SECOND ANNUAL REPORT ON THE IMPLEMENTATION OF THE SCOTLAND ACT 2016

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

Second 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 2018

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

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

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FOREWORD

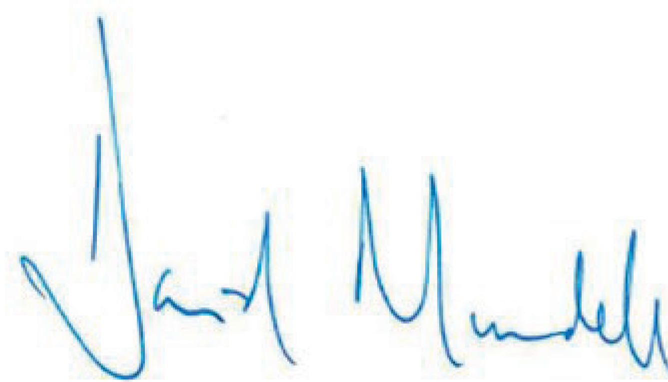
The 2018 annual report on the Scotland Act 2012 and Scotland Act 2016 marks a year of significant progress in the transfer of powers to the Scottish Government and Scottish Parliament.

Devolution remains a key priority for the UK Government and over the past year ministers and officials have continued to work hard to ensure the safe and secure transfer of all the powers set out in the Scotland Act 2016, delivering on the recommendations of the cross-party Smith Commission Agreement.

It has now been just over two years since the Scotland Act 2016 received Royal Assent, and I am pleased to say that the vast majority of provisions of the Act are already in force. This means that, in addition to the power of the Scottish Parliament to set rates and bands of income tax, the Scottish Parliament also has the power to legislate on a variety of new areas including creating new benefits in devolved areas, equalities in the public sector, onshore oil and gas licensing, and management of the Crown Estate.

By devolving historic new powers, it is important to recognise that the Act makes the Scottish Parliament one of the most powerful devolved parliaments in the world. In November of this year we will be celebrating the 20th anniversary of the Scotland Act 1998 which led to the creation of the Scottish Parliament. Over the past twenty years we have seen that a powerful Scottish Parliament within a strong United Kingdom offers people in Scotland maximum security and opportunity, representing their interests in the world and allowing resources and risks to be shared effectively.

Devolution has also been shown to be flexible and responsive to changing needs and circumstances. I am confident that the UK and Scottish Governments will continue to work together constructively not only on Scotland Act implementation, but also as we move forward together in new discussions about devolution in the UK as a result of leaving the European Union.



Rt Hon DAVID MUNDELL MP
SECRETARY OF STATE FOR SCOTLAND

PART 1: SCOTLAND ACT 2016

CHAPTER 1

INTRODUCTION

Scope and Content of this Part

1. This report on the Scotland Act 2016 is the second published since the Act received Royal Assent on 23 March 2016.

2. 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.

3. This report provides an update on these sections, and also outlines 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, carer's, and payments from the 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.

4. The fiscal framework was published on 25 February 2016[1]. On Tuesday 15 March 2016 the Scottish and UK Governments published a further annex[2]. 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;
    - Spill over effects;
    - Borrowing; and
    - Scrutiny.

5. 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. The information contained in this part is also relevant to the statutory requirements contained in the Scotland Act 2012, outlined in part 2 of this report. 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_201....pdf

CHAPTER 2

IMPLEMENTATION PROGRESS

6. 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
3	Elections	18 May 2017
4	Power to make provision about elections	18 May 2017
5	Timing of elections	18 May 2017
6	Electoral registration: the digital service	18 May 2017
7	Expenditure in connection with elections	18 May 2017
8	Review of electoral boundaries by the Local Government Boundary Commission for Scotland	18 May 2017
9	Functions exercisable within devolved competence: elections	18 May 2017
10	Minor and consequential amendments: elections etc.	18 May 2017
11	Super-majority requirement for certain legislation	18 May 2017
12	Scope to modify the Scotland Act 1998	18 May 2017
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	23 May 2016

15	Consequential amendments: income tax	23 May 2016
16	Assignment of VAT	23 May 2016
17	Tax on carriage of passengers by air	23 May 2016 Provision will take effect at a time agreed by UK and Scottish Governments.
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]
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

[3] Legislative competence is transferred under the Scotland Act 2016 (Commencement No. 5) Regulations 2017, (http://www.legislation.gov.uk/uksi/2017/455/contents/made) but executive competence is retained for a transitional period. See chapter 6. Section 22(1) and section 22(3) commenced on 5 September 2016.

[4] Section 23(1) and section 23(3) commenced on 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
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
47	Onshore Petroleum	09 February 2018
48	Onshore Petroleum: Consequential amendments	09 February 2018
49	Onshore Petroleum: existing licences	29 November 2017
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
58	Fuel poverty: support schemes	01 December 2017
59	Energy company obligations	01 December 2017
60	Apportionment of targets	01 December 2017
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

7. A number of provisions came into force on Royal Assent and two months after Royal Assent. Since that point, eight 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.

8. 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

9. 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.

10. The Board meets every six weeks 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

Since 6 April 2017, the Scottish Parliament has had the 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.

Steps taken towards implementation since previous report

11. The Scottish Parliament's income tax-raising powers were enhanced by the Scotland Act 2016. From 2017-18, the Scottish Parliament has 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.

12. 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 therefore pay the 40p higher rate if they earn £43,000 or more, whereas taxpayers in the rest of the UK will pay the 40p higher rate if they earn £45,000 or more.

13. On February 20th the Scottish Parliament passed a Scottish Rate Resolution[5] to set the rates and bands which will apply to Scottish non-savings, non-dividend taxable income for the following tax year:

Over £11,850-£13,850	Starter rate	19%
Over £13,850-£24,000	Basic rate	20%
Over £24,000-£43,430	Intermediate rate	21%
Over £43,430-£150,000	Higher rate	41%
Over £150,000	Top rate	46%

14. In the course of 2017-18 HMRC has implemented all the required changes to its PAYE systems to accommodate the further Scottish income tax powers. Relevant IT changes will be made to self-assessment systems by April 2018, before the issuing of the self–assessment returns for the 2017-18 tax year.

