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

Second Report on the Implementation of the Scotland Act 2016

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

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Foreword

This report demonstrates the considerable progress made over the past year in operationalising the Fiscal Framework and implementing the wide range of new powers devolved to the Scottish Parliament.

The 2018-19 Budget process led to a fundamental change in income tax in Scotland. From next year there will be a new, fairer and more progressive income tax system. The Scottish Parliament has voted for a 5-band income tax schedule, including the introduction of two new rates: a Starter Rate and an Intermediate Rate. As a result of these changes, as well as the increase in the Personal Allowance, 70% of Scottish taxpayers will pay less income tax next year. These reforms are forecast to raise an additional £219 million to help support our vital public services and help to mitigate the effects of UK Government Budget cuts. The Scottish Government has also continued to engage constructively with HMRC to deliver the Scottish income tax powers.

2017 was the first year of the Scottish Fiscal Commission operating as a statutory independent body, with responsibility going forward for forecasting the economy, tax revenue and expenditure on devolved social security payments, and I am grateful for its hard work to support the Budget process.

Preparations are also underway to ensure the smooth transition of social security and employability powers and the creation of the new social security agency. The Scottish Government is committed to using these powers to create a Scottish social security system based on dignity, fairness and respect which will help to support those who need it, when they need it. Our top priority is to ensure the safe and secure transition of the 11 social security payments for the 1.4 million people who rely on them, and the Social Security (Scotland) Bill was introduced to the Scottish Parliament on 20 June 2017. Furthermore, from April 2018, Fair Start Scotland will also support at least 38,000 disabled people or those at risk of long term unemployment over the course of three years of referrals up to March 2021.

Implementing the new powers is a major challenge and I am grateful for the Scottish Parliament for its continued scrutiny of this process. Programme arrangements are in place across the different areas to plan and monitor delivery, including costs, to ensure a smooth and efficient transition for the people of Scotland.

DEREK MACKAY MSP

Chapter 1 - Fully Devolved Taxes

Scotland Act 2012

Legislation

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

Fully devolved taxes – rates and bands

2. Proposed rates and bands for 2018-19 for Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) were published in Scotland's Budget: Draft Budget 2018-19 on 14 December 2017.[1] On the same day, the Scottish Fiscal Commission published its 5-year forecasts for the fully devolved tax revenues in Scotland’s Economic and Fiscal Forecasts December 2017.[2]

3. LBTT rates and bands will remain unchanged for 2018-19 along with the rate for the Additional Dwelling Supplement (ADS). SLfT rates will rise in line with inflation and continue to match tax rates in the rest of the UK. A rate-setting Order for SLfT was laid before the Scottish Parliament on 28 February 2018, and will be considered by Parliament on the 14 March. Subject to parliamentary approval, the new rates will be in place for 1 April 2018.

4. In addition to this, the Draft Budget introduced a new LBTT relief for first-time buyers of properties up to £175,000. The relief raises the zero tax threshold for first-time buyers from £145,000 to £175,000. First-time buyers buying a property above £175,000 will also benefit from the relief on the portion of the price below the threshold. This will benefit around 12,000 first-time buyers every year by up to £600, and 80% of first-time buyers will not pay any LBTT at all.

5. A consultation on the relief was launched on 9 February 2018. Following the consultation the Scottish Government will introduce secondary legislation to the Scottish Parliament. The Scottish Government’s intention is for the relief to be in place for June 2018, subject to parliamentary approval.

Land and Buildings Transaction Tax (LBTT) – supplement on additional homes

6. An order to amend the Land and Buildings Transaction Tax (Amendment) (Scotland) Act 2016, which introduced an LBTT supplement on purchases of additional residential properties (ADS), came into force on 30 June 2017. The Land and Buildings Transaction Tax (Additional Amount-Second Homes Main Residence Relief) (Scotland) Order 2017 provides relief to economic units (spouses, civil partners and cohabitants) replacing their main residence but where only one name was on the title deeds of the previous main residence.

[1] http://www.gov.scot/Publications/2017/12/8959/0
[2] http://www.fiscalcommission.scot/media/1196/scotlands-economic-fiscal-forecasts-publication.pdf

7. The Land and Buildings Transaction Tax (Relief from Additional Amount) (Scotland) Bill was introduced to Parliament on 13 November 2017 and aims to give retrospective effect to the LBTT Order. The Bill is undergoing the process of parliamentary scrutiny and will come into effect in June 2018 if it secures parliamentary consent.

Scottish Landfill Tax (SLfT) – Amending Regulations

8. Scottish Ministers introduced the Scottish Landfill Tax (Administration) Amendment Regulations 2017 on 28 April 2017 which came into force on 29 May 2017. The regulations make minor technical changes to the communities fund and update incapacity and bankruptcy provisions. The instrument brings references in the regulations to insolvency and bankruptcy up to date following the Bankruptcy (Scotland) Act 2016 and into line with the Land and Buildings Transaction Tax (Scotland) Act 2014. The regulations also align accounting and reporting duties placed on approved bodies (bodies that distribute funds) with normal statutory accounting practice as set out in the Companies Act 2006. The regulations also make minor technical amendments to the communities fund to provide additional clarity on what constitutes spending.

Tax Tribunals

9. Work has been completed regarding the integration of the Scottish Tax Tribunals to the new Scottish tribunal system under the Tribunal (Scotland) Act 2014. The Scottish Tax Tribunals were transferred to the First Tier Tribunal for Scotland Tax Chamber and the Upper Tribunal for Scotland on 24 April 2017. Both are administered by the Scottish Courts and Tribunals Service.

10. The tax tribunal has an important role to play in resolving tax payer disputes, if they are unhappy with decisions made by Revenue Scotland and to assist in clarifying the law for Revenue Scotland and taxpayers.

Revenue Scotland Operations

11. The following paragraphs summarise the progress and performance of Revenue Scotland in its first year of collecting devolved taxes; comments on projected revenue outturn against forecasts; and notes the tax legislation changes made by the Scottish Parliament during the year.

12. Revenue Scotland completed its second full operational year in April 2017, collecting a total of £633m - £484m of Land and Buildings Transaction Tax and £149m of Scottish Landfill Tax. This meant that since coming into effect in April 2015, over £1bn had been collected from the devolved taxes by Revenue Scotland. The organisation operated efficiently and effectively, with running costs in its first two years of less than 1% of the total tax collected.

13. At the end of the 2016-17 financial year, 99.7% of all tax returns submitted had been paid either within the financial year or within five days of the year end.

14. The LBTT Additional Dwelling Supplement came into effect from 1 April 2016 for purchases of second homes and buy-to-let properties in Scotland. Revenue Scotland provided a range of communication and engagement activities before and after the introduction of the supplement to support agents' understanding of the change and help reduce the risk of complications for residential transactions.

15. The organisation continued to encourage agents and taxpayers to use the Scottish Electronic Tax System (SETS), building on the healthy take-up of online submissions from Year One. The proportion of returns filed online increased from 98.1% to 98.8%. In terms of customer service, average call waiting times to Revenue Scotland's support desk fell from 10 seconds in 2015-16 to under 7 seconds in 2016-17. Of the written communication initiated by taxpayers and agents, 97.9% were responded to within 10 working days, an improvement on 2015-16 (95.6%).

