



FINANCE COMMITTEE

AGENDA

11th Meeting, 2013 (Session 4)

Wednesday 17 April 2013

The Committee will meet at 10.00 am in Committee Room 5.

1. **Decision on taking business in private:** The Committee will decide whether to take item 3 in private.
2. **UK economic and fiscal outlook:** The Committee will take evidence from—
Robert Chote, Chairman, The Office for Budget Responsibility.
3. **Appointment of a budget adviser:** The Committee will consider its approach.

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The papers for this meeting are as follows—

Agenda item 2

UK Budget and Implementation of the Scotland Act 2012

FI/S4/13/11/1

Agenda Item 3

PRIVATE PAPER

FI/S4/13/11/2 (P)

Finance Committee

11th Meeting, 2013 (Session 4), Wednesday, 17 April 2013

UK Economic and Fiscal Outlook

Background

1. At its meeting on 17 April the Committee will hear from Robert Chote, Chairman of the Office for Budget Responsibility (OBR).

2. This is the second of three evidence sessions on the UK Budget following the appearance of Paul Johnson, Director, Institute of Fiscal Studies at the Committee on 6 March:

<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=7806&mode=pdf>

3. The Committee is also due to hear from the Chief Secretary to the Treasury on 15 May.

Economic and Fiscal Outlook (EFO)

4. On 20 March the OBR published, alongside the UK budget, its latest EFO: <http://cdn.budgetresponsibility.independent.gov.uk/March-2013-EFO-44734674673453.pdf>. The executive summary is attached.

Scottish Tax Forecasts

5. The evidence session will also focus on the OBR's latest Scottish tax forecasts: <http://budgetresponsibility.independent.gov.uk/wordpress/docs/March-2013-Scottish-tax-forecast-456435643564.pdf>. The OBR states that: "At this stage, HM Treasury will notionally assign these forecast receipts to the Scottish budget to show how much of what is currently grant funding would be replaced by tax." These forecasts do not currently have any impact on the size of the Scottish budget. However, the necessary adjustments to the block grant following the implementation of the new financial powers will be based on outturn tax receipts data as well as the OBR's Scottish tax forecasts.

6. The clerk has drafted a paper on the adjustment of the block grant and this is attached alongside the OBR's latest Scottish Tax forecasts. The Budget Adviser will also provide a briefing for the Committee on the block grant adjustment prior to its meeting on 17 April.

Jim Johnston
Clerk to the Committee

Finance Committee

11th meeting (Session 4), Wednesday 17 April 2013

Block Grant Adjustment

Introduction

1. At its meeting on 12 December 2012 the Committee agreed to take further evidence on the implementation of the Scotland Act 2012 including on the adjustment of the block grant following the devolution of further financial powers. The Committee further agreed to submit its views on the adjustment of the block grant to the Scottish Government by the end of May 2013 in order to inform the discussions of the Joint Exchequer Committee.

2. The timetable for these evidence sessions is as follows:

- 17 April: Robert Chote, Chairman, Office for Budget Responsibility (OBR);
- 24 April: Professor Gerald Holtham, Chair, Independent Commission for Funding and Finance for Wales (Holtham Commission);
- 24 April: Roundtable with the David Hume Institute: Ken Gibb; David Heald; John McLaren; Drew Scott; David Bell; Jeremy Peat; David Ulph.

3. The Budget Adviser has also drafted a briefing paper on the block grant adjustment and he will present this in a briefing to the Committee prior to its meeting on 17 April. The paper will then form part of the discussions with the DHI on 24 April.

Scottish Rate of Income Tax (SRIT)

4. The UK Government's white paper, *Strengthening Scotland's Future*¹, proposes that SRIT will be introduced in April 2016. Section 26 of the Scotland Act 2012 provides for the basic rate, higher rate and additional rate of the non-savings income of a Scottish taxpayer to be reduced by 10%. The Scottish Parliament will then levy a new SRIT which will apply equally to all of these rates. This power will supersede the existing tax varying power, the Scottish variable rate (SVR).

Deciding SRIT

5. The new Scottish rate will need to be set annually by the Scottish Parliament. The Scotland Act 2012 requires that a *Scottish rate resolution* "must be made before the

¹ http://www.scotlandoffice.gov.uk/scotlandoffice/files/Scotland_Bill_Command_Paper.pdf

start of the tax year” and that the “Standing Orders must provide that only a member of the Scottish Government may move a motion for a Scottish rate resolution.” However, the white paper states that in order to allow HMRC to process the necessary administrative and compliance measures the Scottish rate “will need to be formally communicated to the UK Government by the end of December in the preceding calendar year.”

