

Preparations for the implementation of the Scotland Act 2012



 AUDITOR GENERAL

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Summary



Key messages

- 1** The Scottish Government established clear structures for managing the set-up of Revenue Scotland and there are now well-developed project plans for implementing the devolved taxes. The staff required to manage the overall programme were not in place early enough. There were also delays in procuring the IT system to collect and administer the taxes. These delays have reduced the time available to develop the IT system and appoint staff. As a result, there is increased risk that the IT system may not be fully operational by 1 April 2015 and that Revenue Scotland may not have the expertise to manage the devolved taxes effectively from 1 April 2015. In recognition of the reduced time available, Revenue Scotland is developing contingency plans.
 - 2** The Scottish Government is working closely with HMRC to prepare for the implementation of the Scottish rate of income tax in April 2016. It has clear oversight of progress and contributes to decisions. The Scottish Government is responsible for meeting the costs of the Scottish rate of income tax. The latest estimated set-up costs are between £35 million and £40 million, revised downwards from initial estimates of £40 million to £45 million.
 - 3** The Scottish Government has established the Fiscal Capability 2015 programme to manage preparations for its new financial powers. It is working to incorporate the financial aspects of the new powers within its financial management arrangements.
 - 4** The Scottish and UK Governments have still to agree the terms of the block grant adjustment in relation to the devolved taxes and use of the cash reserve. The administrative arrangements for capital borrowing are also still to be fully agreed.
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Recommendations

Revenue Scotland should:

- closely monitor how recruitment to the operational team, and in particular to the prioritised posts in the operational team, is progressing to inform its decision on whether to implement its contingency plans
- clarify what progress needs to be made to ensure the IT system to collect the devolved taxes will be in place by 1 April 2015, to inform its decision on whether to implement its contingency plans
- finalise its contingency plans and ensure that the points at which contingencies would be activated allow sufficient time for effective tax collection from 1 April 2015.

The Scottish Government should:

- review staffing devoted to the Scottish rate of income tax project to ensure there are enough appropriately skilled people in place in the Scottish Government to support the successful implementation of its responsibilities in April 2016.

Background

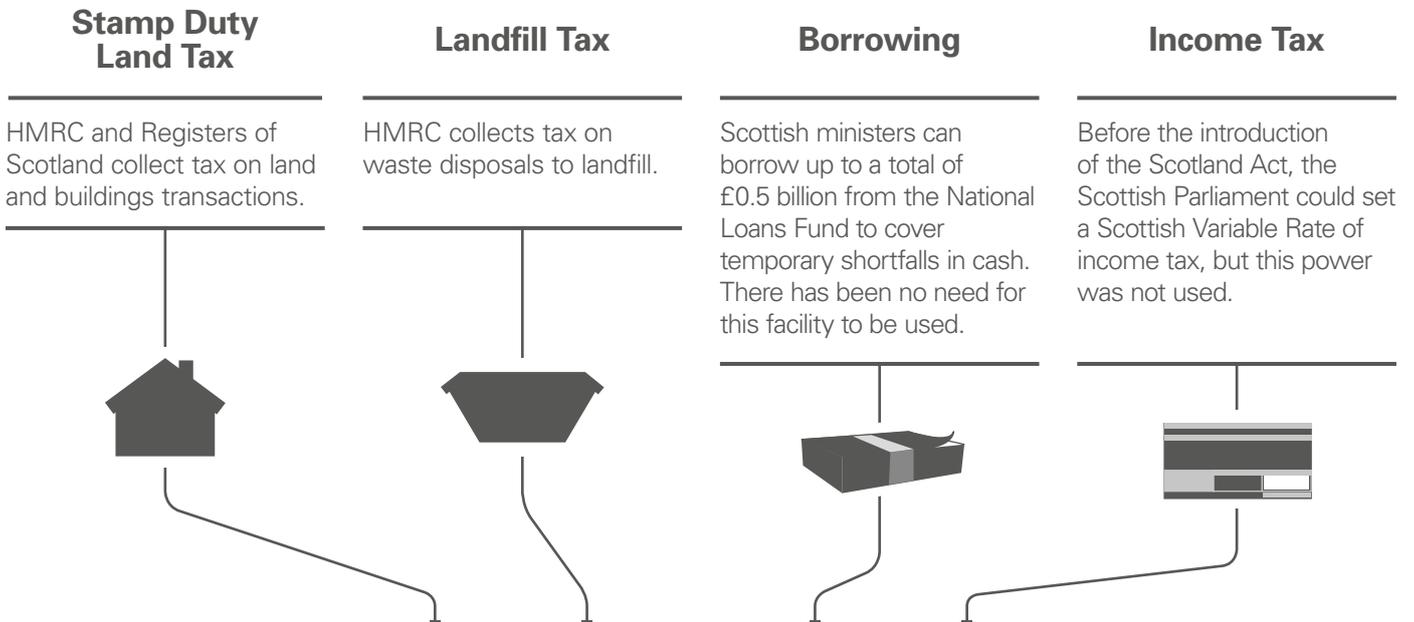
1. The financial environment for government in Scotland is changing. The Scotland Act 2012 introduces new financial powers for the Scottish Parliament that will increase fiscal autonomy and strengthen accountability ([Exhibit 1, page 6](#)). The financial powers in the Scotland Act 2012 will start to be introduced from 2015, specifically:

- taxes, devolved from the UK Government, on land and buildings transactions and disposing waste to landfill, from 1 April 2015
- new borrowing and cash management powers, from 1 April 2015
- new powers to set a Scottish rate of income tax, from 1 April 2016.

2. The Scottish Government is working with Registers of Scotland (RoS), the Scottish Environment Protection Agency (SEPA) and HM Revenue and Customs (HMRC) to get ready to implement the devolved taxes and Scottish rate of income tax. Discussions are ongoing between the Scottish and UK Governments on related matters, including the impact on funding that the Scottish Government receives from the UK Government and how the new borrowing and cash management powers will work in practice.

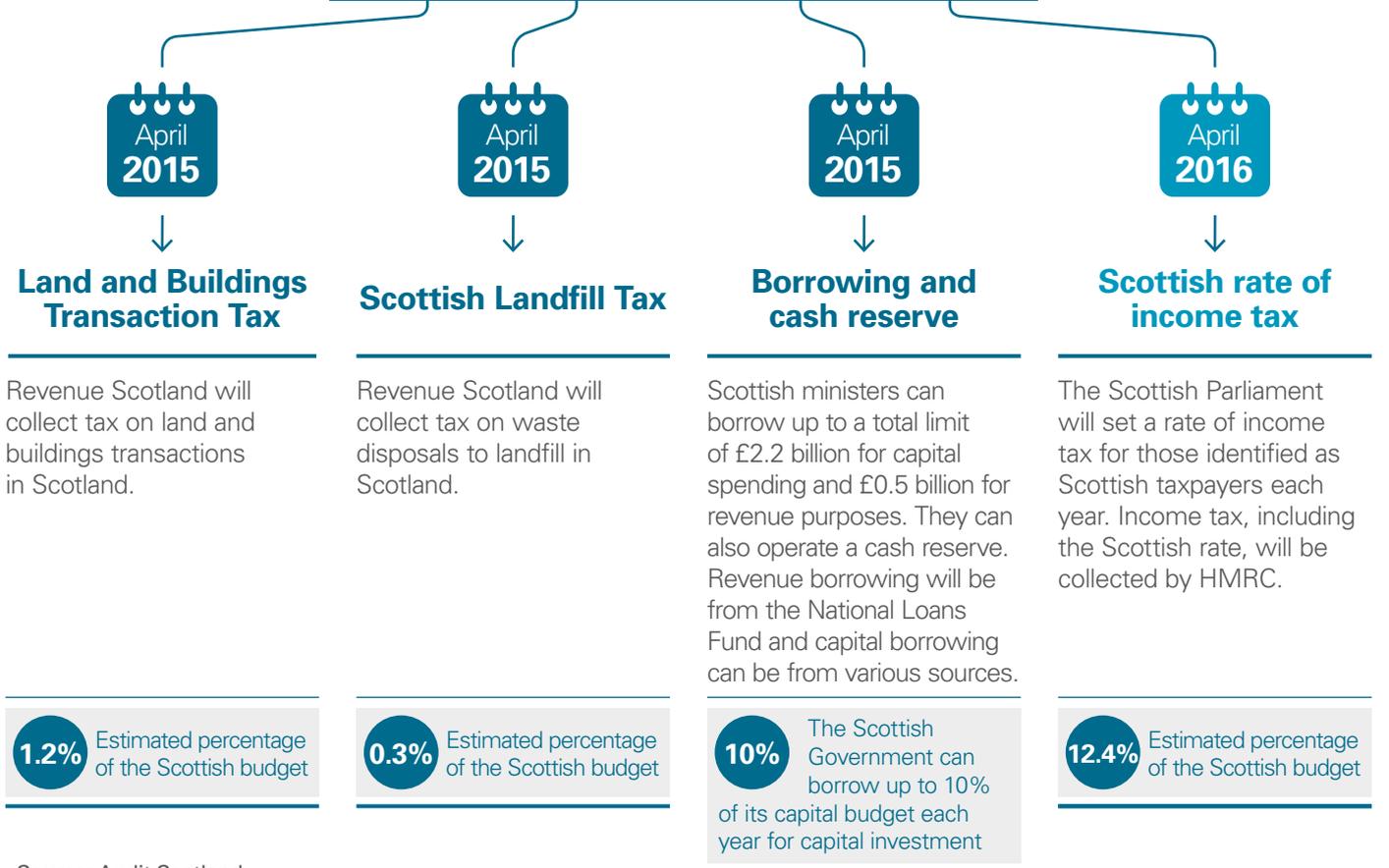
Exhibit 1 New financial powers arising from the Scotland Act 2012