16. The organisation places a strong emphasis on effective stakeholder engagement and consultation. Following positive feedback from attendees of our LBTT and SLfT forums that were held during our first year, a schedule of further events enabled stakeholders to hear from Revenue Scotland on significant changes (e.g. Additional Dwelling Supplement) and provide insight and reflection on the end-user experience of our systems and processes.

17. In April 2018, Revenue Scotland will publish its second Corporate Plan, setting out the strategic objectives and ambitions of the organisation for 2018-21.

Scotland Act 2016

Air Departure Tax

18. Following the devolution of powers over Air Passenger Duty (APD) to the Scottish Parliament under the Scotland Act 2016, and as confirmed in the 2016-17 Programme for Government[3] published on 6 September 2016, the Scottish Government introduced the Air Departure Tax (Scotland) Bill[4] to the Scottish Parliament on 19 December 2016.

19. The Air Departure Tax (Scotland) Act 2017 received Royal Assent on 25 July 2017. This makes provision for a tax to be charged on the carriage of chargeable passengers on chargeable aircraft by air from airports in Scotland. ADT tax bands and tax rate amounts are to be set by regulations.

[3] http://www.gov.scot/programme2016
[4] http://www.parliament.scot/parliamentarybusiness/Bills/102778.aspx

20. Provision had been made for Air Departure Tax (ADT) to replace APD in Scotland from 1 April 2018 under terms agreed between the Scottish and UK Governments in the fiscal framework.[5]

21. However, the introduction of ADT in Scotland has now been deferred until the issues raised in relation to the exemption for flights departing from the Highlands and Islands can be resolved. The UK Government will maintain the application of Air Passenger Duty in Scotland in the interim.

22. Revenue Scotland, Scotland's tax authority for devolved taxes, will be responsible for collecting and managing Air Departure Tax. Following the decision to defer introduction of the tax in Scotland, Revenue Scotland has conducted a programme closedown exercise and communicated a high-level 'start-up' plan to Scottish Government to help inform plans for introduction in the future.

[5] Paragraph 26 of the Scottish Government's fiscal framework sets out the 1 April 2018 date: http://www.gov.scot/Publications/2016/02/3623

Chapter 2 - Scottish Rate of Income Tax and Scottish Income Tax

23. The Scottish Government has continued to work with HMRC and DWP on both the remaining implementation work for the Scottish Rate of Income Tax (SRIT), and the implementation work to support the devolution of the further income tax powers in the Scotland Act 2016. This includes programme management arrangements and close monitoring of costs.

24. The Scottish Parliament's Finance and Constitution Committee took evidence on HMRC's collection and management of SRIT and implementation of Scottish Income Tax from Jim Harra, HMRC's Director General, Customer Strategy and Tax Design, and Sarah Walker, Deputy Director for Devolution, on 29 November 2017.[6]

25. The National Audit Office (NAO) published its third report on the administration of SRIT on the 27 November 2017.[7] Audit Scotland reviewed the approach taken by the NAO and endorsed it in its own report[8] published on 27 November 2017. Caroline Gardner, Auditor General for Scotland and Sir Amyas Morse Comptroller and Auditor General gave evidence on their respective reports to the Scottish Parliament's Public Audit and Post-Legislative Scrutiny Committee on 11 January 2018.

26. These reports and evidence sessions have provided additional assurance to the Scottish Government on HMRC's administration of SRIT in 2016-17 and the work undertaken following the introduction of the further powers in April 2017.

Scotland Act 2012

27. HMRC are due to report the outturn figure for Scottish Income tax collected in 2016-17 in July 2018. The Office for Budget Responsibility forecast that SRIT would raise £4.9bn in 2016-17.

28. HMRC has reduced its lifetime cost estimates for the implementation of SRIT to £20m - £23m, which it has split between non-IT costs of £7m, and IT costs of £13m - £16m. In 2016/17 HMRC invoiced the Scottish Government for £4.5m, made up of £3.4m of IT costs and £1.1m of non-IT costs. For the year 2017-18 to Q2 the Scottish Government has been invoiced for £1.4m and forecast a total cost of £3.4m. To date the Scottish Government has paid HMRC £17m of implementation costs.

29. The total running costs recharged to the Scottish Government in 2016-17 are provided in paragraph 35.

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[6] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11233&mode=pdf
[7] https://www.nao.org.uk/wp-content/uploads/2017/11/The-administration-of-the-Scottish-rate-of-Income-Tax-2016-17-1.pdf
[8] http://www.audit-scotland.gov.uk/uploads/docs/um/srit_171128.pdf

30. The DWP SRIT implementation project completed its work and closed in 2016-17. In 2016.17 the total costs recharge to the Scottish Government were £0.3m. The total cost of the project was £1.1m.

Scotland Act 2016

31. From 2017-18, the Scottish Parliament has the power to set the income tax rates and band thresholds (excluding the personal allowance) that apply to the non-savings and non-dividend income of Scottish taxpayers. The Scottish Government forecast that Scottish income tax would raise £11.9bn in 2017-18. This forecast was reviewed by the Scottish Fiscal Commission and was endorsed as reasonable and this is the amount that has flowed from HM Treasury into the Scottish Government's Consolidated Fund during the course of this financial year.

32. The Service Level Agreement agreed between the Scottish Government and HMRC seeks to operationalise the Memorandum of Understanding ensuring that Scottish taxpayers and the employers of Scottish taxpayers receive the same level of service as taxpayers in the rUK. The governance arrangements between Scottish Government and DWP are founded on the Exchange of Letters dated 1 December 2016.[9]

33. The Scottish Government published a discussion paper on income tax policy "The Role of Income Tax in Scotland's Budget"[10] on 2 November 2017. This together with roundtables led by the Cabinet Secretary for Finance and the Constitution informed debate ahead of the publication of the Draft Budget.

34. The Scottish Parliament approved the Scottish Government's Scottish Rate Resolution for 2018-19 on the 20 February 2018. The Scottish Parliament agreed to introduce a 19 per cent Starter Rate of tax on earnings over £11,850 and up to £13,850 and maintain a Basic Rate of 20 per cent on earnings over £13,850 and up to £24,000. The Scottish Parliament further agreed to add an Intermediate Rate of 21 per cent on earnings over £24,000 and up to £43,430 and increase the Higher Rate to 41 per cent on income over £43,430 and up to £150,000. The Scottish Parliament also agreed to increase the Top Rate to 46 per cent on incomes over £150,000. The Scottish Fiscal Commission has estimated that this will raise £12.2bn which will be available to the Scottish Government to draw down from HM Treasury throughout financial year 2018-19.

35. HMRC estimates that the implementation of the further income tax powers will cost £2.8m, split between a total non-IT cost of £1.1m and a total IT cost of £1.7m. For the implementation of the further income tax powers up to Q2 of 2017-18, HMRC has invoiced the Scottish Government for £0.7m, with a further £0.5m forecast for Q3 and Q4. In 2016-17 total running costs were £0.2m. To date HMRC have not charged the SG for any running costs in 2017-18, but are forecasting running costs of £0.5m.

