HM Treasury

Wales Office

Empowerment and responsibility:

devolving financial powers to Wales

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Preface

When the coalition was formed in 2010, our Programme for Government made three specific commitments relating to Wales: establish a process for the Welsh Assembly similar to the Calman Commission in Scotland; introduce a referendum on further Welsh devolution and take forward the Housing Legislative Competence Order. We have delivered all three commitments.

Following the Assembly referendum, we established the independent Commission on Devolution in Wales (the 'Silk Commission') in 2011 to examine the financial and constitutional arrangements in Wales, and recommend ways in which they might be improved.

The Commission reported in November 2012 on whether the financial accountability of the devolved institutions in Wales – the National Assembly for Wales and the Welsh Government – can be improved by devolving fiscal (tax and borrowing) powers. The Welsh Assembly needs to have stronger financial accountability to the people of Wales, while retaining the benefits of the security and stability of sharing resources as part of the United Kingdom.

The Silk Commission made 33 recommendations to improve financial accountability while remaining consistent with the United Kingdom's fiscal objectives. We are grateful to Paul Silk and the members of the Commission for their hard work and dedication in producing such a thorough report.

Following the announcement made by the Prime Minister and Deputy Prime Minister on 1 November, the Government's detailed response is set out in this document and builds on the work the Commission has done. We fully agree with the Commission's key recommendation: that the funding model of a block grant and some devolved taxes best meets sound principles for funding the Welsh Government, and that part of its budget should be funded from devolved taxation under its control. Our plans set out in this document take forward this principle.

The Commission is now looking at how the Welsh devolution boundary can be modified to better serve the people of Wales, and we look forward to reading the Commission's findings on that in the spring of next year.

Rt Hon David Jones MP

Secretary of State for Wales

Rt Hon Danny Alexander MP

Chief Secretary to the Treasury

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1 Introduction

1.1 The Government established the independent Commission on Devolution in Wales (the 'Silk' Commission) in October 2011 to review the present financial and constitutional arrangements in Wales. The Commission is chaired by Paul Silk and includes representatives from all four political parties in the National Assembly for Wales ("the Assembly") as well as independent members.

1.2 The Commission is undertaking its work in two parts. In Part I of its remit, the Commission looked at how to improve the financial accountability of the Assembly and the Welsh Government, and reviewed the case for the devolution of fiscal powers. In November 2012, the Commission published its report on its Part I findings. The unanimous report made 33 recommendations to devolve a package of tax and borrowing powers to the Assembly and the Welsh Ministers.

1.3 The Government carefully assessed the implications of these recommendations and, in response to concerns expressed by business, consulted further during the summer on the possible impacts of devolving stamp duty land tax (SDLT) to Wales. On 1 November, the Prime Minister and the Deputy Prime Minister announced that the Government accepted the Commission's key recommendations, including giving the Welsh Ministers the power to borrow for capital investment, devolving landfill tax and stamp duty land tax in Wales, and providing for a referendum to take place so that people in Wales can decide whether responsibility for some of their income tax should be devolved.

1.4 This document sets out the Government's response to all 33 recommendations, including those already announced by the Prime Minister and Deputy Prime Minister. Chapter 2 explains the Government's response and sets out our plans. Annex A details the Government's specific response to each recommendation while Annex B summarises the responses to the consultation on the potential impacts of devolving stamp duty land tax to the Welsh Assembly.

1.5 The Commission is now working on Part II of its remit, considering the powers of the Assembly and recommending whether modifications are needed to the devolution boundary. It will report on Part II by spring 2014.

2 The Government's plans

Existing funding arrangements

2.1 Most of the budget of the Assembly and the Welsh Government is currently funded by a block grant approved by the UK Parliament. Tax revenues from across the UK (including from Wales) are pooled centrally, with a share of these redistributed to the Assembly. Changes in the size of the block grant are determined by the Barnett formula, under which the Assembly receives a population-based proportion of changes in planned spending on comparable services in England.

2.2 While the Government recognises the concerns raised about the Barnett formula, the present system has many strengths. Resources and risks are shared across the UK, which ensures that the Assembly is provided with stable levels of funding to deliver the wide range of devolved public services for which it and the Welsh Government are responsible. The system is also simple, transparent and efficient; key requirements for any funding system.

2.3 However, under this system the Assembly has only very limited responsibility (and powers) for raising the money it spends. While Welsh Ministers and Assembly Members are accountable to the Welsh electorate for how their budget is spent, they are not similarly accountable for revenue-raising and are unable to determine the overall levels of tax and spending in Wales. As it stands, council tax and non-domestic (business) rates are the only taxes over which the Assembly and the Welsh Ministers have any influence.

2.4 The coalition's programme for Government committed to establishing a process for the Assembly similar to the Calman Commission in Scotland. The Government therefore established the Commission on Devolution in Wales (the 'Silk Commission') in 2011 to review the case for the devolution of fiscal powers to the Assembly and consider how to increase its financial accountability.

The Commission's remit and recommendations

2.5 The Commission, chaired by Paul Silk, has considered the question of financial accountability in considerable detail. It recognised that the current system of fiscal transfers is important for the economic success of the Union and so should be retained, but concluded that the current funding arrangements do not meet the requirements of a mature democracy and are anomalous in an international context. The Commission therefore recommended funding arrangements for Wales that brought more tax (and borrowing) powers under the control of the Assembly and the Welsh Ministers, thereby increasing the financial accountability of the devolved institutions within the framework of a strong United Kingdom.

