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

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FOREWORD

The Scotland Act 2012 marked a significant step forward for Scottish devolution. The Act provided the largest transfer of fiscal power from London since the creation of the United Kingdom, introducing a new Scottish rate of income tax, devolving Stamp Duty Land Tax and Landfill Tax, establishing powers to create new devolved taxes or devolve existing taxes by agreement between the two governments, and creating new borrowing powers for the Scottish Government.

These new financial powers represent a radical, historic and significant change to the financing of public services in Scotland. The Office for Budget Responsibility forecasts that these measures will enable the Scottish Government to fund around a third of the spending it controls; more than double the proportion currently funded through council tax and non-domestic rates.

The Scotland Act 2012 implemented the recommendations of the Commission on Scottish Devolution, delivering substantive reforms to the devolution settlement in Scotland on a range of financial and non-financial matters. Delivering the Act was a significant achievement; from its introduction in November 2010 through to Royal Assent in May 2012, the legislation was subject to detailed scrutiny in the UK and Scottish Parliaments and received overwhelming support from both. But as we recognised during the passage of the Bill, the legislation is just one part of the process and both governments are now focused on the practical steps required to implement these important changes.

The significant devolution of fiscal powers is set out in Part 3 of the Scotland Act. The implementation of these powers represents a substantial body of work and a timeline that stretches into 2016 and beyond to ensure that the new system operates with stability and predictability for the provision of devolved services in Scotland. In order to ensure that both parliaments are kept informed, we committed during the passage of the Bill to publish an annual report on the implementation of the financial provisions. This is the first annual report and provides an opportunity to reflect on how we have acted to implement these important changes since the Bill received Royal Assent on 1 May 2012.

The work undertaken over the last year illustrates the power of devolution, with two parliaments and two governments working together in the interests of Scotland. The new powers will give the Scottish Parliament greater control over a significant proportion of the Scottish Government Budget and how this money is raised, while transitional arrangements and new borrowing powers for Scottish Ministers ensure that the support and stability of the wider UK economy continues to apply in Scotland. With the implementation of these finance provisions, Scotland will continue to have the best of both worlds.

Rt. Hon. Michael Moore MP
Secretary of State for Scotland

CHAPTER 1

INTRODUCTION

Scope and Content of this Report

1. Part 3 of the Scotland Act 2012 deals exclusively with the devolution of financial powers. These include:
    - 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 borrowing by Scottish Ministers; and
    - the power to devolve further existing taxes and create new devolved taxes.

2. The financial provisions represent a substantial body of work and it is recognised that their implementation must be carefully managed over a period of time. The financial provisions will be implemented over a number of years, in line with the timetable set out in the Command Paper which accompanied the Scotland Bill in November 2010, to ensure that appropriate transitional arrangements are put in place. In order that both the UK and Scottish Parliaments are fully informed through this process, section 33 of the Scotland Act 2012 requires the Secretary of State for Scotland and Scottish Ministers to report annually on the implementation of this part of the Act.

3. Both parliaments will be sighted on the views of both administrations: the Secretary of State for Scotland is required to report to the UK Parliament and provide a copy to Scottish Ministers who are required to lay it before the Scottish Parliament; and Scottish Ministers are required to report to the Scottish Parliament and provide a copy to the Secretary of State, who is required to lay it before both Houses of Parliament at Westminster. Both governments will continue to report until April 2020, or the first anniversary of

the day on which the last provisions of Part 3 come into force, if that is after April 2020.

4. Section 33(5) of the Scotland Act requires the annual reports to contain:
   (a) a statement of the steps which have been taken, whether by the maker of the report or by others, since the making of the previous report (or, in the case of the first report, since the passing of this Act) towards the commencement of the provisions of this Part,

   (b) a statement of the steps which the maker of the report proposes should be taken, whether by the maker of the report or by others, towards the commencement of the provisions of this Part,

   (c) an assessment of the operation of the provisions of this Part which have been commenced,

   (d) an assessment of the operation of any other powers to devolve taxes to the Scottish Parliament or to change the powers of the Scottish Ministers to borrow money, and of any other changes affecting the provisions inserted or amended by this Part,

   (e) the effect of this Part on the amount of any payments made by the Secretary of State under section 64(2) of the 1998 Act (payments into the Scottish Consolidated Fund), and

   (f) *any other matters concerning the sources of revenue for the Scottish Administration (within the meaning of section 126(6) of the 1998 Act) which the maker of the report considers should be brought to the attention of the Parliament of the United Kingdom or the Scottish Parliament.*

5. Each of these areas is addressed in the relevant sections of the report. Annex A provides a detailed list of the paragraphs in the report which address each of these requirements.