[9] https://beta.gov.scot/publications/scottish-income-tax-arrangements-sg-dwp/
[10] http://www.gov.scot/Publications/2017/11/5307

36. The Scottish Government and HMRC have always agreed that a robust process for the identification of Scottish taxpayers is not only critical to the successful implementation of the Scottish income tax powers, but that it will also be a key on-going exercise. Therefore, during 2017-18, the Scottish Government has worked closely with HMRC as it continues to refine and update its processes for identifying Scottish taxpayers, which are now based on live data. HMRC estimates that there are around 2.6m Scottish taxpayers; figures on the actual number of Scottish taxpayers in tax year 2016/17 will be available for the first time in 2018.

37. The Scottish Government has engaged with HMRC on the compliance processes and activity that will take place each year following the agreement of both the Scottish and UK Governments' income tax rates and bands, and which will take account of the degree to which there is any consequent divergence. Overall, the Scottish Government will benefit from the compliance work that HMRC conducts to protect UK income tax yield as well as bespoke activity identified for Scottish income tax. In addition, the Scottish taxpayer identification work which HMRC conducts will also have an input to the enforcement and compliance work.

38. DWP's project to ensure that DWP's systems can deal with the implementation of the further income tax powers in Scotland Act 2016 completed its work and closed in early 2017-18. In total the project cost £0.4m.

Chapter 3 - VAT Assignment

Scotland Act 2016

39. The Scotland Act 2016 allows for receipts from the first 10p of the standard rate of VAT and the first 2.5p of the reduced rate of VAT in Scotland to be assigned to the Scottish Government.

40. The power to set VAT rates will remain reserved to the UK Government. As such, the Scottish and UK Governments have agreed that requiring businesses to report their VAT separately for Scotland and the UK would impose an unwanted administrative burden, and have agreed that VAT raised in Scotland will instead be estimated.

41. Assignment of VAT to Scotland will begin in 2019-20. As per the Fiscal Framework agreement[11] there will be a one-year transitional period during which VAT assignment will be forecast and calculated, but with no impact for the Scottish Government's budget. From 2020-21 the financial impacts of any difference between forecast VAT receipts and the associated block grant adjustment will be applied to the Scottish Government's budget.

42. The Scottish Government is working with HMRC and HM Treasury to produce a model of VAT liabilities in Scotland, this will produce a Scottish VAT outturn estimate for use in reconciling the final budget position. This consists of producing a regional version of HMRC's VAT Theoretical Tax Liability (VTTL) model.

43. 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.

44. The VAT assignment working group expects to produce its first estimate of VAT receipts in Scotland in 2018. The estimate will relate to outturn VAT.

45. UK and Scottish Government agreed that the Scottish Fiscal Commission (SFC) will forecast the Scottish share of VAT receipts and Office for Budget Responsibility's (OBR) forecasts of UK government receipts will be used to inform the block grant adjustments. The first forecasts of VAT receipts will be available in late 2018.

[11] http://www.gov.scot/Publications/2016/02/3623/0

Chapter 4 - Block Grant Adjustments, Reconciliation and Indexation

46. Following the Fiscal Framework agreement, changes in the Scottish Government's block grant continue to be determined via the operation of the Barnett Formula. The block grant is then adjusted to reflect the retention in Scotland of devolved revenues. The block grant adjustments (BGAs) involve two elements: (i) an initial baseline adjustment; and (ii) an indexation mechanism.

47. The general position set out in the Fiscal Framework and associated technical annex[12] is that the initial baseline adjustments for each tax will be equal to the UK Government's receipts from the relevant tax generated in Scotland in the year immediately prior to devolution (year 0). Indexation will then be applied to the year 0 baseline to determine the block grant adjustment for each tax in the first year of devolution (year 1), and annually thereafter. The full indexation formulae and methodologies for BGAs can be found in part two of the technical annex.

48. Over the period to 2021-22, the BGAs for tax will be indexed using the Comparable Model (CM) and the results will then be adjusted to achieve the outcome delivered by Indexed Per Capita (IPC). The figures in this chapter refer to figures achieved by the IPC method. The BGAs based on both the CM and IPC mechanisms can be found on page 31 of the Scottish Government's Draft Budget for 2018-19.[13]

Scotland Act 2012

49. Implementing the financial provisions for the Scotland Act 2012 powers has required BGAs in 2017-18 for SLfT and LBTT.

Scottish Landfill Tax (SLfT) and Land and Buildings Transaction Tax (LBTT)

Autumn Budget 2017 Block Grant Adjustments						
	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
LBTT	£534m	£591m	£600m	£622m	£650m	£682m
SLfT	£131m	£104m	£94m	£86m	£79m	£75m
TOTAL	£665m	£695m	£694m	£708m	£729m	£757m

[12] http://www.gov.scot/Publications/2016/02/3623/4
[13] http://www.gov.scot/Resource/0052/00529171.pdf

2016-17

50. For 2016-17, the Scottish and UK Governments agreed a provisional one-year BGA of £600m for LBTT and SLfT. This figure was also agreed prior to the Fiscal Framework agreement in March 2016. As part of this agreement, it was agreed that the £600m figure would be revisited after the Fiscal Framework was agreed to ensure budgetary certainty.

51. Outturn data for 2016-17 for corresponding UK Government Receipts has now been published by HMRC. Consequently, the combined BGA for LBTT and SLfT for 2016-17 has increased from £600 million to £665 million.

52. This update will apply to the Scottish Government's 2017-18 budget. This £65 million increase in the block grant adjustment was anticipated at an early stage in financial year 2017-18 planning and has been proactively managed within our established in-year budget management processes.

2017-18

53. The initial BGAs for LBTT and SLfT for 2017-18 were £545m and £119m respectively. These figures were used for the purpose of calculating the Scottish Government's block grant at the Autumn Statement 2016 and for the Scottish Government's Draft Budget for 2017-18.

54. The block grant adjustments for the fully devolved taxes are updated once a year at every UK Government Autumn fiscal event. The reason for this is that Scottish Government uses receipts from fully devolved taxes as they are collected during the year to fund spending. The corresponding block grant adjustments are therefore also updated during the year to reflect latest forecasts of corresponding tax receipts in the rest of the UK.

55. At the Autumn Budget 2018, these BGAs were updated to £591m and £104m to reflect the latest forecasts for 17-18 receipts made by the OBR. This £31m increase in the block grant adjustment is being carefully and proactively managed through the Scottish Government's in-year financial management process.

56. Outturn data for 2017-18 receipts is likely to be available in Summer 2018. The final reconciliation to outturn data of these block grant adjustments will be applied at the UK Government's Autumn Budget 2018.

2018-19

57. The initial BGAs for LBTT and SLfT for 2018-19 are £600m and £94m respectively. These figures were used for the purpose of calculating the Scottish Government's block grant at the Autumn Budget 2017 and for the Scottish Government's Draft Budget for 2018-19.

58. These figures should be updated based on the latest available data at UK Government's Autumn Budget 2018. The final reconciliation of these block grant adjustments will be applied at the UKG Autumn Budget 2019.

59. Block grant adjustments for future years are included for completeness. These block grant adjustment values have had no impact on the Scottish Government's block grant, although are used for financial planning purposes.

