

**FIFTH ANNUAL REPORT ON THE
IMPLEMENTATION AND OPERATION OF PART 3
(FINANCIAL PROVISIONS) OF THE
SCOTLAND ACT 2012**

**FIRST ANNUAL REPORT ON THE
IMPLEMENTATION OF THE SCOTLAND ACT 2016**

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

Presented to Parliament pursuant to Section 33(1)(b) of the
Scotland Act 2012

Presented to the Scottish Parliament pursuant to Section
33(1)(c) of the Scotland Act 2012

April 2017

First Annual Report on the Implementation of the Scotland Act 2016

Presented to Parliament by the Secretary of State for Scotland
by Command of Her Majesty

April 2017

SG/2017/35



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Print ISBN 9781474142779

Web ISBN 9781474142786

ID 04041702 04/17

Printed on paper containing 75% recycled fibre content minimum

Printed in the UK by the Williams Lea Group on behalf of the Controller of Her Majesty's Stationery Office

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FOREWORD



This annual report on the Scotland Act 2012 and Scotland Act 2016 marks just over year one since the Scotland Act 2016 received Royal Assent.

One of the greatest privileges and responsibilities that I have held as Secretary of State for Scotland was the guiding of this significant legislation through the UK Parliament. Over the year that has followed Royal Assent, Ministers and officials have worked hard to ensure the safe and secure transfer of powers to Scotland. As a result, I am delighted to report excellent progress in the implementation of the Act which has been recognised as delivering on the recommendations of the all-party Smith Commission Agreement in full.

I am confident that the UK Government and the Scottish Government will continue to work constructively together to bring the Act's remaining sections into force. The implementation of this landmark legislation will ensure that the Scottish Parliament is one of the most powerful devolved legislatures in the world

A handwritten signature in black ink, reading "David Mundell". The signature is written in a cursive style with a large initial 'D'.

**Rt Hon DAVID MUNDELL MP
SECRETARY OF STATE FOR SCOTLAND**

PART 1: SCOTLAND ACT 2012

CHAPTER 1

INTRODUCTION

Scope and Content of this Report

1. This report on Part 3 of the Scotland Act 2012 is the fifth published since the Act received Royal Assent on 1 May 2012. This section of the report covers the Scotland Act 2012. Information relating to the Scotland Act 2016 can be found in Part 2 of this report.
2. 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 create new devolved taxes.
3. 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 publication of 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.
4. Both Parliaments are therefore 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.

5. Section 33(5) of the Scotland Act 2012 requires the annual reports to contain:
 - *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;*
 - *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;*
 - *an assessment of the operation of the provisions of this Part 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;*
 - *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*
 - *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.*

6. *Annex A* provides a detailed list of the paragraphs in the report which address each of these requirements. However, the report is not limited to these requirements, and can also contain any other matters that each Government believes to be relevant or useful to both Parliaments.

CHAPTER 2

SCOTTISH RATE OF INCOME TAX

From April 2016, the main UK rates of Income Tax were reduced by 10 pence in the pound for those identified as Scottish taxpayers. The Scottish Parliament set, in its annual budget, the Scottish Rate of Income Tax to be added to the reduced UK rates. The Scottish block grant was adjusted to reflect this change in funding streams. Implementation of the Scottish Rate is led by a HMRC project with representatives on the project board from HM Treasury, Scotland Office and the Scottish Government.

Steps taken towards implementation since previous report

7. The Scottish Rate of Income Tax (SRIT) commenced on 6 April 2016. In February 2016, the Scottish Parliament set the SRIT at 10% for 2016-17, thereby effectively matching the tax rates in the rest of the UK at 20%, 40% and 45% for that year.
8. HMRC's focus in 2016-17 has been on getting the final stages of implementation ready for launch on time. HMRC delivered, to time and within budget, the systems and changes necessary for the commencement of SRIT. Further changes will be required to enable pensions Relief at Source to incorporate Scottish income tax from April 2018 and these are on schedule.

IT development

9. Following the successful rollout of the updates to HMRC's PAYE system, HMRC has been implementing changes to the Self-Assessment systems. HMRC also made a number of changes to its financial accounting systems and to automated customer outputs, such as annual tax statements, to enable them to account for and refer to separate Scottish rates.

Scottish taxpayer identification

10. Last year's report set out a number of steps that HMRC had taken to communicate the upcoming changes to the Scottish tax system to Scottish taxpayers, including the issuing of 2.45 million notification letters sent out to Scottish taxpayers. Following the issue of the letters, HMRC undertook a review of the records scanning process from which the mailing list derived. This established that, due to the variety of formats in which address details are held in HMRC IT systems, not all those with a Scottish address had been correctly flagged as Scottish taxpayers. This resulted in approximately 420,000 individuals with a Scottish address not being flagged as Scottish taxpayers and receiving the notification letter.
11. HMRC took immediate steps to rectify this issue. An interim solution was in place within weeks of the start of the tax year whereby HMRC records were amended to ensure all individuals with a Scottish address were flagged as Scottish taxpayers. This ensured that, where appropriate, the affected Scottish taxpayers and their employers were issued with the correct Scottish PAYE code. HMRC put in place a permanent fix by October 2016.
12. This issue did not have any financial consequences for either taxpayers or the Scottish Government and no costs related to its rectification were passed on to the Scottish Government. HMRC has since conducted extensive post-solution testing to check that the system is operating correctly, providing significant reassurance that identification is working as intended with Scottish taxpayers flagged as such on HMRC records and coding notices sent to employers.

Relief at Source

13. Scottish taxpayers receive tax relief on pension contributions at Scottish rates. This ensures that pensions relief remains linked to the level of tax an individual is chargeable to.
14. Scottish taxpayers who contribute to pension schemes that operate net pay i.e. the pension contribution is deducted from their pay before income tax is

calculated, will automatically receive tax relief at the Scottish rates of tax. For the Relief at Source mechanism, HMRC and pension administrators are developing new systems so that pension schemes can identify Scottish taxpayers and provide relief at source at the correct basic rate. This new process will start from April 2018 and is on schedule for delivery.

15. In the interim, HMRC will resolve discrepancies between relief given and relief due via PAYE and Self- Assessment should the rest of the UK and Scottish basic rates diverge (the Scottish Parliament agreed to freeze the basic tax rate at the current UK level for 2016/17). Work has been carried out to understand the changes needed in the reconciliation processes, which would involve matching returns from pension schemes with HMRC data on Scottish taxpayers. This has involved working closely with pension scheme administrators to systematically improve data quality, including a data cleansing exercise and the introduction of data validation checks into IT systems.

Communications

16. HMRC has undertaken an extensive programme of communication around the commencement of SRIT on 6 April 2016 that focused on the importance of taxpayers keeping HMRC updated of changes to address details. Both non-paid for communications and paid for activity have been delivered via direct communication with taxpayers, agents and employers; advertisements in a range of local and national Scottish newspapers; a radio campaign broadcast across Scottish commercial radio stations; and a social media campaign on Twitter and Facebook in conjunction with the Scottish Government and Scotland Office.

Compliance

17. HMRC's high level compliance approach in relation to Scottish taxpayer status is based on analysis of risks, taking account of the likely behaviour of different categories of taxpayer, and is designed to ensure that activity represents best value for money for the Scottish Government.

18. As the SRIT for 2016/17 has not diverged from rates in the rest of the UK, HMRC compliance work has focussed on checking for errors as part of HMRC's UK-wide compliance strategy that covers employers, high net worth and affluent individuals and agents such as tax advisors. Analysis has also been done on current customer behaviours to provide a baseline for future compliance once rates diverge.

Project governance and assurance

19. Implementation of SRIT and the further Scottish income tax powers (see Part 2, Chapter 3) are delivered by HMRC through separate projects with oversight and governance provided by HMRC's Scottish Tax Devolution Implementation Programme. Both programme and project boards include representatives from HMRC, HM Treasury, Scotland Office and the Scottish Government. Project and programme board members are involved in decision making to ensure that the projects deliver effective solutions and value for money.