CHAPTER 2

SCOTTISH RATE OF INCOME TAX

From April 2016, the main UK rates of income tax will be reduced by 10 pence in the pound for those identified as Scottish taxpayers. The Scottish Parliament will set, in its annual budget, the new Scottish rate of income tax to be added to the reduced UK rates. The Scottish block grant will be adjusted to reflect this change in funding streams.

Steps taken towards implementation

6. Implementation of the Scottish rate of income tax is led by an HMRC project with oversight provided by the programme board, made up of representatives from HMRC, HM Treasury and the Scotland Office as well as the Scottish Government.

7. The programme is responsible for the implementation of the Scottish rate of income tax as well as the disapplication of Stamp Duty Land Tax and Landfill Tax in Scotland. The Scottish Government is represented on the programme board and on the boards of projects responsible for the changes to each of the three taxes. The fully devolved taxes are discussed in greater detail in chapters 3 and 4 of this report.

8. Programme board members are involved in decision making to ensure that the projects provide effective solutions and value for money.

9. To provide a framework to support the successful implementation of the Scottish rate, HMRC and the Scottish Government have set out their respective roles and responsibilities in a Memorandum of Understanding. This agreement sets out the arrangements for the two governments to work together on the implementation of the Scottish rate, including the arrangements for the Scottish Government to meet HMRC's costs of implementation, and how HMRC will ensure that its expenditure represents value for money for the Scottish Government. UK and Scottish Ministers agreed the final text of the Memorandum in February and it has subsequently

been signed by officials. The Memorandum has also been shared with the Scottish Affairs Committee by HMRC on 14 March 2013, and Scottish parliamentary committees by the Scottish Government, and published on the HMRC and Scottish Government websites[1].

10. The Scottish rate of income tax project is responsible for three significant activities necessary for implementation:
    - Identifying Scottish taxpayers and preparing them along with employers, agents, pension providers, software developers and payroll bureaux for the introduction of the Scottish rate of income tax;
    - Enabling the administration and collection of the Scottish rate of income tax due from April 2016 through changes to the PAYE ('pay-as-you-earn') and Self Assessment systems – work on system changes is expected to start in 2014;
    - Developing a transparent and efficient process to account for taxes collected under the Scottish rate for the 2016-17 tax year and onwards.

11. In the first phase of the project, which began on Royal Assent and will continue during 2013, HMRC is examining UK income tax systems including PAYE, Self Assessment and Pensions, in order to establish the impact of the Scottish rate of income tax. This includes an examination of HMRC customer information and the key forms and guidance currently used to communicate with taxpayers, as well as the finance and accounting processes that would be required to account for the Scottish rate of income tax.

12. The cost for the project has been estimated at £40m-45m for implementation, including around £10m in IT costs. After implementation, the annual running costs are estimated to be £4.2m each year. HMRC has invoiced the Scottish Government for the costs associated with the implementation project in 2012-13 – a total of £165,141. HMRC has shared an estimate of costs with the

[1] The Memorandum of Understanding on the Scottish rate of income tax can be found at: http://www.hmrc.gov.uk/news/mou-sri-tax.htm

Scottish Government for the programme in 2013-14 of £1.5m which covers the cost in that year of work associated with switching off Stamp Duty Land Tax and Landfill Tax as well as implementing the Scottish rate of income tax.

13. Shortly after the Scotland Bill was introduced to Parliament in 2010, HMRC set up three technical groups to examine a number of consequential issues arising as a result of the Scottish rate – the groups looked at pensions tax relief, charitable giving and general income tax issues (for example, the taxation of income from trusts) and included representatives of the legal and accountancy professions, charities and pension providers, and representatives of employers and developers of payroll software. In discussion with these groups, HMRC developed a series of proposals for the treatment of these reliefs and types of income and, in May 2012, published a Technical Note on the HMRC website seeking comments. The respondents to this Note were content with the proposed way forward. A further document will be published in 2013 confirming the changes to be implemented and providing an opportunity for comments on draft regulations.