BEFORE



AFTER

Scotland Act 2012



3. Establishing arrangements for these new powers is a large and complex task. This includes developing an overall approach to devolved tax and the legislative framework to implement it, and putting in place the practical arrangements to collect the taxes such as staff and IT systems. The Scottish Government has successfully developed a legislative framework for the devolved taxes set out in the Scotland Act 2012. Three bills were passed by the Scottish Parliament:

- Land and Buildings Transaction Tax (Scotland) Act (July 2013).
- Landfill Tax (Scotland) Act (January 2014).
- Revenue Scotland and Tax Powers Act (September 2014).

4. The Scottish Government consulted publicly on each of these three bills and related subordinate legislation. As well as consultation papers, it held workshops and meetings with interested parties such as the Law Society and Chartered Institute of Taxation, and established working groups to discuss the main policy issues.

5. Following the referendum on Scottish independence in September 2014, the UK Government established the Smith Commission to consider what further powers should be devolved to the Scottish Parliament. The Commission published its report on 27 November 2014. This sets out heads of agreement between Scotland's five main political parties, including an agreement to strengthen the financial responsibilities of the Scottish Parliament.

6. When fully implemented, the Scotland Act 2012 will give the Scottish Government more financial powers and will introduce greater volatility in its funding. Scotland's economic performance is likely to influence the amount raised through the new taxes, and the Scottish Government will bear the risk of the amounts raised being more or less than budgeted for. This, and the prospect of further powers, has implications for Scotland's public finances. We will continue to keep this under review.

About our report

7. This report assesses the Scottish Government's progress in preparing for the financial measures in the Scotland Act 2012; in particular, preparations for:

- administering and collecting the devolved taxes and introducing the Scottish rate of income tax ([Part 1](#))
- managing the new financial powers ([Part 2](#)).

8. We carried out our audit while preparations for the implementation of the Scotland Act were ongoing, to highlight any potential risks before the new powers start to be introduced on 1 April 2015. Therefore, our audit assesses the Scottish Government's progress to early November 2014, while acknowledging that substantial activity is ongoing. Our audit focuses on preparations for the implementation of the devolved taxes, which come into effect from 1 April 2015. The timescale for the introduction of the Scottish rate of income tax is longer. We provide some initial observations on progress and intend to do further audit work in this area.

9. Our findings are based on a review of documents, supplemented by discussions with relevant individuals. Our audit methodology is in the [Appendix](#).

Part 1

Preparing for the devolved taxes and a Scottish rate of income tax



Key messages

- 1 The Scottish Government established clear structures for managing the set-up of Revenue Scotland and there are now well-developed project plans for implementing the devolved taxes. The staff required to manage the overall programme were not in place early enough. There were also delays in procuring the IT system to collect and administer the taxes. These delays have reduced the time available to develop the IT system and appoint staff. As a result, there is increased risk that the IT system may not be fully operational by 1 April 2015 and that Revenue Scotland may not have the expertise to manage the devolved taxes effectively from 1 April 2015. In recognition of the reduced time available, Revenue Scotland is developing contingency plans.
- 2 The Scottish Government is working closely with HMRC to prepare for the implementation of the Scottish rate of income tax in April 2016. It has clear oversight of progress and contributes to decisions. The Scottish Government is responsible for meeting the costs of the Scottish rate of income tax. The latest estimated set-up costs are between £35 million and £40 million, revised downwards from initial estimates of £40 million to £45 million.

it has taken longer than originally proposed to establish arrangements for collecting the devolved taxes

Two new taxes will be introduced in Scotland on 1 April 2015

10. On 1 April 2015, the power to raise taxes on land and buildings transactions (currently known as stamp duty) and waste disposals to landfill will be devolved to the Scottish Parliament. Scotland will therefore have two new Scottish taxes ([Exhibit 2, page 9](#)):

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

11. Revenue Scotland was set up as an administrative unit within the Scottish Government Finance Directorate in 2012. The Revenue Scotland and Tax Powers Bill received Royal Assent in September 2014. This provides for the establishment of Revenue Scotland as a non-ministerial department responsible for collecting and managing the devolved taxes. Revenue Scotland is expected to begin operating as a non-ministerial department in early 2015. Appointments to the board are expected to be made in December 2014 and the first board meeting will take place in January 2015. The board will appoint a chief executive for Revenue Scotland.

Exhibit 2

The Land and Buildings Transaction Tax and Scottish Landfill Tax

The two devolved taxes will be introduced on 1 April 2015.



Land and Buildings Transaction Tax



Scottish Landfill Tax

What is it?	It is a tax on land and buildings transactions, such as buying a house.	It is a tax on disposing waste to landfill.
Main features	Rather than charging one rate of tax on the whole purchase price when it falls within a particular price band, the Land and Buildings Transaction Tax will be based on the proportion of the purchase price that falls within each relevant price band.	It provides additional powers to tax illegally dumped materials. For example, anyone found to be running an unlicensed landfill site will have to pay the tax.
Estimated tax raised in 2015/16¹	£441 million	£117 million
When will it be collected?	For each individual transaction from 1 April 2015	Quarterly from 1 July 2015
How many transactions are expected?	450 to 600 transactions per day	About 56 transactions every quarter ²

Notes:

1. Estimated full-year tax receipts are from *Scottish Draft Budget 2015/16*, Scottish Government, October 2014.

2. This is based on the number of authorised landfill operators. *Landfill sites and capacity report for Scotland 2012*, SEPA, 2012.

Source: Audit Scotland

The Scottish Government established clear structures for managing the implementation of the devolved taxes

12. The Scottish Government set up the Tax Administration Programme (TAP) in early 2013 to put arrangements in place for collecting the devolved taxes. The TAP board includes senior representatives from the Scottish Government (including Revenue Scotland), RoS, SEPA and HMRC. RoS and SEPA have established project boards to manage their organisation's responsibilities in respect of the devolved taxes.

