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Finance Committee

1. The remit of the Finance Committee is to consider and report on-
   a. any report or other document laid before the Parliament by members of the Scottish Government containing proposals for, or budgets of, public expenditure or proposals for the making of a tax-varying resolution, taking into account any report or recommendations concerning such documents made to them by any other committee with power to consider such documents or any part of them;
   b. any report made by a committee setting out proposals concerning public expenditure;
   c. Budget Bills; and
   d. any other matter relating to or affecting the expenditure of the Scottish Administration or other expenditure payable out of the Scottish Consolidated Fund.

2. The Committee may also consider and, where it sees fit, report to the Parliament on the timetable for the Stages of Budget Bills and on the handling of financial business.

3. In these Rules, “public expenditure” means expenditure of the Scottish Administration, other expenditure payable out of the Scottish Consolidated Fund and any other expenditure met out of taxes, charges and other public revenue.

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Gavin Brown
Scottish Conservative and Unionist Party

Mark McDonald
Scottish National Party

Jean Urquhart
Independent
INTRODUCTION

1. Draft Budget 2016-17 ("the Draft Budget") was published by the Scottish Government on 16 December following the publication of the UK Spending Review on 25 November. A revised timetable for budget scrutiny was agreed with the Scottish Government which is inevitably shorter than normal due to the timing of the UK Spending Review.

2. The devolution of new financial powers fundamentally changes the nature of the budget process. Figure 1 illustrates the increase in taxation powers already devolved to the Scottish Parliament as a consequence of the Scotland Act 2012 and the taxation powers in the current Scotland Bill being considered by the UK Parliament.

Figure 1: Taxation as a share of devolved expenditure

Source: Financial Scrutiny Unit (FSU)

3. The budget process has historically focused on the Scottish Government’s spending plans. This expenditure was almost wholly funded by a block grant from Westminster and the Scottish Variable Rate, introduced in the Scotland Act 1998, was never used so there has been little scrutiny of taxation. The devolution of further financial powers necessitates a much greater focus on the scrutiny of the Scottish Government’s taxation policies. This year’s draft budget is the first time that the Scottish Parliament will decide the Scottish Rate of Income Tax (SRIT) as well as whether there should be any changes to the rates and bands for the
devolved taxes. The Finance Committee has focused its scrutiny on these areas while the subject committees continue to focus on the Scottish Government’s spending priorities.

4. To provide a structure for this approach the Committee has previously agreed to adopt the following four principles of financial scrutiny—

- Affordability – the wider picture of revenue and expenditure and whether they are appropriately balanced;

- Prioritisation – a coherent and justifiable division between sectors and programmes;

- Value for Money – the extent to which public bodies are spending their allocations well and achieving outcomes; and

- Budget Processes – integration between public service planning and performance and financial management.

5. The Committee has agreed to scrutinise affordability and budget processes. The Committee also wrote to subject committees on 16 January 2015 recommending that examining prioritisation and value for money should be an on-going aspect of budget scrutiny and wider financial scrutiny. This should include scrutiny of the extent to which public bodies are adopting a priority-based budgeting approach and whether they are spending their allocations well and achieving outcomes.

6. The Committee subsequently issued guidance to the subject committees on 2 April 2015 in which it recommended that they may wish to examine the contribution public bodies are making towards the national outcomes within the National Performance Framework (NPF). The Committee believes that consideration of the performance of public bodies in delivering outcomes should inform the scrutiny of future allocations. For example, how performance information has been used by public bodies to adjust spending priorities. The Committee welcomes the work which the subject committees have carried out in making this shift towards a more outcomes-based approach.

7. The Committee published four calls for evidence as part of its own budget scrutiny in relation to SRIT, Land and Buildings Transaction Tax (LBTT), the Scottish Futures Trust (SFT) and preventative spending. All written submissions are available on the Committee’s web pages.

8. The Committee visited Pitlochry on 18 January 2016 and held a workshop in the morning with local businesses and organisations on the likely impact of the draft budget on the local area. The Committee then heard from the Deputy First Minister (DFM) on his spending proposals in the afternoon having previously examined him on his revenue proposals at its meeting on 13 January 2016. This is the first year in which the Committee has had separate evidence sessions with the
DFM on revenue and expenditure and it worked well. The Committee will consider the need for any further changes to the budget process as part of its legacy paper.

9. Briefings were provided to the Committee by its adviser, Professor Gavin McEwen\(^3\) and by the FSU\(^4\). The Committee would like to thank all those who participated in its visit to Pitlochry and everyone who provided evidence as part of the budget process.

**AFFORDABILITY**

10. This aspect of financial scrutiny relates to the need for a balanced budget which means expenditure should be no greater than the revenue source. With the devolution of SRIT, the Scottish Parliament now has responsibility for raising around a fifth of the money which it spends. The other devolved taxes are LBTT, Scottish Landfill Tax (SLfT), Council Tax and non-domestic rates. Table 1 provides the estimated receipts for the devolved taxes for 2016-17.

<table>
<thead>
<tr>
<th>Tax</th>
<th>Forecast Revenue (2016-17) £m</th>
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<tr>
<td>SRIT</td>
<td>4,900</td>
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<tr>
<td>LBTT</td>
<td>538</td>
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<tr>
<td>SLfT</td>
<td>133</td>
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<tr>
<td>NDR Income</td>
<td>2,769</td>
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<tr>
<td>Council Tax</td>
<td>1,949</td>
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<td><strong>Total</strong></td>
<td><strong>10,289</strong></td>
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11. The Scottish Fiscal Commission (SFC) “believes the forecasts of devolved tax revenues and the economic determinants of NDRI for the 2016-17 Draft Budget are reasonable.”\(^5\)

**Scottish Rate of Income Tax**

12. The Scotland Act 2012 introduces a SRIT which will apply to the non-savings non-dividend (NSND) income of Scottish taxpayers from 6 April 2016. The UK Government will deduct 10p in the pound from the basic, higher and additional rates of income tax and the Scottish Parliament will then have the power to levy a Scottish rate that will apply equally across each tax band. The SRIT will be collected by HM Revenue and Customs (HMRC) on behalf of the Scottish Government.

13. The Scotland Bill 2015’s tax provisions are expected to supersede SRIT by granting the Scottish Parliament unrestricted powers to set the rates and bands of income tax payable on the NSND income of Scottish taxpayers. However, SRIT will not be a fully devolved tax and the command paper *Scotland in the United*
Kingdom: An Enduring Settlement states that “all other aspects of Income Tax will remain reserved to the UK Parliament.”

Rate

14. The Draft Budget states that the Scottish Government proposes to apply a 10p rate of SRIT meaning that Scottish taxpayers will continue to pay the same rate of income tax as those in the rest of the UK. The Scottish Government therefore expects the impact of the SRIT to be revenue neutral in 2016-17. The Draft Budget also suggests that “there are advantages” to allowing the work HMRC has been doing in relation to the identification of Scottish taxpayers “to bed in against a background of no change” to income tax rates.

15. The Office for Budget Responsibility (OBR) has produced forecasts for SRIT revenues (assuming a 10p rate) for 2013-14 to 2020-21 as set out in the following table.

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<td>4449</td>
<td>4648</td>
<td>4894</td>
<td>5208</td>
<td>5501</td>
<td>5793</td>
<td>6134</td>
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<tr>
<td>liabilities (pre-measures)</td>
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<td>New measures</td>
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<td>18</td>
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<td>9</td>
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<tr>
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<td>4649</td>
<td>4900</td>
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<td>5521</td>
<td>5802</td>
<td>6148</td>
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<tr>
<td>liabilities (post-measures)</td>
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16. HMRC has produced estimates of the impact of a 1p change to SRIT (positive or negative) on revenues over the next 3 years as set out in the following table —

17. The Committee received 26 responses to its call for evidence on SRIT. The Committee’s budget adviser has produced a briefing paper summarising these responses.

18. A number of individual respondents favoured a reduction in the rate on the basis that this would act as a stimulus to the wider economy and boost jobs and growth. NHS Health Scotland advocated an increased rate on the basis that higher taxation revenues could be used to reduce health inequalities—

“We know that the Scottish Government is working hard to mitigate some of the so-called welfare reforms that have come from Westminster. There is a strong case to do something soon and urgently to increase the Scottish rate of income
tax, while using the revenue to ensure that people on lower incomes are not penalised.”

19. The majority of responses from organisations, however, supported the maintenance of the 10p rate for 2016-17 citing factors such as complexity for employers, mobility of labour, the economy’s ongoing but incomplete recovery from recession and the “blunt” nature of the power. Professional bodies including the Institute of Chartered Accountants Scotland (ICAS), the Chartered Institute of Taxation (CIoT) and the Low Incomes Tax Reform Group (LITRG) expressed no view on the appropriate rate for SRIT but raised issues they felt should be considered in setting the rate. These included the administrative costs for employers and HMRC of having a different rate from the UK one and the impact of potential behavioural responses from taxpayers.

20. Both Lucy Hunter-Blackburn and Ben Thomson highlighted the interaction of SRIT with local taxation and perceived issues relating to the council tax freeze although they proposed different solutions. Ms Hunter-Blackburn suggested that a higher rate of SRIT could be used to provide additional funding for local services which are relied upon by the most vulnerable and to improve the student grant for poorer students. In her view the council tax freeze disproportionately benefits those with higher incomes and an increased rate of SRIT would go some way to redressing the balance. It would also restore the tax income lost since the implementation of the freeze in 2008.

21. Conversely, Ben Thomson proposed that increased revenues from a reformed council tax which placed a higher tax burden on owners of more expensive properties would help to empower local government and could be offset against a reduction in the rate of the SRIT.

22. In oral evidence Ms Hunter-Blackburn acknowledged the attraction of waiting for the implementation of the expected Smith Commission powers, stating “The argument that we should wait has validity, and if we were not living in these times I would consider the argument to be very sensible from a public administration point of view.”

23. However, given the current budgetary situation she was of the view that time was of the essence; “this is a question of urgency; I see the political debate about austerity and public service cuts as an urgent issue.”

24. However, the Scottish Trades Union Congress (STUC) view was that “having been through an historically unprecedented collapse in real wages over the past five years, 2016-17 is not the moment in which to increase taxes on the lower paid.” The STUC also suggested, however, that “the Scottish Government should accompany any decision to leave SRIT at 10p in 2016-17 with a comprehensive statement on tax policy in the future.”

24. Price Waterhouse Coopers (PwC) also urged caution, stating that—

“Keeping the status quo would probably be better while you are trying to embed a new tax regime in Scotland. Yes—you should see how you go in the first year
while you let the new regime embed. What you do with future powers post Smith will obviously need careful modelling, but you could perhaps do something differently then."\textsuperscript{15}

25. Both the STUC and NHS Health Scotland commented on the “bluntness” of the SRIT powers with the STUC stating “I wish that we were discussing the Smith commission powers now. If that were the case, our submission and recommendations for next year would look very different from the ones that we have expressed in our written submission.”\textsuperscript{16} However, NHS Health Scotland differed from the STUC in terms of using the SRIT powers now—

“Clearly, it would be much more interesting if we could describe a sharper tool that would allow us to vary the bands and be much more progressive. However, there is urgency on the issue.”\textsuperscript{17}

26. The DFM explained to the Committee that the “decision to set the rate at 10 per cent has been influenced by the limited nature of the income tax power that is currently available to the Scottish Parliament” and that “any increase would necessarily have inflicted an additional tax burden on lower income tax payers.”\textsuperscript{18} He stated that he “could not support that at a time when those people are already being adversely affected by the austerity programme” of the UK Government.\textsuperscript{19}

27. The Committee supports the Scottish Government’s proposal to set SRIT at 10p for 2016-17. However, the Committee also notes some of the innovative proposals from witnesses for tax changes and recommends the need for a wide ranging debate across Scotland on taxation policy once the new financial powers arising from the Smith Commission are introduced. The Committee will consider this as part of its legacy paper.

\begin{tcolorbox}
**Progressive Taxation**

28. The Scottish Government has stated its intention to apply a progressive taxation policy in line with Adam Smith’s four principles of taxation. This means that the average rate of tax should increase as a taxpayer’s income increases. However, the Committee heard conflicting evidence regarding the progressivity of SRIT. Ben Thomson, for example, stated that—

“it would be much more progressive if we were allowed to vary the bands. That will potentially happen later, once the effects of the Smith Commission come in. However, at this stage, the 10p rate is across all bands, so it is quite an inflexible tax. If we look at it as a percentage of how much tax increases, it will hit the people on lower taxes more as a percentage of the total tax that they pay than people on higher rates, although those on higher rates will pay more in absolute terms.”\textsuperscript{20}
\end{tcolorbox}
“In absolute terms, the people who pay more tax will pay a greater amount, but people at the lower end will pay a greater percentage.”