20. The SRIT project has been reviewed several times using the Office of Government Commerce (OGC) gateway process. The most recent review, OGC Review 4, took place in March 2016. The review team concluded that it had confidence that the mitigation actions and plans developed would fully resolve the taxpayer identification issue. The OGC review made six recommendations, which HMRC has either already implemented or is in the process of doing so.

21. The National Audit Office (NAO) published its second annual report on HMRC's work on implementing (and in due course, administering) the SRIT, on 19th December 2016 as it is required to do under the Finance Act 2014. The report's conclusions reinforced the importance of maintaining an up-to-date and accurate record of the Scottish income tax paying population; and highlighted a number of future challenges, which HMRC is already addressing.

22. HMRC has continued to provide written and oral evidence to both the UK and Scottish Parliaments on the implementation of Scottish tax powers, with

senior HMRC officials appearing before the Scottish Parliament's Finance and Constitution Committee on 14 December 2016 and the UK Parliament's Public Accounts Committee in February 2017.

Costs

Overall estimated costs for implementing the Scottish Rate of Income Tax

23. The 2016 annual report included overall estimated costs for implementing the Scottish Rate of Income Tax at £25m-30m, down from the previous year's projection of £30m-35m. HMRC has continued to make good progress on the downward trajectory of costs and has further reduced the forecast estimate to £20m-£25m. This comprises estimated IT costs in the range of £13m-17m and non-IT costs of £7m.

Actual implementation costs

24. In 2015/16, HMRC invoiced the Scottish Government for £8.4m. This was made up of £5.7m in IT costs and £2.7m in non-IT costs. This compares to a forecasted spend of £10.1m in last year's report.
25. Final figures for 2016/17 are not yet available. At the time of publication, HMRC has invoiced the Scottish Government for £2.7m for work done during 2016/17. HMRC estimates total costs for 2016/17 will be £4.6m, comprised of £3.5m IT costs and £1.1m non-IT costs. This is £3.9m lower than the £8.5m estimated at the time of last year's report, primarily due to lower than expected manpower and IT costs associated with adjusting for Relief at Source pension schemes.
26. Since the project commenced, HMRC has invoiced the Scottish Government £13.8m for the implementation of the Scottish Rate of Income Tax.

Running costs

27. The Scottish Rate of Income Tax became operational in 2016/17. There is a continuing cost to HMRC to maintain accurate records of Scottish taxpayers, deal with enquiries and correspondence, and where necessary to conduct

compliance activity to counter attempts to misrepresent Scottish taxpayer status.

28. Final figures for 2016/17 are not yet available. At the time of publication, HMRC has invoiced the Scottish Government for £0.03m for costs associated with running the Scottish Rate of Income Tax during 2016/17. HMRC estimates total running costs for 2016/17 will be £0.2m. This is lower than the £1.5m estimated at the time of last year's report because the levels of customer contact have been much lower than anticipated, in part due to successful communications activity, and because some of the estimated costs HMRC expected to attribute to Scottish income tax have instead been attributed to HMRC business as usual costs.

29. The 2016 annual report included estimated annual running costs of Scottish Income Tax of £1.5m. For 2017/18, HMRC estimates annual running costs remain in this order of magnitude. HMRC and the Scottish Government are currently working towards a framework that will support the identification and quantification of estimates for normal business as usual running costs.

Welfare

30. DWP made the necessary changes to its infrastructure for the introduction of the Scottish Rate of Income Tax for tax year commencing 6 April 2016. An exchange of letters between DWP and Scottish Government in December 2015 outlined the financial and practical arrangements agreed between both parties for ensuring DWP administered taxable benefits and associated IT systems recognise and interact with the Scottish Rate of Income Tax, and that benefit recipients, who are also Scottish taxpayers, have the correct tax information recorded for HMRC purposes.

31. Costs were reduced this year through careful supplier management. Last year's estimated costs of £1.7m (highlighted in the fourth Annual Report) have been reduced to approximately £1.2m. These costs include an in-year change request from HMRC to enhance the end of year reporting between DWP and HMRC and allow HMRC to accept an additional tax regime field. This change

allowed HMRC to track the customer's tax position accurately, directly impacting upon the Income Tax revenue that the Scottish Government will receive.

Further steps that will be taken towards implementation in 2017-18

32. With regards to Relief at Source, Ministers agreed a two-year transitional period, which ends in March 2018, to allow the pension industry to prepare its systems for the SRIT. A key focus for HMRC during 2017-18 will be to ensure the successful delivery of the next phase of its IT development programme, which will put in place services to allow the industry to check the correct Relief at Source rate to be applied for individuals within a pension scheme.
33. Most compliance activity will start once the reconciliation of the first year's SRIT PAYE returns has been completed in mid-2017 and when self-assessment returns are received. As the SRIT for 2016/17 has not diverged from rates in the rest of the UK, HMRC compliance work has focussed on checking for errors as part of HMRC's UK-wide compliance strategy that covers employers, high net worth and affluent individuals and agents such as tax advisors. Some analysis has also been done on current customer behaviours to provide a baseline for future compliance once rates diverge.
34. HMRC will continue to test and update its Scottish address data, including through the transition to a Business As Usual support model, providing ongoing assurance about the accuracy of its Scottish taxpayer data.

CHAPTER 3

BORROWING POWERS OF SCOTTISH MINISTERS

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

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

Steps taken towards implementation since previous report

35. The Scotland Act 2012 borrowing powers have been in operation since April 2015, in which month loan agreements between the Treasury, Scotland Office and the Scottish Government were put into place for capital and resource borrowing from the National Loans Fund.

36. The Scottish Government set out in its Budget, which was passed in February 2016, that it intends to borrow £322m under the Scotland Act 2012 powers in 2016-17.

37. As of April 2017 the Scottish Government is able to operate the additional borrowing powers provided by the Scotland Act 2016, as agreed in the Scottish Government's new fiscal framework (see Borrowing Powers of Scottish Ministers in Chapter 5, Part 2 of this report).

CHAPTER 4

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.

Steps taken towards implementation since previous report

38. This power came into force on the same date as the Scotland Act 2012. To date, neither the Scottish Government nor the UK Government has put forward proposals to create new devolved taxes under this power.

CHAPTER 5

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 in 2011, a fundamental principle of tax devolution is that an element of the block grant is exchanged for the ability to levy taxes. In 2016 the UK and Scottish Governments, through the Joint Exchequer Committee, agreed updated block grant funding arrangements (though to 2021-22) as part of the Scottish Government's new fiscal framework.

Steps taken towards implementation since previous report

39. The UK and Scottish Governments have agreed a block grant deduction of £4,900m in relation to the Scottish Rate of Income Tax (SRIT) for 2016-17, which will not be revisited. For future years, the Scottish block grant will be adjusted to reflect the Scottish Government's new income tax powers from the Scotland Act 2016 (see 'effect of new powers on the Scottish block grant' under the Scotland Act 2016 section below).
40. As noted in the previous implementation report, the UK and Scottish Governments agreed that the block grant adjustment arrangements in relation to Stamp Duty Land Tax (SDLT) and Landfill Tax should be considered as part of the wider fiscal framework under the Smith Agreement. This framework was agreed in February 2016, with further details set out in a technical annex, and is now being implemented.
41. Under this agreement, the two governments have agreed the approach to block grant initial baseline deductions and ongoing indexation mechanisms for all taxes being devolved or assigned in Scotland. This will apply for a transition period up to (and including) 2021-22, after which an independent

review (reporting to both governments by the end of 2021) will inform longer-term arrangements.

42. For SDLT and Landfill Tax the fiscal framework will ultimately be applied from 2016-17 onwards, with the previously agreed 2015-16 one-off block grant adjustment (£494m, as set out in the previous implementation report) left unchanged.