Transitional Period

6. Following the devolution of SRIT there will be a transitional period which is expected to be around 2 or 3 fiscal years during which the deduction in the block grant arising from the 10p reduction will be calculated annually. During this period the deduction in the size of the block grant will be based on the OBR forecast of Scottish income tax receipts for the forthcoming fiscal year. The command paper states that: “These will not be reconciled during transition and the UK Government will bear the risk of any deviation of outturn from the forecast.”²

Forecasting Scottish Taxes

7. The OBR began providing forecasts of various Scottish tax receipts alongside its *Economic and fiscal outlook* (EFO) for the UK economy and the public finances in March 2012³. The OBR will continue to publish its forecast for these taxes alongside each EFO which is published at the time of the UK budget and each Autumn. As with the OBR’s main UK forecasts these are five-year forecasts.

8. The OBR produced a methodology note in March 2012 setting out how it plans to forecast Scottish tax receipts. It states: “The OBR’s role in forecasting is starting three years ahead of the initial devolution of the taxes, which will allow us to develop and improve forecasts in the light of experience and the availability of new information sources.”⁴ In evidence to the Finance Committee on 28 March 2012 the chairman of the OBR stated that: “We very much view the forecasts as work in progress for the time being. This is a learning experience, for us and for everybody.”⁵

9. The OBR have now published three Scottish tax forecasts. The figures for SRIT are as follows:

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/69803/Scotland_Bill_Command_Paper.pdf

³ <http://budgetresponsibility.independent.gov.uk/economic-and-fiscal-outlook-march-2012/>

⁴ <http://budgetresponsibility.independent.gov.uk/wordpress/docs/Forecasting-Scottish-taxes.pdf>

⁵ Finance Committee, 28 March 2012, OR Col. 888.

March 2012-SRIT

Year	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
£ million	4375	4417	4542	4874	5265	5633

December 2012-SRIT

Year	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
£ million	4480	4462	4472	4602	4918	5242	5587

March 2013-SRIT

Year	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
£ million	4330	4240	4246	4332	4649	4976	5308

10. The OBR states that the shortfall in the forecast tax receipts for March 2013 compared with the December 2012 forecast reflects the “deterioration in the UK forecast and the Budget 2013 policy announcement that the personal allowances will reach £10,000 in 2014-15.” However, they go on to state that they “still expect growth in receipts to pick up from 2014-15 onwards” on the basis of “stronger growth in average earnings and rises in employment as the economy improves.”

Block Grant Adjustment

11. The UK Government and the Scottish Government have agreed “to develop and agree the block grant adjustment mechanism based on the proposals of the Holtham Commission”⁶ This approach “would recalculate the block grant adjustment mechanism year by year by indexing it to movements in the Non Savings Non Dividend income tax base in the rest of the UK.”⁷ The two governments have also identified several technical issues to work through including:

- ensuring that the measure of indexation is based on transparent data;
- the use of forecasts and reconciliation with outturn receipts;
- ensuring that the adjustment is transparent;
- selection and preparation of estimates of tax base movements in advance of actual information being available;
- the thresholds and treatment of spill-over effects caused by UK income tax policy decisions;
- the number of annual adjustments.

12. The Scottish Government has informed the UK Government that: “We will seek the Scottish Parliament’s agreement to changes in the Scotland’s funding arrangements, now and the future, in order to provide democratic oversight and in assurance that Scotland’s interests are bring properly considered.”⁸

⁶ Cabinet Secretary for Parliamentary Business to the Secretary of State for Scotland, 21 March 2012.

⁷ Secretary of State for Scotland to the Minister for Parliamentary Business, 20 March 2012.

⁸ Cabinet Secretary for Parliamentary Business to the Secretary of State for Scotland, 21 March 2012

13. The Cabinet Secretary stated in evidence to the Committee:

“Ultimately, the block grant adjustment mechanism will be a key feature in how issues are resolved and agreement is reached. The committee might want to spend time considering how the mechanism will operate, to inform the debate and influence the Scottish Government in relation to what we take to discussions with the UK Government...If I know what the Parliament is looking for, I will have a better sense of what I might achieve in negotiations with the UK Government.”⁹

Land and Buildings Transaction Tax

14. The SG has introduced a Land and Buildings Transaction Tax (Scotland) Bill¹⁰ to replace the current UK Stamp Duty Land tax when it is devolved from April 2015. The Bill “makes provision for a tax which should be as simple as possible to understand and pay and which will place the minimum administrative burden on the taxpayer or their agent and on the tax authority.” The Scottish Government also intends to replace the current “slab” structure with a “proportional progressive structure.”

15. The Committee published its Stage 1 report on the general principles of the LBTT Bill on 27 March 2013.¹¹ The Committee concluded that it supports the general principles of the Bill and emphasises that it will aim to closely monitor the implementation and delivery of LBTT.

Block Grant Adjustment

16. The Committee considered the block grant adjustment following the devolution of stamp duty during its inquiry on the LBTT Bill. Witnesses pointed out during the inquiry that while the SG intends that the financial impact of the new tax should be broadly neutral the volatility of the tax may make this difficult to achieve.