14. In November 2012, Edward Troup (Tax Assurance Commissioner and Second Permanent Secretary, HMRC) was appointed Additional Accounting Officer with responsibility for the Scottish rate of income tax. This role was identified in the Command Paper published with the Scotland Bill in 2010. The Additional Accounting Officer is accountable for the performance of HMRC in establishing and operating the Scottish rate and has undertaken to give evidence to committees of the Scottish Parliament on HMRC's administration of the Scottish rate when requested. On 21 November 2012, Edward Troup gave evidence to the Scottish Parliament's Public Audit Committee on the Scotland Act 2012 and he has been invited to attend the Finance Committee in May 2013.

Further steps that will be taken towards implementation

15. During 2013-14, the project will design new processes which will ensure that HMRC can accurately and efficiently collect the Scottish rate of income tax. The project will develop an approach to identifying Scottish taxpayers, based

on an examination of current HMRC data on taxpayers' places of residence and potential additional sources of information. Work will also begin on the design of appropriate compliance processes to provide assurance that people are correctly identified as Scottish taxpayers and are paying tax at the correct rate, and on developing a communication strategy to ensure that individuals and employers affected by the implementation of the Scottish rate receive the information they need and understand their obligations. HMRC expect to make potential Scottish taxpayers aware during 2015-16.

16. As these processes are designed, estimates of the cost of the implementation project will be refined and revised as necessary. Work planned in 2013-14 will lead to a more accurate estimate of the cost of identifying Scottish taxpayers – the major element of non-IT costs for the Scottish rate project. Where there are options for the way in which implementation is designed, these will be taken through the project and programme governance, involving Scottish Government representatives. Detailed work to implement the IT systems changes required for the Scottish rate of income tax will begin in 2014 and take around two years: more accurate estimates of the cost of system changes will not be available until that work has been agreed.

17. At Budget 2013, the UK Government announced its intention to introduce legislation in Finance Bill 2014 to require the National Audit Office to report direct to the Scottish Parliament annually on HMRC's administration of the Scottish rate of income tax. This will ensure that the auditing and reporting arrangements set out in the Command Paper 'Strengthening Scotland's Future', published alongside the Scotland Bill in November 2010, can be fully implemented. Consultation on the draft legislation will take place during autumn 2013.

CHAPTER 3

SCOTTISH TAX ON LAND TRANSACTIONS

The Scotland Act 2012 provides for Stamp Duty Land Tax to be devolved. From April 2015, the UK tax will cease to apply in Scotland and the Scottish Government will be able to levy its own tax in respect of land transactions. The UK tax will be 'switched off' and a corresponding adjustment will be made to the Scottish block grant.

Steps taken towards implementation

18. An HMRC project has been set up to manage the disapplication of Stamp Duty Land Tax for Scotland, with oversight provided by the implementation programme board. The project board includes representatives from HMRC and the Scottish Government. Board members are involved in decision making to ensure that the project provides effective solutions and value for money.

19. The Stamp Duty Land Tax project has focused attention on analysis of how existing HMRC systems will be affected by the disapplication of the tax in Scotland from 2015 and the identification of stakeholders that will be affected by the change. HMRC has so far invoiced the Scottish Government for £18,153 in respect of this work.

20. The design and implementation of the tax set up to replace Stamp Duty Land Tax is a matter for the Scottish Government and Parliament, as this area will be fully devolved. The Scottish Government's consultation on the replacement for Stamp Duty Land Tax took place between June and August 2012. The Land and Buildings Transaction Tax (Scotland) Bill was placed before the Scottish Parliament in November 2012. In June 2012, the Scottish Government announced a new tax authority to administer Scotland's devolved taxes; Revenue Scotland will be set up as an administrative unit of the Scottish Government. More information on the Scottish Government's plans can be found in the Scottish Government's own report on the implementation

of Part 3 which is presented to Parliament alongside this report.

Further steps that will be taken towards implementation

21. In 2013-14, detailed plans will be drawn up for technical changes to existing systems as well as the building and testing of any new components or changes needed to disapply Stamp Duty Land Tax in Scotland. In 2013, further work will be done to produce estimated costs for this work, including estimates from suppliers. An implementation plan will be developed by summer 2014 for review by the Scottish Government before implementation in 2015.

22. The devolution of this tax will be accompanied by a corresponding adjustment to the block grant. Further information on the effects of the tax powers on the Scottish block grant can be found in chapter 7 of this report.

CHAPTER 4

SCOTTISH TAX ON DISPOSALS TO LANDFILL

The Scotland Act 2012 provides for Landfill Tax to be devolved. From April 2015, the UK tax will cease to apply in Scotland and the Scottish Government will be able to levy its own tax in respect of disposals to landfill. The UK tax will be 'switched off' and a corresponding adjustment will be made to the Scottish block grant.