15. 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 rate bands. Additionally, financial accounting systems will be enhanced in 2018-19 to ensure all tax collected on earned income by Scottish taxpayers is accurately accounted for.

Legislation

16. Certain reserved income tax reliefs required consequential amendment to accommodate the new structure of income tax rates and bands set by the Scottish Parliament for 2018-19. A statutory instrument making the necessary changes (e.g. ensuring Scottish taxpayers had continued access to pension relief at source and marriage allowance) was made in March 2018.[6]

[5] Under Section 80C of the Scotland Act 1998.

[6] The Scottish Rates of Income Tax (Consequential Amendments) Order 2018.

Project governance

17. 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.

18. HMRC and the Scottish Government have updated their Memorandum of Understanding to ensure its continued operation under the further income tax powers and in November 2017 signed a Service Level Agreement for the operation of Scottish income tax by HMRC.

Costs

19. HMRC estimates the overall estimated cost of implementing the further Scottish income tax powers to be £2.8m. This is made up of £1.7m in IT costs and £1.1m in non-IT costs. This excludes any extra costs that may arise, and will be recharged to the Scottish Government, from work required to accommodate the new 2018-19 rates and thresholds within HMRC systems and processes.

Actual implementation costs in the 2017-18 reporting period

20. Final figures for 2017-18 are not yet available. HMRC has so far invoiced the Scottish Government in 2017-18 for £0.7m for costs associated with implementing the further Scottish income tax powers. HMRC estimates total implementation costs for 2017-18 to be £1.2m, made up of £0.7m IT costs and £0.5m non-IT costs. 2017-18 running costs are forecast to be £0.5m.

21. 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

22. The Scotland Act 2016 builds on the powers to set a Scottish Rate of Income Tax, devolved by the Scotland Act 2012, by devolving further income tax powers to the Scottish Parliament. The Scottish Parliament now has the freedom to set the Income Tax and the limits at which they are paid for the non-savings and non-dividend income of Scottish tax payers. As the tax system interfaces with the social security benefits, work was required to ensure DWP systems were compliant.

23. DWP set up a dedicated taxation project team to ensure that all areas of the DWP systems, legislation and business processes/products were impacted, amended and developed to support the capability to deliver taxation changes introduced by the SRIT and Scotland Act 2016 going forward.

24. At the end of the project assurances have been given to the Scottish Government that agreed processes are in place to accommodate any future taxation changes resulting from the Scotland Act 2016.

CHAPTER 4

OTHER TAX POWERS & FISCAL PROVISIONS

The Scotland Act 2016 provides for Air Passenger Duty and the Aggregates Levy to be devolved, and for the assignment of VAT receipts. The UK and Scottish Governments agreed in November 2017 to delay Air Passenger Duty devolution, and the introduction of the Scottish Government's replacement Air Departure Tax. A timetable has not yet been agreed by the Joint Exchequer Committee for the disapplication of the Aggregate Levy. The Act also makes provision in relation to VAT. 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. The UK and Scottish Governments have agreed that VAT assignment will commence in 2020-21, following a one year transition period to test the assignment methodology. HMRC's Scottish Tax Devolution Programme Board will directly oversee the transition of these other tax powers.

Steps taken towards implementation since previous report

25. 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, and the Air Departure Tax (Scotland) Act 2017 received Royal Assent on 25 July 2017. 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.

26. In November 2017 the Scottish and UK Governments agreed that the introduction of Air Departure Tax in Scotland would be deferred until issues raised in relation to the exemption for flights departing from the Highlands and Islands have been

resolved. The Scottish Government and UK Government will be working closely in order to achieve this as early as possible. As agreed, the UK Government will maintain the application of Air Passenger Duty in Scotland in the interim.

27. The UK and Scottish Governments have agreed via Joint Exchequer Committee (JEC) that there will be a one year transition period for VAT assignment commencing in 2019-20, where assignment will be forecast but not applied to the Scottish Government's budget. This will allow the assignment methodology to be tested before VAT is fully assigned to the Scottish Government, and the corresponding block grant deduction applied, from 2020-21.

28. JEC has also agreed that the Scottish Fiscal Commission will be responsible for producing the forecasts for VAT assignment. The OBR will continue produce VAT forecasts for the whole UK, which will be used to inform the block grant adjustments.

29. As part of the Fiscal Framework agreement, the Scottish and UK Governments agreed to share equally all costs incurred as a result of the implementation and administration of VAT assignment. The Scottish Government and HMRC agreed the governance arrangements for the allocation and payment of these costs in February 2017. In 2016-17 total costs incurred by HMRC and the SG were £0.2m and in 2017-18, up to Q3, totalled £0.1m. These costs were split equally between the organisations.

Further steps to be taken towards implementation in 2018-19

30. HMRC will continue to work on finalising the methodology for VAT assignment alongside HMT and the Scottish Government. Once the methodology is finalised, the Scottish Fiscal Commission will be expected to produce its first forecast for 2019-20, to inform the transition period.

31. 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.

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.*

The Scottish Government's fiscal framework sets out more detail in relation to these borrowing powers.

Steps taken towards implementation since previous report

32. The Scottish Government's new borrowing powers and Scotland Reserve came into effect in April 2017.

33. Following the fiscal framework agreement[7], the Scottish and UK Governments have agreed a paper setting out further detailed arrangements for the Scottish Government's new resource borrowing powers. The paper is attached at annex C.

[7] https://www.gov.uk/government/publications/the-agreement-between-the-scottish-government-and-the-united-kingdom-government-on-the-scottish-governments-fiscal-framework

It was agreed via JEC, and includes detail on resource borrowing triggers, limits, sources, and draw-down arrangements.

34. The two governments agreed a Memorandum of Understanding for capital borrowing on 5 March 2018, updating the arrangements by which the Scottish Government can borrow from the National Loans Fund. The Scottish Government have chosen to borrow the full £450m for capital expenditure in 2017-18 from the National Loans Fund, which will be repaid over 25 years.