2.6 The Government strongly agrees that the UK benefits enormously from an integrated economic and fiscal union. Any changes to the funding of the Assembly and the Welsh Government must therefore be consistent with maintaining the integrity of this system. The UK Government will remain responsible for macroeconomic policy and the UK's substantially unified tax system must remain fully integrated and coherent, so that it continues to work effectively for business and individuals and ensures the trade of goods, services and capital between Wales and the rest of the UK is unimpeded.

2.7 The Commission's recommendations and the Government's responses are set out in full in Annex A. The fundamental proposal is that the Assembly's funding should be re-balanced, with a larger proportion of funding being generated from taxes under its control. The Commission also recommended that the Welsh Government should have access to borrowing powers for capital investment. In its view, such an arrangement would retain the existing benefits of the system of fiscal transfers, while substantially increasing the autonomy and financial accountability of the Assembly and the Welsh Government.

2.8 The Commission's main recommendations to achieve this are:

- the income tax base should be shared between the UK and Welsh Governments. An initial 10p should be deducted from each of the main rates of income tax in Wales, with the Welsh Government able to set a Welsh rate for each band. This should be accompanied by a reduction in the block grant using an indexed deduction mechanism proposed by the Holtham Commission;
- the devolution of income tax should be subject to a referendum in Wales;
- stamp duty land tax, landfill tax, long-haul air passenger duty and aggregates levy should be devolved, alongside a fixed reduction in the block grant;
- the Welsh Assembly should be given the power to legislate for the introduction of new taxes in Wales, subject to the agreement of the UK Government; and
- Welsh Ministers should be able to borrow to increase capital investment, within an overall limit.

2.9 The Commission further recommended that the Welsh Government should have new tools to manage these new tax powers, and that improvements should be made in relation to financial information and institutional arrangements.

The Government's plans

2.10 The Government has given careful consideration to the Commission's recommendations to empower the devolved institutions in Wales – the Assembly and the Welsh Government - and increase financial accountability.

Tax powers

Income tax

2.11 The Government accepts that sharing the income tax base would significantly enhance the accountability of the Assembly and the Welsh Government, as income tax contributes the greatest proportion of tax revenue in Wales and would provide a relatively stable revenue stream. However, the Government agrees with the Commission that the devolution of income tax should be subject to a referendum in Wales (see paragraph 2.14 overleaf).

2.12 The Commission recommended that 10p should initially be deducted from each of the main UK rates in Wales, with the Welsh Government able to set unrestricted individual rates for each band. Although the Commission highlights some potential benefits to the Welsh Government of independent rate-setting, the Government is concerned that this could distort the redistributive structure (or progressivity) of the income tax system and could potentially be detrimental to the UK as a whole. While the impacts are uncertain, as this would be unprecedented in the UK, the flexibility to set independent rates may lead to significant behavioural responses, such as migration, that reduce revenues in other parts of the UK. This risk is particularly acute higher up the income distribution – the Commission noted that higherearning individuals are particularly responsive to tax rates – and is likely to be exacerbated by the large number of individuals living close to the border between England and Wales.

2.13 The Government believes that the key objective of increased accountability for the Assembly and Welsh Government could be achieved by granting the power to vary the basic, higher and additional rates of income tax (currently 20 per cent, 40 per cent and 45 per cent respectively) up or down in tandem. This would also maintain the redistributive structure of the income tax system at a UK level.

2.14 The Government also agrees that the people of Wales should be able to decide whether the Welsh Government has responsibility for an element of income tax in Wales, and that the Assembly should be able to trigger a referendum in Wales to decide the matter. We believe it is important that the Assembly is able to decide when a referendum should be triggered, and agree with the Commission that the model in the Government of Wales Act 2006 worked well in terms of the referendum on legislative powers.

2.15 On this basis, and subject to a referendum, the Government is proposing to devolve equivalent powers to those legislated for in the Scotland Act 2012. This would mean that 10 percentage points of each UK tax rate would no longer be due to the UK government. The Welsh Government would then be able to set a "Welsh Rate" to replace this, with revenues due to the Welsh Government but still collected by HMRC. If the Welsh Rate was 10 per cent, overall income tax rates for Welsh taxpayers would remain unchanged at 20 per cent (the basic rate), 40 per cent (the higher rate) and 45 per cent (the additional rate). However, if the Welsh Government set the Welsh Rate at 11 per cent, these overall rates would become 21 per cent, 41 per cent and 46 per cent. The Welsh Rate would apply to taxable income except where this was generated from savings or dividends. To reflect the devolution of these tax-raising powers, there would be a corresponding reduction in the block grant to the Assembly.

2.16 The Commission recommended that the devolution of income tax powers "should be conditional upon resolving the issue of fair funding in a way that is agreed by the Welsh and UK Governments". In October 2012, both governments established a process to review relative levels of funding for Wales and England in advance of each spending review and, if convergence is forecast to resume, to discuss options to address the issue in a fair and affordable manner. These robust arrangements for monitoring funding levels provide a firm basis for the devolution of income tax, subject to a referendum.

Smaller yielding taxes

2.17 The ability of the Assembly and Welsh Government to control smaller devolved taxes will be dependent on establishing a framework that allows sufficient autonomy in tax matters for state aid purposes. The Scotland Act 2012 provides a useful precedent here.