43. The table overleaf sets out the following for Landfill Tax and SDLT:

- The year 0 baseline deductions (i.e. for 2014-15, the year prior to devolution of both taxes);
- The 2015-16 deductions that were agreed between the two governments as one-off block grant adjustments;
- For comparison, the block grant adjustments for 2015-16 that would have been generated using the method set out in the fiscal framework (which has not been applied), under both the Comparable and the Indexed Per Capita (IPC) Models;
- The provisional 2016-17 block grant adjustment for both taxes, which was used to inform the Scottish Government's 2016-17 budget; and
- The latest estimates for the block grant adjustments from 2016-17 through to 2020-21 under the fiscal framework, using both the Comparable and the IPC Models. These are based on current forecasts of receipts for both taxes, and will ultimately be reconciled to outturn data once available.

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
	Baseline deduction	Agreed adjustment	Provisional adjustment				
		£494m	£600m				
	Fiscal framework adjustment (latest estimates)						
Landfill Tax	£149m	<i>Comparable model</i>					
		£138m	£130m	£113m	£103m	£96m	£93m
		<i>IPC model</i>					
		£138m	£129m	£111m	£101m	£94m	£91m
SDLT	£468m	<i>Comparable model</i>					
		£487m	£520m	£587m	£627m	£666m	£712m
		<i>IPC model</i>					
		£486m	£517m	£582m	£620m	£656m	£701m

44. The information in the table above has been shared with the Scottish Government during the course of the last twelve months as updated data has become available.

CHAPTER 6

OTHER REPORTING REQUIREMENTS

45. 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; and
- 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 fifth following the passage of the Act in May 2012. 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. Section 32 came into force on 12 December 2014.

47. From 1 April 2015, Stamp Duty Land Tax (SDLT) and the Landfill Tax ceased to apply in Scotland. They were replaced by the Land and Buildings Transaction Tax (LBTT) and the Scottish Landfill Tax respectively, which are both administered by Revenue Scotland. Throughout 2016, HMRC and Revenue Scotland have continued to collaborate as the LBTT and Scottish Landfill Tax become established. HMRC and Revenue Scotland are exploring opportunities for sharing data between the tax authorities to aid compliance activity across the UK.

48. In the December 2016 Scottish Budget, the Scottish Government announced that the residential and non-residential rates and bands for Land and Building Transaction Tax (LBTT) will remain unchanged; and the Standard Rate of Scottish Landfill Tax (SLfT) will be increased to £86.10 per tonne and the Lower Rate of SLfT to £2.70 per tonne in line with retail price index inflation and landfill charges in the rest of the UK.
49. The Scotland Act 2016, which enacts the cross-party Smith Commission Agreement, devolves responsibility to the Scottish Parliament for the setting of income tax rates and thresholds for earned income. This includes the ability to introduce new bands. The Act also devolves Air Passenger Duty and Aggregates Levy, and provides that a proportion of the VAT that is attributable to Scotland may be assigned to the Scottish Government's budget. The Act provides that the first ten percentage points of the standard rate of VAT and the first 2.5 percentage points of the reduced rate of VAT will be assigned to the Scottish Government's budget. Information outlining progress made to implement the Scotland Act 2016 since it gained Royal Assent on 23 March 2016 is in part 2 of this report.

PART 2: SCOTLAND ACT 2016

CHAPTER 1

INTRODUCTION

Scope and Content of this Part

50. This part of the report on the Scotland Act 2016 is the first published since the Act received Royal Assent on 23 March 2016.

51. The Scotland Act 2016 devolves a range of further powers to the Scottish Parliament, and sets out a range of financial powers and measures. These include:

- devolution of Income Tax powers including the power to set rates and bands on earned income;
- assignment of VAT;
- devolution of air passenger tax;
- devolution of aggregate tax;
- the power to borrow; and
- the destination of Fines, Forfeitures and Fixed Penalties

52. This report will provide an update on these sections, and also outline updates against the devolution of non-financial powers set out on the Scotland Act 2016. These include the devolution of a range of new welfare powers including the power to create new benefits in devolved areas and the power to top-up reserved benefits in Scotland. It also includes other spending powers relating to welfare benefits (for example disability, carers, and payments from the regulated social fund), roads, policing of railways in Scotland, onshore petroleum licensing, tribunals, elections, consumer advocacy and advice, and remaining areas of the Scotland Act 2016.

53. The fiscal framework was published on 25 February 2016¹. On Tuesday 15 March the Scottish and UK Governments published a further annex² to the fiscal framework for the Scottish Government. The fiscal framework sets out the agreement between the Scottish Government and the UK Government on the Scottish Government's fiscal framework, consistent with the principles contained in the Smith Commission Agreement and including a number of elements which will be covered by this report, including:

- Block grant adjustments for taxation and welfare;
- Administration and implementation costs;
- Spillover effects;
- Borrowing; and
- Scrutiny.

54. The fiscal framework outlines the reporting requirements for the Scotland Act 2016, that both the UK Government and the Scottish Government will prepare and publish an annual update report on functions and duties being devolved under the Scotland Act 2016 that will be provided to both Parliaments. As outlined in part 1 of this report, the information contained in this part is also relevant to the statutory requirements contained in the Scotland Act 2012. Therefore the reporting requirements for the Scotland Act 2016 are being presented in one document alongside that for the Scotland Act 2012.

1

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/503481/fiscal_framework_agreement_25_feb_16_2.pdf

² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508102/Fiscal_Framework_-_Text_-_Annex_to_the_fiscal_framework_-_15th_March_2016....pdf

CHAPTER 2

IMPLEMENTATION PROGRESS

55. The following provisions in the Scotland Act 2016 have been commenced since Royal Assent on 23 March 2016:

Section	Section Title	Date of commencement
Part 1 : Constitutional Arrangements		
1	Permanence of the Scottish Parliament and Scottish Government	23 March 2016
2	The Sewel convention	23 May 2016
Part 2: Tax and Fiscal		
13	Power of Scottish Parliament to set rates of income tax	30 November 2016
14	Amendments of Income Tax 2007	6 April 2017
15	Consequential amendments: income tax	6 April 2017
16	Assignment of VAT	23 May 2016
17	Tax on carriage of passengers by air	23 May 2016 Provision will take effect from April 2018
18	Tax on commercial exploitation of aggregate	23 May 2016 Provision will take effect at a time determined by the Joint Exchequer Committee
19	Devolved taxes: further provision	23 May 2016
20	Borrowing	1 April 2017
21	Provision of information to the Office for Budget Responsibility	1 April 2017
Part 3: Welfare		
22	Disability, industrial injuries and carer's benefits	17 May 2017 ³

³ Legislative competence is transferred under the Scotland Act 2016 (Commencement No. 5) Regulations 2017, (<http://www.legislation.gov.uk/ukxi/2017/455/contents/made>) but executive competence is retained for a transitional period. See chapter 6.

23	Benefits for maternity, funeral and heating expenses	17 May 2017 ⁴
24	Discretionary payments: top-up of reserved benefits	5 September 2016
25	Discretionary housing payments	1 April 2017
26	Discretionary payments and assistance	5 September 2016
28	Power to create other new benefits	5 September 2016
29	Universal Credit: costs of claimants who rent accommodation	5 September 2016
30	Universal Credit: persons to whom, and time when, paid	5 September 2016
31	Employment Support	5 September 2016
32	Functions exercisable within devolved competence	5 September 2016
33	Social Security Advisory Committee and Industrial Injuries Advisory Council	5 September 2016
34	Information-sharing	5 September 2016
35	Extension of unauthorised disclosure offence	5 September 2016
Part 4: Other Legislative Competence		
36	Crown Estate	36 (1), (5), (6), (9), (10), (11), (12) on 23 March 2016 The remainder on transfer date for Crown Estate Scheme on 01 April 2017
37	Equal opportunities	23 May 2016
38	Public sector duty regarding socio-economic inequalities	23 May 2016
39	Tribunals	23 May 2016
40	Roads	23 May 2016
41	Roads: Traffic signs etc	23 May 2016

⁴ Legislative competence is transferred under the Scotland Act 2016 (Commencement No. 5) Regulations 2017, (<http://www.legislation.gov.uk/ukxi/2017/455/contents/made>) but executive competence is retained for a transitional period. See chapter 6.