CHAPTER 6

WELFARE POWERS

Part 3 of the Scotland Act 2016 devolves significant powers 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, while maintaining the benefits of the single jobs market and the UK's ability to pool risks. All of these sections have now been commenced, with the exception of section 27 regarding Welfare Foods.

Steps taken towards implementation since previous report

35. Regulations for the commencement of sections 24-26 and 28-35 in Part 3 of the Act were made on 14 July 2016. These sections commenced on 5 September 2016, apart from section 25 (Discretionary Housing Payments) which commenced on 1 April 2017.

36. Legislative competence relating to sections 22-23 of the Act commenced on 17 May 2017. These sections transfer responsibility for disability, industrial injuries and carer's benefits, and benefits relating to maternity, funeral and heating expenses respectively. This enabled the Scottish Government to introduce their Social Security (Scotland) Bill[8] to the Scottish Parliament in June 2017. DWP will continue to be responsible for the delivery of these existing benefits until the Scottish Government take over executive competence which regulations specify must be from March 2020.

37. The Joint Ministerial Working Group on Welfare have agreed that, following the transfer of executive competence, DWP if requested by the Scottish Government, may continue delivering some devolved benefits on a parity basis for a defined

[8] http://www.parliament.scot/parliamentarybusiness/Bills/105267.aspx

period of time under an Agency Agreement. This would help the Scottish Government during the transition phase whilst they set up their Scottish Social Security Agency and take full responsibility for the delivery of the devolved benefits.

38. An Order under section 93 of the Scotland Act 1998 that sets out the legal basis for the undertaking of delivery of Scottish Government functions by the UK Government is needed before an Agency Agreement can be put in place. A section 93 Order which will allow for functions relating to disability and carer benefits to be carried out by DWP is expected to come into force later in 2018.

39. Scottish Ministers have decided to proceed with delivering their Carer's Allowance Supplement in 2018 prior to delivering their Carer's Assistance benefit through their planned Scottish Social Security Agency. Under this solution, the Scottish Government will deliver the Carer's Allowance Supplement with DWP's support and DWP will continue to deliver the existing Carer's Allowance, under an Agency Agreement, to customers living in Scotland on behalf of the Scottish Government.

40. DWP is working closely with the Scottish Government to enable them to deliver further devolved benefits, including the Scottish Government's Best Start Grant and Funeral Expenses Assistance from 2019.

Implementation Programme

41. The DWP Scottish Devolution Programme remains fully committed to supporting the transfer of devolved benefits and employment support provided for in the Scotland Act 2016.

42. Close working between DWP and the Scottish Government, along with regular joint meetings with stakeholders, remains key to keeping the transfer of powers on track and ensuring a safe and secure transition. This includes visible DWP Ministerial engagement through quarterly Joint Ministerial Working Group on Welfare meetings, jointly chaired by Secretary of State Scotland and the Scottish Cabinet Secretary.

43. Over the last 12 months there has been significant progress supporting the Scottish Government to deliver the first benefit changes and in the use of their powers in relation to employment support and Universal Credit including:

    - Supporting the delivery of two transitional Scottish Government Employment Support programmes introduced in April 2017 – Work First Scotland and Work Able Scotland
    - Agreed referral process to support the implementation of Fair Start Scotland, which came into force on 3 April 2018, replacing the transitional programmes.
    - A Joint Operating Framework for Employability has been developed to support the on-going working relationship between DWP and the Scottish Government. This will ensure any decisions or guidance required can be achieved quickly and effectively. Both agree the framework will help to ensure we continue to put the customer at the heart of the work.
    - From October 2017, Universal Credit Scottish Choices for new claims, covering frequency of payment and giving people choice over whether their housing costs are paid direct to landlords was introduced.
    - An amendment to the Universal Credit (Claims and Payments) (Scotland) Regulations for Universal Credit Scottish Choices was laid in the Scottish Parliament on 15 December 2017 and came into force on 31 January 2018. The amendment will allow Universal Credit Scottish Choices to be extended to existing claimants on Universal Credit full service prior to 4th October and those transferring from live to full service once their claim has been established.

44. Extensive information sharing and knowledge building activities continue under the terms of the comprehensive Memorandum of Understanding, which was agreed between DWP and the Scottish Government.

45. A joint communications approach ensures both parties are fully aware of progress and that correct information is provided to DWP’s customers, staff and stakeholders. Shared communications products include coordinated announcements and briefing, joint presentations and project factsheets. Within

DWP, all staff have access to a newly updated intranet site with wide-ranging information covering Scottish devolution.

46. To date the DWP, Scottish Devolution Programme often working with DWP Devolution Policy, has delivered over 150 joint workshops, awareness raising and learning events, to help both DWP and Scottish Government colleagues to build their knowledge of the DWP business processes and customer journeys.

47. The DWP Scottish Devolution Programme continues to provide a comprehensive information sharing system which manages requests for data and management information from both the Scottish Government and DWP – this has facilitated the sharing of over 400 pieces of information to date.

Further steps to be taken towards implementation in 2018 -19

48. The Scottish Government's Social Security (Scotland) Bill 2017, currently being debated in the Scottish Parliament, is expected to receive Royal Assent in Spring 2018. This Bill is a high level enabling Bill and the Scottish Government will start to build on this as detailed plans for how they will use their devolved powers. DWP will continue to work closely with the Scottish Government as these emerge to determine feasibility and impacts on DWP as well as providing support as we move towards 2020.

49. The Department of Health and Social Care will continue to work closely with the Scottish Government on the commencement of section 27 of the Act, towards anticipated commencement in early 2019.

CHAPTER 7

STEPS TOWARDS IMPLEMENTATION SINCE LAST REPORT - 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*
- *Fines, Forfeitures and Fixed Penalties*

Sections 3-10: Elections
Steps taken towards implementation:

50. These sections came into force on 18 May 2017.

Section 36: The Crown Estate in Scotland
Steps taken towards implementation:

51. 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, via a transfer scheme[9] agreed between the two governments.