29. Lucy Hunter-Blackburn, however, disputed this position stating—

“It is absolutely right to say that, under the Scottish rate, as a percentage of the current tax, the extra penny will be more for those on lower incomes. However, that argument does not pick up the point that, at lower incomes, people pay much less of their income as tax full stop. It [the SRIT] increases the proportion of income that people pay as tax. If you put a penny on everyone’s income tax above roughly £10,000, people will pay a larger share of their income as tax, because they will pay more of their income as tax, generally. That is progressive.”

30. NHS Health Scotland stated—

“We need to be careful because, if we take money from across society with a blunt income tax tool such as the SRIT, there are risks that some groups will be disadvantaged, but we also need to discuss what that additional revenue would be used for. It could be used to mitigate loss of income to some lower-income groups.’’

31. Striking a similar tone, the STUC highlighted the view that outcomes were more important than a strict interpretation of “progressivity” stating—

“I do not think that the SRIT is progressive in and of itself, but that is not to say that the funds that could be raised through increasing it could not be used in progressive ways. Lucy Hunter Blackburn makes a reasonable case, but I cannot agree with her on the fundamental point of whether the SRIT is in and of itself progressive. It is clearly a regressive tax.”

**Behavioural Response - SRIT**

32. The Committee heard from a number of witnesses that a key consideration when determining the rate of SRIT or any tax should be the likely behavioural response of taxpayers to any changes in the tax rate. As Professor David Bell stated—

“Multiplying the average additional tax liability by the number of Scottish taxpayers gives an arithmetic estimate of the extra revenue but the outcome may be quite different, because that simple calculation does not take account of how taxpayers’ behaviour may change if tax rates change.”

33. This behavioural response is described by economists as the “elasticity of labour supply” and according to Professor Bell, could include people reducing their working hours, withdrawing from the labour market entirely, switching the way in which their income is accounted for (for example by taking income as profit rather than earnings) or migrating to take advantage of more favourable tax rates in
another jurisdiction. Witnesses agreed that the impact of any behavioural response could be expected to be most apparent in relation to high earners.

34. On that basis, Professor Bell explained that the Scottish Government “faces considerable revenue risk if that group alters its behaviour.” He therefore suggested that the Scottish Government should “proceed cautiously—ca cannie—when considering significant changes to the structure of income tax in Scotland.”

35. The Committee’s budget adviser produced a paper which reviewed some of the evidence for tax driven migration in other countries where sub-national governments have power to set income tax rates. Whilst he was clear that many factors aside from tax influence migration, examples from the US, Switzerland and Canada gave “good reason to expect that relative changes in rates of income tax between Scotland and the rest of the UK, provided the differences are expected to persist, will have an effect on the migration decisions of high-income individuals.”

36. Professor Bell also submitted a paper on behavioural responses to changes in income tax rates which noted that worldwide evidence tended to agree that higher income tax rates will lead to behaviours that have a negative effect on tax revenues such as reducing labour supply, tax avoidance and migration. Whilst Professor Bell considered that the applicability of the evidence to Scotland was “difficult to judge,” he highlighted the responses of high income earners who generate a disproportionate share of tax revenues as being “particularly important.” This is clearly illustrated by Figure 2 below.

**Figure 2: Lorentz curve for Scottish taxpayers 2010-11**

Source: Professor David Bell, Stirling Management School and Centre on Constitutional Change
37. Professor Bell explains that the highest 10 per cent of taxpayers pay more than 50 per cent of income tax revenues whilst the top 1 per cent contributes around 20%. He also estimated there to be around 11,000 additional rate taxpayers in Scotland. As such a large proportion of tax revenues is dependent on a relatively small number of taxpayers, Professor Bell noted that “how this group reacts to changes in tax rates will be very important for the health of the Scottish economy.”

38. PwC agreed with this view explaining that “individuals who are more mobile can move if the rate fluctuates, and that drives investment and the economy in Scotland to a certain extent. We are therefore saying that you should be mindful in what you do.” PwC went on to confirm that “it is clear from the clients with whom we engage—the higher-rate and additional-rate taxpayers—and from history that there is mobility in that section of the taxpaying population, so it is likely that some of them would move, depending on what you do with the rate.”

39. Similarly HMRC stated—

“Our experience with the wider tax system has been that those individuals who change their behaviour for tax reasons tend to be those who have most to gain, and they are the better off, so it is the levels of tax that apply to the wealthy that are most likely to result in a behavioural effect.

If I had to conjecture, I would say that, for the overwhelming majority of the population, the sort of differential in tax rates that is likely to come about—as suggested by past experience—will have an almost negligible effect. However, to the extent that there are significant differentials for the better off, that is where we would expect to see a change in behaviour, and we would probably be looking to ask compliance questions about that.”

40. Whilst the CIoT stated that, in its view- if the status quo is not maintained, taxpayer behaviour will need to be considered. Taxpayers might accelerate or defer income if they are in a position to do so, and they might base themselves either north or south of the border—whichever suits them—for the determination of whether they are Scottish taxpayers in the first instance. Those are the more complex cases in which it is not particularly straightforward to work out whether the person in question is a Scottish taxpayer, and such people are likely to be the most mobile in our employment sector.

41. However, the STUC disputed the extent to which changes to the SRIT might impact on labour mobility stating—

“Even under the SRIT, it is very difficult to envisage circumstances in which increases will materially affect labour mobility—I just do not really see it. There will be much more of a discussion on that when we assume full control over rates and thresholds. I would argue that we need a significantly higher top rate of tax and a lower threshold, and there should be a discussion about what that
might mean for labour mobility. However, I think that it is a false issue in relation to the SRIT. If we stuck 2p on the SRIT, I do not think that we would suddenly see a flow of executives from Scotland to the rest of the UK.”

42. The DFM told the Committee that his officials are carrying out some work on behavioural responses in advance of the new income tax powers being introduced. His view is that it is “important that, when Parliament makes its judgement on these questions, it is informed by the most advanced behavioural analysis that we can develop.”

43. The Committee recommends that it is essential that future decisions on taxation policy are fully informed by relevant behavioural analysis.

Implementation Costs

44. The Scottish Government will meet costs of implementing SRIT and the Committee has monitored preparations for its implementation since its announcement. To this end, the Committee took evidence from HMRC on 28 October. At the meeting, HMRC confirmed it was “on track to implement the Scottish rate on time and within—indeed, a little bit below—the original budget…the estimate of the costs of implementation remains a set-up cost of £30 million to £35 million against an original estimate of £40 million to £45 million.”

45. Audit Scotland confirmed this in a report published on 10 December 2015 which found that—

“The Scottish Government and HMRC are working well together in preparing for the introduction of the Scottish rate of income tax in April 2016. The estimated cost range of setting up the Scottish rate of income tax has decreased by £10 million, to between £30 million and £35 million.”

46. The DFM wrote to the Committee on 10 December to inform it that the Scottish Government had also agreed to meet one-off costs estimated at £1.8 million for the updating of Department for Work and Pensions (DWP) systems so they can recognise and process information relating to Scottish taxpayers.

Identification of Scottish Taxpayers

47. One area in which the Committee has taken a particular interest is the identification of Scottish taxpayers. In oral evidence, HMRC outlined its plans to ensure its starting database is as accurate as possible before stating that “about 98% of the taxpayers for whom HMRC holds Scottish addresses are correctly identified as likely to be Scottish taxpayers.” HMRC further explained that it was in the process of checking its data against other sources but accepted that “With very large data sets—we are talking about 2.5 million people—we are never going to be 100 per cent accurate. That is just the reality.”
48. As noted above HMRC went on to set out its intention to write to all identified Scottish taxpayers to inform them of their status. This would give taxpayers who felt they had been wrongly identified as such (eg people with a property in Scotland but who spent most of their time at an address in the rest of the UK) to contact HMRC to correct their status.

49. HMRC confirmed that taxpayers are not obliged to inform it of a change of address but explained that the PAYE system would pick up employees moving to Scotland from a different part of the UK in the same way that it currently does for employees who have moved to the UK from abroad. However, PwC stated in oral evidence that “There needs to be a sea change in taxpayer mentality with regard to whether people want to tell HMRC that they are Scottish taxpayers or that they have changed their address.”

50. HMRC’s intention was to write to all identified Scottish taxpayers to inform them of the new S tax code that reflected their status but this was delayed as a result of the late publication of the draft budget. However, the letters have now been issued.

51. When giving oral evidence in September, PwC stated that “the area is complex, and awareness across the population is relatively low. We engage with a number of employers from a range of industry sectors, and we find that awareness is very low.” In the same evidence session, the CIoT stated “We are starting from a very low base on publicity. We have not undertaken any surveys, but comments that we have received from members suggest that there is very low awareness of the introduction of the Scottish rate of income tax from next April.” ICAS, similarly suggested that “the SRIT seems to have got completely lost in all the noise about Smith.”

52. The DFM confirmed that HMRC has issued letters to around 2.5 million Scottish taxpayers and that the amount of communication it has had in response “has been significantly lower than would have been anticipated.”

53. The Committee asks the Scottish Government to confirm that it is content that sufficient work has been carried out by HMRC to ensure a high level of public awareness of SRIT when it is introduced on 6 April.

Tax Reliefs

54. A further issue on which questions were raised in evidence related to reliefs for taxpayers who make donations under the gift aid scheme or who make pension contributions. ICAS explained that—

“Relief is to be given at the Scottish rate of income tax, but the systems that are in place at the moment, and which will be in place from next April, only give
relief at the 20 per cent tax rate, so a taxpayer’s liability will have to be adjusted to give the correct relief overall. We do not know how smoothly that will go.”

55. Whilst PwC stated its understanding that HMRC—

“is looking at updating systems so that it can give the correct relief, but that might take two years. HMRC might accelerate that or give further consideration to it if the Scottish rate of income tax diverges significantly from the UK rate.”

56. The Committee asks the Scottish Government what discussions it has had with HMRC to ensure that reliefs for taxpayers who make donations under the gift aid scheme or who make pension contributions will continue to apply once SRIT is introduced.

Compliance

57. The Revenue Scotland and Tax Powers Act 2014 introduced a General Anti Avoidance Rule (GAAR) in respect of the devolved taxes. The GAAR is broader in scope than the UK General Anti Abuse Rule as its focus is on tax avoidance rather than abuse. However, as the SRIT will not be a fully devolved tax the Scottish GAAR will not apply to it.