2.18 The Government accepts the Commission's recommendation that stamp duty land tax (SDLT) and landfill tax as they relate to Wales should be devolved to the Assembly, with a corresponding deduction to the block grant. The Government will keep the devolution of aggregates levy under review, with the intention of devolving in the future subject to the resolution of ongoing state aid issues, but is not convinced of the case for devolving air passenger duty (APD) to Wales given the potential effects across the country as a whole.

2.19 The Government will also work with the Welsh Government to fully devolve non-domestic (business) rates. While Welsh Ministers already set these rates in Wales, under current arrangements the revenue generated does not directly affect the level of funding available to the Welsh Government.

2.20 The Government also accepts the Commission's recommendation that the Assembly should be given the power to introduce specified taxes, subject to the case-by-case agreement of the Government.

Managing tax powers

2.21 Alongside the implementation of new tax powers, the Welsh Government will need new tools to manage the volatility of tax revenues. The Government will therefore provide the Welsh Government with the ability to save surplus revenues into a cash reserve, which can be drawn upon where future revenues are lower than forecast. The Government will also put in place appropriate short-term borrowing powers, which will provide the Welsh Government with a further option if revenues are lower than forecast and funds in the cash reserve are insufficient.

Capital borrowing

2.22 The Government has accepted in principle[1] the case for Welsh Government capital borrowing powers for infrastructure investment, subject to the availability of an appropriate independent stream of revenue to support borrowing costs.

2.23 The Government's plans for tax devolution set out above would provide such an independent stream of revenue, and so would support commensurate levels of capital borrowing to enable the Welsh Government to invest in infrastructure in Wales; for example, to upgrade the key routes on the trans-European road network - the M4 in South Wales and the North Wales Expressway. The precise levels of capital borrowing will therefore depend on the outcome of the income tax referendum, and will be discussed with the Welsh Government alongside discussions on the detailed arrangements for implementing the devolved taxes.

2.24 In addition, the Government has previously signalled its support for the improvement of the M4 in South Wales. The Government will therefore provide the Welsh Government with early access to limited capital borrowing powers in advance of the implementation of tax powers. This will enable the Welsh Government to get work underway on this important project as soon as possible[2].

Institutional and governance arrangements

2.25 The Government recognises the need to ensure that institutional and governance arrangements continue to be appropriate in light of the changing devolution settlement. The key areas where the Government intends to strengthen existing arrangements are:

- The Government will formally ask the Office for Budget Responsibility (OBR) to forecast revenues from taxes devolved to the Welsh Assembly;
- The Government will work with the Welsh Government to put in place suitable memoranda of understanding to support the implementation and operation of the new powers; and
- Consistent with its transparency programme, the Government is fully committed to improving the information that is made available to assist public understanding and increase accountability.

[1] Joint statement from the UK Government and the Welsh Government at https://www.gov.uk/government/news/governments-reach-new-agreement-on-welsh-funding.
[2] Further information on plans for the M4 improvements can be found at: http://wales.gov.uk/consultations/transport/m4cor

Implementation

2.26 These plans will require legislation in Parliament. The Government envisages introducing the necessary legislation as soon as parliamentary time allows, with a view to legislating in this Parliament. We will publish a draft Wales Bill for pre-legislative scrutiny in the current Parliamentary session, which will include provisions to implement those parts of the package (including tax and borrowing powers) that require primary legislation. Some of the recommendations we are taking forward can be implemented without legislation, and we will give careful thought to the appropriate timetable for implementing each one.

2.27 The draft Wales Bill will include provision for a referendum to be held on the devolution of income tax, as the Silk Commission recommended. The provisions will be drafted along the same lines as the provisions in the Government of Wales Act 2006, which provided for the 2011 referendum on the Assembly's legislative powers. The Assembly will decide when to trigger a referendum.

2.28 Before implementing any of the above proposals, the Government will consult the European Commission to confirm its detailed plans are compatible with EU state aid rules. The state aid regime sets out strict criteria for the extent of devolution of taxes within EU Member States. However, the Government is confident that its proposals are consistent with these criteria, and notes that fiscal devolution in the Scotland Act 2012 sets an important precedent in this regard.

2.29 The Government welcomes the commitments of the Welsh Government and the Assembly to take forward work on the Commission's recommendations that relate to them. The Government has had positive and productive discussions with the Welsh Government on the Commission's findings, and will continue to work with Welsh Ministers and their officials during implementation of the reforms.

2.30 These changes provide a firm basis for devolved government in Wales to be more financially accountable, and give the Welsh Government the tools to invest in infrastructure development in devolved areas in Wales and support growth in the Welsh economy.

A Response to each recommendation

A.1 This annex contains each of the Commission's recommendations and the Government's response.

Principles of fiscal devolution

R1 The current funding arrangements for the Welsh Government do not meet the requirements of a mature democracy and are anomalous in an international context. The funding model of a block grant and some devolved taxes best meets sound principles for funding the Welsh Government. We therefore recommend that part of the budget for the Welsh Government should be funded from devolved taxation under its control.

The Government agrees that a funding model comprising a block grant and some devolved taxes will most effectively empower the Assembly and the Welsh Government and make them more accountable to the people of Wales.