42	Roads: Speed limits	23 May 2016
43	Roads: Parking	23 May 2016
44	Roads: consequential provision etc	23 May 2016
45	Policing of railways and railway property	23 May 2016
46	British Transport Police: cross border public authorities	23 May 2016
50	Consumer Advocacy and Advice	23 May 2016
51	Functions exercisable within devolved competence: consumer advocacy and advice	23 May 2016
52	Gaming machines on licenced betting premises	23 May 2016
53	Abortion	23 May 2016
Part 5: Other Executive Competence		
54	Gaelic Media Service	23 May 2016
55	Commissioners of Northern Lighthouses	23 May 2016
56	Maritime and Coastguard Agency	23 May 2016
57	Rail: franchising of passenger services	23 May 2016
61	Renewable electricity incentive schemes: consultation	23 May 2016
62	Offshore Renewable Energy Installations	01 April 2017
63	References to Competition and Markets Authority	23 May 2016
Part 6: Miscellaneous		
64	Gas and Electricity Markets Authority	23 May 2016
65	Office of Communications	18 August 2016
66	Bodies that may be required to attend before the Parliament	23 May 2016
67	Destination of fines, forfeitures and fixed penalties	01 April 2017
PART 7: General		
68	Subordinate legislation under functions exercisable within devolved competence	23 March 2016

69	Transfers of property etc to the Scottish Ministers	23 March 2016
70	Transitional provision	23 March 2016
71	Power to make consequential, transitional and saving provision	23 March 2016
72	Commencement	23 March 2016
73	Short Title	23 March 2016

Implementation and commencement across the Scotland Act 2016

56. A number of provisions came into force on Royal Assent and two months after Royal Assent. Since that point, five commencement regulations have been made to bring further sections of the Act into force. The UK Government is continuing work to bring the remaining sections into force.

57. The fiscal framework agreement sets out a number of agreed dates between the Governments on implementation and commencement of the powers in the Scotland Act 2016.

Governance

58. The Scotland Act 2016 Implementation Board was set up after Royal Assent of the Act as the overseer of implementation across the whole Act. The Board is chaired by the Director of the Scotland Office, and attended by government Departments with policies covered in the Act.

59. The Board meets on a monthly basis to monitor progress on implementation and commencement. It supplements governance structures within UK Government departments that exist to implement the provisions in the Scotland Act 2016 and transfer responsibilities to the Scottish Parliament and the Scottish Government.

CHAPTER 3

INCOME TAX

From 6 April 2017, the Scottish Parliament will have full freedom to set the income tax rates and limits applicable to Scottish taxpayers on their non-savings and non-dividend income. The rates and limits will be set each year in its Scottish Rate Resolution. The Scottish block grant will be adjusted to reflect the change in funding stream in the manner set out in the fiscal framework agreement between the UK & Scottish Governments of February 2016. Implementation of the Further Scottish Income Tax Powers is led by a HMRC project with representatives on the project board from HM Treasury, Scotland Office and the Scottish Government.

Steps taken towards implementation since the Act was passed

60. The Scottish Parliament's income tax-raising powers were enhanced by the Scotland Act 2016. From 2017-18, the Scottish Parliament will have the power for the first time to set both the rates and band thresholds (excluding the personal allowance) that apply to all non-savings and non-dividend income tax paid by Scottish taxpayers.

61. In 2016-17, there was no difference between rates in Scotland and the rest of the UK. In February 2017, the Scottish Parliament voted to freeze income tax rates for 2017-18, with no increases to the basic, higher or additional rates. In addition, it agreed to maintain the higher rate of income tax threshold at £43,000 in 2017/18. The UK Parliament had previously voted to increase the higher rate threshold still applicable in the rest of the UK to £45,000. Scottish taxpayers will therefore pay the 40% higher rate if they earn £43,000 or more, whereas taxpayers in the rest of the UK will pay the 40% higher rate if they earn £45,000 or more.

62. HMRC has undertaken a number of activities to ensure that its processes and systems are in a position to accommodate the flexibility introduced by the further income tax powers, including, for example, assessing the extent of

change required to HMRC's PAYE and Self-Assessment systems; advising software developers of the technical changes required to support the production of new payroll software; and preparing communications to support individuals, employers, software developers and agents.

Legislation

63. In November 2016 HMRC issued a Technical Note relating to the further Scottish Income Tax Powers. The Technical Note explains that there has been no change to the previous position outlined in earlier Technical Notes (of May 2012 and December 2014) so all aspects of the income tax system will interact with the further, Scotland Act 2016, powers in exactly the same manner that they currently interact with SRIT.

64. Some minor consequential amendments to legislation were required to ensure this is the case and a Statutory Instrument was laid before the UK Parliament in March 2017.

Project governance

65. HMRC put in place a dedicated project team to implement the further devolved powers set out within the Scotland Act 2016, including the further income tax powers. The project board comprises members from HMRC, HMT, the Scotland Office and the Scottish Government and reports into HMRC's overall Scottish Tax Devolution Programme Board to ensure cohesion with HMRC's other Scotland Act implementation projects.

66. HMRC and the Scottish Government have updated their Memorandum of Understanding to ensure its continued operation under the further income tax powers.

Costs

Overall estimated costs for implementing Scotland Act 2016 income tax powers

67. HMRC estimates the overall estimated cost of implementing the further Scottish income tax powers to be £2.6m. This is made up of £1.3m in IT costs and £1.3m in non-IT costs. This excludes extra costs that will be

recharged to the Scottish Government to reflect work to update the PAYE system to recognise the new rates and thresholds as agreed by the Scottish Parliament in February.

Actual implementation costs

68. Final figures for 2016/17 are not yet available. HMRC has so far invoiced the Scottish Government in 2016/17 for £0.6m for costs associated with implementing the further Scottish income tax powers. HMRC estimates total costs for 2016/17 to be £1.4m, made up of £0.8m IT costs and £0.6m non-IT costs.
69. These costs are in addition to those identified for the Scottish Rate of Income Tax and specifically relate to the further Scottish income tax powers provided for in the 2016 Act.

Welfare

70. The UK Social Security System, administered by the DWP, is responsible for a number of benefits where entitlement is dependent on income net of tax. Some social security benefits are taxable, for example Jobseekers Allowance, and others are non-taxable, such as Disability Living Allowance.
71. The DWP set up a dedicated Taxation Project Team to work with its IT suppliers, HMRC and Local Authorities, to identify all benefits and the related IT systems which receive and store tax code and/or use the tax code within the calculation of the award, and took forward the IT and Guidance changes to ensure that by 6th April 2017 DWP Systems and Business processes were capable of complying with the changes introduced by the Scotland Act 2016.
72. A revised exchange of letters between DWP and the Scottish Government took place on 9th December 2016 which set out the terms of agreement for reimbursement of costs associated with making changes to DWP's IT and non

IT systems. These letters have been placed in both the UK Parliament libraries and the Scottish Parliament.⁵

73. The DWP Taxation Project Team meets regularly with the Scottish Government to agree each specific cost item and the amount forecast and subsequently incurred. These meetings are based upon the same principals utilised within SRIT delivery and afford the Scottish Government the opportunity to challenge and seek further information on any aspects of the costs.

74. The baseline cost agreed with the Scottish Government within version 1.0 of the forecast Cost Model as at 1st June 2016 was £761k. The Taxation Project has worked very closely with the DWP business and HMRC to reduce these costs by the confirmation of business requirements and the subsequent rigorous challenge of supplier estimates. This has enabled the Project to reduce the costs to a lifetime estimate of £0.5m.