58. When invited to expand on the compliance work it would undertake for those suspected of giving a wrong address, HMRC stated—

“It is quite easy to change one’s address, just as it is quite easy to fill in a tax return and put false figures on it. However, that is not a good thing to do, because our compliance work is quite effective. We resource according to risk.

We are not that worried about people giving false information, because the better-off are aware of the consequences. The concern is about ensuring that we have in our net everybody who ought to be there. People are more likely to be tripped up by a lack of awareness than a deliberate misstatement of their position.”

59. The DFM was asked by the Committee whether it is concerning that the Scottish GAAR would not apply to SRIT. He responded that “I would not say so” as “it is more difficult to avoid and to conjure up ways of getting around.”

Block Grant Adjustment - SRIT

60. An issue that is of paramount importance in respect of SRIT and the future devolution of further tax raising powers is that of the block grant adjustment, a subject that the Committee has scrutinised in detail over recent years. For SRIT there will be a transition period of 2-3 years in which the block grant adjustment will be calculated annually, based on the OBR’s forecast of tax receipts. These will not be reconciled with outturn receipts and the UK Government will bear the risk of
any deviation of outturn from forecast. Following the transition period, there will be a one-off deduction to the block grant. The intention is that the transition period will have provided real outturn data for Scottish tax receipts.

61. It was previously agreed between the Scottish and UK Governments that the Holtham indexation method would be used to adjust the block grant for SRIT in future years following the transition period. This means recalculating the block grant adjustment year-by-year by indexing it to movements in the NSND income tax base in the rest of the UK.

62. The Committee has considered this approach on a number of occasions and has consistently raised concerns about the impact of changes in the size of the population on the indexation of the block grant. The main concern is that the Scottish tax base may grow more slowly than that of the UK as a whole due to the relatively lower number of higher rate tax payers in Scotland compared to the rest of the UK and relative population growth. The relatively lower number of higher rate tax payers in Scotland compared to the rest of the UK largely explains why Scotland’s tax contribution to the UK is 7.3% which is less than its population share of 8.3%.

63. During the Committee’s inquiry on the fiscal framework the DFM was asked by the Committee whether the Holtham method should be applied to the Smith proposals for income tax devolution. He responded that we “think that is the most robust mechanism.” He was further questioned about the likely impact of relative population changes. He responded that “if we are growing our population and benefits are arising from that, we should see the fruits of that” and that “if we take on those risks, we have to have mechanisms in place that enable us to manage and deal with them as different outcomes materialise.”

64. However, in a response to a Parliamentary question on 9 December 2015 he stated—

“there have been a number of very substantial contributions to the debate from the Scottish Trades Union Congress, Professor Anton Muscatelli, Professor David Bell and the Institute for Fiscal Studies. I think that they have provided very good, dispassionate commentary on the issues that are at stake and on what I consider to be the crucial issue, which is the block grant adjustment for income tax. Mr Chisholm asked me whether I agreed with him that indexed deduction per capita is the best way to proceed with that, and I am very happy to confirm to Parliament that I do.”
65. The Committee has consistently raised concerns about the impact of relative population growth on the indexing of the block grant adjustment for income tax. The Committee, therefore, welcomes that the DFM now supports indexed deduction per capita and recommends that this approach is agreed in the fiscal framework.¹

Land and Buildings Transaction Tax

66. The Scottish Government proposes to maintain the rate and bands for LBTT at their current levels which are set out in the table below.

67. The Scottish Government also proposes levying an LBTT supplement on purchases of additional residential properties, such as buy-to-let properties and second homes. The supplement will be 3% of the total price of the property for all relevant transactions above £40,000.

Residential Transactions

68. The Draft Budget 2016-17 states that by maintaining the rates and bands for residential transactions this will—

   • Take over 10,000 additional house purchases out of tax compared to SDLT;
   • Reduce the tax charge relative to SDLT for over 36,000 house purchases at or below £330,000; and
   • Ensure that over 93% of house buyers are no worse off than under SDLT.⁴⁸

69. The Committee published a call for evidence in July 2015 asking for views on the operation of LBTT and whether there should be changes to the rates and bands in the forthcoming draft budget. 13 responses were received and the Committee’s Adviser provided a summary of the written evidence. ⁴⁹

¹ Lesley Brennan MSP and Gavin Brown MSP dissented from this sentence.
70. The Committee heard from some witnesses that the introduction of LBTT has had a negative effect on the higher end of the property market. Homes for Scotland stated in their written submission that—

“early indications are that the revised rates are having an adverse effect on the sale of properties in the middle to higher end of the residential new build market, where activity has diminished. This may particularly be the case for properties with a value above £500,000.”

71. They are not calling for an immediate change but suggest that the bands and rates should be kept under close review.

72. The Scottish Property Federation (SPF) state in their written submission that there has been a significant reduction in transactions above £400,000 and, in particular, transactions above £750,000 have reduced markedly. They told the Committee that there has been a 22.5% decline in sales of properties over £400,000 between May and September 2015 compared with the same period in 2014 and a 54% reduction in the sale of £1m plus properties.\(^{50}\) They propose increasing the 5% rate threshold to £500,000 and abolishing the 12% rate which “we believe is making little positive contribution to LBTT revenues.”

73. The Committee’s budget adviser states that the market data shows a significant reaction to the introduction of LBTT. In particular, the Your Move/Acadata house price index for August 2015 demonstrates a considerable impact at the very top of the market. This shows that between January and March 2015 there were 112 sales of homes worth £1m or more whereas in the following three months only ten such houses were sold.\(^ {51}\) Christine Campbell, Your Move’s managing director in Scotland, stated that LBTT “has slowed high value property sales considerably.”\(^ {52}\)

74. However, the more recent price index for October which was published by Your Move/Acadata in December shows that there were 30 sales of homes worth more than £1m between August and October compared with 14 in the previous 3 month period. Christine Campbell states that after “the introduction of the new levy in April, home sales in this price bracket ground to a halt, but they are now picking up again.”\(^ {53}\) Table 2 below provides details of the number of monthly sales of £1m plus houses between January and October 2015.

### Table 2

<table>
<thead>
<tr>
<th>Month (2015)</th>
<th>£1m plus sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>8</td>
</tr>
<tr>
<td>February</td>
<td>14</td>
</tr>
<tr>
<td>March</td>
<td>90</td>
</tr>
<tr>
<td>April</td>
<td>0</td>
</tr>
<tr>
<td>May</td>
<td>2</td>
</tr>
<tr>
<td>June</td>
<td>8</td>
</tr>
<tr>
<td>July</td>
<td>4</td>
</tr>
<tr>
<td>August</td>
<td>13</td>
</tr>
<tr>
<td>September</td>
<td>11</td>
</tr>
<tr>
<td>October</td>
<td>6</td>
</tr>
</tbody>
</table>
75. The Your Move/Acadata report states that “It would thus appear that the market is slowly edging back to include the same number of high value transactions as that experienced prior to the introduction of the LBTT.”

76. While LBTT may have slowed sales at the higher end of the market, Your Move/Acadata suggest that it has had a much more positive impact on the middle and lower tiers. In October, Christine Campbell stated that the tiers at this end of the market “have got a new lease of life under the new tax regime” and more recently in December that “property sales in Scotland for first-time buyers and home movers are increasing three times faster than the rest of the UK.”

77. The DFM was asked why he had not considered a change in the rates at the higher end of the market. He responded that given that the “forestalling effect is so tangible, it would be prudent to wait and see the completion of a full year, and perhaps to wait even longer.”

78. The Committee supports the Scottish Government’s proposal to maintain the current rates and bands for residential LBTT.

79. The Committee recommends that the Scottish Government conducts a review of the operation of the first year of LBTT once outturn figures are available for the full year and that this is made public.

Residential Revenue Forecasts

80. The Scottish Government has, for the first time, produced five year forecasts for the devolved taxes. The forecasts for residential LBTT are set out in Table 3 below.

Table 3

<table>
<thead>
<tr>
<th></th>
<th>2015-16 (£m)</th>
<th>2016-17 (£m)</th>
<th>2017-18 (£m)</th>
<th>2018-19 (£m)</th>
<th>2019-20 (£m)</th>
<th>2020-21 (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>245</td>
<td>295</td>
<td>355</td>
<td>415</td>
<td>480</td>
<td>545</td>
</tr>
</tbody>
</table>

81. The figure for 2015-16 is a revised forecast and is £10m higher than the forecast in last year’s draft budget. The SFC also point out that £188m out of the £300m increase between 2015-16 and 2020-21 is due to fiscal drag whereby rising house prices will push some transactions into higher bands. This assumes that the bands are not adjusted in line with house price inflation.

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2 Gavin Brown MSP dissented from this sentence.
82. There have been no significant changes to the forecasting methodology used by the Scottish Government for residential LBTT since last year's draft budget. The Scottish Government’s methodology paper states that the residential LBTT forecasts have “been calculated in the same manner as the forecasts underpinning the 2015-16 Scottish Budget.”

83. The SFC states that the overall progress “in developing the forecasting methodologies has been slower than the Commission has hoped” and that “in some instances the Commission has yet to be convinced that all possible avenues have been fully explored.”

84. For example, the SFC reiterates the concerns it raised in its report on Draft Budget 2015-16 that the Scottish Government’s forecasting methods for residential LBTT contain some deficiencies. In particular, there is a need to widen the economic determinants incorporated into the modelling of the housing market that underpins the forecast. The SFC states that it continues to encourage the Scottish Government to explore a multi-variate modelling approach.

85. The SFC also advises that the available outturn data for 2015-16 does not feed into the forecast. It is not clear why this is the case and the Scottish Government’s methodology paper does not address this issue. The OBR substantially revised down its forecast for residential LBTT in November 2015 on the basis of outturn receipts for the first 6 months of the new tax.

86. The Scottish Government has agreed with the Committee’s recommendation in its Stage 1 report on the SFC Bill that it should respond within 4 weeks to the recommendations of the SFC in its report on the Draft Budget. The Committee will consider this response when it is published.

87. The Committee asks why the available outturn data for 2015-16 adjusted for forestalling was not used in producing the residential LBTT forecasts for 2016-17.

88. The Committee was also told by the SFC in oral evidence that the forecasters used the last complete year of outturn data for the LBTT forecasts. The Committee asks why this does not appear to be mentioned in either the Scottish Government’s methodology paper or the SFC’s report.

89. The Committee recommends that in future draft budgets the Scottish Government should provide an updated draft forecast for the current financial year as well as future years and should provide an explanation for any changes to its forecasts year on year. So, revised forecasts for 2016-17 to 2020-21 should be included in Draft Budget 2017-18 including the reasons for any change to the forecasts.
Behavioural Response - LBTT

90. The SFC has also consistently raised concerns in relation to the lack of any analysis of the behavioural response to LBTT. One of the key issues which the Committee has considered is the extent to which behavioural factors in response to the introduction of LBTT are temporary or longer term. The temporary response is known as forestalling whereby homeowners shifted the timing of property transactions when the tax was introduced. A longer term response would include homeowners deciding to upgrade existing homes rather than moving home.

Forestalling

91. The Scottish Government estimates the loss of revenues for 2015-16 due to forestalling to be in the range of £12m to £37m “with the expectation that they would lie towards the bottom of this range.” The SFC advises that this “comes from examining the response observed in Scottish data to the stamp duty holiday analysed by Best and Kleven (2015).” Professor Leith explained to the Committee on 25 November 2015 that “we encouraged the Scottish Government to look into that paper” and that the range of £12m to £37m “capture[s] the range of estimates as to the magnitude of the behavioural effect and how long it lasts.” These estimates do not include any permanent behavioural effects but relate only to forestalling which is a temporary effect.