Smaller yielding and local taxes

R2 Business rates should be fully devolved, subject to the Welsh and UK Governments agreeing the details and assessing any risks involved.

The Government accepts the Commission's recommendation that fully devolving business rates would be consistent with increasing the accountability of the Welsh Government. The Commission highlighted that, while the legislative responsibility for business rates is already fully devolved (including for rate-setting), the revenue generated currently has no impact on the overall resources available to the Welsh Government[1]*. Full devolution would mean that the revenues from business rates available to the Welsh Government would be more closely linked to the performance of the Welsh economy.*

R3 Stamp Duty Land Tax should be devolved to the Welsh Government with Welsh Ministers given control over all aspects of the tax in Wales. A fixed deduction should be made to the block grant with the value of this agreed between the Welsh and UK Governments taking due consideration of the volatility of receipts.

Following a consultation in the summer, the Government accepts the Commission's recommendation that stamp duty land tax (SDLT) should be devolved with a corresponding block grant deduction agreed with the Welsh Government.

R4 Landfill tax should be devolved to the Welsh Government with Welsh Ministers given control over all aspects of the tax in Wales. A fixed deduction should be made to the block grant with the value of this agreed between the Welsh and UK Governments taking due consideration of the declining taxable base.

The Government accepts the Commission's recommendation that landfill tax should be devolved with a corresponding block grant deduction agreed with the Welsh Government.

[1] Changes to the Welsh Government budget in relation to business rates are currently determined through Barnett consequentials on comparable spending in England, rather than according to the level of business rates collected in Wales.

R5 Subject to the outcome of discussions between the UK Government and the EU Commission on state aid issues, aggregates levy should be devolved to the Welsh Government, with Welsh Ministers given control over all aspects of the tax in Wales. A fixed deduction should be made to the block grant with the value of this agreed between the Welsh and UK Governments taking due consideration of the declining taxable base.

The Government agrees that it is not appropriate to devolve aggregates levy while state aid issues remain unresolved. The Government will continue to keep the devolution of aggregates levy under review with the intention of devolving in the future subject to these state aid issues and any 'cross-border' market distortions having been worked through in full.

R6 We recommend that APD should be devolved for direct long haul flights initially and recommend that devolving all rates for APD to Wales should be part of the UK Government's future work on aviation taxation, which should include considering the wider case for regional differentiation for APD or airport congestion charging. We recommend that this issue should be considered in the context of the Davies review and any developments in Scotland and Northern Ireland. A fixed deduction should be made to the block grant with the value of this agreed between the Welsh and UK Governments taking due consideration of the forecast tax revenues in Wales.

The Government announced at Budget 2013 that it has no plans to vary APD rates by levels of airport congestion. Having now given this recommendation careful consideration, the Government is not convinced by the case for devolving APD to Wales. In particular, HMRC published a report in autumn 2012 highlighting that different rates either side of the Wales/England border would be likely to redistribute passengers between airports rather than significantly increasing the overall demand within the UK.

R7 We do not recommend that fuel duty should be devolved. We recommend that in the light of experience of the fuel rebate pilot scheme, the UK Government should assess the extension of the scheme to some rural and remote areas in Wales, subject to EU agreement.

The Government accepts the Commission's recommendation that fuel duty should not be devolved. The Government is currently seeking EU approval for an extension of the rural fuel rebate pilot scheme to remote parts of the UK that display similar characteristics to the islands currently covered by the scheme.

R8 We recommend that the following taxes should not be devolved:

- Alcohol and excise duties
- Vehicle excise duties
- Capital gains tax
- Insurance premium tax
- Stamp duties on shares
- Inheritance tax
- Betting and gambling duties
- Climate change levy

The Government accepts the Commission's recommendation that these taxes should not be devolved.

R9 We recommend that when the UK Government is considering introducing new taxes in devolved areas of policy, there should be a presumption in favour of devolving powers over the tax to the Welsh Government.

The Government will carefully consider the merits of devolving any new taxes on a case by case basis, in discussion with the Welsh Government where appropriate.

R10 Where UK-wide taxes and reliefs are not devolved, we recommend that:

R10a the UK Government should keep under review the scope for introducing tax reliefs which would help to support the Welsh economy in an affordable and cost effective way subject to EU state aid constraints; and

R10b if the UK Government changes the thresholds and allowances or rates for a tax that is not devolved, which includes an element of geographical targeting (for example, capital allowances in Enterprise Zones in selected areas), then an assessment should be made in consultation with the Welsh Government as to whether the Welsh Government should be able to fund additional coverage.

The Government will continue to work closely with the Welsh Government to identify opportunities for providing targeted support to the Welsh economy.

R11 The National Assembly for Wales should be given a power to legislate with the agreement of the UK Government on a case by case basis to introduce specified taxes and any associated tax credits in Wales. The Welsh Government should retain the revenue from these without a deduction to the block grant. The UK Government should adopt a flexible approach to any proposal for these taxes from the Welsh Government.

The Government accepts the Commission's recommendation that the National Assembly for Wales should have the power to legislate for new taxes and associated tax credits in Wales, subject to the case-by-case agreement of the Government. The impact on the block grant would be expected to be limited to the application of a 'no detriment' principle. Under this principle, the Government would apply a block grant adjustment only if a new tax in Wales was expected to reduce revenues to the Exchequer.