[9] http://www.legislation.gov.uk/ukdsi/2017/9780111155103/contents

52. Scottish and UK government officials have been working to agree an MoU in relation to the transfer.

Section 39: Tribunals
Steps taken towards implementation:

53. The Scotland Act 2016 provides a statutory mechanism to enable the UK government to fulfil its commitment to devolve responsibility for the management and operation of functions currently undertaken by reserved tribunals to Scotland. The Act confers wide powers to make one or more Orders in Council, which will need to be approved by both the UK and Scottish Parliaments. This will provide the basis on which the Scottish Parliament may pass legislation to give effect to the transfer of the Scottish functions of reserved tribunals to a Scottish tribunal.

54. The UK Government and the Scottish Government have been working closely throughout the year to agree the terms of the Orders in Council. A public consultation will be undertaken by the Scottish Government, later in 2018, for views on the Orders in Council that have been developed.

55. In July 2017, the Lord Chancellor proposed to the Scottish Government that a simultaneous transfer of three tribunal jurisdictions (social security and child support, employment and tax) could take place by April 2020 as per the Smith Commission Agreement. The UK Government will continue to be responsible for the national policy and the substantive law applied by these tribunals. The UK Government and the Scottish Government have been working to make sure that the transfer of tribunals takes place in a way that preserves the national policy whilst allowing the Scottish Government to manage the system in a way that meets their needs.

Sections 45-46: Policing of Railways & the British Transport Police
Steps taken towards implementation:

56. 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. These sections of the Act were commenced two months after Royal Assent on 23 May 2016.

57. The Railway Policing (Scotland) Act 2017, an Act of the Scottish Parliament to make provision about the arrangements for the Police Service of Scotland to police railways and railway property, received Royal Assent on 1 August 2017. The Act will be commenced once arrangements have been made for the transfer of property and liabilities of the British Transport Police to Police Scotland in Orders under Sections 90 and 104 of the Scotland Act 1998.

58. On 20th February 2018 the Scottish Government wrote to the convenor of the Scottish Parliament Justice Committee reporting the decision to delay the timetable for delivery of the transfer of the BTP to Police Scotland from the previously agreed date of 1 April 2019. A detailed re-planning exercise will now take place over the coming months to ensure robust delivery plans are in place for all of the key elements of the programme and to establish a new delivery date.

Sections 47-49: Onshore petroleum
Steps taken towards implementation:

59. 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.

60. Commencement regulations were made on 28 November 2017 and section 49 came into force on 29 November 2017.

61. Affirmative secondary regulations which make consequential amendments to taxation legislation to reflect the role of Scottish Ministers as the licensing authority in Scotland were debated in Parliament in November 2017 and negative secondary regulations which make consequential amendments to the licencing regime were laid in early 2018.

62. Sections 47 and 48 came into force on 9th February 2018 following parliamentary procedure on the consequential amendments.

Section 50: Consumer Advocacy and Advice
Steps taken towards implementation:

63. 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.

64. Section 50 of the Act was implemented in full two months after Royal Assent on 23 May 2016. A Memorandum of Understanding between the UK and Scottish Governments to underpin this provision is being drafted and will be finalised before the end of the 2017-18 financial year.

Section 58 – 60: Fuel Poverty and ECO schemes
Steps taken towards implementation:

64. Section 58 of the Act transfers certain powers to Scottish Ministers in relation to support schemes applying to gas and electricity suppliers for the purpose of reducing fuel poverty in Scotland. Sections 59-60 transfers certain powers to Scottish Ministers in relation to obligations (currently the Energy Company Obligation, (ECO)) imposed by the Secretary of State on licenced gas and electricity suppliers to promote reductions in carbon emissions or home-heating costs in Scotland.

65. Commencement regulations were made on 28 November 2017 and sections 58-60 came into force on 1 December 2017 for the purpose of enabling Scottish regulations to be passed. Sections 58-60 will come fully into force at the expiry of the respective current legislation for the fuel poverty support scheme (the Warm Home Discount) and for ECO. As a Scottish Supplier Obligation framework will continue to operate within the context of the single GB energy market, the UK Government and Scottish Government will continue to work together to underpin

operational delivery of all schemes. It is anticipated that a Memorandum of Understanding will be drawn up between the UK Government and Scottish Government to underpin the transfer of powers and set out the parameters of their working relationship. Discussions are ongoing across the UK and Scottish Governments to set out their continued working relationship in a Memorandum of Understanding.

Section 67: Fines, Forfeitures and Fixed Penalties

Steps taken towards implementation:

66. 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.

67. HM Treasury has also updated the Scotland Act 1998 (Designation of Receipts) Order, to enable the Scottish Government to retain Fines, Forfeitures and Fixed Penalties collected in Scottish courts from 1 April 2017. The updated Order was laid in UK Parliament on 14 December 2017, and takes effect from the beginning of the financial year 2017-18. 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

The UK and Scottish Governments agreed a fiscal framework for the Scottish Government in February 2016 to underpin the funding arrangements for their new tax and welfare powers.

This sets out how the Scottish Government's block grant should be adjusted to reflect these powers - with the necessary deductions for new revenue raising powers, and additions for new spending powers. The framework sets out the agreed approach for block grant baseline adjustments and on-going indexation mechanisms for all taxes, court revenues, and welfare payments being devolved or assigned in Scotland.

These arrangements are being implemented alongside the Scotland Act 2016 powers. The UK government committed to publishing an annual breakdown of all the changes to the Devolved Administrations' block grant funding at the Autumn Budget 2017.

Steps taken towards implementation since previous report

Revenue raising powers

68. The UK Government set the Scottish Government's block grant adjustments at Autumn Budget 2017, to reflect devolved tax and court revenues. These are set out in the table below:

		2016-17	2017-18	2018-19	2019-20	2020-21
Income Tax	Baseline deduction	£11,214m				
	Comparable model adjustment		£11,790m	£11,807m	£12,144m	£12,596m
	IPC model adjustment		£11,750m	£11,749m	£12,056m	£12,477m
Fines, Forfeitures and Fixed Penalties	Baseline deduction	£25m				
	Comparable model adjustment		£26m	£25m	£25m	£25m
	IPC model adjustment		£26m	£24m	£25m	£25m
Proceeds of Crime	Baseline deduction	£4m				
	Comparable model adjustment		£4m	£4m	£4m	£4m
	IPC model adjustment		£4m	£4m	£4m	£4m

69. As agreed in the fiscal framework, the adjustments consist of a baseline deduction (based on revenues collected in Scotland in the year prior to devolution); and then a subsequent indexation for future years, based on changes in corresponding UK government revenues.