92. The SFC states that the available outturn data provides an opportunity to begin to evaluate to what extent forestalling has materialised. Table 4 provides the most up to date outturn figures relative to the forecast.

Table 4

<table>
<thead>
<tr>
<th></th>
<th>Expected Tax Revenues (%)</th>
<th>Expected Tax Revenues (£m)</th>
<th>Actual Liabilities (Accruals) (£m)</th>
<th>Difference (£m)</th>
<th>Cumulative Difference (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>April</td>
<td>7.5</td>
<td>17.6</td>
<td>7</td>
<td>-10.6</td>
<td>-10.6</td>
</tr>
<tr>
<td>May</td>
<td>8.1</td>
<td>19.1</td>
<td>11.4</td>
<td>-7.7</td>
<td>-18.3</td>
</tr>
<tr>
<td>June</td>
<td>9.3</td>
<td>21.9</td>
<td>18.5</td>
<td>-3.4</td>
<td>-21.7</td>
</tr>
<tr>
<td>July</td>
<td>10.3</td>
<td>24.1</td>
<td>19.4</td>
<td>-4.7</td>
<td>-26.4</td>
</tr>
<tr>
<td>August</td>
<td>9.2</td>
<td>21.5</td>
<td>21.4</td>
<td>-0.1</td>
<td>-26.6</td>
</tr>
<tr>
<td>September</td>
<td>9.1</td>
<td>22.5</td>
<td>18.7</td>
<td>-3.8</td>
<td>-30.3</td>
</tr>
<tr>
<td>October</td>
<td>8.4</td>
<td>21.3</td>
<td>20.0</td>
<td>-1.3</td>
<td>-31.6</td>
</tr>
<tr>
<td>November</td>
<td>9.8</td>
<td>19.8</td>
<td>20.9</td>
<td>1.1</td>
<td>-30.5</td>
</tr>
</tbody>
</table>

93. The SFC looked at the outturn figures for the period up to the end of October and concluded that either the—

- forestalling effects are larger and possibly more prolonged than anticipated;
- underlying forecast is over-predicting revenues received for the year to date; or
process of seasonal adjustment in attempting to allocate an annual forecast across individual months is not accurately capturing the monthly variable in revenues observed this year.62

94. Professor Leith told the Committee that the—

"outturn data is significantly below what one would expect, given the normal seasonality. That may be because of a temporary forestalling effect, or it may be that the change in the tax regime has permanently subdued parts of the market, so the trend will continue indefinitely."63

95. He went on to say that from the data, “the best guess is that there is a combination of a little bit of forestalling and perhaps a little bit of a longer-term effect.”64 He also stated that “it seems that there was substantial forestalling in those early months.”65 The SPF stated that “there will be an element of forestalling, but not to the extent of over £30 million.”66

96. The DFM told the Committee that he accepts that there has been forestalling and that the “shortfall in residential transactions is broadly comparable at this stage with the level of forestalling that was identified or suggested by the OBR.”67 The OBR’s latest forecast68 for the devolved taxes was published in November 2015 and it increased its forecast for forestalling from £20m to £30m.

97. The DFM was asked whether the Scottish Government would be compensated by HM Treasury for the revenue lost due to forestalling when LBTT was introduced. He responded that those “issues are tied up in the block grant adjustment discussions.”69

98. The Committee notes that it is clear that there has been an element of forestalling as a consequence of the introduction of residential LBTT in April 2015. The Committee recommends that in keeping with the principle of no detriment, it is essential that there is an adjustment to the block grant to account for the impact of forestalling. It is also essential that this is done transparently and both the total amount of the adjustment and the workings which underpin it are published.

Longer term

99. Both Homes for Scotland and the SPF raised concerns that the impact of the introduction of LBTT may be longer term. The former stated that on “the basis of the evidence that we have, I think that we will see the lower volume of activity at the middle and upper end of the market continue” and that “that there will be lower levels of activity in those parts of the market for the foreseeable future.”70 The SPF agreed stating that the “trend is not a blip and it reflects not an adjustment but a behavioural change as a result of the cost of moving.”71
100. The SFC stated that “there may be longer-term behavioural responses to the new tax which the current forecasting approach does not allow for.” The SFC’s view is that this could mean the forecast is too optimistic. Professor Leith told the Committee that in “our initial report, there are several instances in which we suggest that it would be best if the behavioural effects of policy could somehow be incorporated into the method of producing the forecast.”

101. The SFC recommended in its report on Draft Budget 2015-16 that behavioural factors should be included in the forecasting methodology as soon as practicable. They pointed out that there may be other environmental or behavioural factors which could have a bigger impact on outcomes than forestalling particularly in the medium term and these need to be considered as well.

102. However, despite these concerns the methodology still doesn’t account for any behavioural response. In its report on this year’s draft budget the SFC state that “we are increasingly concerned about the residential LBTT forecasts which still assume no behavioural responses.”

103. The Scottish Government states in its methodology paper that it “will continue to monitor the appropriateness of the methodology used for modelling LBTT revenues, including the potential to incorporate behavioural analysis into the forecasting approach.” The SFC was questioned by the Committee as to when the lack of any behavioural analysis might mean that the residential LBTT forecast becomes unreasonable. They responded that we “hope that the Scottish Government will tell us how it plans to respond to our recommendations” and we “hope to see changes in the next round.” When pressed as to when the SFC will get beyond hope, the SFC stated that it “is up to the Scottish Government to respond.”

104. However, this seems to be a different interpretation of the role of the SFC to what the DFM told the Committee. The DFM previously explained to the Committee that he would reach agreement with the Commission on the forecast methodology prior to the production of the official forecasts. He explained, we “get to that point of agreement on the methodology weeks before the budget, and then we introduce the numbers.” The SFC interrogates and challenges the model “to make sure well in advance that it is a robust model for generating the numbers that need to go into the budget.”

105. The DFM was asked at the Committee’s meeting on 2 December whether he intends to change the forecast methodology to include behavioural factors. He responded—

“That remains a work in progress. There will be developments in the model that are designed to reflect that, but our understanding of behavioural factors will, in itself, be a developing part of our thinking.”

106. When questioned again on the issue on 13 January 2016 he stated that he is “committed to further development work on behavioural responses.” When it was
put to him that the SFC’s position is that there is a need for greater urgency on the issue he responded that they “are quite right to tell us that we must do more and I accept that. We will do more.”

107. The Committee recommended in its Stage 1 report on the Scottish Fiscal Commission Bill that there needs to be much greater clarity regarding the role of the Commission and how it works in practice. This is again evident from the evidence we have received from the SFC on the Draft Budget. In particular, there is a need to clarify whether the SFC is asked to agree the forecasting methodology prior to the production of the official forecasts and what happens if it does not agree.

108. The Committee recommends that the Scottish Government needs to carry out an analysis of the initial behavioural response to LBTT once a full year of outturn data is available. In particular, there is a need to assess whether there is a longer-term behavioural response to the new tax at the higher end of the market.

109. The Committee also recommends that this work should help to inform whether there is a need to review the rates and bands for residential LBTT and should also inform future revenue forecasts.

Non-Residential Transactions

110. The Draft Budget states that maintaining the rates and bands for non-residential transactions “will ensure that Scotland remains a competitive and attractive location for business.”

111. The SPF pointed out that the increase from 4% to 4.5% for non-residential transactions is absorbed by the seller as the tax is deducted from the value of the asset. Their view is that this change has not “been material enough to lead to a wholesale change in activity” but that there is a need to guard against the fragility of the market. For example, transactional levels in Glasgow and Edinburgh are much lower than they would expect.

112. While the 4.5% rate seems to be working the SPF “would like there to be more transactional activity and more confidence in the market.” Their view is that “the rates in the intensely competitive commercial sector should either remain the same or be re-aligned to be the same as the UK SDLT top rate for the sector.”

113. As noted above the Committee recommends that there should be a review of the first year of LBTT and this should include the impact of the non-residential rates and bands on the commercial property market.
Non-Residential Revenue Forecasts

114. The methodology for forecasting non-residential revenues “has followed the approach which underpinned the 2015-16 forecast and uses the latest OBR growth rates from a base year based on a 3-year average to 2014-15.”

115. The forecasts for non-residential revenue for 2015-16 to 2020-21 are set out in Table 5 below.

Table 5

<table>
<thead>
<tr>
<th>Year</th>
<th>2015-16</th>
<th>2016-17</th>
<th>2017-18</th>
<th>2018-19</th>
<th>2020-21</th>
<th>2021-22</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-residential</td>
<td>£210m</td>
<td>£220m</td>
<td>£230m</td>
<td>£240m</td>
<td>£250m</td>
<td>£260m</td>
</tr>
</tbody>
</table>

116. The figure for 2015-16 is a revised forecast and is £64m higher than the forecast in last year’s draft budget. It is not clear why the forecast has changed by this amount. In contrast the OBR provides a breakdown of the basis for any changes when it publishes its bi-annual forecasts for the devolved taxes.

117. As with the residential forecasts the available outturn data for 2015-16 does not feed into the forecast. Again it is not clear why this is the case and the Scottish Government’s methodology paper does not address this issue. As with the residential forecasts the OBR substantially changed its forecast for non-residential LBTT in November 2015 on the basis of outturn receipts for the first 6 months of the new tax.

118. The SFC recommended that—

“there is a case for using the information contained in the part-year outturn data on non-residential LBTT revenues to improve the base from which non-residential LBTT revenues are projected forwards, particularly when outturn data for the majority of the year are released before the forecast is made.”

119. The Committee asks that the Scottish Government provides a breakdown of the reasons why the non-residential LBTT forecast for 2015-16 has increased from £146m in last year’s draft budget to £210m in this year’s draft budget.

120. The Committee also asks the Scottish Government why the part-year outturn figures were not used to inform the forecasts.

Lack of Data

121. The SFC stated in its report on Draft Budget 2015-16 in relation to non-residential LBTT that “because there is currently a lack of data to forecast this component of the Scottish economy directly, the primary recommendation is to develop new
data sources as a high priority.” Since then HMRC has begun to publish data on commercial property transaction data for Scotland.

122. The methodology paper suggests that the initial HMRC data published in October 2015 shows a reasonably strong relationship between the UK and Scottish data and, therefore, “there is no evidence to suggest that the use of UK level transactions determinants would introduce a systematic bias into Scottish forecasts.”

123. The SFC suggests that “this provides some comfort that the use of projections of UK transactions data is not inappropriate in forecasting” non-residential LBTT revenues. However, “the existence of this data set may also facilitate direct modelling of this variable for Scotland in the future.” The SFC reiterates its view that a new model for forecasting non-residential LBTT revenues “with some explanation of the economic drivers of the revenue variations, and better data, are needed in the longer term.”

124. The SFC was asked whether the existence of the new data means that the Scottish Government could now develop a Scottish model rather than rely on UK level transactions. They responded, yes, there “is a reasonable span of data, so it would be possible to start to do some fairly straightforward modelling work based on Scottish transactions instead of using UK transactions.”

125. The Committee recommends that the Scottish Government develops a Scottish model for non-residential LBTT rather than relying on the UK data.

**Scottish Landfill Tax (SLfT)**

126. The proposed rates for SLfT are £84.40 per tonne for the standard rate and £2.65 per tonne for the lower rate which ensure that the tax burden increases in line with inflation. As with the rates for 2015-16 these are the same rates as the planned UK landfill tax rates for 2016-17. This approach is intended to address the possibility of waste tourism.

127. The credit rate for the Scottish Communities Land Fund will remain at 5.6% compared to the UK credit rate which is 4.2%.