13. The TAP sits within wider governance structures for managing the introduction of all the financial provisions in the Scotland Act ([Exhibit 4, page 20](#)). In establishing the TAP board, the Scottish Government put in place clear structures for managing the implementation of the devolved taxes, including the set-up of

Revenue Scotland. In addition to specific projects for LBTT and SLfT, the TAP board reorganised its structures in April 2014 and oversees four projects:

- Organisational functions project: to set up Revenue Scotland and provide the elements required for effective operational processes and governance arrangements, for example recruitment, staff training, external communications and contingency planning.
- Tax processes project: to establish operational processes in Revenue Scotland for administering the devolved taxes, for example managing records and contact with taxpayers.
- IT implementation project: to provide an IT system capable of administering the devolved taxes.
- Scottish Landfill Communities Fund project: established in July 2014 to oversee the establishment of the Scottish Landfill Communities Fund ([paragraph 21](#)).

Revenue Scotland did not put the required staff in place early enough to manage preparations for the devolved taxes

14. The TAP is being delivered within a strict timeframe and while policy and legislation have been in development. This makes it particularly important to have appropriate resources and strong, effective arrangements in place for managing the project. Revenue Scotland did not put the required staff in place early enough to manage a programme of this scale and complexity.

15. Recruiting staff to Revenue Scotland covers two divisions:

- The tax administration programme division, which is responsible for establishing arrangements for collecting the devolved taxes.
- The operational division, which will be responsible for the operation of Revenue Scotland as a non-ministerial department from early 2015 and the collection of the new taxes.

16. There were delays in recruiting to the tax administration programme division, and the staff required to manage the programme were not in place early enough. Recruitment to the programme division started in 2013. Initial resourcing plans, based on the financial memorandum for the LBTT and SLfT legislation, were for a small programme team. Additional staff requirements were identified over the course of 2013 and processes put in place to fill them. However, there was no clear resourcing plan setting out the number, positions and grades of staff required. The TAP board noted delays in filling posts and in early 2014 there were still vacancies, meaning that some staff had a wide span of responsibilities. Progress was made in recruiting staff between April and October 2014, when the number of people in the programme division increased, from 16 to about 40. This included the appointment of a Programme Director to oversee the TAP who took up post in June 2014. The recruitment process was due to conclude during November 2014.

17. As policy and legislation relating to the implementation of the devolved taxes has developed, Revenue Scotland has refined its plans for managing, monitoring and scrutinising preparations for the devolved taxes. During the first phase of the TAP in 2013 the focus was on providing support and advice to the teams developing the tax legislation, considering the approach to IT and developing high-level operational plans. Towards the end of 2013, the TAP board decided that a central IT system was the most appropriate approach ([paragraph 28](#)). In February 2014, the TAP was restructured so that its supporting workstreams reported to discrete project boards ([paragraph 13](#)), rather than directly to the TAP board. Revenue Scotland produced a detailed project plan for the overall TAP and each of its projects in summer 2014, once consideration of the Revenue Scotland and Tax Powers Bill was in its final stages. Revenue Scotland now has well-developed plans in place, but could have ensured that this detailed planning was done at an earlier stage.

18. Delays in putting staff in place to manage the TAP mean that it has taken longer than originally proposed to establish arrangements for collecting the devolved taxes. For example, recruitment to Revenue Scotland's operational division ([paragraph 23](#)) and the implementation of an IT system to collect the devolved taxes ([paragraph 27](#)) both started later than originally intended. This has increased the risks to the effective implementation of the TAP.

The roles and responsibilities of Revenue Scotland, SEPA and RoS in administering the devolved taxes were not clarified until late 2014

19. Revenue Scotland will have overall responsibility for collecting and ensuring compliance with the devolved taxes. It will work with RoS and SEPA to administer the LBTT and SLfT respectively. In January 2014, the TAP board decided that Revenue Scotland would take a more central role than originally envisaged in collecting online tax payment. This had implications for the respective roles and responsibilities of the three bodies.

20. A clear understanding between Revenue Scotland, RoS and SEPA about their respective roles and responsibilities in administering the devolved taxes has only recently been established. Discussions between the three bodies about how compliance will work in practice are continuing, and details are being finalised. For example, Revenue Scotland has drafted material setting out the approach to compliance with the devolved taxes, which has been shared with RoS and SEPA for comment. Revenue Scotland, RoS and SEPA aim to have written agreements on roles and responsibilities drafted for the new Revenue Scotland board to consider in January 2015, and to publish final versions by the end of February 2015.

21. In December 2013, SEPA agreed to regulate the new Scottish Landfill Communities Fund that will replace the existing UK Landfill Communities Fund from 1 April 2015. The fund will enable landfill operators to give a proportion of the landfill tax they owe to environmental and community projects that are located close to a landfill site, and receive tax credits in return. The regulator's role was set out when the Scottish Government published its proposed model for the Scottish Landfill Communities Fund for consultation in May 2014.¹ SEPA has agreed to undertake this role, and is working with the Scottish Government and Revenue Scotland to establish the appropriate regulatory arrangements. SEPA is developing its view of the skills and expertise needed to regulate the fund and will work with the Scottish Government to secure the resources required to undertake this work. Draft regulations on the Scottish Landfill Communities Fund, which will provide more detail on the regulator's role, are expected to be laid in Parliament in December 2014.

There is a risk that Revenue Scotland will not fill all of its operational posts in line with its plans

22. The Chief Operating Officer of Revenue Scotland was appointed in May 2013 and is supported by a shadow leadership team of three people. The operational staffing structure for Revenue Scotland was finalised in early July 2014 and consists of 40 posts. Revenue Scotland has prioritised recruitment to senior leadership roles.

23. Revenue Scotland initially planned to confirm job descriptions and grades by mid-July 2014 and to have all staff in post by the end of October 2014. In the event, the recruitment strategy for the operational posts was approved at the end of August 2014, and included plans for a three-phase recruitment process. Subsequently, a detailed resource plan was developed and the 40 posts are now being recruited in two phases. Some of the current timescales for recruitment are later than originally estimated:

- **Phase one (20 posts)** – confirm job descriptions and grades by the beginning of October 2014 (originally August). Recruitment process started in October with all staff to be in post by January 2015 (originally November 2014).
- **Phase two (20 posts)** – confirm job descriptions and grades by mid-October 2014 (originally September). Staff in post by the end of February 2015 (as originally estimated).

24. In anticipation of difficulties in recruiting enough people with the appropriate skills and experience in tax administration and roles in legal, IT and finance, Revenue Scotland is:

- prioritising recruitment to senior and specialist posts
- advertising across Scottish Government and other government bodies and externally
- finalising contingency plans that highlight the essential posts to be filled by April 2015, including options should the posts not be filled by then.

25. Revenue Scotland expects that some staff currently in the programme division will move into operational posts, and that existing Scottish Government staff may fill other posts. Both Revenue Scotland and the Scottish Government will need to be satisfied that, in doing so, this does not create gaps in capacity elsewhere.

26. By the end of October 2014, ten staff had been offered posts. These included specialist finance and legal posts. The recruitment process has started for the majority of the remaining posts in both phases one and two. However, the risk remains that Revenue Scotland will not fill all of the operational posts in line with its revised plans. If Revenue Scotland does not have the staff in place that it has identified by February 2015, there is a risk that it will not have the skills and expertise required to manage the devolved taxes effectively from 1 April 2015.

There is a risk that the IT system for collecting the devolved taxes will not be fully implemented by 1 April 2015

27. Implementing an IT system to collect the devolved taxes is central to the success of the TAP. Revenue Scotland could have managed the IT implementation project more effectively at an earlier stage, by making the decision to appoint an external supplier sooner. The timescale for implementing the new system is now very tight and there is a risk that the full IT system will not be in place in time. This may have consequences for Revenue Scotland's performance in collecting the devolved taxes. For example, if Revenue Scotland has to process tax payments manually rather than online it will take longer to process the payments and may increase the risk of errors.

