in-year financial management processes will manage these.
76. There is still on-going discussion with HM Treasury on some aspects of the Fiscal Framework and these will be concluded as soon as possible.
77. Progress was also made in relation to commitments to developing financial reporting, transparency and accessibility, through in particular the publication of "Scotland's Finances -Key facts and figures" on 14 December 2016<sup>19</sup>.

### Audit and Accountability

#### **Scotland Act 2016**

78. Both the Scottish and UK Governments have agreed to update auditing and accountability arrangements in light of the fiscal framework and Scotland Act 2016. The technical annex to the fiscal framework sets out key principles on governance, accountability and audit that audit arrangements should be efficient and effective, avoid duplication, and should not result in auditors becoming overburdened once the Smith provisions are fully implemented.
79. We are currently considering with UK Government officials the production of guidance setting out how the principles in the technical annex should be applied practice. Detailed arrangements will then be agreed by Scottish and UK Ministers at the Joint Exchequer Committee (JEC).

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<sup>19</sup> <http://www.gov.scot/Resource/0051/00511587.pdf>

## Chapter 7 - Scottish Fiscal Commission

### Scotland Act 2012

80. The Scottish Fiscal Commission was established on a non-statutory basis in 2014 to provide assurance over the reasonableness of the Scottish Government's forecasts of revenue from the devolved taxes and of the economic determinants underpinning the Scottish Government's forecasts of revenues from non-domestic rates.
81. Over the course of 2016-17, the Commission has continued its scrutiny of the devolved tax forecasts and NDR assumptions by means of a series of challenge meetings with the Scottish Government analysts who prepared them. The Commission published its third report on the Scottish Government's forecasts of revenue from income tax, LBTT and SLfT for the 2017-18 Draft Budget, as well as the forecasts of the economic determinants of Non-Domestic Rates, on 15 December 2016.
82. The Scottish Fiscal Commission Act 2016 established, from 1 April 2017, a robust and fully independent Commission on a statutory basis, with direct accountability to the Scottish Parliament. The initial statutory remit of the Commission was proportionate to the fiscal powers devolved to the Scottish Parliament at the time of the Bill process.

### Scotland Act 2016

83. Following the agreement reached with the UK Government on the Scottish Government's new fiscal framework, and passage of the Scotland Act 2016, the Scottish Government launched a consultation<sup>20</sup> on designating additional functions to the Commission on the 27 October 2016.
84. The *Scottish Fiscal Commission (Modification of Functions) Regulations 2017* were subsequently laid on the 27 January and passed by the Scottish Parliament on 8 March 2017. From 1 April, the Commission will be responsible for preparation of tax revenue forecasts including, for the first time, the preparation of forecasts for Air Departure Tax revenues as well as the existing devolved taxes. The Commission will also produce Scottish onshore GDP forecasts, income tax attributable to a Scottish rate resolution, non-domestic rates and demand-led devolved social security forecasts, as well as assessing the reasonableness of Scottish Ministers' borrowing projections.
85. In addition to the modification of the Commission's functions, amendments were also made to the Scotland Act 1998 by way of the *Scottish Fiscal Commission Act 2016 (Consequential Provisions and Modifications) Order 2017*. This instrument constituted the Commission as a non-Ministerial department within the Scottish Administration and included further provisions

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<sup>20</sup> <https://consult.scotland.gov.uk/fiscal-responsibility/modification-of-functions-regulations-2016/>

to secure its independence. The Order was passed by the UK Parliament on 21 February 2017.

### Membership and appointments

86. To ensure that the Commission is appropriately resourced to discharge its expanded remit, Scottish Ministers have determined that the statutory Commission should have a maximum of four members. Lady Rice, appointed as Chair of the non-statutory Commission on 24 June 2014, will continue in the role with a further two members, David Wilson and Professor Alastair Smith, identified and recruited through a public appointment round.
87. The Scottish Fiscal Commission Act 2016 provides that appointments to the statutory Commission should be made by Scottish Ministers, regulated by the Commissioner for Ethical Standards in Public Life in Scotland, and subject to the approval of the Scottish Parliament. The appointments of David Wilson and Professor Smith were the first statutory Ministerial appointments to undergo this double scrutiny process and were approved by the Scottish Parliament on 21 February 2017.

## Chapter 8 – Social Security and Employability

### Social Security

#### **Scotland Act 2016.**

88. 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 which in 2015-16 accounted for around £2.8 billion of spending in Scotland.
89. Transferring the devolved benefits safely presents a challenge on a scale unlike anything the Scottish Government has faced since devolution. Meeting this challenge requires a large-scale programme of transition, legislation and implementation. Change of this magnitude carries risks: the safe and secure transition of every claimant and every payment will be paramount, to ensure nobody falls through the gaps.
90. A Joint Ministerial Working Group on Welfare (JMWGW) and Joint Senior Officials Group have been established to facilitate joint working between the Scottish Government and DWP to oversee the transition of social security supported by comprehensive and independently assured governance bodies at Departmental level. Since the Scotland Act 2016 received Royal Assent there have been three JMWGW meetings. Minutes agreed from the meeting are made publicly available to both Parliaments by the UK and Scottish Governments respectively.
91. The JMWGW has agreed a phased approach for the commencement of the Welfare Benefits and Employment Support part (Part 3) of the Scotland Act 2016. Tranche 1 which was commenced on 14 July 2016<sup>21</sup> relates to:
- 24: Discretionary payments: top-ups of reserved benefits
  - 25: Discretionary Housing Payments
  - 26: Discretionary payments and assistance
  - 28: Powers to create other new benefits;
  - 29: Universal credit: costs of claimants who rent accommodation
  - 30: Universal credit: persons to whom, and time when, paid
  - 31: Employment support
  - 32: Functions exercisable within devolved competence
  - 33: Social Security Advisory Committee and Industrial Injuries Advisory Council
  - 34: Information-sharing
  - 35: Extension of unauthorised disclosure offence.