**Revenue Forecast**

128. The forecasts for SLfT are set out in Table 6 below.

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>£ million</td>
<td>117</td>
<td>133</td>
<td>123</td>
<td>114</td>
<td>104</td>
<td>94</td>
</tr>
</tbody>
</table>
129. These forecasts assume that the Scottish Government meets its target of reducing total waste reduction by 85% of its 2011 level by 2025 and that total disposals to landfill fall by 5% of total waste by 2025. The SFC state that it “has obviously been concerned that a target does not automatically imply a forecast and has therefore sought reassurance that this projection is a reasonable one.” They further state that “they have sought a quantitative evaluation of the impact of various environmental policies to assess whether or not these are capable of delivering the implied reduction in landfill volumes” and that they are “broadly satisfied that there are potential policies which could feasibly deliver the target which underpins the forecast.”

130. However, the Rural Affairs, Climate Change and Environment (RACCE) note that there has been a 1.9% increase in the amount of household waste generated for 2013-14 although the latest figure is 6% lower than 2011, the baseline year. They have raised concerns about a real terms reduction of 16.5% to the Zero Waste Scotland budget during the current parliamentary session and have asked what impact this reduction may have on the reducing household waste indicator in the NPF.

131. In contrast to the forecasting methodology for the LBTT forecasts the methodology for the SLfT forecasts has been revised on the basis of the first 6 months of outturn data. The SFC point out that unlike “the other forecasts where the part-year outturn data do not directly affect the forecast, in the case of the SLfT the outturn data are being used to refine the forecast in various ways.” It is unclear why the outturn data for 2015-16 has been used to refine the forecast for SLfT but not for LBTT.

132. The Committee asks to what extent the household waste indicator in the NPF is used to inform the forecast for SLfT and whether the 1.9% increase has been factored into the forecasts for 2016-17 to 2021-22.

133. The Committee asks why part-year outturn data was used to refine the forecast for SLfT but not for LBTT.

Block Grant Adjustment – Devolved Taxes

134. The UK and Scottish Governments have yet to agree a permanent block grant adjustment mechanism for the fully devolved taxes. A one year adjustment of £494m was agreed for 2015-16. This was based on the mid-point of the Scottish Government and the OBR forecasts for the devolved taxes.

135. Draft Budget 2016-17 states that discussions on a permanent adjustment mechanism are on-going as part of the negotiations on the fiscal framework. In the meantime a further one year agreement has been reached for 2016-17 of £600m. The Scottish Government forecasts tax revenues of £671m for LBTT and SLfT for 2016-17 while the OBR forecast is £627m. The mid-point of these two
forecasts is £644m. It is, therefore, unclear how the adjustment of £600m has been arrived at.

136. The Committee has previously raised concerns about the lack of transparency regarding adjustments to the block grant arising from the devolution of further powers. The Scottish Government consequently agreed the following changes to the Written Agreement—

“The Scottish Government will ensure that the Finance Committee is kept informed of progress on any agreement, or change to existing agreement, with the UK Government on adjustments to the block grant arising from the devolution of further powers. Wherever possible, the Scottish Government will consult with the Finance Committee prior to final agreement being reached, and where for any reason consultation is not possible, the Scottish Government will as soon as possible write to the Committee providing reasons for not consulting and setting out how the adjustments and any changes to them were calculated. The Scottish Government will aim to provide this information prior to the publication of the Draft Budget, to support budget scrutiny.”

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137. The DFM was asked by the Committee how the adjustment of £600m was arrived at. He responded that it “was arrived at through discussion between the Chief Secretary to the Treasury and me” and “I cannot present to the Committee a scientific analysis of how we got to £600 million, but a range of numbers were discussed.”

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138. The DFM also advised the Committee that the £600m adjustment is a provisional agreement and “can be reviewed once the financial year is complete.” He further explained that there is a potential for the £600m figure to be revised and that this will be informed by the outcome of the fiscal framework negotiations. Beyond 2016-17 the Scottish Government’s aim is to “have a fiscal framework that operates mechanically.”

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139. The Committee has consistently raised concerns about the lack of transparency in relation to the adjustments to the block grant arising from the devolution of further financial powers. The Committee believes that full transparency is an essential element in securing public confidence in the process. In particular in providing reassurance that the no detriment principle is being delivered.

140. The Committee, therefore, recommends that a detailed explanation is provided in the fiscal framework in relation to the adjustment to the block grant for the devolved taxes for both 2016-17 and beyond. This must include the workings used to arrive at the overall figures.
Revenue Scotland

141. Revenue Scotland (RS) have set up an LBTT forum to focus on practical and technical issues specific to the administration and operation of LBTT. In advance of the first meeting, the CIoT gathered the views of its members. The general view, both of the CIoT’s members and of participants in the forum, is that for day-to-day conveyancing the system is working well. The LBTT forms are generally simpler and quicker to complete than their Stamp Duty Land Tax (SDLT) equivalents. There is a requirement for additional returns in respect of leases which may prove burdensome for those occupying a large number of properties, however.

142. RS’s communication channels are primarily digital but there is provision for communication by telephone or letter. The CIoT considers this to be essential. There is an email enquiry facility for questions which are 'in principle' or are queries of a general nature. Currently, the responses to such enquiries refer to the relevant RS guidance. Both the CIoT and other members of the LBTT forum consider that the responses should be referenced to the LBTT legislation since alternative interpretations of the legislation may be possible.

143. There is also online provision for RS to provide opinions on certain situations and on specific transactions. RS reports that it has received a steady stream of such enquiries from taxpayers and agents. Currently, RS's target for answering these is 25 working days. Both the CIoT and other LBTT forum members would like greater resources put into this facility as a 25 working day turnaround is not business friendly.

144. The CIoT understands that the majority of queries relate to leases, transitional provisions, partnerships and Multiple Dwellings Relief and they recommend that the relevant guidance is reviewed to see if amendments to improve clarity in these areas are possible. Roadshows around Scotland are already a communication tool for RS and the CIoT would like to see this commendable initiative extended to further locations and supplemented by webinars to reach as wide an audience as possible.

145. RS provide guidance both on legislation and of a practical nature and the CIoT suggest that this could be improved by clearly indicating on the website when guidance has been updated or new material added and such updates should be made regularly in the light of experience. Areas where the current guidance is inadequate include lease variations and 'substantial performance'. With respect to SDLT, HMRC have indicated that 90% consideration or 90% possession constitutes 'substantial'. RS have suggested that, for LBTT, each taxpayer must look at the specific facts of each transaction to determine what is or is not substantial. But practically a clear 'rule of thumb' is required and the Institute understand that, following forum discussions, RS is now considering whether percentages can be issued as a guide.
146. With regard to collection, the CIoT understands that by the end of August approximately 48,000 returns had been submitted with tax outstanding beyond the deadline in only approximately 300 cases, less than 1%. The LBTT forum has suggested to RS that any breach of payment deadlines should be referred not only to the agent submitting the return but also to that firm's LBTT administrator. In most cases the agent will belong to a professional body and breaches of professional conduct will be taken seriously and escalated appropriately.

147. Homes for Scotland reported a member as highlighting a smooth changeover from SDLT to LBTT and that the online system works well. There is concern, however, over RS's reluctance to discuss complex or unclear LBTT issues on an informal basis and this is exacerbated by the slowness of response under the alternative formal opinion process. RS does not necessarily follow HMRC guidance, built up over a period of years, even where the statutory provisions concerned are effectively identical. This causes great uncertainty particularly in the absence of informal routes of enquiry.

148. ICAS have found RS professional, helpful and responsive to comments and feedback. Their use of multiple channels of communication is welcomed and their use of 'town hall' style meeting is helpful. Their website is well laid out and a good source of information. Feedback from members is that operational implementation has gone well and that LBTT returns are more straightforward than SDLT ones. Anecdotal evidence suggests that the working relationships and boundaries of LBTT legislation in the more complex commercial transaction have still to be tested and fully established.

149. The CIoT considers that RS's publication of specific areas where it will not provide an opinion, for example, on the possible application of the GAAR, is unhelpful and possibly inefficient. Accepting such enquiries will give early warning of tax planning gambits. The taxpayer should have the right to request an opinion in any circumstance and it will always be open to RS to disagree with a view expressed or to decline to give an opinion in the circumstances. In broad terms, RS's opinions have been helpful and bring together primary and secondary legislation and forms. However, in restating legislation the guidance does not help taxpayers and their advisers to understand how RS interprets the provisions in practice. A particular example is the treatment of leases. They also refer to an IFS discussion paper on the legal status of HMRC guidance which may be relevant to determining the status and certainty of RS's guidance.

150. PwC find the 'Guidance' and 'Forms' sections of the RS website easy to navigate and providing useful information. The portal for submitting LBTT returns is also easy to navigate and user friendly. On the other hand they report an example of a significant delay and difficulty in obtaining a conclusive response to request for an opinion. In this particular case, the relevant LBTT provisions mirrored the SDLT provisions, HMRC had provided a non-statutory clearance on the application of the SDLT provisions to the same structure and a copy of this clearance was given to RS. The reasons for the delay appeared to be a request for further information
in response to the original submission which already included all the information in RS's checklist. This was compounded by a lack of communication regarding the reason for the delay and no indication of when a response might be expected. PwC suggest that RS could improve communication and knowledge sharing with HMRC in regard to the non-statutory clearance process.

151. The SPF judge that RS is performing well in the collection of LBTT, with the shortfall against forecast in residential LBTT due to rate and threshold policy, not collection. However, some members have expressed concern at the weakness of guidance and administrative support. When attempting to determine the correct course of action for their client they find it difficult to obtain the necessary direction from RS. They feel inhibited in voicing criticism of performance because of their need to build an on-going relationship with RS. There is also a concern that RS are underestimating the level of recurring 'commercial lease events' and there is little evidence that they are preparing to educate taxpayers on their three yearly liability.

152. The Committee invites Revenue Scotland to respond to the above issues raised by witnesses.

Non-Domestic Rates Income

153. Table 7 presents the Non-Domestic Rates Income (NDRI) projections in each draft budget since 2012-13.

Table 7

<table>
<thead>
<tr>
<th>NDRI projections (£m)</th>
<th>2012-13</th>
<th>2013-14</th>
<th>2014-15</th>
<th>2015-16</th>
<th>2016-17</th>
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<tr>
<td>Draft Budget 2012-13</td>
<td>2,272</td>
<td>2,435</td>
<td>2,664</td>
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<td>Draft Budget 2013-14</td>
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<td>Draft Budget 2014-15</td>
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<td>2,883</td>
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<tr>
<td>Draft Budget 2015-16</td>
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<td>2,649.5</td>
<td>2,799.5</td>
<td></td>
<td></td>
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<tr>
<td>Draft Budget 2016-17</td>
<td></td>
<td></td>
<td>2,799.5</td>
<td>2,768.5</td>
<td></td>
</tr>
</tbody>
</table>

154. Despite an additional £60m from the increase in the large business supplement, NDRI is forecast to fall by £31m or 2.8% in real terms. The FSU advise that this “is a very different picture to the previous spending review period, when each year saw a year on year above real terms increase.” The DFM explained to the Committee that the projected reduction is due to two factors. First, inflation is much lower than “when we made our estimates of non-domestic rates,” Secondly, the “buoyancy estimate for 2014-15 was...1.55% but it actually translated to 0.82%, which has an effect on our estimates.”

155. The DFM stated in his ministerial statement on the Draft Budget that over the “last two years, the levels of inflation, coupled with below-inflation increases in poundage have generated lower” NDRI than anticipated. This contrasts with his
comments in the previous year’s ministerial statement on the Draft Budget when
he stated that between 2008 and 2014, the difference between the outturn figures
and the NDRI forecasts was £40m out of a total of £13.1 billion or 0.3%.