Steps taken towards implementation

23. An HMRC project has been set up to manage the disapplication of Landfill Tax for Scotland, with oversight provided by the implementation programme board. The project board includes representatives from HMRC and the Scottish Government. Board members are involved in decision making to ensure that the project provides effective solutions and value for money.

24. The project team has identified stakeholders and started work to identify potential Landfill Tax customers likely to be affected by the disapplication of the tax in Scotland. It has been established that technical changes to HMRC systems for Landfill Tax are unlikely to be necessary.

25. The Scottish Government's consultation on a Landfill Tax for Scotland took place between October 2012 and January 2013. The Landfill Tax (Scotland) Bill was introduced into to the Scottish Parliament on 17 April 2013.

Further steps that will be taken towards implementation

26. In 2013-14, the focus of the project will be on developing the planning work for the transfer of full responsibility to the Scottish Parliament for the taxation of disposal of waste to landfill from April 2015 as smoothly as possible. A communications plan to provide information to Landfill Tax operators and users of landfill sites in Scotland will also be developed.

27. The devolution of this tax will be accompanied by a corresponding adjustment to the block grant. Further information on the effects of the tax powers on the Scottish block grant can be found in chapter 7 of this report.

CHAPTER 5

BORROWING POWERS OF SCOTTISH MINISTERS

The provisions in the Scotland Act 2012 enable Scottish Ministers to borrow for three purposes from April 2015:

- *for capital investment, Scottish Ministers can borrow up to 10% of the Scottish Government's capital DEL budget each year within a statutory total borrowing limit of £2.2bn. Loans will usually be for a maximum of ten years but with the option of a longer period in line with the expected life of the asset;*
- *to enable the Scottish Government to deal with deviations between forecast and actual revenues, in addition to operating a cash reserve, Scottish Ministers can borrow up to £200m annually up to a total of £500m. Loans will be for a maximum of 4 years; and*
- *to provide the Scottish Consolidated Fund with an appropriate cash working balance to deal with temporary shortfalls between receipts and expenditure. Note that a similar facility existed under the Scotland Act 1998.*

Steps taken towards implementation

28. HM Treasury and the Scottish Government have agreed the following process to enable borrowing for all three purposes from the National Loans Fund (NLF):
    - the Scottish Government should give reasonable notice of its intention to borrow for capital purposes from the NLF. This will include a forecast of expected borrowing during the upcoming financial year, which will be updated at set points during the year. Actual borrowing does not have to be at the exact levels forecast;
    - NLF loans will be administered by HM Treasury with the funds to flow through Scotland Office in line with payment of the block grant. Loans will be available from the NLF following 5 days' notice;
    - Standard NLF terms will apply to each loan – these are the terms available to all approved borrowers and enable loans to be agreed and advanced

quickly. In particular, interest rates will be determined by the Debt Management Office (DMO) and will reflect the rates ruling at the time. The rates, which are published, cover the cost of funding plus a small margin to cover administrative costs.

29. The Scottish Government can additionally borrow from commercial banks for capital investment purposes, while the UK Government has also consulted on enabling the Scottish Government to issue bonds and will respond to the consultation in due course[2].

30. Prior to the full implementation of borrowing powers in April 2015, Scottish Ministers are able to exercise a narrow version of these powers for specified capital expenditure with the agreement of HM Treasury. From 2011-12, Scottish Ministers were able to use prepayments to fund early work on the Forth Road Bridge Replacement Crossing. The full powers will come into effect in April 2015 alongside the introduction of the fully devolved taxes, which will provide the Scottish Government with an independent revenue stream to support borrowing.

Further steps that will be taken towards implementation

31. As noted above, the UK Government will respond to the consultation on Scottish bonds in due course.

[2] The consultation document is available at: http://www.hm-treasury.gov.uk/consult_scotlandact2012_bond_issuance.htm

CHAPTER 6

POWERS TO DEVOLVE FURTHER EXISTING TAXES AND CREATE NEW DEVOLVED TAXES

With the agreement of both governments, further existing taxes can now be devolved and the Scottish Parliament is able to introduce new Scotland-specific taxes. These powers support the ongoing evolution of devolved responsibilities and provide the Scottish Parliament with a new means of achieving policy outcomes, as well as potentially raising additional revenues.