17. The most recent data for receipts for SDLT in Scotland demonstrates the extent of the volatility as follows:

Year	2007-8	2008-9	2009-10	2010-11	2011-12
£ million	565	320	250	330	275

18. Given this volatility the Cabinet Secretary stated that: “the fair and reliable way of considering the issue is to take an average of those five years and make an adjustment

⁹ Finance Committee, 5 September 2012, OR Col. 1457.

¹⁰

http://www.scottish.parliament.uk/S4_Bills/Land%20and%20Buildings%20Transaction%20Tax%20Bill/b19s4-introd.pdf

¹¹ <http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/61649.aspx>

on that basis.”¹² He also pointed out that the Scotland Bill Committee in the previous parliament “stated that it should be a one-off, non-index linked adjustment to the block grant.” The UK Government has indicated that following the devolution of SDLT there will be a one-off reduction to the block grant “which will then be deducted from the block grant for all future years.”¹³ It is unclear whether this will be non-index linked as recommended by the Scotland Bill Committee.

19. Some witnesses also raised concerns regarding the accuracy of the OBR forecasts for SDLT receipts. The Cabinet Secretary also pointed out that the forecasts have already been significantly revised which is evident from the OBR’s figures from March 2012, December 2012 and March 2013:

March 2012 - SDLT

Year	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
£ million	319	328	369	426	480	536

December 2012 – SDLT

Year	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
£ million	275	296	328	368	416	464	516

March 2013 - SDLT

Year	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
£ million	275	323	348	372	410	456	509

20. In relation to the March 2013 forecasts the OBR states that: “Although we have assumed a slower recovery in property transactions than in December, we still expect this to be the main driver behind the rise in SDLT over the forecast period.”

21. The Cabinet Secretary stated in evidence to the Committee on the LBTT Bill:

Between the March and December forecasts in 2012 that looked forward from 2012-13 onwards, the OBR reduced the estimated tax-take by 9.75 per cent, 11.1 per cent, 13.6 per cent, 13.3 per cent and 13.4 per cent. I put those numbers on the record to make the point that, given that pattern, the forward estimating of SDLT is very difficult. I therefore think that a retrospective average assessment is a much more reliable way of making the block grant adjustment. Obviously, that is a subject of discussion with the UK Government.”¹⁴

22. The UK Government has stated that:

¹² OR Col. 2327 - 2328

¹³

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/69803/Scotland_Bill_Command_Paper.pdf

¹⁴ Finance Committee, 27 February 2013, OR Col.2327-2328

Upon the passage of the Scotland Bill, the UK Government will engage with both the Scottish Government and Parliament on the means of calculating the reduction in block grant associated with the devolution of SDLT and LfT. The resulting calculations will be transparent, published and open to scrutiny or audit by external parties and based on outturn tax receipts data as well as the tax receipts forecast carried out by the independent OBR.¹⁵

Landfill Tax

23. The Scottish Government has recently consulted on a Landfill Tax for Scotland with a Bill due to be introduced on 17 April.¹⁶ The Finance Committee is likely to be the lead committee in scrutinising the Bill.

24. There are no Scotland-specific figures for landfill tax revenues available from HMRC as revenue receipts are based upon reporting at a company level rather than by landfill site, and many companies operate cross the UK. The SG states in its consultation that while it is difficult to accurately forecast future revenues from landfill tax in Scotland “it is highly likely the Scottish Government's Zero Waste Plan will see both the quality and type of material landfilled in Scotland change substantially, with far less material going to landfill and what is landfilled being largely inert materials.”¹⁷

25. The OBR forecast Scottish landfill tax receipts by assuming a constant share of UK landfill tax receipts based on an average of the last three years. It does not appear to take account of the impact of SG policy on receipts. The first three forecasts are as follows:

March 2012

£ million	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Landfill Tax	115	123	132	145	151	157

December 2012

£ million	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Landfill Tax	98	97	96	105	107	107	110

March 2013

£ million	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Landfill Tax	98	99	95	104	105	105	108

¹⁵

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/69803/Scotland_Bill_Command_Paper.pdf

¹⁶ <http://www.scotland.gov.uk/Topics/Government/Finance/scottishapproach/landfilltax>

¹⁷ <http://www.scotland.gov.uk/Publications/2012/10/3524/4>

26. The OBR explain that the significant fall in forecast receipts from March 2012 to December 2012 is primarily due to a weaker UK forecast.

Reporting on implementation

27. Section 33 of the Scotland Act 2012 provides both the UK government and Scottish government with a statutory duty to report annually to their respective parliaments on the implementation and operation of the financial powers within the Act. The report from the UK Government will also be laid before the Scottish Parliament by Scottish Ministers. The first reports are due one year from when the Act was passed which will be 1 May 2013. The reports must include the steps taken towards implementation since the publication of the previous report as well as proposals for next steps. The report should also include an assessment of each of the powers once they become operational.

28. The Committee is due to take evidence on the respective implementation reports from the Cabinet Secretary for Employment, Finance, Employment and Sustainable Growth on 1 May and from the Chief Secretary to the Treasury on 15 May.

**Jim Johnston,
Clerk to the Committee**