Larger yielding taxes

R12 We do not recommend devolving corporation tax to Wales. However, if the UK Government were to agree to devolve corporation tax to both Scotland and Northern Ireland, we recommend that the same powers should be given to Wales.

The Government accepts the Commission's recommendation that corporation tax should not be devolved to Wales.

R13 We recommend that the enhanced capital allowances should be able to be offered within more enterprise zones in Wales subject to state aid rules and provided the Welsh Government pays the incremental cost.

The Government accepts the Commission's recommendation that the Welsh Government can fund enhanced capital allowances in additional areas of its existing Enterprise Zones that conform to the established criteria, subject to the state aid rules and legislation governing the scheme.

R14 Variation of VAT rates within a member state is prohibited by EU law. We therefore have no option but to rule out the devolution of VAT, although we recognise that there are also other arguments against the devolution of VAT. To make devolved budget adjustments when those adjustments are not the result of the actions of the Welsh Government could be regarded as the opposite of improved accountability. As a result we do not recommend assigning VAT.

The Government accepts the Commission's recommendation that VAT should not be devolved or assigned to Wales.

R15 We do not recommend that NICs in their current form should be devolved. There is an intrinsic link between contributions and the National Insurance Fund which funds social security benefits. We recommend that the UK Government should give further consideration to regionally differentiated adjustments, such as the employers NICs holiday, to support the labour market within state aid rules. The Welsh Government should be able to fund extra such geographically differentiated adjustments within Wales, if compatible with EU commitments and the UK social security system.

The Government accepts the Commission's recommendation that NICs shouldn't be devolved to Wales and that it should continue to work with the Welsh Government to identify opportunities for targeted support for the Welsh economy.

R16 We recommend that the UK and Welsh Governments should share the yield of income tax. The Welsh Government should have responsibility for setting income tax rates in Wales and we recommend the following package:

R16a income tax on savings and distributions should not be devolved to the Welsh Government;

R16b there should be new Welsh rates of income tax, collected by HMRC, which should apply to the basic and higher and additional rates of income tax;

R16c the basic, higher and additional rates of income tax levied by the UK Government in Wales should be reduced initially by 10 pence in the pound. Over time the Welsh Government's share could increase if there is political consensus;

R16d the Welsh Government should be able to vary the basic, higher and additional rates of tax independently;

R16e the Welsh Government should not be restricted in its rate setting above the reduced UK rates;

R16f the block grant adjustment mechanism should be based on the indexed deduction method as advocated by the Holtham Commission and being implemented in Scotland, which automatically incorporates the principle of 'no detriment'; and

R16g there should be transitional arrangements following the introduction of income tax devolution, in particular to help manage the transfer of risk.

The Government accepts the Commission's recommendation that sharing the income tax base would significantly enhance the accountability of the Welsh Government. The Government's proposals for devolving income tax powers (as set out in Chapter 2) reflect many of the Commission's detailed recommendations but would not allow tax rates for each band to be varied independently given the potential impact on the progressivity of the tax system and UK-wide tax revenues.

R17 We recommend that the Office for Budget Responsibility (OBR) should produce Welsh income tax forecasts in a similar way to Scotland and the amounts forecast should be assigned to the Welsh Government prior to the introduction of legislation, without any impact on the Welsh Government's spending power.

The Government intends to formally ask the OBR to produce forecasts of all taxes devolved to the Welsh Assembly (as it currently does for taxes devolved to the Scottish Parliament).

R18 We recommend that the transfer of income tax powers to the Welsh Government should be conditional upon resolving the issue of fair funding in a way that is agreed by both the Welsh and UK Governments.

The joint statement[2] made by the Government and the Welsh Government in October 2012 established a process to review relative levels of funding for Wales and England in advance of each spending review and, if convergence is forecast to resume, to discuss options to address the issue in a fair and affordable manner. These robust arrangements provide a firm basis for the devolution of income tax (subject to a referendum).

Borrowing

R19 We recommend that Welsh Ministers should be given an additional power to borrow to increase capital investment above the Welsh Government DEL budget. There should be an overall limit to such borrowing, at least proportionate to that in Scotland, whilst taking into consideration the relative lack of exposure to PFI in Wales. The agreed annual profile should provide some flexibility and be subject to review in each spending review. Borrowing should be from the National Loans Fund and commercial sources. We also believe that the Welsh Government should be able to issue its own bonds.

The Government has previously announced in principle agreement to Welsh Government capital borrowing powers commensurate with its independent revenues. The Government's plans in this respect are set out in the previous chapter and are currently limited to borrowing from the National Loans Fund and commercial sources.

R20 We recommend that new powers for Welsh Ministers to borrow for short term purposes should be introduced to manage cash flow and volatility in taxes when devolved taxes are in place, similar to those in the Scotland Act 2012.

The Government accepts the Commission's recommendation that Welsh Ministers would need additional tools to manage new tax powers and has set out plans in the previous chapter.

R21 We recommend that the Welsh and UK Governments should work together to promote increased investment in Wales through the variety of funding mechanisms available.

The Government strongly supports the Commission's recommendation and will continue to work with the Welsh Government to promote increased investment in Wales.