32. A process for creating new taxes and/or devolving existing taxes has been agreed by the UK and Scottish governments. This process involves the following key elements:

- Initial proposals will be discussed and agreed in principle by both governments prior to moving into a detailed assessment of the evidence base;
- The assessment phase should be commensurate with the likely impact of the proposal and is expected to include wider consultation on the proposals. It will also explore whether the proposal is consistent with the 'no detriment' principle;
- If Scottish and UK Ministers are content to proceed following the analysis phase, a legislative process will be taken forward in both the UK and Scottish parliaments prior to the tax being implemented in, or devolved to, Scotland.

33. This power came into force on the same date as the Scotland Act 2012. To date, it has not been used.

CHAPTER 7

EFFECT OF NEW POWERS ON THE SCOTTISH BLOCK GRANT

Since devolution in 1999, the Scottish Parliament has had almost complete flexibility over how it spends its income, the bulk of which has been provided in a block grant determined by the Barnett formula. As set out in the Command Paper published alongside the Scotland Bill, a fundamental principle of tax devolution is that an element of the block grant is exchanged for the ability to levy taxes. In order to ensure that the adjustment process is transparent and equitable, the UK and Scottish governments, through the Joint Exchequer Committee, have agreed a set of overarching principles as the basis for considering mechanisms for adjusting the block grant. Further information on the Joint Exchequer Committee is set out at paragraph 39 of this report and the agreed principles are included at Annex B.

34. As the Scottish rate of income tax represents more than 90% of the value of the tax powers transferred by the Act, it was the initial focus of block grant adjustment discussions between the UK and Scottish governments.

35. Following an assessment of options against the agreed principles, the Joint Exchequer Committee agreed that an adjustment indexed to growth in the UK non-savings, non-dividend income tax base would be most appropriate. This adjustment mechanism provides incentives for the Scottish Government to grow the income tax base in Scotland more quickly than in the UK as a whole, while shielding Scotland from UK-wide economic shocks that the UK Government is better placed to manage.

36. The two governments continue to work together to consider how Scotland's block grant should be adjusted in relation to the smaller fully devolved taxes (Stamp Duty Land Tax and Landfill Tax).

37. Options were discussed by the Joint Exchequer Committee in February, and officials are now engaged in further analysis to assess options against the agreed block grant adjustment principles.

CHAPTER 8

OTHER ACTIVITIES TOWARDS IMPLEMENTATION

38. A range of further activities have also been undertaken over the past year to ensure the smooth implementation of the Act.

Joint Exchequer Committee

39. The UK Secretary of State for Scotland, Chief Secretary to the Treasury and Exchequer Secretary to the Treasury along with the Scottish Cabinet Secretary for Parliamentary Business and Government Strategy and Cabinet Secretary for Finance, Employment and Sustainable Growth formed a Joint Exchequer Committee to discuss and take decisions jointly on the implementation of the Part 3 finance provisions. The Committee first met in September 2011 and has since met twice more, most recently on 14 February 2013. The papers and minutes of the first meeting were exceptionally released and were sent to the Scottish Affairs Committee on 4 September 2012. The minutes are attached at Annex C of this report for information. Notes of subsequent meetings are routinely published by the UK and Scottish Governments in order to provide transparency in this process[3].

Forecasts by the Office for Budget Responsibility

40. The Office for Budget Responsibility (OBR) began to publish forecasts of Scottish taxes in March 2012. Further forecasts were published in December 2012 and, most recently, in March 2013. The OBR will continue to publish these forecasts twice a year, with the next update due in the autumn of 2013[4].

41. This includes a forecast of Aggregates Levy, which has not been devolved as it is currently subject to legal challenge in the European Courts. The UK Government will keep this under review and in the meantime will quantify the share of Aggregates Levy revenues attributable to Scotland.

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[3] Notes of subsequent JEC meetings can be found at:
June 2012: https://www.gov.uk/government/news/joint-exchequer-committee-communique
February 2013: https://www.gov.uk/government/news/joint-exchequer-committee

[4] The OBR's Scottish tax forecasts can be found on its website at:
http://budgetresponsibility.independent.gov.uk/

Cash reserve

42. The cash reserve provides the Scottish Government with a further tool to help manage their new tax powers. In order to support the transition to the new system, Scottish Ministers can currently make discretionary payments into the cash reserve until June 2016 up to an overall total of £125 million. From 2015-16 the Scottish Government will be able to maintain a reserve using an element of tax revenues, which can be accessed if future tax revenues are lower than forecast.