Scotland Act 2016

Income Tax

Autumn Budget 2017 Block Grant Adjustments					
	2017-18	2018-19	2019-20	2020-21	2021-22
SIT	£11,523m*	£11,749m	£12,056m	£12,477m	£12,936m

*Under the Fiscal Framework, the figure agreed at Autumn Statement 2016 (£11,750m) is not updated until reconciliation to outturn data.

60. Since 6 April 2017, the Scottish income tax (SIT) powers under the Scotland Act 2016 have been in force.

2017-18

61. A block grant adjustment of £11,750m for 2017-18 was made at Autumn Statement 2016 based on the OBR's forecast of corresponding UK Government receipts of NSND Income Tax.

62. In contrast to the block grant adjustments for the fully devolved taxes, the block grant adjustments for Scottish income tax remain fixed until outturn data is available. For 2017-18, it is anticipated that outturn figures will be available in Summer 2018. A reconciliation of the block grant adjustment will then be made as part of the Scottish Government's Draft Budget for 2020-21.

2018-19

63. A block grant adjustment of £11,749m was made at Autumn Budget 2018 based on the OBR's forecast of corresponding UK Government receipts of NSND Income Tax. This block grant adjustment will remain fixed until outturn data is available in Summer 2020. A reconciliation of the block grant adjustment will then be made as part of the Scottish Government's Draft Budget for 2021-22.

64. Block grant adjustments for future years are included for completeness. These block grant adjustment values have had no impact on the Scottish Government's budget, although are used for financial planning purposes.

Baseline Adjustment Value

65. 2016-17 is the year used as the baseline adjustment for the Scottish income tax BGA, as this is the year immediately prior to the devolution of the current powers.

66. At the time of Autumn Statement 2016 and Scottish Government's Draft Budget 2017-18, a baseline adjustment value of £11,520m was used to inform the block grant adjustment for 2017-18. This figure reflected the most current forecast that the Office for Budget Responsibility had produced at the time for non-savings, non-dividend (NSND) income tax receipts raised in Scotland in 2016-17.

67. For the Scottish Government's Draft Budget for 2018-19, the Scottish Government and HM Treasury agreed to use the SFC's 2016-17 forecast – rather than that provided by the OBR – for the baseline adjustment that informs the 2018-19 block grant adjustment. This is as a consequence of different methodological approaches taken by the SFC and the OBR which, without this change in approach, would have meant that the 2016-17 baseline adjustment was not fiscally neutral as anticipated in the Fiscal Framework. As such, to inform the 2018-19 block grant adjustment for income tax, a value of £11,214m was used as the baseline.

68. The 2016-17 NSND IT data for Scotland from HMRC's April 2018 Trust Statement will be used as an outturn figure to finalise this baseline. However, there will be no fiscal effect on the Scottish Government as the baseline year receipts must be the same as the block grant adjustment, so any reconciliation nets to zero.

Fines, Forfeitures and Fixed Penalties (FFFP)

Autumn Budget 2017 Block Grant Adjustments					
	2017-18	2018-19	2019-20	2020-21	2021-22
FFFP	£26m	£24m	£25m	£25m	£25m

69. The Scotland Act 2016 includes provision for fines, forfeitures and fixed penalties imposed by courts and tribunals in Scotland to be retained in Scotland. To bring this provision into effect, the UK Government laid a designation of receipts order on 15 December 2017 so that income from fines, forfeitures and fixed penalties imposed from 1 April 2017 are retained in the Scottish Consolidated Fund.

70. Under the Fiscal Framework, an adjustment has also been made to the Scottish Government's block grant to reflect the retention of this income in Scotland from April 2017 onwards.

2017-18

71. A figure of £33m was initially used at the Autumn Statement 16 and Scottish Government's Draft Budget for 2017-18 as the BGA for FFFP. This figure was updated in-year to £26m at Autumn Budget 2018 based on the latest forecast provided by the Ministry of Justice of corresponding UK Government receipts.

72. Outturn data for 2017-18 receipts is likely to be available in Summer 2018. The final reconciliation to outturn data of this block grant adjustment will be applied at the UK Government's Autumn Budget 2018.

2018-19

73. Scottish Government's Draft Budget for 2018-19 used £24m as the BGA for FFFP. Outturn data for 2018-19 receipts is likely to be available in Summer 2019. The final reconciliation to outturn data of this block grant adjustment will be applied at the UK Government's Autumn Budget 2019.

74. Block grant adjustments for future years are included for completeness. These block grant adjustment values have had no impact on the Scottish Government's budget, although are used for financial planning purposes.

Baseline Adjustment Value

75. 2016-17 is the baseline adjustment year for Fines, Forfeitures and Fixed Penalties (FFFP), as it is the year prior to the devolution of these powers. The Fiscal Framework agreed that revenues from courts and tribunals in Scotland would be used as the baseline deduction. A figure of £33m was initially used at the Autumn Statement 2016; the final reconciled figure of £25m was derived using outturn from the Scottish Consolidated Fund accounts for 2016-17.[14]

Proceeds of Crime

76. The Scotland Act 2016 also includes provision for sums raised under Proceeds of Crime legislation in Scotland to be retained by the Scottish Government. The block grant adjustment to be made for Proceeds of Crime is still under discussion between the UK Government and Scottish Governments.

Crown Estate and Coastal Communities Fund

77. The UK and Scottish Governments agreed in the Scotland Act 2016 that the Scottish Government will take on responsibility for managing the Crown Estate assets in Scotland and responsibility for the Coastal Communities Fund would be devolved to the Scottish Government. These functions commenced on 1 April 2017.

[14] https://beta.gov.scot/publications/scottish-consolidated-fund-accounts-year-ended-31-march-2017/

78. In accordance with the arrangements in the Fiscal Framework, £6.1m was deducted from the block grant to reflect the retention of Crown Estate revenues in Scotland and £5.1m was added to reflect responsibility for managing the Coastal Communities Fund. Neither of these values will be indexed.

Next Steps

79. The Budget Process Review Group recommended that a Fiscal Framework Outturn Report be produced to support scrutiny of the operation of the Fiscal Framework including the reconciliation process, the Scotland Reserve and borrowing powers. The Scottish Government welcomed this recommendation and intends to produce the first outturn report in Autumn 2018.

Chapter 5 - Borrowing and Scotland Reserve

Borrowing

Scotland Act 2012

80. The Scotland Act 2012 allowed Scottish Ministers to undertake borrowing to fund capital expenditure subject to a statutory aggregate cap of £2.2 billion. HM Treasury has set out administrative rules, which limits borrowing in any one year to 10 per cent of the capital budget (Capital Departmental Expenditure Limit or CDEL). These arrangements have now been superseded by the Scotland Act 2016 and the Fiscal Framework.

Scotland Act 2016

81. The Fiscal Framework and the Scotland Act 2016 increase the Scottish Government's capital borrowing limits to £3 billion. The annual limit on capital borrowing also increased to 15 per cent of the overall borrowing cap, i.e. £450m per year. The Scottish Government may borrow through the UK Government from the National Loans Fund, by way of a commercial loan or through the issue of bonds. The new limits came into effect from 1 April 2017.