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<sup>21</sup> The Scotland Act 2016 (Commencement No.1) Regulations 2016 (SI 2016/759) and The Scotland Act 2016 (Saving) Regulations 2016 (SI 2016/761)

92. The remaining sections, proposed for Tranche 2, are more complex as they transfer responsibility for existing and on-going benefits and will have more potential to negatively impact those receiving them if not transferred carefully. These are: section 22, which transfers responsibility for existing and on-going benefits relating to disability, industrial injuries and carers benefits; and section 23, which covers benefits for maternity, funeral and heating expenses.
93. At the JMWGW on 11 October 2016, Ministers agreed:  
“... that officials should work to commence sections 22 and 23 of the Scotland Act with an approach of splitting legislative and executive competence, with the intention of legislative competence passing by June 2017 and executive competence passing by April 2020. Thereafter, agency agreements would be put in place as necessary.”
94. Commencement and transitional regulations which will deliver this approach have been made by the UK Government and were shared with Scottish Government officials before being laid. The regulations deliver the split commencement approach and incorporate key safeguards.
95. At the JMWGW on 20 February, 2017 Ministers agreed that the UK Government should proceed to make and lay regulations in the UK Parliament on or around the 10 April. In the event, these were laid slightly earlier, on 22 March. The Commencement Regulations are due to come into force, with no further procedure required, on 17 May.
96. The Scottish Government and DWP have developed close working relationships across a number of areas, including delivering the Scottish Government’s changes to Universal Credit, information sharing and appraising options for implementing the Scottish Government’s commitment to increase the rate of Carer’s Allowance.

#### Social Security Bill.

97. In the 2016-17 Programme for Government, the Scottish Government made a commitment to bring forward a Social Security Bill within the first year of the new Parliament in order to implement powers transferred via the 2016 Scotland Act.
98. On 29 July the Scottish Government issued a public consultation, “*A New Future for Social Security, Consultation on Social Security in Scotland*”, to inform the content of the new Scottish Social Security Bill. The consultation set out the vision and key principles for social security in Scotland. The consultation was in three parts, covering:
- a principled approach;
  - the devolved benefits;
  - operational policy.
99. In addition to the formal consultation, the Scottish Government held over 120 events carried out with partners across 32 local authorities in Scotland between July to October 2016. These events provided stakeholders with the

opportunity to communicate their views and contribute to the development of the proposals contained in the Bill. The independent analysis of the consultation responses, by Research Scotland, along with the Scottish Government response were published on 22 February 2017.

100. One of the key principles of Social Security in Scotland is that the processes, procedures and systems will be designed and built with and for the people of Scotland. To do that, at least 2,000 people with direct personal experience of the current social security system are being invited to join 'Experience Panels'. As part of this recruitment, the DWP sent personal invitations to 18,000 people on behalf of the Scottish Government who have recent or current experience of the social security system. The Experience Panels will bring together groups of people who are willing to share their views of how the current system works, and how it could and should work. We will collaborate over the next four years with these Experience Panels to design and build Scotland's new Social Security system.

#### Scottish Social Security Agency.

101. In March 2016, Scottish Ministers announced their decision to establish a new executive agency to oversee the delivery of the devolved social security powers. The decision to create an agency was taken after considering a range of evidence and in consultation with stakeholders, who indicated support for administering benefits through a public body which is part of the Scottish Government and accountable to Scottish Ministers.
102. The Scottish Government has undertaken a detailed second stage options appraisal to examine in greater detail how the new agency can best deliver in a way that is aligned with our core principles of fairness, dignity and respect, and achieves value for money.
103. The Scottish Government has again taken a co-production approach to this work by involving a number of partners to work alongside us to determine and assess the options appraisal criteria. We will announce the conclusions of this work and a preferred model for delivery in spring 2017.
104. The Scottish Government already spends more than £70m per year on social security, prior to further social security devolution under the Scotland Act 2016. As part of our measures to tackle poverty, we have also invested over £1 billion in the Council Tax Reduction scheme since 2013-14, assisting almost half a million households each year to meet their council tax, and established the Scottish Welfare Fund which provides support to people in crisis and low income households.
105. The Scottish Budget announced on 15 December 2016 indicated that further spend in 2017-18 on the developing social security programme will be funded from the centrally held budget relating to Scotland Act 2016 non-tax implementation (£80m). Implementing a new social security system for Scotland is a highly complex exercise and we are continuing to develop detailed costed plans.

## Employability

106. Employability Powers in place under section 31 of the Act have been implemented from 3 April 2017. One year transitional services, Work First Scotland and Work Able Scotland will provide continuity of support for up to 4,800 people with a disability or long term health condition. From April 2018, Fair Start Scotland (FSS) will support at least 38,000 disabled people or those at risk of long term unemployment over the course of three years of referrals up to March 2021. Action to procure FSS services in 9 contract areas covering Scotland is underway with contracts expected to be awarded in October 2017. Scottish Ministers are committed to supporting the delivery of devolved employability services, with additional investment of up to £20m in 2017-18 and an additional £20m per annum from 2018 significantly enhancing the Fiscal Framework settlement. The Scottish Government continues to work closely with the DWP on implementation, and delivery of the 2017 and 2018 services.

## **Chapter 9 - Conclusion**

107. As set out in this report, there has been significant progress over the last 12 months to implement both the Scotland Act 2012 and the Scotland Act 2016.
108. The next annual report on the implementation of both Acts will, in accordance with Section 33(3)(b) of the Scotland Act 2012, be published before 1 May 2018.



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