Further steps to be taken towards implementation in 2017-18

75. Financial accounting systems will be enhanced to ensure all tax collected on earned income by Scottish taxpayers is accurately accounted for.

76. Relevant IT changes will be made to self-assessment systems by April 2018, before the issue of the self-assessment returns for the 2017-18 tax year. HMRC will also make changes to automated customer outputs, such as annual tax statements, to enable them to account for and refer to separate Scottish rates.

⁵ Deposited Paper: Exchange of letters between the Scottish Government and the DWP regarding the Scottish rate of Income Tax (SRIT) and Scottish Income Tax, Department for Work and Pensions (DEP2016-0878)

CHAPTER 4

OTHER TAX POWERS & FISCAL PROVISIONS

The Scotland Act 2016 provides for Air Passenger Duty and the Aggregates Levy to be devolved. From April 2018, Air Passenger Duty will cease to apply in Scotland and will be replaced by the Scottish Air Departure Tax. No timetable has yet been set by the Joint Exchequer Committee for the disapplication of the Aggregate Levy. The 2016 Act also makes provision in relation to VAT. From April 2019, the Scottish Government will be assigned the first 10 percentage points of the revenue attributable to Scotland from the standard rate of VAT and the first 2.5 percentage points of the revenue attributable to Scotland from the 5 per cent reduced rate. VAT rates will continue to be set at a UK-wide level. HMRC's Scottish Tax Devolution Programme Board will directly oversee the transition of these other tax powers.

Steps taken towards implementation since the Act was passed

77. The Scottish Government introduced the Air Departure Tax (Scotland) Bill to the Scottish Parliament on 20 December 2016 in preparation for the switch-over from UK Air Passenger Duty from April 2018. HMRC have worked closely with both the Scottish Government and Revenue Scotland, who will administer the new Scottish tax, holding monthly meetings to ensure administration is as simple as possible for customers and to avoid issues such as double taxation. HMRC is represented on Revenue Scotland's newly established Programme Board, which met for the first time on 8 December 2016. HMRC expects the cost of switching off APD in Scotland to be minimal and therefore do not expect to charge the Scottish Government for costs incurred.

78. HMRC has been working with the Scottish Government and HMT on a methodology for estimating how much VAT is generated in Scotland in accordance with the Scottish Government's fiscal framework, prior to the assignment of VAT receipts to Scotland in 2019-20. HMRC and the Scottish Government agreed the governance arrangements for the allocation and

payment of these costs in February 2017. Costs on this work in 2016/17 up to Q3 totalled £130k, which was split equally between the organisations.

Further steps to be taken towards implementation in 2017-18

79. HMRC will continue to liaise with Revenue Scotland and the Scottish Government to ensure the readiness of all parties for the switch off of the Air Passenger Duty in April 2018. This will include publishing updated guidance and undertaking joint communications activity with the Scottish Government and Revenue Scotland in the run up to April 2018.
80. HMRC will continue to work on the methodology for VAT apportionment alongside HMT and the Scottish Government.
81. The Joint Exchequer Committee (JEC) will agree on a suitable point for the commencement for devolution of the Aggregates Levy once current state aid and other outstanding issues have been resolved. At this stage it is unclear as to whether any progress will be made, with the domestic legal challenges stayed while the issue remains before the European Courts. In the event of progress, HMRC will conduct initial discussions with the Scottish Government to agree the next steps.

CHAPTER 5

BORROWING POWERS

The Scotland Act 2016 provides the Scottish Government with additional borrowing powers, building on those delivered in the Scotland Act 2012. In addition to the circumstances set out in the Scotland Act 2012, the provisions in the Scotland Act 2016 enable Scottish ministers to borrow for the following two purposes:

- to meet current expenditure because of an excess of welfare payments over forecast welfare payments, and;*
- to meet current expenditure because of a Scotland-specific negative economic shock;*

The Scotland Act 2016 provisions also:

- increase the Scottish Government's current borrowing limit from £500m to £1.75bn, and;*
- increase the Scottish Government's capital borrowing limit from £2.2bn to £3bn.*

Steps taken towards implementation since the Act was passed

82. The Scottish and UK Governments agreed further detail relating to the Scottish Government's additional borrowing powers as part of the fiscal framework agreement in February 2016, and in the technical annex that followed in March 2016.

83. It was agreed in the framework that the Scottish Government's new borrowing powers would commence from April 2017, and the UK Government laid the necessary commencement regulations in December 2016 in order to do so.

84. The UK and Scottish Governments have agreed in the framework that within the statutory overall borrowing limit of £1.75bn, the Scottish Government will have an annual limit for resource borrowing for all purposes of £600m, with the in-year cash management limit remaining at £500m. Within the £600m annual limit for resource borrowing for all purposes, there will be an annual

limit for forecast errors of £300m, and an annual limit of £600m for mitigating the effects of a Scotland-specific negative economic shock.

85. The fiscal framework specifies that a Scotland-specific economic shock is triggered when onshore Scottish Gross Domestic Produce (GDP) growth is observed, or is forecast, to be below 1% in absolute terms on a rolling four quarter by four quarter basis, and is also at least 1% below UK GDP growth over the same period.

86. Following the fiscal framework agreement, the Scottish and UK Governments have worked together to agree further detailed arrangements for reporting and repaying borrowing, and the operation of the Scotland Reserve. These will be finalised through the Joint Exchequer Committee.

CHAPTER 6

WELFARE POWERS

Part 3 of the Scotland Act 2016 contains 14 sections relating to welfare benefits and employment support. The provisions in these sections of the Act give the Scottish Parliament greater powers to ensure that welfare provision in Scotland is tailored to local circumstances. At the same time, the package maintains the benefits of the single jobs market, the UK's ability to pool risks and for different parts of the UK to support each other when necessary. Once transferred, the Scottish Parliament and the Scottish Government will be responsible for welfare benefits which in 2015/16 accounted for around £2.8 billion of spending in Scotland.

Steps taken towards implementation since the Act was passed

87. Following agreement at the Joint Ministerial Working Group on Welfare on 16 June 2016, 11 of the 14 sections in part 3 of the Act were commenced on 14 July 2016⁶. This covered the following sections:

- 24: Discretionary payments: top-ups of reserved benefits
- 25: Discretionary Housing Payments
- 26: Discretionary payments and assistance
- 28: Powers to create other new benefits
- 29: Universal credit: costs of claimants who rent accommodation
- 30: Universal credit: persons to whom, and time when, paid
- 31: Employment support
- 32: Functions exercisable within devolved competence
- 33: Social Security Advisory Committee and Industrial Injuries Advisory Council
- 34: Information-sharing
- 35: Extension of unauthorised disclosure offence

⁶ The Scotland Act 2016 (Commencement No.1) Regulations 2016 (SI 2016/759) and The Scotland Act 2016 (Saving) Regulations 2016 (SI 2016/761)

88. Commencement of all of these sections, other than section 25, came into force on 5 September 2016. Discretionary Housing Payments, under section 25, came on 1 April 2017.

89. The remaining three sections in part 3 are more complex as they deal with existing or on-going benefits and payments.

- Section 22 of the Act covers provisions which transfer responsibility for benefits relating to disability, industrial injuries and caring responsibilities, including Attendance Allowance, DLA, PIP and Carer's Allowance, also Severe Disablement Allowance and all weekly paid Industrial Injuries Benefits;
- Section 23 of the Act covers provisions which transfer responsibility for benefits relating to maternity and funeral expenses and the costs of heating in cold weather, being the Sure Start Maternity Grant, Funeral Payments, Cold Weather Payments and the Winter Fuel Payments;
- Section 27 of the Act transfers responsibility for welfare foods, enabling the Scottish Parliament to abolish or amend schemes for the provision of welfare foods, as currently made in regulations under section 13 of the Social Security Act 1988, or to make new schemes for the provision of welfare foods. The implementation of this provision is being led by the Department of Health.