82. The Scottish Government will continue to maximise investment within the capital limits imposed by HM Treasury, and has utilised the maximum £450m of capital borrowing powers available in 2017-18. This borrowing was accessed in one draw down in March 2018, and will be repaid over 25 years on an equal repayment (ER) basis. The purpose of the borrowing is to support the infrastructure investment programme as a whole, rather than borrowing for individual assets. £450m represents around 12% of the capital programme for 2017-18.

83. In order to maximise our commitment to investing in infrastructure, we will make use of the full £450 million available in 2018-19. In assessing affordability, this is modelled as being drawn from the National Loans Fund in 2018-19 with an assumption of repayment over 10 years, an interest rate of 2 per cent, and repayments of both principal and interest from 2019-20 onwards. Final decisions on borrowing arrangements will be taken over the course of the year reflecting an ongoing assessment of programme requirements.

Resource Borrowing

Scotland Act 2012

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

statutory £500m overall limit. These arrangements have now been superseded by the Scotland Act 2016 and the Fiscal Framework.

Scotland Act 2016

85. Since 1 April 2017, the Scottish Government has had the power to borrow up to £600m each year within a statutory overall limit for resource borrowing of £1.75 billion. The Fiscal Framework set out the conditions and limits for elements of resource borrowing: for in-year cash management, an annual limit of £500m; for forecast errors, an annual limit of £300m; for any observed or forecast shortfall where there is or is forecast to be a Scotland-specific economic shock, an annual limit of £600m.

86. Resource borrowing will continue to be from the National Loans Fund and the repayment period will be between three and five years, as determined at the time of borrowing. In December 2017, the JEC agreed the arrangements for revenue borrowing in the event of forecast errors, or a Scotland-specific economic shock. The paper finalising these arrangements has been attached as an annex to this report.

87. There are no plans to use resource borrowing powers in 2017-18 or 2018-19.

Scotland Reserve

88. The Scotland Reserve has applied since 1 April 2017 and enables the Scottish Government to manage volatility associated with the fiscal powers. The Scotland Reserve is separated between resource, capital and financial transactions. Payments into the resource reserve may be made from the resource budget including tax receipts. Funds in the resource reserve may be used to fund resource or capital spending. Payments may be made into the capital reserve from the capital budget and capital reserve funds may only be used to fund capital spending.

89. The Scotland Reserve is capped in aggregate at £700m. The Governments have agreed that annual drawdowns from the reserve is limited to £250m for resource and £100m for capital. There are no annual limits for payments into the Scotland Reserve.

90. At the time of the publication of the Scottish Government’s 18-19 Draft Budget on 14 December, there was £74m in surplus tax receipts in the Scotland Reserve.

Chapter 6 - Scottish Fiscal Commission

Scotland Act 2012

91. The Scottish Fiscal Commission was established on a non-statutory basis in 2014 to assess the reasonableness of the Scottish Government's forecasts of revenue from the devolved taxes and of the economic determinants underpinning the Scottish Government's forecasts of revenues from non-domestic rates.

92. The Scottish Fiscal Commission Act 2016 established, from 1 April 2017, a fully independent Commission on a statutory basis, with direct accountability to the Scottish Parliament.

Scotland Act 2016

93. Following the Fiscal Framework agreement and passage of the Scotland Act 2016, the Commission's functions were expanded from 1 April 2017. The Commission prepares forecasts of devolved tax revenues, Scottish onshore GDP, income tax attributable to a Scottish rate resolution, non-domestic rates income and devolved social security. The Commission also assesses the reasonableness of Scottish Ministers' borrowing projections.

94. The Commission's first independent forecasts[15] were published in December 2017 to accompany the publication of the Scottish Draft Budget. Updated income tax forecasts were published in February 2018 to reflect policy changes announced in January 2018.

95. The Commission and the Scottish Government agreed a protocol in March 2017 which set out their working relationship and timings of the interactions between the Commission and the Government. Amendments to this were mutually agreed by the Commission and the Government in consultation with the Scottish Parliament during the course of the year to reflect that additional forecasts would be required during the passage of the Budget Bill.

Function Changes

96. The Scottish Parliament and the Scottish Government jointly formed a Budget Process Review Group which reported in June 2017. The Commission's Chief Executive was a member of the Group. The Group recommended that the Scottish Government prepare a Medium Term Financial Strategy which should be supported by forecasts from the Scottish Fiscal Commission. The Commission's functions will be amended to reflect this new process. Regulations will be laid in the Scottish Parliament in Spring 2018 to make this change. The regulations will also be used to confer the responsibility on the Commission to prepare forecasts of assigned VAT receipts.

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[15] http://www.fiscalcommission.scot/publications/scotlands-economic-and-fiscal-forecasts/scotlands-economic-and-fiscal-forecasts-december-2017/

Membership and Appointments

97. The Scottish Fiscal Commission currently comprises three Commissioners. Commissioners have executive responsibility for core functions, including the judgments reached in its forecasts, and abide by a Code of Conduct. The Commissioners are also responsible for the corporate governance of the Commission through a Governance Board. The Board is collectively responsible for the leadership and direction of the Commission and for ensuring it achieves the strategic objectives set out in the Corporate Plan.

98. Dame Susan Rice was reappointed as Chair of the Commission in February 2018 and her appointment will run until June 2022. An appointments process commenced in February 2018 for a fourth Commissioner. It is intended that this appointment will commence in Summer 2018.

99. The Scottish Fiscal Commission Act 2016 provides that appointments to the statutory Commission should be made by Scottish Ministers, regulated by the Commissioner for Ethical Standards in Public Life in Scotland, and subject to the approval of the Scottish Parliament. The appointment of all Commissioners is subject to that double scrutiny.

Chapter 7 - Social Security and Employability

Scotland Act 2016

101. Part 3 of the Scotland Act 2016 contains 14 sections relating to social security and employment support. The provisions in these sections of the Act give the Scottish Parliament greater powers to ensure that social security in Scotland is tailored to the needs of Scottish citizens. Once transferred, the Scottish Parliament and the Scottish Government will be responsible for social security benefits ultimately worth around £3.3 billion of spending each year in Scotland.

102. Transferring the devolved benefits safely presents a challenge on a scale unlike anything the Scottish Government has faced since devolution. Meeting this challenge requires a large-scale programme of transition, legislation and implementation. Change of this magnitude carries risks: the safe and secure transition of every payment will be paramount, to ensure nobody falls through the gaps.

103. A Joint Ministerial Working Group on Welfare (JMWGW) and Joint Senior Officials Group was established to facilitate joint working between the Scottish Government and DWP to oversee the safe and secure transition of social security. Since the Scotland Act 2016 received Royal Assent there have been five JMWGW meetings. Minutes agreed from the meeting are made publicly available to both Parliaments by the UK and Scottish Governments respectively.

104. The JMWGW has agreed a phased approach for the commencement of the Welfare Benefits and Employment Support part (Part 3) of the Scotland Act 2016. Tranche 1 which was commenced on 14 July 2016[16] relates to:

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

105. The remaining sections, in Tranche 2, are more complex as they transfer responsibility for existing and on-going benefits and will have more potential to negatively impact those receiving them if not transferred carefully. These are:

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

section 22, which transfers responsibility for existing and on-going benefits relating to disability, industrial injuries and carers benefits; and section 23, which covers benefits for maternity, funeral and heating expenses.