28. The Scottish Government originally anticipated that Revenue Scotland would delegate responsibility for collecting LBTT and SLfT payments to RoS and SEPA respectively. On this basis, RoS and SEPA carried out preliminary work. RoS developed proposals for the user-facing website for collecting LBTT online, and staff in SEPA spent time analysing IT system requirements for SLfT. At the end of 2013, on the advice of in-house specialists, the Scottish Government decided that it would be more appropriate to develop a central system that would be more effective, better protect taxpayer information and could be used to collect additional taxes that may be devolved in future. As a result, the financial memorandum to the Revenue Scotland and Tax Powers Bill (December 2013) set out the additional investment required and was the basis of the approach to IT development which is now being pursued.

29. In January 2014, the TAP board agreed a proposal by the IT Implementation Manager to develop a centralised IT system for collecting tax payments in Revenue Scotland. The proposal indicated that time would be needed to pilot the new system and to train Revenue Scotland staff in using it, and it set out an initial timeline to have the system in place by October 2014. Revenue Scotland worked with RoS and SEPA to identify the requirements for the new IT system, based on the development work they had done up to that point.

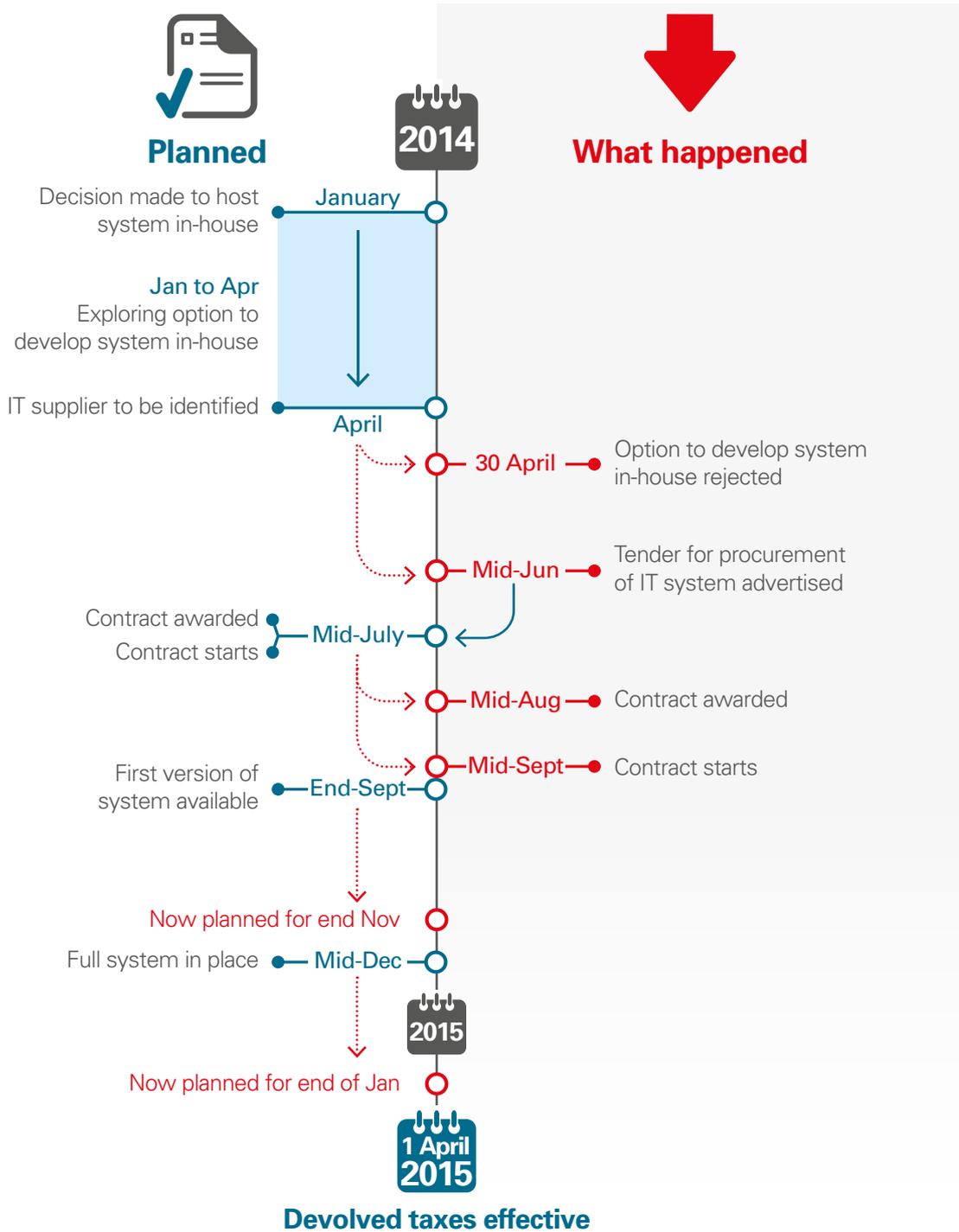
30. Revenue Scotland aimed to identify a supplier for the IT system by April 2014, but this took four months longer than planned ([Exhibit 3, page 14](#)). It explored the option to develop the IT system fully within the Scottish Government. This was rejected at the end of April 2014, as the Scottish Government did not have the staff or expertise available to develop the system within the timescales, due to other commitments. Revenue Scotland then put arrangements in place to identify an external supplier, but the time taken to make this decision has reduced the time available to implement the IT system.

31. In mid-June 2014, Revenue Scotland advertised a tender to supply the required IT system. This set out Revenue Scotland's aim to award a contract to the successful supplier by mid-July, for an immediate start. It wanted the first release of the tax collection and tax administration systems to be available for testing by the end of September. The second release of the systems, with improved functionality, was to be available for testing by mid-December. It did not award the contract until August, with a start date in mid-September. The first version of the system is not expected to be available until the end of November 2014, and the full system is not due to be in place until the end of January 2015 ([Exhibit 3, page 14](#)).

Exhibit 3

Progress in implementing an IT system to collect and administer the devolved taxes

The timescales for implementing an IT system to collect the devolved taxes have slipped.



32. Due to the tight timescales, Revenue Scotland is prioritising the development of the part of the IT system that it will use to process tax returns. The public-facing part of the system through which people will submit their tax returns online will be developed after this, which may be after April 2015. The increasingly tight timescales have reduced the time available to:

- implement the full IT system and to ensure it is compatible with the Scottish Government's accounting system (SEAS) and relevant IT systems in RoS
- test the system and fix any potential problems before the taxes take effect on 1 April 2015
- train staff in Revenue Scotland, RoS and SEPA and provide guidance to those who will be affected most, such as solicitors and landfill operators.

33. If Revenue Scotland's IT system is not in place to receive tax payments online from 1 April 2015, it will have implications for the collection of LBTT. This tax will be collected immediately from 1 April 2015 with approximately 450 to 600 transactions every day. Given the large volume of transactions anticipated, any move away from the electronic processing of LBTT is likely to have cost and performance implications. Revenue Scotland, the Scottish Government, HMRC and RoS are currently working together to assess what impact the recent announcement of the LBTT rates and bands might have on the housing market. They are also assessing what impact the next Help to Buy Scheme, which starts 1 April 2015, will have. The results of this analysis will be factored into the operational plans for Revenue Scotland for the first quarter of 2015/16.

34. There will be less impact on the collection of SLfT, which will be collected quarterly from 1 July 2015 and will involve about 56 transactions. Currently landfill operators complete paper tax returns for HMRC, and so there would be little impact on them if they needed to complete paper tax returns for Revenue Scotland. The volume of transactions is much smaller than LBTT, but Revenue Scotland would need to ensure it had enough staff in place to process the returns.

35. In recognition of the reducing time available between now and 1 April 2015 to establish the required IT systems, the IT implementation group is developing contingency plans. Revenue Scotland plans to decide in December 2014 whether it needs to implement any of its contingency plans. This could, for example, lead to an increase in processing costs and may bring reputational risks for Revenue Scotland.

36. Revenue Scotland intends to use the Scottish Government's accounting system (SEAS) to record and account for the devolved taxes. Work to develop SEAS is happening under the Scottish Government's existing contract with the SEAS supplier. Currently, this work has not been affected by the delays in developing the central tax collection IT system.