90. A Joint Ministerial Working Group on Welfare (JMWGW) and a supporting Joint Senior Officials Group were established to facilitate joint working between the Scottish Government and the DWP to oversee the transition of welfare powers (not including section 27 which is overseen by the Department of Health), supported by comprehensive and independently assured governance bodies at Departmental level. Since the Scotland Act 2016 received Royal Assent there have been three JMWGW meetings. Minutes agreed from the meeting are made publicly available to both Parliaments by the UK and Scottish Governments respectively.

91. On 11 October 2016, the JMWGW agreed to consider the proposal from the Scottish Government to split legislative and executive competence for the commencement of sections 22 and 23. The intention was that legislative competence would be transferred by June 2017 and executive competence would be transferred by April 2020. This would enable the Scottish Government to introduce and pass primary legislation on social security in the Scottish Parliament. During the transitional period of split competence, the UK Government would retain executive competence for delivery of, and accountability for, existing benefits. Executive competence could also transfer earlier than April 2020, should it be needed by Scottish Government Ministers.

92. On 20 February 2017, the JMWGW agreed to proceed with the making of the commencement and transitional regulations⁷ to bring about the split commencement approach for sections 22 and 23. These regulations come into force on 17 May 2017, in order to enable the Scottish Government to introduce their Social Security Bill by June 2017.

Implementation Programme

93. DWP have established a Scottish Devolution Programme team specifically to manage the implementation of the new devolution settlement provided for in the Scotland Act 2016. The Programme works closely with the Scottish Government, DWP stakeholders and other Government departments in preparing for the transition to future arrangements.

94. To underpin this work and set the tone for collaboration, in summer 2016, there was a joint meeting of the DWP and Scottish Government Executive Teams.

⁷ The Scotland Act 2016 (Commencement No. 5) Regulations 2017,
<http://www.legislation.gov.uk/uksi/2017/455/contents/made>
The Scotland Act 2016 (Transitional) Regulations 2017
<http://www.legislation.gov.uk/uksi/2017/444/contents/made>

95. DWP have undertaken extensive information sharing and knowledge building activities under the terms of a comprehensive Memorandum of Understanding agreed between DWP and the Scottish Government. The DWP Scottish Devolution Programme has now facilitated the sharing of over 300 pieces of information to help the Scottish Government build its knowledge of DWP business processes and customer journeys for the devolved welfare measures.

96. DWP has also completed well over 100 workshops and meetings for Scottish Government staff to explain in more detail the current DWP benefit processes, from completion of the claim form through to the assessment and payment. A similar approach has been taken to explain the current DWP commercial processes.

97. Learning events have been a key element of our joint working arrangements. The Scottish Devolution Programme has organised a number of knowledge building sessions with expert domains to improve Scottish Government understanding of other areas of work within DWP. The Programme has undertaken significant work to support the Scottish Government to develop its proposals on employability and welfare. The Programme:

- Worked collaboratively on the design and introduction of new employment programmes from April 2017, which are unpinned by DWP payment systems;
- Carried out a DWP feasibility study considering options to deliver the Scottish Government's commitment to pay carer's allowance at a higher rate in Scotland;
- Worked closely with the Scottish Government about their use of Universal Credit flexibilities, enabling Scottish Government to draft and consult on their first regulations;
- Supported the devolving of Discretionary Housing Payments from April 17, including agreeing a clear funding settlement;
- Completed significant work to help Scottish Government understand the existing benefits that they will be taking responsibility for; and

- Supporting the Scottish Government in the recruitment of claimants for their Customer Experience Panels.

98. A joint communications approach is also being taken to ensure consistent and correct information is provided to DWP's customers, staff and stakeholders. Shared communications products to date have included co-ordinated announcements, joint presentations and factsheets.

Further steps to be taken towards implementation in 2017-18

99. DWP's work with the Scottish Government going forward will very much depend on the delivery arrangements that the Scottish Government wish to introduce, but the UK Government expects to agree Agency Arrangements to underpin the transfer of powers in a safe and secure manner.

100. The Department of Health will continue to work closely with the Scottish Government on the transfer of section 27 of the Act, towards an anticipated transfer date in spring 2018.

CHAPTER 7

STEPS TOWARDS IMPLEMENTATION - OTHER SECTIONS IN THE ACT

There are a number of other provisions in the Scotland Act 2016 that have effects on the Scottish Government's spending powers, the arrangements for which are covered by the Fiscal Framework. These include the following provisions:

- *Scottish Parliamentary and local government elections*
- *The Crown Estate in Scotland*
- *Tribunals*
- *Policing of railways*
- *Onshore oil and gas licensing*
- *Consumer advocacy and advice*
- *Destination of Fines, Forfeitures and Fixed Penalties*

Sections 3-10: Elections

Steps taken towards implementation:

101. Sections 3-10 provide the Scottish Parliament and Scottish Ministers with certain powers in relation to elections to the Scottish Parliament and local government elections in Scotland. The Cabinet Office are working with the Scottish Government on the transfer of these powers. The UK Government is committed to commencing these sections (together with sections 11 and 12) as soon as is practicable.

102. Section 11 of the Act stipulates the requirement for a two thirds majority (super-majority) in order to pass certain legislation in the Scottish Parliament. Section 12 gives the Scottish Parliament the power to amend the Scotland Act 1998 in relation to the operation of the Scottish Parliament and Scottish Government. This sections will be commenced with sections 3-10.

Section 36: Crown Estate

Steps taken towards implementation:

103. Section 36 (1), (5), (6) and (9) to (12) were commenced on 23 March 2016, the day the Act passed. The responsibility for managing Crown Estate assets in Scotland was subsequently transferred to Scottish Ministers on 1 April 2017. This was achieved by a transfer scheme made by HM Treasury, which was subject to the approval of Scottish Ministers.

104. A draft of the scheme was published in the House Libraries during the passage of the Scotland Bill. Following Royal Assent of the Act, UK and Scottish Government officials have worked together to update this scheme. A final draft was agreed between UK and Scottish Government Ministers in January 2017. The scheme was laid in the UK Parliament in March 2017, and came into force on 1 April 2017⁸.

Section 39: Tribunals

Steps taken towards implementation:

105. Section 39 transfers the responsibility for the reserved tribunals to the Scottish Parliament. This provision was commenced on 23 May 2016, two months after the Act received Royal Assent.

106. The UK Government and the Scottish Government have been working closely on plans to implement section 39 of the Scotland Act 2016. The transfer of responsibility for the management of reserved tribunals represents a significant legal and operational challenge, as the UK Government will continue to be responsible for the majority of the national policy and the substantive law applied by those tribunals. It is therefore essential that the transfer is implemented in a way that preserves the

⁸ <http://www.legislation.gov.uk/ukdsi/2017/9780111155103/contents>

integrity of the national policy without placing unnecessary requirements on the Scottish Government in managing the system.

107. The UK Government and the Scottish Government continue to work through the legislative and operational requirements to implement this measure effectively. It is currently expected that the transfer will be implemented by way of a phased approach. This would provide for Her Majesty's Courts and Tribunals Service (HMCTS) to transfer physical operations to enable the Scottish Courts and Tribunals Service (SCTS) to create a single unified system for tribunals in Scotland dealing with matters which include devolved welfare benefits and tax.

108. It is proposed that the transfer of tribunal functions, with any restrictions on their exercise, will be specified by relevant Orders in Council(s) which are subject to agreement in both Parliaments. This will be followed by further legislation in the Scottish Parliament to effectively complete the transfer.