156. The Committee questioned why the forecast for NDRI is falling when there is an
increase in the large business supplement and a 0.8% increase in poundage and
annualised economic growth is expected to be around 2%. The DFM responded
that “he is exploring the very same questions” as the “non-domestic rates position
looks a bit out of kilter.”

157. The SFC is required to provide an assessment of the reasonableness of the
economic determinants underpinning the NDRI forecasts. It raised concerns in its
report on the 2015-16 Draft Budget that the forecast buoyancy rate of 1.55% was
on the optimistic side. The DFM, therefore, revised down the forecast buoyancy
rate to 1.25%. This resulted in a reduction in the NDRI forecast from £2,883m in
the previous draft budget to £2,799.5m. Despite this NDRI was still projected to
grow by 4% in real terms in 2015-16.

158. The DFM told the Committee that the forecast buoyancy rate for 2016-17 is 0.97%
and 1.25% for 2015-16. However, in its report on Draft Budget 2016-17 the SFC
does not make any comment on the buoyancy rate used by the Scottish
Government and it is not clear how the rate was calculated. There is no indication
as to what base year was used or what data was used for the long-run historical
average.

159. The SFC had previously raised concerns about the lack of historical data on
buoyancy and as a result the Scottish Government “developed two historical
series, one a direct measure of buoyancy, the other inferred from NDRI
receipts.” They explained to the Committee that this data appears to show a
cyclical pattern—

“In previous years, no adjustment was made to the cyclical pattern, because the
data span was not long enough for us to identify it. Now that we have found it to
exist, the Scottish Government has adjusted its buoyancy forecast- and
therefore the non-domestic rates income forecast – to account for it. Given
where we are in the revaluation cycle, one would expect the revenues to
reduce.”

160. However, this information is not included in the SFC’s report and it is not clear
what impact it has had on the buoyancy forecast or the NDRI forecast.

161. The SFC noted in its report on Draft Budget 2015-16 that the underlying average
growth in buoyancy is “adjusted upwards or downwards based on an assessment
of a number of macroeconomic and microeconomic leading indicators.” The
SFC explains in its report on this year’s draft budget that they “discouraged this
approach as no link between the macroeconomic variables and buoyancy had
been formally demonstrated to justify the magnitude of the adjustment.” They
subsequently told the Committee that the buoyancy forecast “does not take
account of economic growth” and that previously “we were adjusting it in an ad hoc fashion, based on broad-brush evidence on the state of the economy.”\(^{107}\) Again, it is not clear why this information was not included in the SFC’s report.

162. The Committee is concerned about the lack of transparency in how the NDRI forecast is calculated despite the role of the SFC. It is unclear why the DFM is “exploring the very same questions” as the Committee in relation to why the forecast is falling after the official forecast has been published. The Committee’s view is that these questions should have been addressed prior to the publication of the forecast and should have been assessed by the SFC.

163. The Committee recommends that the methodology paper produced by the Scottish Government for the devolved taxes should also include NDRI. This should include details of the change in buoyancy and how the forecast is calculated. The SFC should also provide an assessment of the buoyancy forecast and how it is calculated.

Large Business Supplement

164. It is proposed that the large business supplement is doubled from 1.3p to 2.6p. The Committee received a submission from ASDA which raised concerns about a “significant additional burden on business at a time when costs are under considerable pressure.”\(^{108}\) ASDA’s view is that this proposal undermines the Scottish Government’s ambition to make Scotland the best business environment in the UK.

165. The DFM was questioned about ASDA’s submission and stated that he understood these concerns and “do not in any way dismiss them.”\(^{109}\) He also pointed out that the Scottish Government has not committed to having the same business rates regime as in England and that there is a significantly more generous small business bonus scheme in Scotland. The Scottish Government has, however, committed to maintaining the uniform business rate which is maintained at 48.4p. The DFM was also questioned about whether a business and regulatory impact assessment had been carried out on the large business supplement. He responded that we “are in consultation on that.”\(^{110}\)

Borrowing

166. Table 8 below sets out the capital borrowing available to the Scottish Government under the powers within the Scotland Act 2012.

Table 8

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<tbody>
<tr>
<td>Capital borrowing limits (£m)</td>
<td>306</td>
<td>316</td>
<td>319</td>
<td>324</td>
<td>337</td>
</tr>
</tbody>
</table>
167. The Scottish Government has indicated that similar to 2015-16 it intends to use the borrowing powers available through the Scotland Act 2012.

168. The Scottish Government can borrow from the National Loans Fund (NLF), from banks on commercial terms or through issuing bonds. In last year’s draft budget the Scottish Government stated that it is “evaluating these options for borrowing and will in due course take a decision on which method or methods to use based on the prevailing economic conditions.” The Committee requested that it is provided with the details of the terms of the borrowing once agreed with HM Treasury. The DFM responded that details would be provided in due course.

169. The Written Agreement states that the draft budget should include details of any planned borrowing including the “amounts to be borrowed, and a commentary explaining the use of the powers.” The DFM also stated in a letter to the Convener dated 13 November 2013 that each draft budget would include an annual update on the costs of repayment and the Scottish cash reserve.

170. The DFM explained to the Committee that “in essence, the borrowing facility is there to fund our capital programme” and we “will borrow the amount of money that we require to support our plans between now and the end of the financial year.” He also confirmed that “we will borrow at the cheapest rate; whatever route we take will be the cheapest, in terms of repayments.”

171. The Committee asks that it is provided with details of the terms of the borrowing once agreed with HM Treasury.

Scottish Futures Trust

172. The Scottish Futures Trust (SFT) aim is ‘to improve the efficiency and effectiveness of infrastructure investment and use in Scotland by working collaboratively with public bodies and industry, leading to better value for money and improved public services’.

173. To inform its consideration of draft budget 2016-17, the Committee invited written evidence on how stakeholders felt the SFT was achieving this aim. A total of 45 responses were received. The Committee also took oral evidence from the SFT at its meeting on 18 January 2016.

174. The overwhelming majority of the written responses were positive and indicated a high regard for the work of SFT. Its staff are mentioned positively throughout the written responses and they appear highly regarded by stakeholders. Their helpfulness, expertise, and willingness to work with other sectors collaboratively was welcomed in the responses. In some responses suggestions were made on areas where it was felt SFT could make improvements and on the types of work that could benefit from its future involvement.
175. The Committee heard from the SFT that it valued its collaboration with the public and private sectors and was pleased that the responses had been so positive. Barry White, Chief Executive told the Committee that SFT was keen to take forward suggestions that had been made by stakeholders. Mr White highlighted it had already done so in one instance by holding discussions with Reiach and Hall to see where improvements could be made following the concern in their written submission that the while the current Non-Profit Distributing (NPD) process had led to improvements there was still a ‘huge amount of waste in the system’ around the time and effort invested by firms bidding in the process.

176. In respect of the SFT’s role in securing better value for money and improved public services the general view from stakeholders was that SFT play a positive role in encouraging collaboration and sharing examples of good practice. However, Angus Council expressed the view that, in relation to the Hub Companies Tier 1 contractors, added value could be derived if SFT placed a greater emphasis on ensuring awareness of the benefits of having a strategic public sector work stream.

177. When asked about this by the Committee the SFT concluded that it believes the strategic relationship is one that the public sector and private sector need to work together to secure. SFT believes the securing of that strategic relationship is a joint responsibility between all parties and that it would work with Angus Council and others on that basis.

178. The written evidence received by the Committee reflected the SFT’s positive role in developing the National Housing Trust (NHT) working with public and private sectors and lending institutions to deliver over 1,350 homes and support around 1,750 jobs in the construction industry. The Committee heard from SFT that the NHT agrees to purchase a set number of houses from a project on its completion. Having this pre-purchase agreement in place helps developers secure lending for the development as banks can lend in the knowledge that a certain amount of income will be available to the developer on completion of the project.

179. In oral evidence the Committee heard about the establishment of the LAR (Local Affordable Rent) Housing Trust. The LAR Trust, along with the NHT and the NHT Council Variant will secure the building of 3000 homes to the value of £365 million. SFT explained that it is not ‘wedded’ to one particular model but will use which ever approach provides the best value for money and the different models for housing demonstrated this.

180. The Committee questioned why SFT’s estimates for its capital investment programme in 2015-16 reduced from £954 million to £787 million. The Committee raised a concern that it appears that each year there is a reduction in the amount actually invested against what was estimated to be invested. SFT explained that the construction industry uses a ‘standard S-curve’ graph to set out its spending. At the financial close of the project this ‘assumed’ S-curve is replaced by an actual S-curve. The actual S-curve can vary from the original if the contractor has taken
a different approach, such as when and how much work is undertaken each winter or making competitive based decisions. As the money to be spent follows the progress of the project then the actual spend depends on how far the project has progressed.

181. The Committee welcomes the positive responses to its call for evidence on the SFT. In particular, there was an emphasis in the responses on the positive impact of the SFT’s collaborative approach. The SFT has also helped to improve the efficiency and effectiveness of infrastructure investment and use in Scotland leading to better value for money. The Committee also notes the areas that have been identified by witnesses where improvements could be made and recommends the Scottish Futures Trust gives consideration to these suggestions.

European System of Accounts 2010

182. With regard to the specific changes to the 2015-16 estimates the SFT explained that the main reason for the reduction was the impact of the European System of Accounts 2010 (ESA10) which has “had a very big impact.” This led to 12 hub design, build, and finance and maintenance projects being paused from the start of the year until they got clearance to move forward to financial close.

183. ESA10 is new European accounting guidance which came into effect in September 2014. The new guidance means that some projects that were formerly classified as private sector will now be classified as public sector. The FSU advises that projects that “are deemed to be public sector projects require upfront budget cover to be provided from the capital DEL budget over the construction period of the asset.” Consequently, the capital DEL budget includes £398m to allow for capital costs in 2016-17 in relation to a number of NPD projects.

184. £183m has been included in the motorways and trunk roads capital DEL budget for the Aberdeen Western Peripheral Route (AWPR) which the ONS has determined should be treated as a public sector project. £215m has been included in the health DEL capital budget for three health projects which are under construction. The ONS has yet to make a decision regarding whether these should be treated as public sector or private sector projects.

185. A dozen hub design projects were also delayed due to ESA10. However, the SFT explained in written evidence that “following a period of review, amendments have been agreed to hub contracts to align the hub structure with the new ESA10 rules. ONS has offered the view that the proposed hub structure would be classified to the private sector.” This means that the two community health and ten school hub projects which has been put on hold are now able to progress.

186. The Scottish Government’s view is that while classification to the public rather than the private sector “has no cash flow impact” the draft budget “makes
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provision for the construction costs of the AWPR and four other NPD projects which may attract the same classification.” The Infrastructure and Capital Investment (ICI) Committee state that “the need to provide up-front capital budget cover for the projects will have an opportunity cost for other capital programmes, which might mean that other projects may not be able to funded.” The SFT was asked by the Committee whether the classification of capital projects to the public sector would mean less funding being available for other capital projects and they confirmed that this is correct.

187. The SFT also informed the Committee that Eurostat are due to update the ESA10 guidelines but that they do not believe this will have a significant impact on the hub design projects but “until we see the final document, we cannot be certain.”

188. The Health and Sport (H&S) Committee has asked the Scottish Government “whether this upfront capital funding for a number of NPD projects has implications for the timing or affordability of other capital projects that had been planning to use traditional capital financing.” They have asked the Scottish Government to clarify how the £215m will be allocated if these NPD projects are classified as private.