Budgeting arrangements for devolved powers

43. During the next 12 months, one of the key milestones will be agreeing the budgeting arrangements in relation to devolved powers – specifically, how the budgeting framework will support spending funded through devolved tax revenues and borrowing.

44. HM Treasury has been developing proposals during the latter half of 2012-13, which it intends to share with the Scottish Government in the coming weeks. We will report on this to Parliament at the appropriate time.

CHAPTER 9

OTHER REPORTING REQUIREMENTS

45. In addition to the areas covered above (steps taken towards implementation, steps yet to be taken and effect of provisions on the block grant), section 33 of the Scotland Act 2012 requires annual reports on Part 3 of the Act to include:
    - an assessment of the operation of the provisions of Part 3 which have been commenced;
    - an assessment of the operation of any other powers to devolve taxes to the Scottish Parliament or to change the powers of the Scottish Ministers to borrow money, and of any other changes affecting the provisions inserted or amended by this Part;
    - any other matters concerning the sources of revenue for the Scottish Administration (within the meaning of section 126(6) of the 1998 Act) which the maker of the report considers should be brought to the attention of the Parliament of the United Kingdom or the Scottish Parliament.

46. This report is the first following the passage of the Act in May 2012. At this stage, the tax powers have not been devolved and, accordingly, the Government is unable to provide an assessment of the operation of the provisions. It should be noted that, in accordance with section 44(2)(b) of the Act, all provisions of Part 3 came into force two months after the passing of the Act itself, with the exception of section 25(7) (and Schedule 2) - Scottish rate of income tax: consequential amendments - and section 32 - borrowing by Scottish Ministers. The provisions will, however, require Orders from HM Treasury before they can be considered operational. An assessment of the operation of the provisions will therefore follow in further annual reports.

47. At this stage, no other powers to devolve taxes to the Scottish Parliament have been put into operation nor have there been any further provisions to change the powers of the Scottish Ministers to borrow money, and the UK

Government is not aware of any other matters concerning the sources of revenue for the Scottish Administration.

CONCLUSION

48. The implementation of Part 3 of the Scotland Act 2012 is progressing effectively and efficiently. The UK Government is confident that the two governments working together will be able to deliver this historic shift of power from Westminster to Holyrood in the expected timescales.

49. Much has been achieved over the past year, and it is clear that there also remains a substantial amount of work to be done before these provisions become operational. Each Parliament will continue be updated on this work as it progresses.

50. The next annual report on the implementation of Part 3 of the Scotland Act 2012 will be published, in accordance with Section 33(3)(b)of the Scotland Act 2012, before 1 May 2014.

Annex A – Reporting requirements in the Scotland Act 2012 and where they are addressed in this report

1. *a statement of the steps which have been taken, whether by the maker of the report or by others, since the making of the previous report (or, in the case of the first report, since the passing of this Act) towards the commencement of the provisions of this Part,*

   Chapter 2: paragraphs 6-14
   Chapter 3: paragraphs 18-20
   Chapter 4: paragraphs 23-25
   Chapter 5: paragraphs 28-30
   Chapter 6: paragraphs 32-33
   Chapter 8: paragraphs 38-42

2. *a statement of the steps which the maker of the report proposes should be taken, whether by the maker of the report or by others, towards the commencement of the provisions of this Part,*

   Chapter 2: paragraphs 15-17
   Chapter 3: paragraphs 21-22
   Chapter 4: paragraphs 26-27
   Chapter 5: paragraph 31
   Chapter 8: paragraphs 43-44

3. *an assessment of the operation of the provisions of this Part which have been commenced,*

   See chapter 9.

4. *an assessment of the operation of any other powers to devolve taxes to the Scottish Parliament or to change the powers of the Scottish Ministers to borrow money, and of any other changes affecting the provisions inserted or amended by this Part,*

   See chapter 9.

5. *the effect of this Part on the amount of any payments made by the Secretary of State under section 64(2) of the 1998 Act (payments into the Scottish Consolidated Fund),*
   Chapter 7: paragraphs 34-37

6. *any other matters concerning the sources of revenue for the Scottish Administration (within the meaning of section 126(6) of the 1998 Act) which the maker of the report considers should be brought to the attention of the Parliament of the United Kingdom or the Scottish Parliament.*

   See chapter 9.