The Scottish Government estimates that the set-up costs for the collection of the devolved taxes will be £4.3 million, £1.1 million more than planned

37. In June 2012, the Scottish Government estimated that the set-up and running costs for collecting the devolved taxes would total £16.7 million over the seven years from 2013/14 to 2019/20. This included costs in Revenue Scotland, RoS and SEPA. In December 2013, the financial memorandum to the Revenue Scotland and Tax Powers Bill (RSTPB) included a revised estimate of £20.2 million; an increase of £3.5 million.² The Scottish Government revised and added to its estimates having gained a better understanding of the practical implications of collecting and administering a new tax system. Costs for the setting up and running of the Scottish Tax Tribunals had not been included in the original estimate as it had not been decided at that stage to operate Scottish tribunals. Further expenditure in relation to compliance costs, IT investment, and costs associated with charging tax on illegally dumped waste were also identified during this process.

38. There is a two-year budget for setting up Revenue Scotland and arrangements for collecting the devolved taxes.³ The budget for set-up costs was £3.2 million over 2013/14 and 2014/15 – £2.3 million in Revenue Scotland, £0.6 million in SEPA and £0.3 million in RoS. Total spend in 2013/14 was £0.8 million, the majority of which was staff costs. The TAP board estimates that set-up costs for 2014/15 will be £2.9 million, with a further £0.6 million spend in 2015/16 for staff in Revenue Scotland. Therefore, the total revised estimate for set-up costs is £4.3 million, which is £1.1 million more than the budget. The total revised estimated cost for the set-up and first five years of operation is £21.9 million, which includes £0.7 million for the set-up and running of the Scottish Tax Tribunals. This is £1.7 million more than the RSTPB budget of £20.2 million. The increase in expected costs is mostly attributable to the need for additional staff to lead and implement the TAP.

The Scottish Government is working closely with HMRC to manage the introduction of the Scottish rate of income tax in 2016

39. From April 2016, the Scottish Parliament must set a new Scottish rate of income tax (SRIT) for those identified as Scottish taxpayers. HMRC will administer and collect this tax.

40. HMRC is responsible for the project to implement the SRIT. The Scottish Government has a responsibility to ensure that expenditure on SRIT represents value for money and to seek assurances that the new system will collect the correct amount of SRIT. The Scottish Government is also responsible for proposing a rate for approval by Parliament.

41. To fulfil these responsibilities, the Scottish Government is working closely with HMRC, and is represented on its programme and project board. The Scottish Government has clear oversight of progress and contributes to decisions relating to the project, including costs. Given Revenue Scotland's difficulties in recruiting to their operational team, as the timescales for introducing SRIT get closer, the Scottish Government needs to review the number of staff it has allocated to the elements of the project that it is responsible for. The Scottish Government's current assessment is that while it currently has enough skilled people in place to fulfil its responsibilities, it is dependent on a single member of staff and consequently there is a need to consider resilience as April 2016 approaches.

42. HMRC will continue preparations for introducing the SRIT throughout 2015/16. We expect that this work will take account of any developments coming from the Smith Commission and heads of agreement on further powers for the Scottish Parliament.⁴ At this stage, HMRC's project to implement the SRIT is progressing in line with plans. The main areas of work during 2014/15 are:

- developing systems and processes for identifying Scottish taxpayers
- working with HMRC's IT supplier to estimate IT costs as accurately as possible and enable the start of IT delivery
- developing methods for informing everyone that the new tax will affect, for example employers, taxpayers and pension providers, about what will change
- developing processes for enforcement and compliance
- ensuring that systems are in place to enable operating costs to be tracked accurately following implementation.

43. HMRC is identifying and analysing data to improve the accuracy of the information it holds on Scottish taxpayers. HMRC plans to write to the people it has identified as Scottish taxpayers in autumn 2015, giving them the chance to tell it about any errors in the data. This will help HMRC ensure that the information it holds on Scottish taxpayers is as accurate as possible by early 2016.

44. In September 2014, HMRC received a proposal from its IT supplier on the requirements for the SRIT and how much it would cost to implement them. The HMRC procurement team discussed this proposal with relevant officials in the Scottish Government, including procurement specialists. Both HMRC and the Scottish Government are testing and refining these cost estimates. Under the memorandum of understanding between HMRC and the Scottish Government on setting up and operating the SRIT, the Scottish Government can commission independent cost assessments of IT requirements.⁵ It has not yet used this measure.

45. HMRC has commissioned work to find out how much affected groups such as employers and taxpayers know about how the SRIT will affect them, and the best ways of telling them about the changes to income tax. HMRC and the Scottish Government will use this information to help them decide how to communicate the changes to the SRIT. This work will be carried out during late 2014 and early 2015.

HMRC has invoiced the Scottish Government for almost £1 million for implementing the SRIT

46. The Scottish Government is responsible for meeting HMRC's costs in setting up and operating the SRIT.⁶ In 2010, HMRC estimated that set-up costs would be between £40 million and £45 million, and that it would cost £4.2 million a year to administer and collect the SRIT. Since then, HMRC has been working with the Scottish Government to refine the cost estimates as decisions are made on exactly how the SRIT will operate. The latest estimate of set-up costs has been revised downwards, to between £35 million and £40 million.⁷ This estimate includes:

- non-IT costs, such as communicating the changes to taxpayers, which are estimated to be £25 million (revised downwards from between £30 million and £35 million)
- IT costs, which are estimated to be between £10 million and £15 million (revised upwards from £10 million).

47. To date, HMRC has invoiced the Scottish Government for almost £1 million for costs arising from the work to implement the SRIT (£0.17 million in 2012/13 and £0.79 million in 2013/14). Most of these costs are HMRC staff time; they do not include Scottish Government staff time. Costs are discussed and monitored at the programme and project boards, and HMRC consults with the Scottish Government on decisions that may have an impact on the cost of the SRIT implementation project.

48. Many of the decisions that will affect the costs are still to be finalised. These include the details of the process for identifying Scottish taxpayers and the changes required to existing IT systems in HMRC. The Scottish Government continues to work with HMRC to refine the cost estimates as they make these important decisions.

Recommendations

Revenue Scotland should:

- closely monitor how recruitment to the operational team, and in particular to the prioritised posts in the operational team, is progressing to inform its decision on whether to implement its contingency plans
- clarify what progress needs to be made to ensure the IT system to collect the devolved taxes will be in place by 1 April 2015, to inform its decision on whether to implement its contingency plans
- finalise its contingency plans and ensure that the points at which contingencies would be activated allow sufficient time for effective tax collection from 1 April 2015.

The Scottish Government should:

- review staffing devoted to the Scottish rate of income tax project to ensure there are enough appropriately skilled people in place in the Scottish Government to support the successful implementation of its responsibilities in April 2016.
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Part 2

Financial management of new powers



Key messages

- 1** The Scottish Government has established the Fiscal Capability 2015 programme to manage preparations for its new financial powers. It is working to incorporate the financial aspects of the new powers within its financial management arrangements.
- 2** The Scottish and UK Governments have still to agree the terms of the block grant adjustment in relation to the devolved taxes and use of the cash reserve. The administrative arrangements for capital borrowing are also still to be fully agreed.