Sections 45-46: Policing of Railways & the British Transport Police

Steps taken towards implementation:

109. Section 45 of the Scotland Act 2016 amends the Scotland Act 1998 to give the Scottish Parliament legislative competence over the policing of railways in Scotland. Section 46 designates British Transport Police Authority, and senior officers of the British Transport Police force as cross-border public authorities; this paves the way for the subsequent transfer of executive competence through Orders under the Scotland Act 1998. These sections of the Act were commenced two months after Royal Assent on 23 May 2016.

110. The UK and Scottish Governments have agreed to work towards a full transfer of railway policing functions to take place in April 2019.

Sections 47-49: Onshore petroleum

Steps taken towards implementation:

111. Sections 47-49 include provisions relating to onshore oil and gas extraction that provide Scottish Ministers with the powers to administer the existing onshore oil and gas licensing regime in Scotland, and create a bespoke licensing regime.

112. Commencement regulations will be made to allow these provisions to come into force in due course. Negative and affirmative secondary regulations, making consequential amendments by regulation to petroleum licensing and taxation legislation, and to existing licences, are also expected to be made in due course.

Section 50: Consumer Advocacy and Advice

Steps taken towards implementation:

113. Section 50 of the Act transfers responsibility for consumer advocacy and advice in relation to general consumer matters, electricity, gas and postal services to the Scottish Parliament. Section 50 of the Act was commenced two months after Royal Assent on 23 May 2016. The UK Government and Scottish Government are in the process of agreeing a Memorandum of Understanding to underpin the transfer of this provision.

Section 67: Fines, Forfeitures and Fixed Penalties

Steps taken towards implementation:

114. Section 67 of the Act gives the Secretary of State the power to amend, with Treasury consent, any primary legislation requiring or authorising the payment of relevant Fines, Forfeitures and Fixed Penalties into the UK Consolidated Fund; so that these payments are required or authorised to be

paid instead in to the Scottish Consolidated Fund. The necessary regulations were made on 5 December 2016 to commence this power from 1 April 2017.

115. This will enable two statutory instruments to be made by the Department of Transport and Government Equalities Office respectively, to amend the necessary legislation to divert relevant Fines, Forfeitures and Fixed Penalties to the Scottish Consolidated Fund.

116. HM Treasury will also update the designation of receipts order, to reflect the fact that Fines, Forfeitures and Fixed Penalties will be paid into the Scottish Consolidated fund from 1 April 2017. The updated order will need to be laid in the UK Parliament after 1 April 2017, to ensure that these are paid into the Scottish Consolidated Fund from this date.

117. The following chapter sets out the effect of the new powers on the Scottish Block Grant.

CHAPTER 8

EFFECT OF NEW POWERS ON THE SCOTTISH BLOCK GRANT

As a result of further tax devolution and assignment of revenues in the Scotland Act 2016, the Scottish Government will be responsible for raising more of what it spends. Once the Scotland Act 2016 is implemented in full, the Scottish Government will be able to raise over 50% of its own funding through Scottish taxes. As a result of welfare devolution in the Scotland Act 2016, the Scottish Government will also have powers over benefits worth approximately £2.8bn in 2015/2016. The UK and Scottish Governments agreed a fiscal framework for the Scottish Government in February 2016 to underpin the funding arrangements for these new powers, including how the Scottish Government's block grant should be adjusted – with the necessary deductions for new revenue raising powers, and additions for new spending powers.

118. The fiscal framework agreed between the Scottish and UK Governments sets out the approach to block grant baseline adjustments and ongoing indexation mechanisms for all taxes, court revenues, and welfare payments being devolved or assigned in Scotland.

119. The arrangements set out in the fiscal framework agreement will be implemented alongside the Scotland Act 2016 powers.

120. The block grant adjustments for 2017-18 were set at the Autumn Statement in November 2016. These are fixed until outturn data is available. The UK Government also provided the Scottish Government with figures for provisional block grant adjustments from 2018-19 up until 2020-21.

121. These figures were sent to the Scottish Government in their settlement letter, and are set out in the table below. The table includes:

- The year 0 baseline deductions for Income Tax; Fines, Forfeitures and Fixed Penalties (FFFPs); and Proceeds of Crime (i.e. for 2016-17, the year prior to devolution). To note, the UK and Scottish Governments

have agreed that the baseline deduction for FFFPs will need to be updated to £28m at the Autumn Budget 2017, as the original deduction of £33m was incorrect. All of the baseline deductions will be reconciled to outturn data for 2016-17 receipts once available;

- The provisional year 0 baseline deduction for Air Passenger Duty (i.e. for 2017-18, the year prior to devolution). This will be updated at the Autumn Budget 2017 to reflect forecast 2017-18 receipts, and then fixed until outturn data is available;
- The block grant adjustments for Income Tax, FFFPs, and Proceeds of Crime for 2017-18 under the fiscal framework, using both the Comparable and IPC models. As above, these will be fixed until outturn data is available; and
- The provisional block grant adjustments for Income Tax, FFFPs, Proceeds of Crime, and APD from 2018-19 through to 2020-21. Again, these show the adjustments under the fiscal framework using both the Comparable and IPC models.

		2016-17	2017-18	2018-19	2019-20	2020-21
Income Tax	Baseline deduction	£11,311m				
	Comparable model adjustment		£11,663m	£11,980m	£12,411m	£12,948m
	IPC model adjustment		£11,624m	£11,901m	£12,291m	£12,785m
Fines, Forfeitures and Fixed Penalties	Baseline deduction	£33m				
	Comparable model adjustment		£32m	£32m	£33m	£33m
	IPC model adjustment		£32m	£32m	£32m	£32m
Proceeds of Crime	Baseline deduction	£4m				
	Comparable model adjustment		£4m	£4m	£4m	£4m
	IPC model adjustment		£4m	£4m	£4m	£4m
Air Passenger Duty	Baseline deduction		£316m			
	Comparable model adjustment			£327m	£342m	£358m
	IPC model adjustment			£326m	£339m	£355m

122. The block grant adjustments for the assignment of VAT revenues will begin from April 2019, once this power commences. The block grant adjustments for devolution of the Aggregates Levy and welfare powers will be dependent on the commencement date agreed for these powers.

123. For all other areas of spend being devolved in the Scotland Act 2016, the UK and Scottish Governments agreed in the fiscal framework that the usual machinery of government approach would be applied to calculate the baseline transfers for any programme funding. This includes the following areas:

- Employment programmes
- Consumer advocacy
- Tribunals
- British Transport Police

124. The UK and Scottish Governments have subsequently agreed through the Joint Exchequer Committee that the same approach will be applied to devolution of Discretionary Housing Payments. This is due to the fact that these welfare payments are largely categorised under DWP's Delegated Expenditure Limits (DEL) - as are employment programmes - rather than DWP's Annually Managed Expenditure (AME), like the other welfare powers being devolved.

125. In line with this approach, baseline transfers have been agreed between the Scottish Government and relevant UK Government departments for consumer advocacy, employment programmes, and Discretionary Housing Payments. These figures were formalised through the Joint Exchequer Committee, and, ahead of commencement of the powers in April 2017, the relevant UK Government departments have transferred the amounts to the Scottish Government to cover spending for all remaining years of the Spending Review period (up until 2019/20).

126. If there are subsequent changes in UK Government spending in these areas, the Barnett formula will be applied in the usual way to work out the corresponding change to the Scottish Government's block grant.

127. The agreement of any funding transfers for the devolution of tribunals and British Transport Police will be dependent on the respective dates for commencement and transfer of executive competence.

128. The UK and Scottish Governments have agreed through the fiscal framework the methodology for calculating the baseline deduction to account for the transfer of management of Scottish Crown Estate assets to the Scottish Government. The UK and Scottish Governments have subsequently agreed a provisional block grant deduction through the Joint Exchequer Committee based on this methodology, which will be updated once outturn data for 2016/17 is available in the summer of 2017.

129. The UK and Scottish Governments have also agreed through the Joint Exchequer Committee a baseline transfer figure for devolution of the Coastal Communities Fund.