189. The Committee is concerned about the potential impact of ESA10 on the DEL capital budget and notes that £398m has been allocated from this budget in 2016-17 to cover NPD projects. The Committee recommends the need for transparency on the impact of NPD projects being classified as public sector on the Scottish Government’s infrastructure investment plan. In particular, where this means other capital investment projects being delayed or postponed.

190. The Committee asks whether the impact of ESA10 has been considered as part of the discussions on borrowing in the negotiations on the fiscal framework.

Long-Term Investment Commitments

191. The Scottish Government has stated that it will limit future commitments arising from revenue funded methods of capital investment and borrowing to a maximum of 5% of its expected future total annual DEL budget. Annex A of the draft budget provides an update which shows that the annual revenue costs of committed projects plus planned projects and planned borrowing peak at just over 4.2% in 2020-21. This compares to last year’s draft budget which showed the annual revenue costs peaking at just over 4.5% in 2019-20.

192. The Committee recommended in its report on Draft Budget 2015-16 that the Scottish Government should provide the underlying data behind Figure 1 in Annex A of the draft budget document. The Scottish Government responded that subject to commercial sensitivity they are happy to provide further analysis. However, this does not appear to have been provided.
193. The Committee also recommended that the SFC should have a role in monitoring the Scottish Government’s long-term investment commitments. However, the Scottish Government’s view is that this would fall outside of the remit of the SFC but it is considering a broader role for the SFC in “assessing any wider prudential borrowing regime that might be applied in follow up to the Smith Commission proposals.”

194. The Committee notes that the policy memorandum for the SFC Bill states that independent fiscal institutions can “contribute to a country’s perceived fiscal transparency which in turn can affect a jurisdiction’s cost of borrowing through financial markets.” The SFC’s functions as set out in the Bill include assessing the reasonableness of Scottish Ministers’ projections as to their borrowing requirements.

195. The Committee has recommended that the Bill should be amended to widen the functions of the Commission to include assessing the performance of the Scottish Government against its fiscal rules and an assessment of the long-term sustainability of the public finances.

196. The Committee reiterates its view that the SFC should have a role in monitoring the Scottish Government’s long-term investment commitments which currently amount to over £1 billion annually.

197. The Committee asks that the Scottish Government provides the underlying data behind Figure 1 in Annex A of the Draft Budget as previously agreed.

PRIORITISATION

198. Prioritisation is defined as a coherent and justifiable division between sectors and programmes. The Committee’s former budget adviser suggested that part “of the role of parliamentary scrutiny is to test whether the pledges and commitments made by any government are then reflected in the choices it makes in the allocation of resource within its budget setting process.”

199. The Committee recommended in its report on last year’s draft budget that subject committees continue to focus on prioritisation as part of their budget scrutiny and that this includes the extent to which public bodies within their respective remits are adopting a priority-based budgeting approach.

200. A recurring theme for the H&S Committee is the “need for greater transparency in how the Scottish Government assesses the potential impact of spending before taking decisions on prioritising budgets.” For example, the Royal College of Nurses questioned the rationale for the £200m funding of 6 new elective treatment centres and how it fits with stated priorities. A former budget adviser to the H&S Committee emphasised the need for evidence based spending. He recommends
the use of health outcome measures to consider different scenarios for spending in health services. The H&S Committee have asked the Scottish Government for its view on this proposal and “would welcome greater transparency in respect of the evidence used to support spending decisions.”

201. The Education and Culture (E&C) Committee examined local authority spend on school education which builds on the work they carried out on last year’s draft budget on spending on primary and secondary schools. They found that in almost all Councils, education has a higher share of the total budget in 2015/16 compared to 2012/13 and in general, therefore, education spend appears to have been protected. However, they also found that “the education budget has had increasing demands placed upon it – particularly in terms of teacher employment costs.” The E&C Committee has asked Ministers what impact the protection of the education budget is having on other local authority services which support children.

202. The Economy, Energy and Tourism (EET) Committee has “sought further detail and clarity from the Scottish Government on how it arrives at spending decisions in alignment with its broader strategic priorities, particularly in the case of fuel poverty, but also for budgetary allocations pertaining to the fair work agenda.”

203. The Committee asks to what extent the Scottish Government is content that Scotland’s public bodies are adopting a priority-based budgeting approach and to provide some examples of where this is working well and some examples where it is not working as well as it could be.

Broadband

204. Broadband connectivity regularly emerges as a key issue on the Committee’s external visits and it again featured prominently in our external meeting this year which was in Pitlochry. One of the workshop groups spoke of the impact of poor connectivity in remote areas giving the example of a successful small business that had been forced to relocate from Glen Lyon to an area with better broadband. In addition to the economic impact of the move, the Committee heard of the wider effect on the sustainability of the community as the move had led to children leaving what was already a small local primary school. The Committee also heard of tensions between local groups trying to raise funds to install their own connections and what was seen as an inconsistent approach from BT in relation to where its priorities lay.

205. Even when broadband was available frustrations were expressed because consumers were being charged the full price for high speed connections when actual download speeds represented only a fraction of advertised ones. The Committee also heard of the difficulties faced by farmers when attempting to complete complex and lengthy online forms via an unreliable connection.
206. When invited to respond to these concerns, the DFM explained that £117 million had been set aside to fund the BT contract which was intended to enable at least 95% of properties in Scotland to access superfast broadband by the end of 2017. Around 85% of properties in Scotland were currently connected and the overall programme was “ahead of its milestones,” with around 7,000 properties per week being connected.

207. The DFM expressed confidence that the BT programme was “going well” but explained that his biggest priority was to ensure that the remaining 5% “get superfast broadband not at the programme’s tail-end but as early as possible.” £9 million was being made available to Community Broadband Scotland to support local solutions in areas not covered by the BT programme but—

“The key issue is getting notification from BT about where it is not going. If BT will not spill the beans about that, it is a bit of a waiting game. The minute that BT says, “We’re going there,” the community organisation cannot get the support… I am anxious to have clarity about where BT is not going, so that we can deploy the investment, the focus, and the energy to find out the solutions.”

208. The DFM went on to outline “vigorous” discussions between the Scottish Government and BT and pointed towards funding that had been provided to support community initiatives in rural and island communities which BT had confirmed would not be covered by its programme—

“Some imaginative solutions have been put in place by community collaboration. I want to ensure that we can get on with that, but it is not Government that makes the final determination, so we need good collaboration with BT to enable that to happen.”

209. The RACCE Committee has considered the availability of broadband in rural areas over the last several years and “regrets that communities across Scotland are still not being given adequate information regarding the provision and speed of broadband.” This, it believes, “may be hampering the work of Community Broadband Scotland.”

210. The Committee notes from its visit to Pitlochry and to other rural communities in previous years that broadband connectivity remains a significant issue. The Committee supports the commitment of the Scottish Government to delivering superfast broadband across Scotland and emphasises the need for BT to provide clarity in respect of the localities which will not be covered by its programme in order to ensure that alternative, community based solutions can be implemented without further delay.
Flood Prevention

211. Workshop participants in Pitlochry also spoke of their recent experiences with flooding. It was suggested that overly stringent regulations from SEPA prevented landowners from removing silt from riverbeds whilst the Forestry Commission was also thought to be doing less maintenance of ditches and burns. Both factors were seen as contributing towards flooding in the Highland Perthshire area and several participants spoke of the importance of learning from local experience and knowledge of preventative measures that had worked in the past. Frustrations were also expressed about SEPA’s requirement for costly, locally-commissioned expert reports before considering requests, where previously SEPA would have undertaken its own analysis.

212. When invited to respond to these concerns, the DFM explained that whilst he was unable to comment on specific examples without knowing all the details, SEPA had recently published 14 flood risk management strategies for a range of localities around the country. “It has done the research and has identified the communities and properties that might be at risk of flooding, and it has set out the measures and interventions that could be undertaken to address that.” In that respect, he was of the view that SEPA “has already done exactly” what was being asked of it and “if people think that other work should be undertaken, there is a course of engagement with SEPA that can be followed.”

213. On the subject of high levels of local knowledge and experience, particularly in respect of the silting up of rivers and the clearing of ditches and burns, the DFM stated “it is important that local knowledge on these questions is absorbed by organisations such as SEPA.” The DFM went on to speak of “many examples” of SEPA being approached to grant licences for the clearing of waterways stating that “well over 90 per cent of those applications are approved.” Therefore, in his view, “the idea that there is a prohibition on ditch clearing and the cleaning up of burns is not borne out by the evidence.” However, he confirmed that in some cases, SEPA’s expertise may lead it to recommend the a certain course of action such as retaining water “higher up in flood plains rather than presenting itself in volume in and around the city of Perth.”

214. With regard to SEPA’s budget reduction, the DFM stated that as with other public bodies, it was required to fulfil its statutory obligations and to operate efficiently and with fewer resources “in a time of challenging financial settlements.” However, he confirmed that the Scottish Government “has specifically protected the flood forecasting and flood awareness work that SEPA undertakes” which was funded separately from the SEPA budget. The DFM confirmed that the Forestry Commission was in a similar position to other public bodies in terms of budgetary reductions but went on to describe the importance of the replanting of harvested forests which “have been a very significant resource for capturing water.”

“That is why the woodland grants scheme is so important and why we have maintained those resources; we want to enable more of the hill ground to retain...
more water and to prevent that water from reaching the flood plains and estuaries more quickly, which is what would happen if these woodland activities did not take place.”

215. Draft Budget 2016-17 states that the Natural Assets and Flooding (NAF) budget remains unchanged at £9.1m although SEPA’s budget will reduce by around 6% from £39m to 36.6m. The Forestry Commission’s budget will reduce by over 4% from £64.1m to £61.3m whilst the Woodland Grants budget will be maintained at £36m. The RACCE Committee’s report notes these budgetary reductions (albeit some in real terms only) and sought clarity from the Scottish Government in terms of its flood prevention priorities and of the resources that would be available to address “wider issues” including the role of bodies such as SEPA and planning authorities along with the impact of climate change. The report also noted an overall real terms cut in the Forestry Commission’s budget over the last five years from £77.5m in 2010-11 to £60.3m in 2016-17. However, it did highlight steady real terms growth in the climate change budget from £12.7m in 2011-12 to £19.5m in 2016-17.

216. With regard to tree planting, the report noted the Scottish Government’s target of planting 100,000 hectares of new woodlands between 2012 and 2022, or 10,000 hectares a year. This target has not been met during the current Parliamentary session and the RACCE report stated that it “remains concerned” about the consistent failure to meet the target since 2012. The RACCE report went on to ask the Scottish Government “whether it will review the support given to the forestry sector which could enable the sector to play a larger role in providing public benefit.”

Housing

217. Housing was another issue which was raised during the workshops in Pitlochry. A number of similar issues to those raised in the Committee’s visit to Arran arose including the lack of affordable housing. A lack of land and severe planning restrictions were cited as some of the main challenges to housing supply in the local area.

218. The Draft Budget states that there has been “total investment in housing supply of around £690 million, with an increase in affordable housing supply compared with 2015-16.” The Scottish Government explains that this funding is “the first step in our commitment to provide 50,000 new affordable homes by 2020-21.”

219. The DFM was questioned by the Committee as to where the £90m additional funding for affordable housing is coming from given that the housing supply budget has been reduced from £584.2m to £583.1m. He responded that this is TMDF funding that is part of the local government settlement and totals £91m which “gets added on to that housing supply figure to demonstrate the increase for housing supply.”