The Scottish Government has established a programme to manage preparations for its new financial powers

49. The Scottish Government established the Fiscal Responsibility Implementation Programme (FRIP) in May 2011 to oversee how the financial provisions of the Scotland Act 2012 are being implemented. In early 2014, the FRIP board became the Fiscal Responsibility Steering Group, which oversees four programmes of work ([Exhibit 4, page 20](#)). Two of these programmes focus on preparations for introducing the financial powers in the Scotland Act:

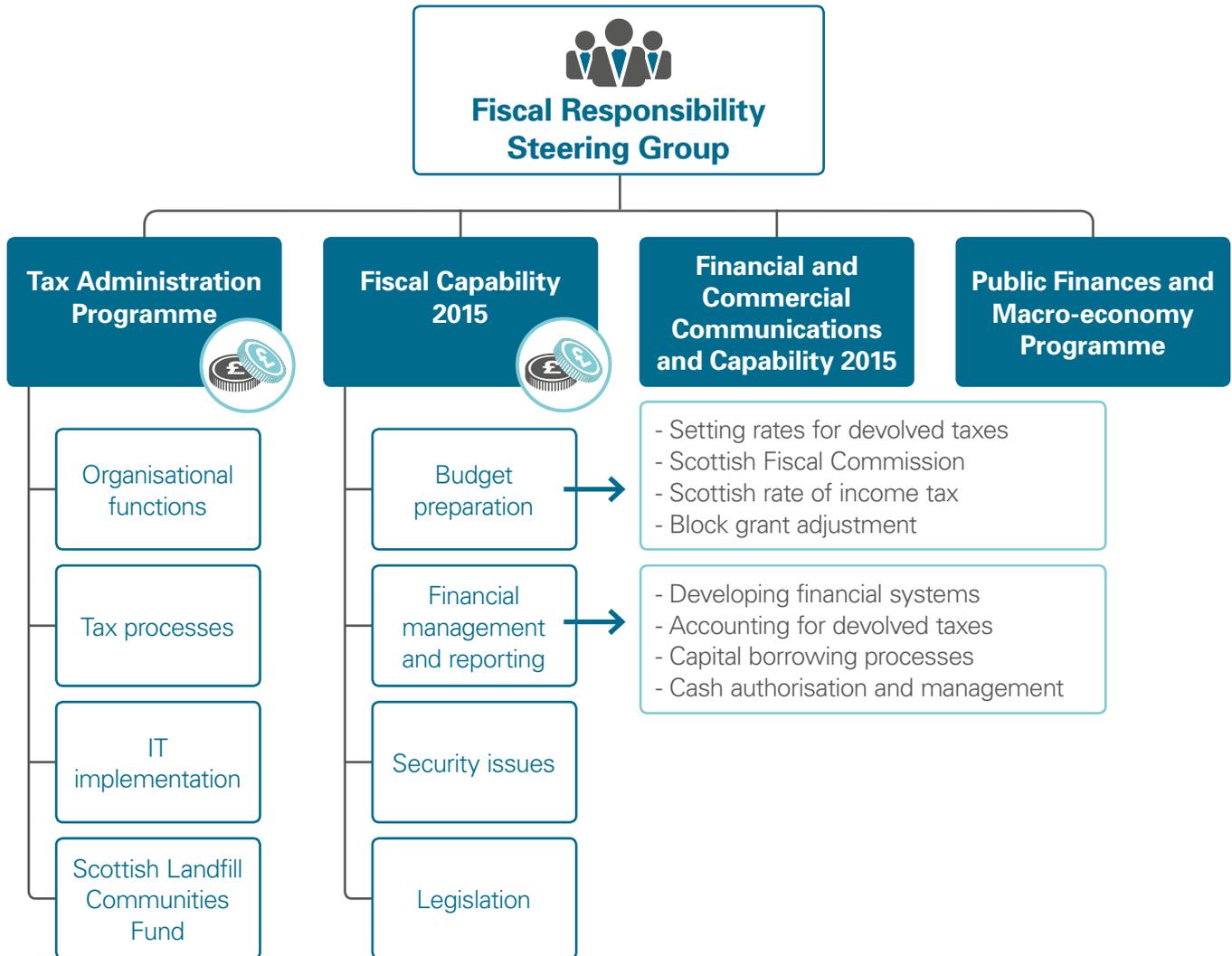
- **Tax Administration Programme** – established in early 2013 to set up Revenue Scotland and the arrangements for collecting the devolved taxes ([paragraph 12](#)).
- **Fiscal Capability 2015** – established in May 2014 to oversee the implementation of devolved fiscal powers, except the parts covered by the Tax Administration Programme.

50. There are four projects within the Fiscal Capability 2015 programme, each covering a number of workstreams. Two of the projects are largely responsible for setting up appropriate financial management and reporting arrangements for the new powers. These include making changes to financial systems and processes and developing accounting systems and budget monitoring arrangements ([Exhibit 4, page 20](#)). Most of these workstreams are due to complete their work by the end of March 2015.

new financial powers have significant implications for how Scotland's public finances are managed

Exhibit 4

Arrangements to manage the implementation of the financial provisions of the Scotland Act 2012
 The Scottish Government is managing the introduction of the financial provisions in the Scotland Act through the Tax Administration Programme and Fiscal Capability 2015 programme.



Source: Scottish Government

The Scottish Government is working to incorporate the new powers in its financial management arrangements

The Scottish Fiscal Commission scrutinises forecasts of receipts from the devolved taxes

51. The Scottish Government needs to develop reliable forecasts of receipts from devolved taxes so that it can plan its budgets accurately and propose tax rates and bands. They must also be transparent so the Scottish Parliament can scrutinise the forecasts used in the budget.

52. Previously, the Office for Budget Responsibility (OBR) provided twice-yearly forecasts of receipts from the UK taxes on land transactions and landfill in

Scotland. The Scottish Government has used this information to help inform and develop its budgeting and forecasting process.

53. The draft budget 2015/16 used forecasts provided by senior professional economists in the relevant Scottish Government analytical services teams – the communities team for the LBTT forecasts and the rural affairs and environment team for the SLfT forecasts – using OBR data and data provided by RoS and SEPA. These forecasts were quality assured by the Scottish Government’s Office of the Chief Economic Adviser.

54. In May 2014, following a report by the Finance Committee of the Scottish Parliament, the Finance Secretary announced his intention to establish an independent Scottish Fiscal Commission to scrutinise and report on these forecasts before the Scottish Government published the proposed tax rates and forecasted receipts in its draft budget. The stated intention was that the Scottish Fiscal Commission’s reports would provide the Scottish Parliament and taxpayers with independent assurance that the forecasts were soundly based and reasonable.

55. Appointments to the Scottish Fiscal Commission were made in June. The Scottish Government announced that it intended to bring forward legislation in due course to establish the Commission on a statutory basis. The initial appointments were non-statutory and so were not covered by the Code of Practice for Ministerial Appointments to Public Bodies in Scotland. Therefore, the Scottish Parliament was asked to approve appointments nominated by the Cabinet Secretary. In future, subject to the passage of legislation, Scottish ministers will make appointments subject to the Code with the Scottish Parliament continuing to have a role in approving appointments.⁸ The Commission comprises three part-time members, who are each appointed for a single term. It was provided with a budget of £20,000 for 2014/15 to cover early operational costs and to commission any research and analysis required to help it scrutinise the Scottish Government’s tax receipt forecasts. The Commission’s remit will be kept under review and updated as necessary, for example before the SRIT is introduced in 2016. The Scottish Fiscal Commission is an important part of the scrutiny process and it is essential that it remains independent of the Scottish Government and has the capacity and budget to fulfil its role.

56. The proposed tax rates for the two devolved taxes were published in the draft budget for 2015/16, supported by a report setting out the forecasting methodology that the Scottish Government had used. The Scottish Fiscal Commission’s report on tax forecasts was published at the same time.⁹ The Commission concluded that the Scottish Government’s forecasts of tax receipts were reasonable, within the constraints of the available data. The Commission recommended that the Scottish Government obtains relevant historical data from existing sources to improve the quality of the information available to forecast LBTT. The Scottish Fiscal Commission also acknowledged the lack of Scotland-specific data in respect of SLfT receipts. It concluded that the assumptions and approach that the Scottish Government had applied in setting the budget were prudent and not unreasonable.

57. The publication of these two reports alongside the draft budget for 2015/16 should assist the Scottish Parliament to scrutinise the proposed rates in more detail. The Scottish Parliament will be invited to approve tax rates through Statutory Instruments by March 2015.