Annex B - Principles agreed through the Joint Exchequer Committee in September 2011 for the adjustment of the block grant

Design

1. Apply the overarching objective of fairness to both the UK and Scottish Governments by:

   a) minimising the risk of gains/losses from funding transfers on both the UK and Scottish Governments;

   b) ensuring that the mechanism is not, when implemented, designed to gain advantage in one set of fiscal circumstances or another;

   c) considering the effects of a shared tax base (including issues related to policy spillover and tax avoidance).

2. Ensure the mechanism delivers on the Scotland Bill's aims to increase financial accountability, giving the Scottish Parliament a direct financial stake in Scotland's economic success;

3. Ensure the mechanism is consistent with Azores criteria and State Aid principles;

4. Ensure the sustainability of the system to adapt to future decisions on tax devolution;

Implementation

5. Ensure that, when the system is introduced it does not cause an unmanageable change in the Scottish Budget (up or down) in the first year;

Operation

6. Ensure that the necessary information and data is shared on a timely and accurate basis to allow both the UK and Scottish Government to plan ahead;

7. Ensure the mechanism delivers value for money by designing a model that is relatively simple to implement and operate and incurs minimal administrative cost;

Review

8. Apply principles of transparency; and

9. Review to ensure that the system remains fair and 'fit for purpose'.

Annex C – Minutes released following the first meeting of the Joint Exchequer Committee on 27 September 2011

JOINT EXCHEQUER COMMITTEE **JEC/11/01**
27 September 2011

Present:
UK Government
David Gauke, MP, Exchequer Secretary (Chair)
Michael Moore, MP, Secretary of State for Scotland
Danny Alexander, MP, Chief Secretary to the Treasury (part of meeting)

Scottish Government
John Swinney, MSP, Cabinet Secretary for Finance, Employment and Sustainable Growth
Bruce Crawford, MSP, Cabinet Secretary for Parliamentary Business and Government Strategy

In Attendance:
UK Government
David Silk, HM Treasury
Oliver Haydon, HM Treasury
Lucy Proctor, Scotland Office
Alisdair McIntosh, Scotland Office
Paul Doyle, HM Treasury
John Mundy, HM Treasury
Doug Stoneham, Her Majesty's Revenue and Customs

Scottish Government
Alyson Stafford, DG Finance
Gary Gillespie, Chief Economic Adviser
Gerald Byrne, International & Constitution
Gill Glass, Private Secretary
Paul Boylan, Private Secretary

Joint Secretariat:
Jacqui Bishop, HM Treasury
Chris Flatt, Scotland Office
Alistair Brown, Scottish Government
Elspeth Hough, Scottish Government

1. The first meeting of the Joint Exchequer Committee took place in St Andrew's House, Edinburgh, hosted by the Scottish Government. The Chair welcomed participants to this initial meeting, noting that he considered the JEC to be a valuable new forum for discussion of the implementation of the financial provisions which formed key elements of the Scotland Bill. The Chair said that the UK Government had been pleased to accept the proposal that the chairmanship of the Committee should alternate between the two Governments. There were many issues for discussion that would be of importance to both Governments including data sharing and milestones for Scotland Bill implementation.

2. The Cabinet Secretary for Finance, Employment and Sustainable Growth welcomed participants to St Andrew's House and said that the Scottish Government looked forward to fruitful discussions at the JEC. The Scottish Government was committed to working jointly and constructively with the UK Government to find a joint approach acceptable to both Governments.

Key Milestones

3. The Secretary of State for Scotland introduced a paper on Key Milestones for Scotland Bill implementation. The following points were raised in discussion:

- the content of the paper drew on the text of the Command paper, "Strengthening Scotland's Future" which had been published alongside the draft Scotland Bill on 30 November 2010. The paper aimed to set out, briefly, the process for implementation of the provisions contained in the draft Bill and Command paper.

- the paper was a useful starting point; further work was required to be taken forward by officials from both Governments in three areas:
  - First, to develop a shared understanding of the critical path for implementation.
  - Second, it would also be essential to ensure that there would be access to necessary information together with active engagement by Ministers and senior officials from both Governments to provide assurance to the JEC.
  - Third, it would be helpful for the detailed references at table 1 in the paper to commencement of the various provisions to be amended to take account of the commencement arrangements that the Scottish Government had proposed in respect of income tax powers, specifically that formal commencement would be subject to the approval of the Scottish Parliament.

- Both governments were committed to working jointly and constructively and to ensuring that the financial provisions in the Bill were implemented in a way that would be fair and that respected agreed principles.