106. The Scottish Government and DWP have developed close working relationships across a number of areas, including delivering the Scottish Government's changes to Universal Credit (Universal Credit Scottish Choices (UC)), information sharing and appraising options for implementing the Scottish Government's commitment to increase the rate of Carer's Allowance. From 4 October 2017, the first two Universal Credit Choices (direct payment of the UC housing element to landlords, and twice monthly UC payments) have been successfully introduced. The Scottish government will also introduce, as part of Wave 1, a Carer's Allowance Supplement to be delivered from Summer 2018, with other Tranche 1 benefits, Best Start Grant and Funeral Expense Assistance delivered by Summer 2019.

Social Security Bill

107. In the 2016-17 Programme for Government, the Scottish Government made a commitment to bring forward a Social Security Bill within the first year of the new Parliament in order to implement powers transferred via the 2016 Scotland Act.

108. Following a period of formal consultation and an extensive programme of over 120 stakeholder events, the Social Security (Scotland) Bill was introduced to the Scottish Parliament on 20 June 2017. The Social Security Committee was appointed as Lead Committee to scrutinise the Bill and they undertook their Stage 1 evidence gathering between July and December 2017. A call for written evidence was issued in July and August 2017, to which they received 119 written submissions.[17] The Committee heard oral evidence between 7 September and 2 November 2017 from 32 people, including individuals with lived experience, organisations representing different groups, academic experts and professional bodies.[18] The Minister for Social Security gave oral evidence at its meeting on 2 November 2017.[19]

109. The draft Bill was also considered by both the Delegated Powers and Law Reform Committee (DPLRC) and Finance and Constitution Committee (FCC). The DPLRC wrote to the Scottish Government to raise questions in relation to a number of the delegated powers in the Bill. The Committee's questions, as well as the response received from the Scottish Government to them, were published as part of the DPLRC report. The Minister for Social Security gave evidence to the DPLRC on 3 October 2017[20], and the DPLRC published its report on the Bill on 31 October 2017[21] (to which the Scottish Government responded directly on 16 January 2018).

17 http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/105715.aspx
18 http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/107325.aspx
19 http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11169
20 http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11134
21 https://sp-bpr-en-prod-cdnep.azureedge.net/published/DPLR/2017/10/31/Social-Security--Scotland--Bill-at-Stage-1/DPLRS52017R48.pdf

110. The FCC issued a call for views on 18 August 2017 and received 8 responses.[22] Scottish Government officials gave oral evidence on 13 September 2017[23], which was followed up with supplementary written evidence on 26 September 2017. Subsequently, the FCC reported to the Social Security Committee in its letter on 4 October 2017, which included a copy of the supplementary evidence.[24]

111. The Social Security Committee published its Stage 1 report on 11 December 2017[25], and the Scottish Government published its response to the report on 15 December 2017.[26] While the Committee was unanimous in agreeing the general principles, its report contains 39 recommendations and/or conclusions, some of which were agreed by majority rather than unanimous decision, and most of which focus on areas where the Committee is seeking for changes to be made. After a plenary debate in the main chamber of the Parliament on Tuesday 19 December 2017, MSPs voted unanimously to support the general principles of the Bill (although some Members indicated there were areas they planned to return to at Stage 2).

112. The Bill is currently undergoing Stage 2 of the Parliamentary scrutiny process, where it may be amended by any MSP (including by the Scottish Government via Ministers). These amendments are being considered by the Social Security Committee as they make a line-by-line examination of the Bill as laid. Stage 2 is expected to last several weeks, and will be followed by Stage 3. More detailed information on the general Parliamentary process for Bills can be found on the Scottish Parliament website.[27]

113. The Scottish Government amendments respond, not only to the various reports produced by Parliament, but also to many of the points made by stakeholders throughout Stage 1. As part of the co-design ethos of the new Scottish social security system, the Minister for Social Security and her officials continued to meet with stakeholders during that phase of the Parliamentary process, and intends to do so again in advance of Stage 3.

Scottish Social Security Agency.

114. In March 2016, Scottish Ministers announced their decision to establish a new executive agency to oversee the delivery of the devolved social security powers. The decision to create an agency was taken after considering a range of evidence and in consultation with stakeholders, who indicated support for administering benefits through a public body which is part of the Scottish Government and accountable to Scottish Ministers.

22 http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/105836.aspx
23 http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11076&mode=pdf
24 http://www.parliament.scot/S5_Social_Security/Inquiries/Letter_to_the_Social_Security_Committee.pdf
25 https://digitalpublications.parliament.scot/Committees/Report
26 http://www.gov.scot/Resource/0052/00529335.pdf
27 http://www.parliament.scot/parliamentarybusiness/Bills/15707.aspx

115. The Scottish Government undertook a detailed second stage options appraisal to examine in greater detail how the new agency can best deliver in a way that is aligned with our core principles of fairness, dignity and respect, and achieves value for money. In doing so the Scottish Government took a co-design approach to this work by involving a number of partners to determine and assess the options appraisal criteria.

116. Following this appraisal the decision was made that the new agency will have central locations as well as providing a local presence across Scotland that provides accessible face-to-face pre-claims advice and support co-located, where possible, in places people already visit. This option will best deliver on our key objectives of consistency of provision across Scotland; person centred, rights based service; a strong local presence with a human face to improve accessibility and support; and the safe and secure transition to the 1.4 million people who rely on this support.

117. On 18 September further detail on the operating model was announced with the First Minister advising that the social security agency will be headquartered in Dundee, with a second site of equal size in Glasgow. This decision makes operational and economic sense and is supported by robust analytical evidence. The results of which were published on 19 September.[28]

118. As part of our wider measures to tackle poverty, we have invested over £1 billion in the Council Tax Reduction scheme since 2013-14, assisting almost half a million households each year to meet their council tax liability. In addition we have established the Scottish Welfare Fund which is a vital lifeline for people across Scotland providing £38 million per annum to councils to support people in crisis and low income households. Responsibility for Discretionary Housing Payments was passed to the Scottish Government from April 2017, and is administered through Local Authorities. The 2018/19 draft budget will allow for a spend of £60.9 million.

119. The Scottish Budget announced on 14 December 2017 indicated that, as in 2017/18, spend in 2018-19 on the developing social security programme will continue to be funded from the centrally held budget relating to Scotland Act 2016 non-tax implementation (£75m). Implementing a new social security system for Scotland is a highly complex exercise and we are continuing to develop detailed costed plans. Programme management arrangements are in place including financial planning, monitoring and reporting.