Further improving financial accountability

R22 There is opportunity for improving the availability of information to increase financial accountability, public understanding and transparency, and we recommend the following, subject to a detailed assessment of the costs and benefits involved by the UK Government and Welsh Government as appropriate:

> R22a estimates of spending in England on services which are devolved in the case of Wales should be made available to help inform the debate on public finances in Wales;
>
> R22b consideration should be given to whether the ONS United Kingdom accounts should include a 'sub-national' tier of government spending;
>
> R22c figures on the amount of tax collected in Wales should be produced. Such figures should also include estimates of the Welsh fiscal balance. This country and regional analysis should be done on a consistent basis across the United Kingdom;

[2] http://www.hm-treasury.gov.uk/d/joint_statement_on_funding_reform_english_23-10-12.pdf

R22d we encourage the UK Government and the devolved administrations to publish annually key comparative statistics in devolved and non-devolved areas; and

R22e the Welsh Government should consider whether more information could be published on the economy in Wales including on Welsh GVA or other income measures, as well as on economic forecasting.

The Government endorses the Commission's recommendation and, consistent with its transparency programme, is fully committed to improving the information that is made available to assist public understanding and increase accountability. In particular:

- *the Statement of Funding Policy, which already includes some information on comparable spending in England, is kept under review;*
- *the ONS is considering the development of 'sub-national' accounts as part of its implementation of the European System of Accounts (ESA) 2010, and is also undertaking work on the comparability of official statistics produced within the UK; and*
- *HMRC is continually seeking to improve the information it makes available on the UK's tax revenues and has recently published an experimental statistics release that disaggregated UK tax revenues to England, Scotland, Wales and Northern Ireland[3].*

R23 The following institutional changes should be made to improve financial accountability:

R23a consideration should be given to the OBR or another body having a wider role in either producing or validating information on public finances and the economies of Wales, Scotland and Northern Ireland; and reviewing and auditing technical aspects of the devolved funding system where appropriate;

R23b changes to the Statement of Funding Policy should be agreed between the UK Government and devolved administrations wherever possible and transparently recorded;

R23c the current finance ministers' meetings should be formalised;

R23d the present arrangement whereby the Chief Secretary to the Treasury has attended the National Assembly's Finance Committee to answer questions on the UK Budget should be formalised; and

R23e more information should be made available on the current scrutiny and accountability of public spending in Wales.

The Government recognises the importance of robust institutional arrangements that reflect the increased fiscal powers that are being devolved to the Welsh Government. The Government's plans to strengthen existing arrangements are set out in the previous chapter.

R24 The Welsh Government should be allowed to switch spending from capital to resource spending within the terms of a concordat agreed with HM Treasury, in the light of the Welsh Government's record on budget management and provided the UK Government's fiscal targets are not put at risk.

The Welsh Government is already able to switch spending from capital to resource on a case by case basis, subject to agreement of the Treasury.

[3] https://www.gov.uk/government/publications/disaggregation-of-hmrc-tax-receipts

R25 The UK and Welsh Governments and other devolved administrations should review experience of the devolved budget exchange scheme in the next spending review and agree appropriate flexibility provided the UK Government's fiscal targets are not put at risk.

The Government fully supports the principle of keeping all budgeting arrangements under regular review, including in relation to the flexibility available under budget exchange.

Implementation

R26 Devolution of income tax should be subject to a referendum in Wales. Provision for such a referendum should be contained in the Act which introduces tax and borrowing powers.

The Government accepts the Commission's recommendation that the devolution of income tax should be subject to a referendum in Wales, and that provision for a referendum should be contained in the legislation that devolves tax and borrowing powers to the Welsh Assembly.

R27 A new Wales Bill should be introduced in this Parliament to devolve tax and borrowing powers. A bill to devolve tax and borrowing powers should not wait until the completion of Part II of our work. Changes which do not require legislation should be introduced as soon as possible.

The Government intends to publish a draft Wales Bill for pre-legislative scrutiny in the current parliamentary session, which will include provisions to devolve tax and borrowing powers to the National Assembly for Wales and Welsh Ministers. Work has already started with the Welsh Government to implement changes that do not require legislation.

R28 The Welsh Government should set up a Welsh Treasury to manage the new powers we are recommending.

This is a matter for the Welsh Government.

R29 The new funding system will require a strengthening of the institutional arrangements to deal with finance:

R29a a joint Intergovernmental Bilateral Committee on Welsh Fiscal Devolution should be established to meet at least twice a year following the OBR's biannual forecasts to discuss taxation and macroeconomic policy

R29b the relationship between HMRC, the Department for Work and Pensions, and the Welsh Government on income tax should be set out in a Memorandum of Understanding, which should be published in advance of implementation;

R29c for the National Assembly for Wales and Welsh Government, the lines of accountability of HMRC in relation to the Welsh rate of income tax should be similar to those of HMRC to the UK Parliament and Government. An HMRC Additional Accounting Officer should be made specifically accountable for the collection of the Welsh rate of income tax

R29d the Wales Bill should enable the National Assembly for Wales to compensate HMRC for the net additional costs associated with implementing and maintaining the Welsh rate of income tax. For the taxes that are to be wholly devolved (SDLT and Landfill tax) and any new taxes, the Assembly will need to agree formal arrangements, for example a contract or accompanying service level agreement, with the body, either new or existing, which they decide to administer the taxes

R29e where a varying tax rate could lead to an increase or decrease in liabilities for the UK Government, the principle which is set out in the Statement of Funding policy that 'the body whose decision leads to the additional cost will meet that cost' should be adhered to;

R29f the UK Government should make sure that the Welsh funding system is as transparent as possible with the key components either verified independently or dependent on independent sources. The OBR should be responsible for forecasting Welsh tax receipts, based on data that will include information provided by the Welsh Government. A memorandum of understanding between the OBR, HMRC and HM Treasury should be published in the lead up to implementation alongside more detail on the forecasting methodology. The 'no detriment' principle should apply as in Scotland; and

R29g the UK Government should invite the Comptroller and Auditor General as head of the NAO to prepare a report to the National Assembly for Wales on HMRC's administration of the Welsh rate of income tax. If the Welsh Government decides to approach HMRC to administer the smaller taxes, and HMRC agree, then it will be up to the Welsh Government to decide how any audit arrangement should work.