70. The table above sets out the results of indexation using both the Comparable and Indexed Per Capita (IPC) Models. The adjustments applied to the Scottish Government's block grant will reflect the results of the IPC Model for a transitional period, until the fiscal framework is reviewed in 2021.

71. In line with paragraph 100 of the fiscal framework, the block grant adjustment for Proceeds of Crime has not been updated following Autumn Statement 2016.

72. In addition to the Proceeds of Crime adjustment, the table above includes:
    - An updated 2016-17 baseline deduction for Income Tax. The UK and Scottish governments have agreed on an exceptional basis to use the SFC's 2016-17 forecast, rather than that provided by OBR. This is due to different methodological approaches taken by the SFC and OBR that would have meant the baseline adjustment was not fiscally neutral as the fiscal framework intended. HMT wrote to the UK Parliament's Scottish Affairs

Committee in December 2017 notifying them of this change. The baseline deduction will ultimately be reconciled to outturn data once available.

- The 2017-18 block grant adjustment for Income Tax. This was applied at Autumn Statement 2016 based on the forecasts at the time, and will not be updated again until outturn data is available. However, HMT have calculated updated figures for the 2017-18 adjustment, based on the forecasts from Autumn Budget 2017. These were £11,866m for the Comparable Model, and £11,837m for the IPC Model (using the OBR 2016-17 baseline); and £11,552m for the Comparable Model, and £11,523m for the IPC Model (using the SFC 2016-17 baseline). As agreed in the fiscal framework, these were updated for information only and not applied to the Scottish Government's block grant.
- The 2018-19 block grant adjustment for Income Tax, which was applied at Autumn Budget 2017. This adjustment reflects the revised 2016-17 baseline deduction above, and indexation based on the latest 2018-19 forecast. This will not be updated again until outturn data is available.
- The 2016-17 baseline deduction for Fines, Forfeitures & Fixed Penalties, which has been updated to reflect 2016-17 outturn data.
- The 2017-18 block grant adjustment for Fines, Forfeitures & Fixed Penalties. This was updated at Autumn Budget 2017 to reflect the revised 2016-17 baseline deduction above, and indexation based on the latest 2017-18 forecast. This resulted in a £6m reduction in the block grant adjustment for 2017-18. This will be updated again at Autumn Budget 2018 once outturn data is available.
- The 2018-19 block grant adjustment for Fines, Forfeitures & Fixed Penalties, which was applied at Autumn Budget 2017. This adjustment reflects the revised 2016-17 baseline above, and indexation based on the latest 2018-19 forecast. It will be not be updated again until outturn data is available.
- Forecasts for 2019-20 and 2020-21 block grant adjustments for Income Tax and Fines, Forfeitures & Fixed Penalties. These are based on the latest forecasts from Autumn Budget 2017.

73. The UK government also set the Scottish Government's 2018-19 block grant adjustments for Landfill Tax and Stamp Duty Land Tax at Autumn Budget 2017. These adjustments are set out in the second half of this report, under 'Effect of new powers on the Scottish Government's block grant', as they relate to Scotland Act 2012 powers.

74. The UK Government will set out the forecast block grant adjustment for VAT assignment at Autumn Budget 2018, to inform the one year transition period in 2019-20. The adjustment will not be applied to the Scottish Government's block grant until Autumn Budget 2019, ahead of full VAT assignment in 2020-21.

75. To note, the figures in this report reflect the block grant adjustments that were applied to the Scottish Government's budget at Autumn Budget 2017. HMT wrote to the Scottish Affairs Committee more recently with updated indicative block grant adjustments, which were calculated using the latest forecasts from the Spring Statement 2018. These are not applied to the Scottish Government's block grant, but may be used by the Scottish Government to inform their spending plans.

76. The block grant adjustments for Air Passenger Duty and Aggregates Levy will be dependent on the devolution dates agreed for each tax.

<u>Welfare powers</u>

77. The block grant adjustments for welfare devolution will be dependent on the dates agreed for the transfer of executive competency to the Scottish Government for each power.

<u>Other areas of spend</u>

78. For all other areas of spend being devolved in the Scotland Act 2016, the usual machinery of government approach will be applied to calculate the baseline additions to the Scottish Government's block grant. This will subsequently be indexed using the Barnett formula in the normal way. Baseline transfers for

tribunals devolution are yet to be agreed, and will be dependent on the respective dates for transfer of executive competence.

Crown Estate

79. The UK and Scottish governments have now agreed a final block grant adjustment for Crown Estate and Coastal Communities Fund devolution.

80. This comprised of a block grant addition for Coastal Communities Fund (as set out in the previous implementation report); and a block grant deduction for Crown Estate (equivalent to the net revenues raised by Scottish assets in 2016-17, minus the cost of managing these assets). This has now been updated to reflect outturn data for 2016-17.

81. As agreed in the fiscal framework, this adjustment will not be indexed in future years.

Administration and implementation costs

82. As agreed in the Fiscal Framework, 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.

83. The UK and Scottish Governments have now agreed that the full £200m for implementation funding will be transferred in 2017-18. For administration funding, the UK Government has agreed to transfer £37m in 2018-19, £59m in 2019-20, and the full £66m from 2020-21 onwards, which will be indexed using the normal application of the Barnett formula.

Block grant transparency

84. The UK government also committed at Autumn Budget 2017 to publish an annual breakdown of the changes to the Devolved Administrations' block grant funding

each year. This includes the changes to the Scottish Government’s block grant set out above, reflecting Scotland Act 2012 and 2016 powers. The first breakdown was published on 20 December 2017.

CHAPTER 9

OTHER ACTIVITIES TOWARDS IMPLEMENTATION OF THE FISCAL FRAMEWORK

Spillover effects

85. The fiscal framework sets out agreement on the treatment of financial spillover effects from either governments' policy decisions, for both direct and behavioural effects.