<u>Employability</u>

120. Employability Powers in place under section 31 of the Act have been implemented from 3 April 2017. One year transitional services, Work First Scotland and Work Able Scotland have provided continuity of support for up to 4,800 people with a disability or long term health condition. From April 2018,

[28] https://beta.gov.scot/publications/central-functions-social-security-agency-location-analysis-phase-1-phase/

Fair Start Scotland (FSS) will support at least 38,000 disabled people or those at risk of long term unemployment over the course of three years of referrals up to March 2021. Action to procure FSS services in 9 contract areas covering Scotland has been completed with the Minister announcing the award of contracts on the 4th October 2017. Scottish Ministers are committed to supporting the delivery of devolved employability services, with additional investment of up to £20 million in 2017-18 and an additional £20 million per annum from 2018 significantly enhancing the Fiscal Framework settlement. The Scottish Government continues to work closely with the DWP on implementation, and delivery of the 2017 and 2018 services, including budgeting and monitoring costs.

Welfare Foods

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

Chapter 8 - Fiscal Framework Implementation

Scotland Act 2016

122. The Fiscal Framework determines, in relation to the Scotland Act 2016: an agreed transfer of funding for administration and implementation costs; principles to ensure no detriment as a result of UK government or Scottish Government policy decisions post-devolution; a commitment to update audit and accountability arrangements.

Administration and Implementation Costs

123. There are administration and implementation costs associated with the new powers and functions being devolved. The UK and Scottish Governments agreed in the Fiscal Framework that the UK Government will provide a non-baselined transfer of £200m to the Scottish Government to support the implementation of the new powers and a baselined transfer of £66m to cover the ongoing administration costs associated with the new powers.

Implementation Costs

2017/18
£200m

124. Within these headline totals, £100m was transferred for administration costs for 2017-18 at the Autumn Statement 2016 to inform the Scottish Government's Draft Budget 2017-18. The drawdown of the remaining £100m was agreed through the Joint Exchequer Committee (JEC) in correspondence in December 2017. This funding will also be transferred within the financial year 2017-18.

125. It is forecast that £31.4m will be used to fund Scotland Act implementation in 2017-18. Costs of implementation are monitored as part of programme management arrangements in place across the range of new powers. All unused balances related to the £200m in 2017-18 will be managed into the next financial year through the Scotland Reserve.

Programme	Forecast Outturn 2017-18 (£m)
ADT	0.6
SRIT / SIT (NSND)	4.6
VAT	0.2[29]
Social Security	24.7[30]
Employability	1.3
Total	**31.4**

[29] Amount Scottish Government paid, or is due to pay ONS and Her Majesty's Revenue and Customs.
[30] 2017/18 social security forecast spend is £16 million of programme spend and £8.7 million from the staff administration budget. 2016/17 figure includes both programme and staff administration spend.

Running Costs

2017/18	2018/19	2019/20	2020/21
£22m	£37m	£51m	£66m

126. For running costs, it was agreed at JEC in November 2016 that £22 million would be transferred for 2017-18. A multi-year profile was agreed through the JEC in correspondence in December 2017. As part of this agreement, £37m will be transferred in 2018-19, £51m in 2019-20 and £66m in 2020-21. This transfer will be indexed through the normal application of the Barnett Formula.

No Detriment as a Result of Policy Decisions Post-Devolution

127. The Fiscal Framework includes provisions on 'policy spillovers' to implement the Smith Commission's conclusion that where either the UK or the Scottish Government makes policy decisions that affect the tax receipts or expenditure of the other, the decision-making government will either reimburse the other if there is an additional cost, or receive a transfer from the other if there is a saving.

128. A working group of officials from Scottish and UK Government (Spillovers Working Group) was convened to discuss the production of guidance setting out how the provisions on policy spillovers should be applied in practice.

129. This Group co-drafted guidance for how the process for direct effects would work, i.e. financial effects that will directly and mechanically exist as a result of the policy change (before any associated change in behaviours). This guidance was agreed by Scottish and UK Ministers through the JEC in correspondence in December 2017. This guidance has been included as an annex to this report. The process outlined in the guidance for direct effects will now be applied to the financial year 2018-19.

130. The Spillovers Working Group reconvened in March 2018 in order to produce guidance setting out how the provisions on behavioural spillovers effects should be applied in practice.

Audit and Accountability

Scotland Act 2016

131. Both the Scottish and UK Governments have agreed to update auditing and accountability arrangements in light of the Scotland Act 2016. The technical annex to the Framework sets out key principles that arrangements should be efficient and effective, avoid duplication, and should not result in auditors becoming overburdened once the Scotland Act 2016 are fully implemented.

132. Scottish Government and UK Government officials have been working together to produce a Framework document setting out how these principles should be applied in practice. Officials have produced a preliminary draft of the document that has been shared with both the Scottish Parliament Public

Audit and Post-Legislative Scrutiny Committee (PAPLSC) and the UK Parliament’s Public Audit Committee. In arriving at the draft, close attention was paid to the previous Scottish Parliament’s recommendations on these matters and to Audit Scotland’s recommendations in discussions throughout the drafting process. UK Government officials have also shared the drafts with the National Audit Office and their feedback has also been taken into account.

133. Scottish Government Officials gave evidence at PAPLSC on Thursday 8 February alongside the Auditor General for Scotland and Audit Scotland. Officials are now working with HM Treasury officials to ensure that feedback from the Committee and Audit Scotland is taken into account alongside any feedback from the UK Parliament and the National Audit Office. The final version of the Framework will be agreed by Scottish and UK Ministers through the JEC.

Chapter 9 - Conclusion

134. As set out in this report, there has been significant progress over the last 12 months to implement both the Scotland Act 2012 and the Scotland Act 2016. The next annual report on the implementation of both Acts will, in accordance with Section 33(3)(b) of the Scotland Act 2012, be published before 1 May 2019.

Annex A: Joint UK Government / Scottish Government Paper on 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 SG 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, SG will draw-down borrowing as and when necessary based on value for money considerations.

SG 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. SG 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 the Treasury 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.

Scotland-specific Economic Shock Resource Borrowing

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:

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

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:

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

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, SG will advise HMT of the term of the borrowing, which will be between 3 and 5 years or the short term facility. The 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.

Annex B: Joint UK Government / Scottish Government Paper on Direct Spillover Effects

Background

1. JEC(O) agreed in July that UKG and SG officials should set up a working group to consider how to account for policy spillover effects, in line with paragraphs 44-53 and 98–104 of the fiscal framework. This is where a policy decision from one government has a financial effect on the other – either through a direct, mechanical change (direct effects); or a change in associated behaviour (behavioural effects).

2. JEC(O) agreed that the working group should focus on direct effects first, with the aim of agreeing a process to account for these by October. Behavioural effects will be considered separately; there may be some elements of the process for direct effects that influence discussions on behavioural effects.

3. The working group – comprising DWP, HMRC, HMT officials from UKG; and social security, tax, finance officials from SG – has since worked to reach a shared understanding of:
    - A definition of direct effects.
    - A process to account for direct effects.

4. This paper sets out where the working group has reached agreement on these, for JEC(O) approval; and it notes the areas that will need further consideration.

5. The working group's aim is to agree a process for spillover effects in relation to tax and welfare. However, there may be issues in other policy areas that the UK and Scottish Governments need to account for under the 'no detriment' principle. Any agreement on a process for tax and welfare should be made without prejudice to how issues may need to be accounted for in other policy areas.

Definition of a direct effect

6. The fiscal framework states that all direct effects should be accounted for. The working group has agreed that:
    - 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.