Scottish and UK ministers are still to agree the adjustment to the block grant for the devolved taxes

58. The LBTT and SLfT will start to be collected from 1 April 2015. Receipts from these two taxes will be added to the Scottish budget, and the UK Government will reduce the level of block grant to Scotland accordingly. The block grant is the funding that the Scottish Government receives from the UK Government every year. The Command Paper published alongside the Scotland Bill stated that 'there will be a one-off reduction which will then be deducted from the block grant for all future years'.¹⁰ The Scottish Government and HM Treasury have still to agree the block grant adjustment and Scottish and UK ministers are currently negotiating this. Until then, the Scottish Government has assumed that the reduction to the block grant in 2015/16 will allow it to meet the funding requirements of its budget and potentially establish the first payment into the cash reserve.¹¹ Once agreement is reached, any necessary adjustments will need to be reflected in the budget.

59. Until an agreement can be reached, uncertainty about the implications of the block adjustment in 2015/16 and beyond will remain. Receipts from the devolved taxes are forecast to be £558 million in 2015/16, which is approximately 1.5 per cent of the overall Scottish budget. Assumptions about the related block grant adjustment have been reflected in the draft budget, but any changes in the amount finally agreed would need to be accommodated within overall spending plans.

Revenue Scotland needs to consider how to report on its performance in collecting the devolved taxes

60. Revenue Scotland is in the process of developing a performance reporting framework. Reporting on performance plays an important role in continuous improvement. Collecting and analysing information in relation to collection rates, processing times and costs, and debt management will provide Revenue Scotland with the relevant information to develop procedures and maximise tax revenues.

61. Public reporting on performance will improve transparency and assist the Scottish Parliament to review Revenue Scotland's performance. This will become increasingly important with the likelihood that more financial powers will be devolved in future.

The Scottish Government can use revenue borrowing and a cash reserve to manage differences between actual and forecast tax receipts

62. The Scottish Government intends to include a commentary on tax receipts in its future draft budgets, once information is available. This will include any variance between forecasts and actual receipts. From 1 April 2015, the Scottish Government will be able to use revenue borrowing (up to a total of £500 million) and build up a cash reserve (up to £125 million), to help manage any differences between actual and forecast tax receipts.

63. Since 2012/13, the Scottish Government has had the option to set aside funds from current budgets in a cash reserve. From 2015/16, the Scottish Government can also pay receipts in excess of tax forecasts into the cash reserve. The Scottish Government can draw down cash from the reserve if future tax receipts are lower than forecast, or borrow from HM Treasury with repayment due within four years. To date, the Scottish Government has not paid into the cash reserve. It is still discussing with HM Treasury how the administrative arrangements of the cash reserve will operate.

64. Revenue Scotland will produce financial statements to account for its operational costs. It will also be responsible for producing financial statements for the devolved taxes showing how much money has been collected. As part of the Fiscal Capability 2015 programme, the Scottish Government is identifying the detailed financial reporting requirements for the devolved taxes and is starting to put appropriate arrangements in place to monitor and report on tax receipts throughout the financial year. The Scottish Government is also considering how the devolved taxes will be reported in the annual accounts of the Scottish Consolidated Fund – the fund which the block grant and tax receipts flow through.

The Scottish Parliament will set a Scottish rate of income tax each year from 2016

65. From April 2016, the Scottish Parliament must set a new Scottish rate of income tax (SRIT), which HMRC will administer and collect. From April 2016, the main UK rates of income tax will be reduced by ten pence for each tax band for those identified as Scottish taxpayers. Each year the Scottish Parliament will be asked to vote on a resolution approving the new SRIT to be added to the reduced UK rates. The OBR will estimate the amount of tax that will be raised from the SRIT being set at ten pence and this will form the reduction in the block grant ([Exhibit 5, page 24](#)). In March 2014, the OBR produced its latest estimates of the amount of income tax that would be raised through the SRIT, assuming a ten pence tax rate, covering the five-year period to 2018/19.¹² It forecasts receipts of £5 billion in 2016/17.

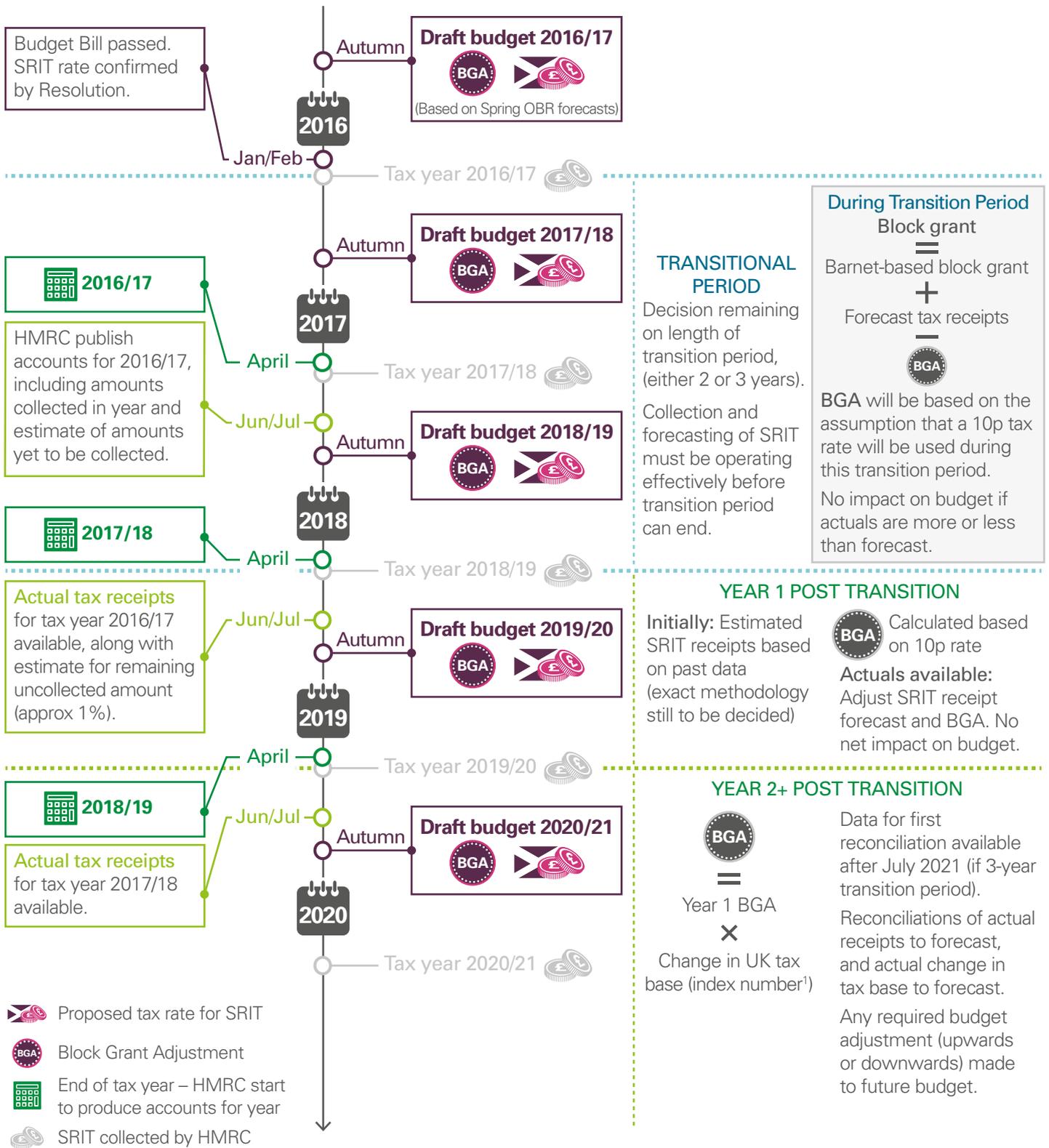
66. Tax receipts from the SRIT will be paid to the Scottish Government and there will be a corresponding block grant adjustment. From April 2016, there will be a transition period lasting two or three years, during which HM Treasury will bear the risk of actual tax receipts not matching the forecasts. This means that during this period the adjustment to the block grant will equal tax receipts, unless the Scottish Parliament sets a rate other than ten pence. After the transition period, the Scottish Government will bear the risk of actual tax receipts being more or less than forecast. Such risks arise from, for example, Scottish Government policy decisions and relative economic performance.