86. The fiscal framework states that all direct effects should be accounted for. The UK and Scottish Governments have agreed via Joint Exchequer Committee the following principles in relation to direct effects for tax and welfare:
    - A direct effect is defined as an automatic change in one government's expenditure or revenue as a result of a change in another government's policy.
    - Direct effects exclude any effects that do not occur as a result of the mechanics of a policy decision and any associated behavioural changes.
    - Any automatic change is considered a direct effect and will need to be accounted for. For welfare, an automatic change to the number of eligible claimants as a result of a policy decision would be considered a direct effect.
    - In some cases, there may also be behavioural changes that occur alongside automatic changes (for instance, more people might be incentivised to claim a benefit following a policy change). In such cases, UK and Scottish Government analysts should seek to separate the direct effect from any behavioural assumptions, as far as possible, when calculating the effect. Any consideration of behavioural effects will be subject to the criteria set out in the fiscal framework and spillovers process for behavioural effects, which remains to be agreed.

87. The UK and Scottish Governments have also agreed via JEC a process to account for direct spillover effects for tax and welfare. This will allow either government to raise any direct effects on their receipts or expenditure from the other government's tax and welfare policy decisions; and provides a joint forum for these to be calculated and agreed between both governments, before subsequent transfers can be agreed via JEC.

88. Both governments have agreed to test the process from January 2018, for any direct effects that arise from UK and Scottish Government tax and welfare policy decisions in 2018-19. This will subsequently be reviewed in 2019-20.

89. Both governments have agreed that the above process for direct tax and welfare spillover effects will be without prejudice to how issues may need to be accounted for in other policy areas under the 'no detriment' principle.

90. UK and Scottish Government officials are working together to agree further detail on a process for both Governments to account for behavioural spillover effects, which will also be finalised via JEC.

Audit and accountability

91. As set out in last year's report, UK and Scottish Government officials have been working together to develop an audit and accountability framework for the exercise of powers devolved to the Scottish Parliament. This sets out lines of accountability for UK and Scottish public bodies to each Parliament.

92. UK and Scottish government officials have also engaged the National Audit Office and Audit Scotland, to inform further detail on auditing arrangements in the framework. The draft framework has been shared with the Scottish Parliament's Public Audit and Post-Legislative Scrutiny Committee, and the UK Parliament's Public Accounts Committee, for their views.

93. Following Committee feedback, the framework will be finalised via the Joint Exchequer Committee (JEC).

Scottish Fiscal Commission

94. Further to the implementation steps set out in last year's report, the SFC produced its first Scottish economic forecast at the Scottish Government's draft budget in December 2017, alongside forecasts for Scottish Government tax receipts.

Information sharing

95. 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 continuing to engage with the Scottish Government, Scottish Fiscal Commission, and the OBR to develop a shared understanding of the 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.

PART 2: SCOTLAND ACT 2012

CHAPTER 1

INTRODUCTION

Scope and Content of this Report

96. This report on Part 3 of the Scotland Act 2012 is the sixth 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 1 of this report.

97. 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.

98. 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.

99. 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.

100. Section 33(5) of the Scotland Act 2012 requires the annual report 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.*

101. 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

For the 2016-17 tax year, 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 steams. 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

102. 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.

103. HMRC delivered, to time and within budget, the systems and changes necessary for the commencement of SRIT. HMRC's focus since then has therefore been on administering the Scottish rate of income tax as part of the wider UK income tax system. However further changes will be required to enable pensions Relief at Source to incorporate Scottish income tax from April 2018 and these are on schedule.

104. In its 2017 Annual Report and Accounts, published on 13th July 2017, HMRC set out its initial estimate of 2016-17 SRIT receipts as £4.6 billion. This figure is an estimate because some actual data is unavailable, for example in respect of Self-Assessment revenue for the 2016-17 tax year where minimal disclosure has been made to HMRC, and PAYE revenue for taxpayers whose accounts had not been reconciled before the document was published.

105. Further information on revenue for the tax year 2016-17 that becomes available during 2017-18 will allow refinement of the calculations. Updated figures will be disclosed in the 2017-18 Trust Statement, allowing a final reconciliation for the 2016-17 tax year.

IT development

106. HMRC has implemented all the required changes to its PAYE and Self-Assessment systems to accommodate the Scottish rate of income tax. 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.

Relief at Source

107. 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.

108. 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.

109. 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

110. HMRC followed the extensive programme of communication that accompanied the commencement of SRIT on 6 April 2016 with an on-going campaign, using existing income tax communication channels, focused on the importance of taxpayers keeping HMRC updated of changes to address details.

Compliance

111. 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.

112. As the SRIT for 2016-17 did not diverge 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

113. Implementation of SRIT and the further Scottish income tax powers 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.

114. The National Audit Office (NAO) published its annual report on HMRC's work on implementing and administering SRIT (and the further Scottish income tax powers) on 27th November 2017 as it is required to do under the Finance Act 2014. The report found that HMRC had successfully addressed the Scottish taxpayer

identification issues identified in this report last year. NAO's conclusions however, reinforced the importance of maintaining an up-to-date and accurate record of the Scottish income tax paying population.

115. HMRC has continued to provide written and oral evidence to the Scottish Parliament on the implementation of Scottish tax powers, with senior HMRC officials appearing before the Scottish Parliament's Finance and Constitution Committee on 29 November 2017 and the Public Audit and Post-Legislative Scrutiny Committee on 15th June 2017.

Costs

Overall estimated costs for implementing the Scottish Rate of Income Tax

116. The 2017 annual report included overall estimated costs for implementing the Scottish Rate of Income Tax at £20m-25m, down from the previous year's projection of £25m-30m. HMRC current estimate of overall costs is £20m-£23m. This comprises estimated IT costs in the range of £13m-16m and non-IT costs of £7m.

Actual implementation costs

117. In 2016-17, HMRC invoiced the Scottish Government for £4.5m. This was made up of £3.4m in IT costs and £1.1m in non-IT costs. This compares to a forecasted spend of £4.6m in last year's report.