The Government recognises the importance of robust institutional arrangements that reflect the increased fiscal powers that are being devolved to the Welsh Government. Additional costs incurred in implementing and administering these new devolved powers will be the responsibility of the Welsh Government, as set out in the Statement of Funding Policy. The Government's plans to strengthen existing arrangements are set out in the previous chapter.

R30 The Welsh Government and UK Government should work closely together to use both devolved and non-devolved economic powers to strengthen the Welsh tax base.

The Government strongly supports the continuation of close working to strengthen the Welsh economy and tax base.

R31 These changes should be introduced in a phased way to manage the risks of instability in public finances and of windfall gains or adverse shocks to the Welsh Budget.

The Government agrees that a phased implementation is the right approach.

R32 The National Assembly for Wales should have legislative control of its own budgetary procedures.

The Silk Commission is currently examining the legislative powers of the National Assembly for Wales under the second part of its remit. The Government noted in its evidence to the Commission that there may be a case for modifying the devolution boundary in respect of the Assembly's budgetary procedures.[4]

R33 The National Assembly Commission may need to consider modest building-up of capacity for financial scrutiny.

This is a matter for the National Assembly Commission

[4] This issue was also discussed in sections 1.29 to 1.31 of the UK Government's evidence to the Silk Commission's Part II work. This can be found at https://www.gov.uk/government/news/uk-government-publishes-its-evidence-to-the-silk-commission.

B Stamp duty land tax consultation - summary of responses

B.1 The consultation was targeted at businesses and asked four questions to determine the potential impacts of devolution of SDLT to the Welsh Assembly. It ran for six weeks between 30 July and 10 September.

B.2 40 responses were received including responses from professional bodies, representative bodies, property developers, chartered surveyors and individuals. 15 respondents were in favour while 10 did not support devolution. The remaining 15 responses were neutral or did not offer a view for or against devolution of SDLT.

B.3 Of those against devolution this was mainly for fear of tax increases or because they saw benefits in having a unified tax system. Those in favour of devolution gave reasons such as the Welsh property market having distinctive characteristics, that it would complement existing policy areas of housing and economic development which are already devolved to the Welsh Government or their support was dependent on reforms they wanted to see made.

B.4 Many respondents observed that it is difficult to give an accurate view on what the impact of devolution will be as it is not clear what the Welsh Government will do with the power. Others suggested policy options the Welsh Government should adopt if power over SDLT was devolved. This summary will focus on the specific substantive answers given to each question.

Q1: How significant would the potential positive or negative impacts be on the construction industry and housing market?

B.5 Some respondents observed there is already a disparity between the English and Welsh property market with the English market being more buoyant. One property developer noted that they see economic distortion and a substantial movement of potential purchasers from Wales into England as the incentives offered on properties in England represent better opportunities.

B.6 An example of this is the Help to Buy scheme which is not available in Wales (although it could be introduced if the Welsh Government chose to fund such a scheme). One south Wales branch of a large UK construction company acknowledged that they have started to buy land in England to take advantage of the benefits the scheme will bring.

B.7 In light of this many of those who responded to this question felt that control of SDLT could give the Welsh Government an extra lever to help house builders in Wales who have not benefitted from these schemes. Although some felt that further inconsistencies with the English system could increase disparities by putting off those looking to buy property in Wales.

B.8 Other respondents observed that a number of positive benefits that could result from devolving SDLT to Wales, particularly with respect to stimulating house building and helping people get access to the property ladder. For example, one representative body said, "a lowering of the rates in the lower bands of the tax, could act as an incentive to help more people onto the property ladder, as well help more people move up through the property ladder. This in turn could result in increased house building volumes, given that more people would be incentivised to purchase a new home."

B.9 Some thought the ability to shape SDLT to the Welsh marketplace would be a useful additional tool to promote growth in Wales if used appropriately. However, the point was made that that SDLT is only one of many factors influencing the property market in Wales, and that "planning, building regulations, business rates and council tax are more influential levers impacting the market's health."

B.10 This point was echoed with one professional body saying, "SDLT would not normally be a key influence on the decision making process other than for property priced just above a threshold level." As well as other property taxes factors such as employment opportunities, location of the property and local amenities were felt to be more important factors.

Q2: What would be the likely impact on investment and business location decisions that might result from different property transaction tax regimes in England and Wales?

B.11 Some respondents felt that devolution of SDLT would have a positive impact on the Welsh economy and that it could be used to encourage those from outside Wales to invest. They felt this power could give the "Welsh Government a method of making Wales an attractive place in which invest when aligned closely with other devolved policy fields."