67. In 2012, Scottish and UK ministers agreed the method for adjusting the block grant in respect of the SRIT. The Scottish Government and HM Treasury now need to finalise the details. Some of these details may be agreed once the SRIT has been introduced. The block grant adjustment will not have an impact on the Scottish Government's budget until 2019 or 2020, at the end of the transition period, unless a rate different to ten pence is set. The Scottish Government intends to set out full information on the impact of the SRIT on the block grant every year, both in the draft budget and in the Scottish Consolidated Fund accounts. The exact form of this reporting is still under discussion. The Written Agreement between the Scottish Government and the Finance Committee on the budget process will be reviewed before the SRIT is introduced in April 2016.

HMRC and the National Audit Office will be responsible for accounting for and auditing the Scottish rate of income tax respectively

68. Spending and receipts relating to the SRIT will be identified separately in HMRC's accounts, which will be audited by the National Audit Office (NAO). The Scottish Parliament will scrutinise how the SRIT operates. From 2014/15, HMRC will provide the relevant audited extracts of its accounts to the Scottish Parliament for scrutiny each year.¹³ At the same time, the Comptroller and Auditor

Exhibit 5 Setting a Scottish rate of income tax



Note: An index number is used when making comparisons over time. An index starts in the 'base' year. An index number of 102 means a two per cent increase from the base year; 98 would mean a two per cent decrease from the base year.

Source: Audit Scotland

General will report to the Scottish Parliament on HMRC's administration of the SRIT.¹⁴ This report must be produced by the January after the financial year that it covers. It will include an assessment on how adequate HMRC's arrangements for collecting the SRIT are and the accuracy of the figures in HMRC's accounts. For 2014/15 and 2015/16, these accounts and the audit reports on them will relate only to the setting up of systems to calculate and collect the Scottish rate.

69. Work is under way to draw up a memorandum of understanding between the NAO and Audit Scotland. This will support us in providing additional assurance to the Scottish Parliament on NAO's audit of HMRC and SRIT. We will report annually on this assurance work.

70. The Scottish Government plans to include information about income from the SRIT in its accounts from 2017, for the financial year 2016/17. It has agreed to provide enough information to clearly show the relationship between actual tax receipts and the block grant adjustment.

The Scottish Government plans to borrow the maximum amount available for capital purposes in 2015/16

71. From 1 April 2015, the Scottish Government will have new capital borrowing powers. It will be able to borrow up to ten per cent of its capital budget each year from 2015/16 to support capital investment, with a total limit of £2.2 billion. The Scottish Government is able to borrow from the National Loans Fund, from banks on commercial terms, or by issuing bonds.

72. In the draft budget for 2015/16, ministers set out their intention to borrow the maximum available amount for capital purposes in 2015/16, which is estimated to be £304 million.¹⁵ The borrowing will be used to supplement the overall capital funding available. The Scottish Government expects borrowing to be affordable and it will be managed within the five per cent affordability limit that it has set for long-term investments. The draft budget 2015/16 provided an assessment of affordability on the basis of borrowing from the National Loans Fund over a repayment period of 25 years at an assumed rate of five per cent.

73. One of the workstreams in the Fiscal Capability 2015 programme is considering how the Scottish Government will manage its new borrowing powers. Currently, the Scottish Government's Infrastructure and Investment Plan (IIP) sets out priorities for investments and a long-term strategy for the development of public infrastructure. The Infrastructure and Investment Board monitors how the capital programme is developed and delivered. Decisions on capital borrowing will be taken in the context of the overall funding requirement to support the Scottish Government's IIP. The Scottish Government will continue to develop the links between its investment plans, how it uses capital borrowing and the affordability of its long-term investment plans as part of its next IIP which is likely to be published around the end of 2015. It plans to draw down the borrowing towards the end of 2015/16 to minimise interest costs.

74. The Scottish Government plans to show the amount of borrowing and the terms on which it was undertaken, both cumulatively and for the most recent year, in budget documents and in its annual accounts. One of the workstreams in the Fiscal Capability 2015 programme is considering the detailed arrangements for this.

Developing public reporting has never been more important

75. The Scotland Act 2012 introduces new financial powers for the Scottish Parliament that aim to increase fiscal autonomy and strengthen accountability. The new powers provide more flexibility but also introduce greater volatility if, for example, the amounts raised through the devolved taxes are more or less than budgeted. The Scottish Government will bear this risk, which will have significant implications for how Scotland's public finances are managed and wider policy-making.

76. Further changes look likely as a result of the Smith Commission's heads of agreement on further powers for the Scottish Parliament, published in November 2014.¹⁶ In this environment, the Scottish Government will need to make significant financial decisions and manage more volatile revenues, while demonstrating financial stability and informing taxpayers.

77. All this strengthens the need for financial reporting that is comprehensive, clear and easy to understand, as highlighted in our report [*Developing financial reporting in Scotland* \[PDF\]](#) . We will publish an update to this report in February 2015.

Endnotes



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- ◀ 1 *Scottish landfill tax: a consultation on subordinate legislation*, Scottish Government, May 2014.
 - ◀ 2 *Revenue Scotland and Tax Powers Bill: financial memorandum*, Scottish Government, December 2013.
 - ◀ 3 *Revenue Scotland and Tax Powers Bill: financial memorandum*, Scottish Government, December 2013.
 - ◀ 4 *Report of the Smith Commission for further devolution of powers to the Scottish Parliament*, the Smith Commission, November 2014.
 - ◀ 5 *Memorandum of understanding on the Scottish rate of income tax*, Scottish Government and HM Revenue and Customs, February 2013.
 - ◀ 6 *Memorandum of understanding on the Scottish rate of income tax*, Scottish Government and HM Revenue and Customs, February 2013.
 - ◀ 7 *Scottish Government Second Annual Report on the Implementation and Operation of Part 3 (Financial Provisions) of the Scotland Act 2012*, Scottish Government, April 2014.
 - ◀ 8 *Appointments to the Scottish Fiscal Commission*, Scottish Parliament Finance Committee, 5th report 2014 (session 4), June 2014.
 - ◀ 9 *Report of the Scottish Fiscal Commission*, Scottish Fiscal Commission, October 2014.
 - ◀ 10 *Strengthening Scotland's future*, UK Government, November 2010.
 - ◀ 11 *Draft budget 2015/16*, Scottish Government, October 2014.
 - ◀ 12 *Economic and fiscal outlook: Scottish tax forecasts*, Office for Budget Responsibility, March 2014.
 - ◀ 13 *Memorandum of understanding on the Scottish rate of income tax*, Scottish Government and HM Revenue and Customs, February 2013.
 - ◀ 14 *Finance Act 2014*, UK Government, July 2014.
 - ◀ 15 *Draft budget 2015/16*, Scottish Government, October 2014.
 - ◀ 16 *Report of the Smith Commission for further devolution of powers to the Scottish Parliament*, the Smith Commission, November 2014.

Appendix

Audit methodology



We reviewed a range of published information during our audit, including the following:

- Papers from the Scottish Parliament's Finance Committee and Public Audit Committee
- The Scottish and UK Governments' annual reports on progress in implementing the Scotland Act
- Papers and minutes from the Scottish Government's Fiscal Responsibility Implementation Programme and Fiscal Capability 2015 Programme
- Papers and minutes from the Scottish Government's Tax Administration Programme, and other relevant programme management documentation
- The Scottish Government's draft budget for 2015/16.

We spoke to representatives from the following organisations:

- Scottish Government (including Revenue Scotland)
- Registers of Scotland
- Scottish Environment Protection Agency
- HM Revenue and Customs.

Preparations for the implementation of the Scotland Act 2012

This report is available in PDF and RTF formats, along with a podcast summary at:
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