118. Final figures for 2017-18 are not yet available. At the time of publication, HMRC has invoiced the Scottish Government for £1.4m for work done during 2017-18. HMRC estimates total costs for 2017-18 will be £3.4m, comprised of £2.7m IT costs and £0.7m non-IT costs. This is £2.0m lower than estimated at the start of the year, primarily due to part of the work relating to Relief At Source for pension schemes being re-profiled into 2018-19.

119. Since the project commenced, HMRC has invoiced the Scottish Government £17.9m for the implementation of the Scottish Rate of Income Tax.

Running costs

120. 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.

121. HMRC invoiced the Scottish Government for £0.2m for costs associated with running the Scottish Rate of Income Tax during 2016-17.

122. As the Scottish Rate of Income Tax was superseded, for the 2017-18 and subsequent tax years, by the further Scottish income tax powers devolved by The Scotland Act 2016, costs for 2017-18 are covered above in Chapter 3 of this report.

CHAPTER 3

BORROWING POWERS OF SCOTTISH MINISTERS

The provisions in the Scotland Act 2012 have enabled 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

123. 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.

124. As set out in chapter 5 of the Scotland Act 2016 section above, the Scottish Government have been able to operate additional borrowing powers from April 2017.

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 on-going 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

125. 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

126. As set out in chapter 8 of the Scotland Act 2016 section above, the UK government adjusted the Scottish Government's block grant at Autumn Budget 2017 for Landfill Tax and Stamp Duty Land Tax devolution, in line with the arrangements agreed in the fiscal framework. The adjustments are set out in the table below:

		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Stamp Duty Land Tax	Baseline deduction	£468m						
	Comparable model adjustment		£487m	£537m	£595m	£606m	£630m	£659m
	IPC model adjustment		£486m	£534m	£591m	£600m	£622m	£650m
Landfill Tax	Baseline deduction	£149m						
	Comparable model adjustment		£138m	£131m	£105m	£96m	£88m	£81m
	IPC model adjustment		£138m	£131m	£104m	£94m	£86m	£79m

127. This table includes:

- Baseline deductions for Stamp Duty Land Tax and Landfill Tax, based on 2014-15 outturn. These have not changed since the previous report, and will not be updated again.
- The IPC and Comparable model indexations for both taxes in 2015-16, for information. As set out in the previous report, a one-off adjustment of £494m was actually applied for 2015-16 – this remains unchanged.
- The block grant adjustments for both taxes for 2016-17, which have been revised to reflect indexation based on outturn data for 2016-17. These were applied to the Scottish Government's block grant at Autumn Budget 2017, and will not be updated again. This resulted in an increase of £64.2m in the block grant adjustment for 2016-17.
- The block grant adjustments for both taxes for 2017-18, which have been updated in-year to reflect indexation based on the latest forecasts from Autumn Budget 2017. These were applied to the Scottish Government's block grant at Autumn Budget 2017. This resulted in an increase of £31.2m in the block grant adjustment for 2017-18. These will be updated again at Autumn Budget 2018, to reflect outturn data.
- The block grant adjustments for both taxes for 2018-19, which reflect indexation based on the latest forecasts from Autumn Budget 2017. These were applied to the Scottish Government's block grant at Autumn Budget 2017, and will be updated again in-year at Autumn Budget 2018 to reflect the latest forecasts.
- The forecast block grant adjustments for both taxes for 2019-20 and 2020-21, based on the latest forecasts from Autumn Budget 2017.

CHAPTER 6

OTHER REPORTING REQUIREMENTS

128. 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.

129. This report is the sixth 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.

130. Since 1 April 2015, Stamp Duty Land Tax (SDLT) and Landfill Tax have been replaced in Scotland by Land and Buildings Transaction Tax (LBTT) and the Scottish Landfill Tax respectively, which are both administered by Revenue Scotland. Throughout 2017 HMRC and Revenue Scotland have continued to collaborate and to explore opportunities for sharing data between the tax authorities to aid compliance activity across the UK.

131. In the December 2017 Draft Budget, the Scottish Government proposed to maintain the residential and non-residential rates and bands for Land and Building

Transaction Tax (LBTT) at 2017-18 levels and announced a new relief for first time buyers of properties over £175,000 to be introduced in 2018-19. The Draft Budget also announced that Standard Rate of Scottish Landfill Tax (SLfT) would be increased to £88.95 per tonne and the Lower Rate of SLfT to £2.80 per tonne in line with retail price index inflation and Landfill Tax charges in the rest of the UK.

132. 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 over the last year is in part 1 of this report.

CONCLUSION

133. 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 2018.

134. 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 and a large number of provisions in the Scotland Act 2016 have now been commenced and implemented.

135. 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 2019.

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 2, Chapter 2: Paragraphs 102 - 122

    Part 2, Chapter 3: Paragraphs 123 - 124

    Part 2, Chapter 4: Paragraphs 125

    Part 2, Chapter 5: Paragraphs 126 - 127

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 2, Chapter 2: Paragraph 102

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

    Part 2, 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, and Part 2, Chapter 6

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 8 and Part 2, chapter 5

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, and Part 2, chapter 6

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 1, Chapter 2
   Part 1, Chapter 3
   Part 1, Chapter 4
   Part 1, Chapter 5
   Part 1, Chapter 6
   Part 1, Chapter 7

2. *An assessment of the operation of provisions which have been commenced*

   Part 1, Chapter 2
   Part 1, Chapter 3
   Part 1, Chapter 4
   Part 1, Chapter 5
   Part 1, Chapter 6
   Part 1, 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 1, Chapter 3
   Part 1, Chapter 4
   Part 1, Chapter 5

4. *The effect on payments into Scottish Consolidated Fund*

   Part 1, 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 1

Annex C – joint UK and Scottish Government paper on arrangements for Scottish Government resource borrowing

Resource borrowing for in-year cash management and forecast error

Triggers

- In-year cash management – where there is a temporary in-year excess of expenditure over income or to provide a working balance in the Scottish Consolidated Fund.
- Forecast error – for a negative impact on the Scottish Government budget following revised forecasts of tax, welfare or block grant adjustments at any point during the financial year or after the reconciliation to outturn.