- There were different views on the approach to commencement. From one perspective, proposals for joint commencement reflected the need for assurance about the effect of technical but potentially very significant financial arrangements in Scotland where a high level of detail would not be available for some time. It was important to focus on the shared ambition to achieve an outcome that was fair, appropriate and non-detrimental and would meet the approval of both Parliaments.

- the Scottish Parliament would need to consider the Legislative Consent Motion (LCM) in early 2012. The information that would then be available on the implementation of the financial provisions was unlikely to provide the level of reassurance the Parliament would require to consent finally to the Bill's proposals. Inclusion of a commencement provision requiring the consent of the Parliament, would enable the Parliament to consent formally to the arrangements agreed between the governments, based on full information, at the appropriate time.

- From the other perspective, the Scotland Bill as it had been developed set out a high degree of certainty; the introduction of commencement orders would introduce uncertainty which would be undesirable and cause delay.

4. <u>The Committee agreed</u> that officials of the Scottish and UK Governments should be asked to develop further the helpful first analysis of key milestones and to update the paper with a view to agreeing this in correspondence. Officials were also asked to look at precedents for commencement orders and to give further consideration to the options.

Terms of Reference
[The Chief Secretary to the Treasury joined the meeting during this item].

5. The Chair introduced the Joint Secretariat's paper on the draft Terms of Reference. This set out the UK Government's proposed Terms of Reference at Annex A**,** which included a number of amendments that had been proposed by the Scottish Government. Further proposed amendments from the Scottish Government were attached at Annex B. Two significant areas of difference remained: the scope and focus of the Committee; and the arrangements for decisions in the event of a failure to reach agreement. The following points were raised in discussion:

- On scope and focus, it was noted that the JEC was the only forum which provided the opportunity for Scottish and UK Ministers to discuss the important and very substantial issues to be addressed in implementing the financial provisions in the Scotland Bill;

- there were other forums to which Ministers could take other issues for consideration;

- the JEC should focus on Scotland Bill implementation;

- the scope of the Committee should not be restricted to the implementation of the Scotland Bill, important as this was;

- it would not be acceptable for decisions to be imposed by the UK Government where no agreement could be reached at the JEC;

- there was a clear shared ambition and an expectation to reach agreement on matters brought to the JEC for decision;

- proposals put forward for a requirement for agreement to be reached were thought to run contrary to the existing devolution settlement. This could be represented as shift in the competence of the two Governments which it would not be appropriate for this Committee to determine;

- tt was important that the Terms of Reference should be drafted with sufficient clarity to endure beyond existing political incumbencies.

6. <u>The Committee agreed</u> that officials from the Scottish and UK Governments should be asked to propose alternative wording on the areas on which no agreement had been reached in this meeting and to ensure that the draft Terms of Reference fully captured the objective of the Committee to reach joint agreement, with a view to subsequent consideration in correspondence.

Block Grant Adjustment

7. The Chief Secretary introduced the UK Government's paper on Block Grant adjustment. This set out high-level principles which would set the framework for development and agreement of a mechanism for block grant adjustment. A suitable mechanism would be consistent with the principles described. The following points were made in discussion:

- This was a useful paper: the principles provided a helpful framework within which to design a mechanism. The inclusion in the principles of a reference to dealing with the effects of policy spillover was welcomed.

- the work to be carried out by the Office of Budget Responsibility would be critical.

- the principles proposed would enable a range of mechanisms to be considered, including the model proposed by Professor Gerald Holtham which was understood to be of interest to the Scottish Government and which the UK Government also considered to have merit.

- the point about access to information was critical. It was essential that the Scottish Government could access, interrogate and understand relevant data held by HMRC.

- there was a shared ambition to keep administration costs low and to ensure that both Governments had access to the right factual information, which might take some time to gather, with a consequent potential impact on the selection of the block grant mechanism.

8. **The Committee agreed the principles outlined in the block grant adjustment paper as the basis for further work on options for mechanisms.**

Communications

9. The Chair noted that it was likely that Ministers from each administration would be required to report to their respective Parliaments on the outcome of the meeting and noted that it was not proposed to publish a joint statement on this occasion.

10. **The Committee agreed** that public statements made by each Government would be in line with the proposed text of the draft Terms of Reference on confidentiality, on which the two Governments were in agreement.

Next meeting

11. The Chair reminded participants that the next meeting of the JEC would be chaired by the Cabinet Secretary for Finance, Employment and Sustainable Growth, in London, in spring 2012.

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