130. As agreed in the fiscal framework, neither the Crown Estate nor the Coastal Communities Fund baseline adjustments will be indexed.

Administration and implementation costs

131. In addition to the block grant adjustments set out above, the UK and Scottish Governments have agreed in the fiscal framework the amounts that the UK Government will transfer to the Scottish Government, to cover the Scottish Government's costs for implementing and administering their new powers.

132. The UK Government will make a one-off non-baselined transfer of £200m to the Scottish Government to cover their implementation costs, and a baseline transfer of £66m to cover their ongoing administration costs as they take on new powers.

133. The UK and Scottish Governments have subsequently agreed through the Joint Exchequer Committee the profile of these transfers for 2017/18. In line with this agreement, the UK Government will make a non-baselined transfer of £100m and a baselined transfer of £22m for 2017/18.

134. Both Governments have agreed that there will be a review of available evidence for subsequent costs by the end of 2017, to inform the funding profile for 2018/19 onwards.

CHAPTER 9

OTHER ACTIVITIES TOWARDS IMPLEMENTATION OF THE FISCAL FRAMEWORK

Spillover effects

135. The Smith Commission Agreement stated that there should be no detriment as a result of UK or Scottish Government policy decisions post-devolution. The UK and Scottish Governments subsequently set out in the fiscal framework that this should include policy decisions affecting the tax receipts or expenditure of either government, for which the decision-making government should either reimburse the other for a cost, or receive a transfer for a saving.

136. The fiscal framework splits these financial consequences into direct effects and behavioural effects. Both governments agreed in the framework that direct effects would be accounted for.

137. For behavioural effects, the framework sets out that those with a material and demonstrable welfare cost or saving should be taken into account in exceptional circumstances; while behavioural effects impacting tax revenues should be taken into account in exceptional circumstances, where they are demonstrated to be material, and both governments agree that it is appropriate to do so.

138. The UK and Scottish Governments are working together to agree further details on the process for both governments to agree and account for direct and behavioural effects. This will be finalised through the Joint Exchequer Committee.

Audit and accountability

139. In line with the Smith Commission Agreement for strengthening intergovernmental relations, the UK and Scottish Governments have agreed

to put in place a set of robust auditing arrangements with respect to the operation of the Scotland Act 2016 and the fiscal framework.

140. This is to reflect the fact that in new devolution arrangements, some UK-wide public bodies will be delivering devolved functions in Scotland, and some Scottish public bodies may be responsible for matters which continue to be of UK-wide interest.

141. The UK and Scottish Governments agreed in the fiscal framework that accountability and credibility to both Parliaments is an essential part of the framework, and that there should be accountability of delivery bodies in both jurisdictions to elected representatives.

142. Both governments agreed that the lines of accountability should be clear and easily understood, and that auditing arrangements should be efficient and effective. They should ensure that duplication is avoided as far as possible, and that auditors are not overburdened by new responsibilities once the Smith Commission Agreement provisions are fully implemented.

143. It was agreed in the fiscal framework that the Joint Exchequer Committee should agree detailed arrangements based on these provisions.

144. In line with this agreement, UK and Scottish Government officials are working together to develop an accountability framework to help UK and Scottish public bodies in their duty to support UK and Scottish national auditors with their auditing responsibilities to each respective Parliament.

145. The framework will be shared with the National Audit Office (NAO) and Audit Scotland in April, with the intention that it will form the basis for them to make any necessary arrangements regarding their auditing responsibilities for relevant UK and Scottish public bodies.

146. It will be for the NAO and Audit Scotland to decide on any further auditing arrangements to fulfil these responsibilities.

Scottish Fiscal Commission

147. The Scottish Fiscal Commission Act 2016 (Consequential Provisions and Modifications) Order 2017⁹ was made by the Secretary of State for Scotland on 28 February 2017 having been approved by both Houses of the UK Parliament. The related Scottish Fiscal Commission Act 2016¹⁰ establishes the Scottish Fiscal Commission (the Commission) as a corporate body, sets out the Commission's functions, and specifies that, in performing its functions, the Commission is not subject to the directions and control of the Scottish Government. Its functions include a statutory duty to prepare forecasts of tax receipts and assessments of the Scottish Government's borrowing projections to inform the Scottish budget process.
148. The Order made by the UK Government makes the Commission part of the Scottish Administration and places a duty on the Office for Budgetary Responsibility to co-operate with the Commission, in line with the Fiscal Framework Agreement. The Scottish Fiscal Commission Act 2016 places a similar obligation on the Scottish Fiscal Commission to co-operate with the Office for Budget Responsibility.
149. This Order came into force on 1 April 2017, which is the same day that the relevant provisions of the Scottish Fiscal Commission Act will be commenced by a Scottish Statutory Instrument.

Information sharing

150. The UK and Scottish Governments agreed in the fiscal framework that appropriate and reciprocal information-sharing agreements will be put in place to enable both governments (as well as the OBR and Scottish Fiscal Commission) to undertake their respective responsibilities. UK Government officials are currently engaging with the Scottish Government, Scottish Fiscal Commission, and the OBR to develop a shared understanding of the

⁹ <http://origin-www.legislation.gov.uk/ukxi/2017/241/contents>- This order was made under Section 104 of the Scotland Act 1998 which enables UK Ministers to make provision which is "necessary and expedient" in consequence of legislation by the Scottish Parliament.

¹⁰ <http://www.parliament.scot/parliamentarybusiness/Bills/92309.aspx>

information and data required by each government for these responsibilities. This should enable them to agree which data-sharing agreements are the most suitable to put in place for relevant tax and welfare responsibilities, including the use of legal gateways where needed.

CONCLUSION

151. Section 33 of the Scotland Act 2012 stipulates that the Annual Report on the implementation and operation of Part 3 of that Act should be laid on or before the anniversary of the date on which Royal Assent was received, which is 1 May. This year's report was laid before Parliament in April 2017.
152. The past year has seen significant progress on both the Scotland Act 2012 and the Scotland Act 2016. The Scotland Act 2012 is close to full implementation. The Scotland Act 2016 received Royal Assent in March 2016, and a large number of the provisions have been commenced and implemented.
153. The next Annual Report on the implementation of Part 3 of the Scotland Act 2012, and the implementation of the Scotland Act 2016, will be published, in accordance with Section 33(3)(b) of the Scotland Act 2012, before 1 May 2018.

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,*

Part 1, Chapter 2: Paragraphs 7-31

Part 1, Chapter 3: Paragraphs 35-37

Part 1, Chapter 4: Paragraph 38

Part 1, Chapter 5: Paragraph 39-44

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,*

Part 1, Chapter 2: Paragraphs 32-34

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

Part 1, chapter 6

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,*

Part 1, chapter 6, and Part 2

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),*

Part 1, chapter 5 and Part 2

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.*

Part 1, chapter 6 and Part 2

Annex B – Reporting requirements in the Fiscal Framework and where they are addressed in this report

1. action taken towards commencement of the provisions

Part 2, Chapter 2

Part 2, Chapter 3

Part 2, Chapter 4

Part 2, Chapter 5

Part 2, Chapter 6

Part 2, Chapter 7

2. an assessment of the operation of provisions which have been commenced

Part 2, Chapter 2

Part 2, Chapter 3

Part 2, Chapter 4

Part 2, Chapter 5

Part 2, Chapter 6

Part 2, Chapter 7

3. an assessment of the operation of any other powers to devolve taxes or to change the powers of Scottish Ministers to borrow and any other changes affecting the finance provisions inserted or amended by the Act

Part 2, Chapter 3

Part 2, Chapter 4

Part 2, Chapter 5

4. the effect on payments into Scottish Consolidated Fund

Part 2, Chapter 8

5. any other matters concerning sources of revenue for the Scottish Administration which should be brought to the attention of both Parliaments

Part 2

ISBN 978-1-4741-4277-9



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