Limits

The Scottish Government will be able to borrow within a statutory overall limit of £1.75bn:

- The annual limit for resource borrowing for all purposes is £600m
- The limit for in-year cash management will remain at £500m
- The annual limit for forecast errors will increase to £300m

Source

The Scottish Government will borrow from the National Loans Fund for this purpose.

Draw-Down Arrangements

For forecast errors and in year cash management, the Scottish Government will draw down borrowing as and when necessary based on value for money considerations.

The Scottish Government will advise HMT of the term of the borrowing, which would normally be between 3 and 5 years. The capital will be repaid in equal instalments of principal, along with interest, every 6 months. The interest rate will be the NLF rate for 3- to 5-year money and would apply from the day of draw-down. The Scottish Government will also retain access to the short-term facility. Further detail is outlined in the Scottish Government Current Borrowing Loan Facility Agreement.

The Scottish Government will provide regular monthly forecasts to HMT of the amount of resource borrowing it expects to make, outstanding debt and repayment profiles, but will be able to borrow within the agreed limits as deemed appropriate.

Resource borrowing for a Scotland-specific Economic Shock

Triggers

A Scotland-specific economic shock is triggered when onshore Scottish real GDP growth is below 1% in absolute terms on a rolling 4 quarter basis, and 1 percentage point below UK real GDP growth over the same period.

The Scotland-specific economic shock provisions can be triggered based on:

1. Scottish Fiscal Commission Forecasts – these will be published at least twice yearly.

2. Scottish Government GDP Outturn – these are published on a quarterly basis.

Once a shock has been triggered, borrowing can be accessed based on:

3. Any observed or forecast shortfall in devolved or assigned tax receipts or demand-led welfare expenditure compared to the original forecasts.

Data used to trigger the Scotland-specific economic shock borrowing powers, whether forecast or outturn, should fully comprise of quarters commencing from 1 April 2017, in line with the commencement date for Scotland Act 2016 borrowing powers. This means that the earliest potential trigger point based on forecast data would be the Scottish Fiscal Commission's GDP forecast for the financial year 2017/18; and the earliest potential trigger point based on outturn data would be the Scottish Government's publication of Q1 2018 GDP data (if the preceding 3 quarters' outturn data from April 2017 showed that onshore Scottish GDP was below 1% in absolute terms, and 1% below UK GDP growth).

Data used to calculate the difference between Scottish and UK GDP growth will be UK GDP growth outturn data, which is the most recent final estimate published by the ONS in the Quarterly National Accounts, and the most recent UK GDP forecast data, which is published by the Office for Budget Responsibility at each fiscal event.
As above, both conditions – that onshore Scottish GDP is below 1% in absolute terms on a rolling 4 quarter basis; and that Scottish GDP is 1 percentage point below UK GDP growth over the same period – will need to be met to trigger a Scotland-specific economic shock.

In order for the first condition to be met, 4 consecutive quarters of Scottish onshore GDP need to be less than 1% greater than the immediately preceding 4 consecutive quarters. This means the following calculation needs to result in an answer that is less than 1:

$$\left(\frac{\textit{The sum of any consecutive 4 quarters of Scottish onshore Real GDP}'_{t5,\,t6,\,t7,\,t8}}{\textit{The sum of the 4 consecutive quarters of Scottish onshore Real GDP immediately before}'_{t1,\,t2,\,t3,\,t4}} - 1\right) * 100$$

In order for the second condition to be met, the growth rate calculated above needs to also be at least 1% below the corresponding calculation at the UK level. This means the following calculation needs to result in an answer that is greater than 1:

$$\left(\left(\frac{\textit{The sum of any consecutive 4 quarters of UK Real GDP}'_{t5,\,t6,\,t7,\,t8}}{\textit{The sum of the 4 consecutive quarters of UK Real GDP immediately before}'_{t1,\,t2,\,t3,\,t4}} - 1\right) * 100\right) - \left(\left(\frac{\textit{The sum of any consecutive 4 quarters of Scottish onshore Real GDP}'_{t5,\,t6,\,t7,\,t8}}{\textit{The sum of the 4 consecutive quarters of Scottish onshore Real GDP immediately before}'_{t1,\,t2,\,t3,\,t4}} - 1\right) * 100\right)$$

The quarters t5, t6, t7, t8 can be any time after April 2017 inclusive (i.e. from Q2 2017 inclusive) in both forecast and outturn as this is when the borrowing powers in the Scotland Act commenced. This means that theoretically the 4 quarters immediately

before these (t1, t2, t3, t4) could run from as early as April 2016 (but only if they are the prior period baseline for the 4 quarters starting in April 2017). The Scottish Fiscal Commission can only ever consider t5, t6, t7, t8 as being either the most recent outturn 4 quarters or in the forecast period (or a combination of the both).

The Scottish Fiscal Commission are responsible for notifying when a shock has been triggered based on forecast data or a combination of forecast and outturn data, as long as the 4 quarters considered are consecutive. This notification will be published alongside the Fiscal Commission's Forecast Report. The Scottish Government is responsible for notifying when a shock has been triggered based on outturn data as long as the 4 quarters considered are consecutive.

Limits

For any observed or forecast shortfall in devolved or assigned tax receipts or demand-led welfare expenditure incurred where there is, or is forecast to be, a Scotland-specific economic shock, with an annual limit of £600m.

Once a shock is triggered, the annual cyclical resource borrowing (of up to £600m) lasts for each financial year in which the trigger applies, plus the following two financial years, as the economy and public finances recover. This is the period during which cyclical borrowing powers may be used.

Source

The Scottish Government will borrow from the National Loans Fund for this purpose.

Draw-Down Arrangements

As per the normal draw-down arrangements for resource borrowing, the Scottish Government will advise HMT of the term of the borrowing, which will be between 3 and 5 years or the short term facility. The UK and Scottish Governments have also agreed that the Scottish Government should have the option of refinancing any debt due to be repaid in a year of a Scotland-specific economic shock under the terms specified in the Loan Agreement.

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