B.12 However, the vast majority of those who responded to this question made clear that SDLT was only a small factor in business location decisions. Other factors such as a skilled workforce and property prices are far more important and SDLT would only be considered in the margins.

B.13 One respondent noted property prices are considerably lower in Wales than in the UK, even in the border areas and that is likely to have a bigger influence on property purchase than SDLT or the Welsh equivalent charge.

B.14 A small number of respondents felt that devolution would have a negative impact on business investment decisions. They felt that uncertainty over the future of SDLT would be priced into investment decisions and lead to increased caution. Overseas investors need certainty and a comprehensive knowledge of the tax implications of decisions they make.

Q3: How significant would the potential administrative burdens be if there were different property transaction regimes and collection authorities in England and Wales?

B.15 Many respondents did not think there would be significant administration burdens or costs following the introduction of a new transaction tax for Wales. They believed it to be one of the easiest taxes to collect and devolution would add little to existing burdens and costs. Others said that there would obviously be some training needed for people to adjust to the new system but that costs could be easily absorbed by business.

B.16 In many responses there was a feeling that as SDLT is a tax on immovable property any administration issues would be minor and easily dealt with by the legal profession. However, some respondents, particularly tax or legal professionals, thought adjusting to devolution might not be so simple.

B.17 One respondent pointed to conveyancing experts who have suggested that it could be a very difficult tax to administer and quite costly if the tax system is radically different in Wales and England. They suggested this could cause significant issues for the business community.

B.18 Other respondents were concerned about the additional complexity created by properties that straddle the border between England and Wales. One noted there are potentially 100s of farms that straddled the border while another said that there are already 81 titles that do. A system of apportionment will be needed in these cases adding complexity to any new system.

B.19 Many others expressed concern about the creation of a new Welsh Revenue service to administer the tax. They saw clear advantages in operating via one agency rather creating a new one. Others questioned the need for a different collection authority, particularly given the relatively small amount collected by SDLT in Wales compared to England and Wales combined (around 2% of the total). One respondent warned that, "a large proportion of the "Welsh" SDLT could be eaten up by the administrative costs of duplicating the existing HM Revenue & Customs systems."

B.20 The extent of the difficulty would depend on how significant any new regime differed from the regime in England. For example one respondent noted that if a different rate of tax were to be charged on second homes this is likely to cause significant additional costs in determining if the property is a second home or not. Another pointed out that general difficulties in tackling SDLT avoidance mean administering a separate regime would be more difficult and costly than many people realise.

B.21 Another respondent noted that UK is ranked 73rd in the world in terms of the ease of registering property (compared with being ranked 7th for doing business). A new parallel but different SDLT regime will make that worse.

Q4: What impacts would devolving SDLT have on the Welsh and English economies, particularly in border areas, and what would be the extent of those impacts?

B.22 The most common view from respondents was that devolution of SDLT would have very little impact on the Welsh and English economies. While some acknowledged any impact would be associated with increased demand (and subsequent house price increase) in the border area to favour the region with the most favourable property transaction regime. Most felt the impact would be minimal.

B.23 Others felt that devolving SDLT to Wales would have very little impact on the English economy but has the potential to offer the Welsh economy substantial opportunities.

B.24 One respondent pointed to the impact various English schemes such as help to buy which is seeing Welsh property firms building on the English side of the border. Depending on what the Welsh Government did there could be a similar impact.

Conclusion

B.25 Based on the responses to this consultation the Government has determined that there is no strong evidence that devolution of SDLT will have a disproportionate impact on businesses. Therefore, as announced by the Prime Minister and deputy Prime Minister on 1 November, the Government accepts the recommendation of the Silk Commission that SDLT should be devolved to the Welsh Assembly.

List of respondents

Representative or professional bodies:

Confederation of British Industry – Representative body

National Federation of Builders (Wales) – Professional Body

Royal Institution of Chartered Surveyors (Wales) – Representative body

The Law Society – Professional Body

The Institute of Chartered Accountants in England and Wales – Professional Body

Home Builders Federation – Representative body

Federation of Master builders – Trade association

Chartered Institute of Housing (Wales) – Professional Body

The Community Housing Wales Group – Representative body for housing associations

National Farmers Union (Wales) – Representative Body

Civil Engineering Contractors Association (Wales) Ltd – Trade association

Federation of Small Businesses Wales – Representative body

Chartered Institute of Taxation – Professional Body

Companies:

Paul Drew – Developers

Welsh Home Finder - Welsh property website

Andrew Thomas – Chartered Surveyor

Ireland – Owen – Surveyors & Property Consultants

Fletcher Morgan – Chartered Surveyor

Rawlins & Madley – Chartered Surveyor

Redrow Homes South Wales – Construction company

Robert Chapman and Company – Chartered Surveyor

Bellways Homes Ltd – Construction company

Geldards LLP – Law firm

Castle View Properties ltd – Property company

Llanmoor Development Company Ltd – Property company

Network Rail – Owner of the rail network

Watkin Jones Group – property developer

Other respondents:

G4C Wales – Independent organisation funded by WG

The Construction Industry Training Board (Wales) – Training Board

Cardiff University – University

Welsh Government – Welsh Government

Mayor of London's Office – Local government

Plaid Cymru – Political party

Land Registry – Government agency

Denbighshire Council – Local Council

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