7. The group has considered various examples in relation to the above, including policy decisions that result in an automatic change to eligibility criteria for devolved and reserved benefits; and policy decisions in relation to personal tax that are not fully captured by the block grant adjustment mechanism.

8. The working group has agreed that 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.

9. 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, UKG and SG 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.

Process to account for direct effects

10. The fiscal framework agreement on direct effects means that both governments should agree a process whereby direct effects can be raised and calculated, with the aim of agreeing a financial transfer if needed.

11. The working group has agreed there should be a single, centralised process every year to examine and agree direct effects, with any transfers ultimately signed off via JEC. The group has agreed that UKG and SG should seek to implement this process in year 1 (i.e. for policy decisions coming into effect from April 2018), noting that it will need to be reviewed once it has been tested against a year of actual policy decisions and effects.

12. This process is set out in the annexed model, and covers the following steps:

November-December – SG and UKG announce policy decisions

- UKG are likely to announce most tax or welfare policy decisions at the Autumn Budget, and the SG will do the same at their draft Budget (although changes may not necessarily come into effect from the start of the next financial year). Where changes are announced at other times in the year, UKG and SG will follow the same process, with mutually agreed revised timelines if needed.

January-February – SG and UKG officials start considering effects

- SG and UKG officials should start internally reviewing potential spillover effects from policy changes that will come into effect that financial year.

March-April – SG and UKG agree which effects should be modelled

- There should be an initial official-level forum for SG and UKG to jointly review policy changes coming into effect from April, and agree the scope of any spillovers work, so that there is a shared understanding of which effects will be calculated, and by whom. The governance of this forum will need to be considered further and agreed between SG, DWP, HMRC, and HMT officials.
- Either government should be able to raise an effect for consideration (whether a cost or saving). However, the government that wishes to raise the effect should be predominantly responsible for doing the work to calculate it; although a methodology should be agreed between analysts first. Where appropriate, the other government will assist in calculating the effect.

- Once agreed at official level, the effects that each government wishes to raise should be put to ministers for clearance. These should then be agreed via correspondence between UK and Scottish Government finance ministers.

May-August – spillover effects to be calculated

- Once ministers have agreed which effects will be raised, there will be a need for engagement between SG and UKG analysts as part of any modelling process to calculate effects.
- As far as possible, there should also be a shared understanding between UKG and SG analysts of how effects will be calculated (which may vary dependent on the effect). The analysts in the government leading the analysis to calculate the effect should engage with analysts in the other government as early as possible on the proposed approach to calculation, e.g. the models and the data used.
- This should include consideration of whether the effect will need to be recalculated every year, or whether there is a way to index the effect in future years (assuming no further UKG/SG policy changes). This will be reviewed once the process has been tested.
- UKG and SG analysts will need to share their calculations, data and modelling with each other, in order to reach an agreed costing of the effect.
- Once effects have been calculated and agreed by analysts, SG and UKG officials should agree the spillovers they wish to progress, and modelling treatment of these effects in future years (i.e. whether they will need to be recalculated each year).

September-October – spillover effects and transfers agreed

- Effects and corresponding transfers will then be agreed via JEC(O), to be put to SG and UKG ministers to sign off via JEC.
- All agreed transfers should then be made via a block grant adjustment at Autumn Budget. This means that agreement will be needed on all transfers by end October.
- There may be some effects which DWP, HMRC, and the SG should prevent from taking place at source, in line with paragraph 89 of the fiscal framework. These are separate from the direct effects that will be dealt with through the spillovers process above and block grant adjustments.

Defining a policy decision

13. Using the process above, either government should be able to raise an effect for consideration. However, the working group also noted that in some instances, it might be difficult to establish which government has made a policy decision, or which decision has caused the effect. The group has agreed that we would not try to define a policy decision now, but would review this once we have tested the process in year 1.

Transfers and review

14. The initial transfers agreed via JEC will be based on forecasts from the SG and UKG modelling process. These effects should be reviewed once outturn data is available, as part of the annual process. Both governments will need to jointly consider outturn data, to agree how far it is possible to agree an improved estimate of the effect; and if so, how this should be calculated. As

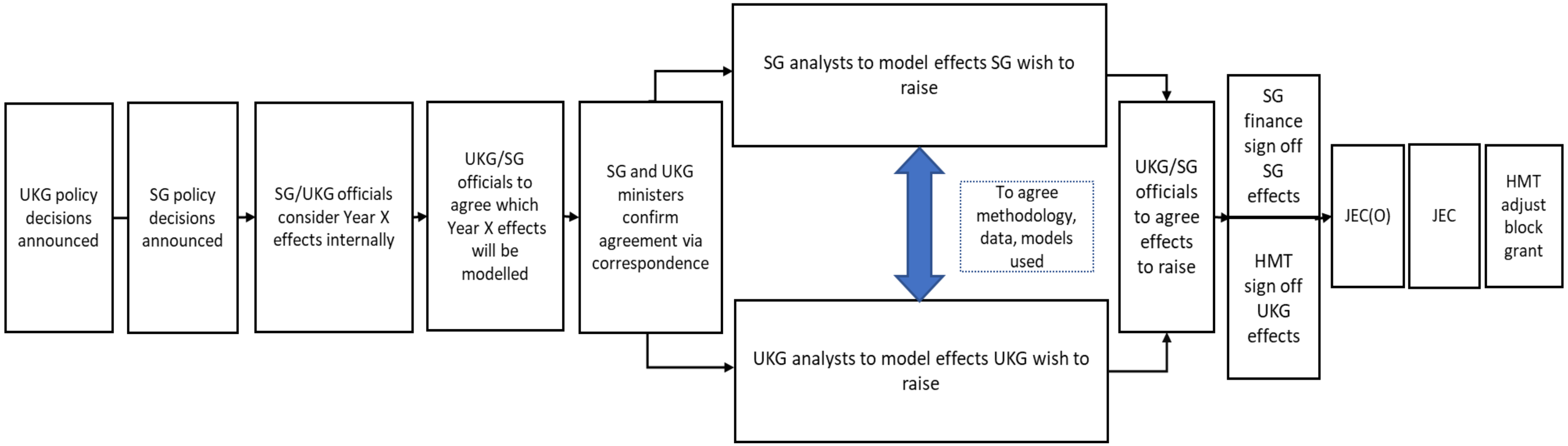
far as possible, UKG and SG should seek to reconcile any effects and corresponding transfers to outturn. Revised effects should be agreed via the annual process, to agree a further block grant adjustment at Autumn Budget.

15. However, the working group noted that it may not always be possible to calculate an effect exactly – either through the forecast, or the outturn data. In these instances, SG and UKG analysts should therefore work together to reach a best estimate of the effect based on the available data.

16. If UKG and SG are unable to agree a sensible estimate of an effect based on the forecast for a given year, there will be no transfer. However, SG and UKG officials will be able to revisit the effect once outturn data is available, with a view to deciding whether this should be raised again via the process based on outturn.

Process to account for direct effects

November	December	January	February	March	April	May	June	July	August	September	October	November
UKG Autumn Budget	*SG draft Budget*			*SG Budget passed*	*Year X policy decisions take effect*							*UKG Autumn Budget*



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