220. Table 9 below provides details of the housing supply and the TMDF budget.
Table 9

<table>
<thead>
<tr>
<th></th>
<th>2015-16 £m</th>
<th>2016-17 £m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing Supply (from Table 9.03)</td>
<td>584.2</td>
<td>583.1</td>
</tr>
<tr>
<td>TMDF (from table 9.13)</td>
<td>104.5</td>
<td>96.5</td>
</tr>
<tr>
<td>Total</td>
<td>688.7</td>
<td>679.6</td>
</tr>
</tbody>
</table>

Source: FSU

221. It is not clear how this amounts to a £90m additional funding for affordable housing.

222. The DFM was also asked whether any budget lines will be reduced in 2016-17. He responded that on “a like for like comparison, there will be a reduction in the resources available for help to buy”\(^{129}\) and agreed to provide further details.

223. The ICI Committee welcomed the Scottish Government’s commitment to provide 50,000 new affordable homes by 2020-21. They also welcomed the Scottish Government’s programme of energy efficiency for existing houses but believe that this work should be accelerated.

224. The ICI Committee also reiterated its recommendation made in previous years that the Scottish Government should continue to fund measures to enhance the future sustainability of all new houses built in Scotland. They also recommended that the Scottish Government should fully investigate the appropriate level of funding for home energy efficiency improvements in the next Spending Review.

225. The Committee asks the Scottish Government to clarify how the additional £90m for affordable housing is being funded and to provide details on the reduction in resources available for help to buy.

Local Government

226. The Scottish Government guarantees the combined general resource grant (GRG) and distributable NDRI figure, approved by Parliament, to each local authority. If NDRI is lower than forecast, this is compensated for by an increase in GRG and vice versa. Therefore, to calculate Local Government’s revenue settlement, the combined GRC + NDRI figure is used. In the Draft Budget the combined GRG+NDRI falls by £507 million, or 5.2%, in real terms from 2015-16 to 2016-17 (the cash terms reduction in this figure is £349m or 3.6%).

227. The Scottish Government has regularly cited a figure of a 2% reduction in “councils’ budgets” during Parliamentary proceedings (see for example, First Minister’s Questions, 14 January 2016\(^{130}\)). The Scottish Government has
confirmed to SPICe that there are two parts to this method of calculating the reduction in the local government settlement.

228. First, the Scottish Government uses a figure of £320m for the cash reduction in the local government revenue budget. This is the £350m cash reduction in GRG+NDRI (rounded from £349.1m – see table 1 above) reduced by £30m. Following the introduction of the Children and Young People Act, £30m was added to the overall revenue figures in Local Government Finance Circular 7/2015. This, however, is not in the Draft Budget.

229. This £320m is then compared to local government’s “total estimated expenditure” in 2016-17, which the Scottish Government states will be £15,800 million, giving a figure of 2% (i.e. £320m as a percentage of £15,800m). In addition to government grant, this figure includes estimated income from the council tax and from fees and charges. The most recently available outturn figure for “total gross revenue expenditure” by local government \(^{131}\) (Scottish Government 2015b) is £15,300 million in 2013-14. It appears that the estimated figure of £15,800 million has been derived from this outturn figure. However, the Committee notes that “total estimated expenditure” for local government is not mentioned in the Draft Budget, and it is not clear how the figure of £15,800 million has been arrived at.

230. The DFM told the Committee that the £350m reduction “must be seen in the context of three important caveats.” These are—

> “the reduction in the local government budget is taking place against the backdrop of a high baseline; in previous years, we have faced difficult decisions of this type and local government has managed to accommodate them without the benefit of having that higher baseline; and we are providing practical assistance through the investment of £250 million in health and social care integration, which is designed to ameliorate some of the challenges.”

231. The DFM was asked whether given new legislation such as the Carers (Scotland) Bill local government was being asked to do more despite the reduction of £350m. He responded that “we have allocated more resources to local government over the years” and that when “Parliament requires local government to provide a particular service, additional resources are put in place.”\(^{132}\)

232. The Committee asks the Scottish Government to clarify how the “total estimated expenditure” for local government of £15,800m has been arrived at.

233. The Committee also asks the Scottish Government to clarify what additional resources have been allocated to local government for 2016-17 in relation to the additional services they will be required to provide resulting from recent legislation such as the Carers (Scotland) Bill.
Sustainable and Active Travel

234. The ICI Committee recommends a step-change in the level of funding for sustainable and active travel in the next Spending Review. One option would be to link this budget to a percentage of the overall transport budget. They also recommend that there should be different budget headings for sustainable travel and active travel.

Fuel Poverty/Energy Efficiency

235. The EET Committee notes that the final budget available for fuel poverty/energy efficiency is £119m for 2015-16 compared to funding of £103.3m for 2016-17 which is a 13% reduction. This means according to the EET Committee that it is now “abundantly clear” that the statutory target for ending fuel poverty “so far as reasonably practicable” by November 2016 will not be met. Energy Action Scotland’s view is that it will not be met by “some considerable way.”

236. The Committee supported calls from the EET Committee in its report on last year’s Draft Budget for a full cost analysis of what it will take to achieve the statutory target. The Scottish Government responded that:

“Modelling a full cost analysis of achieving the statutory target may be desirable but would also be very complex and would also depend on the scope of any new powers available to the Scottish Government as a result of the Smith Commission. Officials are currently exploring whether a full cost analysis is possible but, due to the complexity, such modelling could prove to be very expensive and of limited accuracy. I will report back to the committee on further plans on this front as they develop.”133

237. This has not been provided and the EET Committee has reiterated the need for such an analysis. The Committee agrees with this recommendation and asks the Scottish Government to explain why it has not been provided.

Police Reform

238. The Justice Committee has consistently highlighted the on-going challenges faced by Police Scotland and the Scottish Police Authority (SPA) in achieving the ambitious savings targets of police reform. They are, therefore, concerned that the SPA forecast a budget overspend of £25.3m for 2015-16. The Auditor General for Scotland (AGS) has also estimated that the PSA and Police Scotland could face a potential funding gap of around £85m by 2018-19.

239. Although spending on police reform was intended to end in 2015-16 the Scottish Government has now allocated a further £55m for 2016-17. This funding is intended to assist Police Scotland in taking forward the next phase of reform. The Justice Committee “welcome the Scottish Government’s recognition of the
pressures being faced by policing to achieve savings by making £55 million available for police reform in 2015-16.”

240. The SPA’s accounts show that £67.5m was spent on reform related activities in 2014-15. Audit Scotland explained to the Public Audit (PA) Committee that only £46.5m of that has been identified under specific headings. The other £21m has been spent but Audit Scotland state that “it is difficult to distinguish that expenditure from other expenditure during the year.”134 They went on to say that the “expenditure was aggregated with normal operational expenditure and not distinguished as specific spend associated with reform activity.”135 The AGS emphasised that “there should be transparency and we have not seen it for part of the budget this year.”136

241. The Justice Committee also raised concerns about the failure of the SPA and Police Scotland to develop a clear long-term financial strategy. The AGS stated in December 2015 that—

“Police Scotland is one of our largest and most important public bodies. I first reported on the need for a long-term financial strategy for the service in November 2013. What was once important has now become critical, given the scale of the challenges ahead.”

242. She went on to say that while some progress has been made it has been slow and that the SPA and Police Scotland must “collectively provide stronger leadership in strategic and operational financial management.” The AGS subsequently told the PA Committee that a “financial strategy is not a nice extra to have; it is something that is critical to ensuring that policing remains financially sustainable in the future.”137 A long-term financial strategy is expected to be published by March 2016 but the AGS explained that this deadline which the SPA has set for itself is challenging.

243. The Justice Committee has endorsed this view and has urged the Scottish Government to take a closer interest in ensuring that the new financial strategy being produced by the SPA “addresses long-term financial implications in line with the Auditor General’s recommendations.”

244. The Justice Committee also raised concerns that the AGS has again reported that incomplete records and poor financial management had delayed the audit of the SPA’s accounts and substantial corrections were needed before completion. The AGS told the PA Committee that—

“the audit was very challenging to complete due to the poor quality of the unaudited accounts and major problems with information contained within the fixed asset register. In our experience of auditing public sector accounts, that is exceptional.”138

245. When asked by the PA Committee how exceptional, the AGS responded that “it is extremely unusual” and it is exceptional to find such a case where the auditor “had
to suspend the audit, go away and allow the SPA time to correct the problems in its accounts before she could go back and do the audit work.”

246. The PA Committee has agreed to seek oral evidence from the Scottish Government, the Chief Constable of Police Scotland, the Chief Executive Officer of the Scottish Police Authority and the Board Chair of the Scottish Police Authority on the AGS’s Section 22 report.

247. The Justice Committee noted that the Cabinet Secretary for Justice has been “assured by the SPA that it is taking action to make sure that it has greater accuracy in its accountancy work.”

248. The Committee is concerned that £21m which was supposed to be spent on reform related activities in 2014-15 has been aggregated with normal operational expenditure. Despite this a further £55m has been allocated for police reform in 2016-17. The Committee asks the Scottish Government what assurances it has been given by the SPA and Police Scotland that this additional funding will be used for police reform and not for normal operational expenditure. The Committee believes that it is essential that there is complete transparency in relation to how this £55m and the funding allocated for 2015-16 is spent.

249. The Committee is also concerned about the failure of the SPA and Police Scotland to develop a long-term financial strategy and recommends that the Government needs to ensure that this is produced as a matter of urgency in line with the AGS’s recommendations.

250. The Committee also notes that there are a number of issues in relation to the audit of the SPA’s accounts and that the PA Committee is taking evidence on these issues.

VALUE FOR MONEY

251. Value for money is defined as the extent to which public bodies are spending their allocations well and achieving outcomes. Since 2007 the Scottish Government has adopted an outcomes-based approach to its objectives. A new emphasis was also placed on partnership working with public bodies which were now expected to work towards the shared objectives of government.

252. The Committee recommended in its guidance to subject committees that they may wish to “examine the contribution which public bodies are making towards the national outcomes within the NPF as set out in their respective corporate and business plans.”

253. The E&C Committee examined the outcomes delivered by 5 key public bodies within its remit including the contribution each makes to the NPF—
“We sought to consider their outputs related to their individual corporate plans and the objectives set for them with a view to using performance information against their priorities. Given the lack of performance information available this proved challenging.”

254. The 5 public bodies who between them are responsible for nearly £2 billion of public money are—

- Creative Scotland;
- Education Scotland;
- Scottish Funding Council;
- Scottish Qualifications Agency;
- Skills Development Scotland.

255. The E&C Committee sought to—

- understand the added value that each body provides;
- question the progress they are making on their key strategic objectives;
- understand how transparent they are in evaluating and reporting on the effectiveness of their work;
- question how they contribute to the Scottish Government’s National Performance Framework; and
- potentially consider whether, for example, their funding levels or key strategic objectives should be altered.

256. None of the bodies were able to provide the E&C Committee with any direct link between budgetary decisions and outcomes and most of the evidence received related to inputs and outputs. The E&C Committee have asked the Scottish Government to provide details of how Ministers “assess the extent to which the bodies are providing value for money, in what way outcomes are monitored and whether they consider benchmarking against other comparable bodies should be introduced.”

257. The H&S Committee has in recent years “highlighted the lack of any direct link between budget plans and intended outcomes, indicators and/or targets.” They recommend that the Scottish Government “take further steps to improve and present the connections between these various frameworks and the budget allocations.” The RACCE Committee “continues to believe that the Scottish Government needs to provide a more explicit, transparent and accessible link between the National Performance Framework and its budget documents.” The RACCE Committee also recommends that there needs to be a more direct link between the Equality Statement and the NPF.

258. The Committee has previously supported the view of Audit Scotland that “the Scottish Government needs to demonstrate a more systematic approach to implementing its outcomes by clarifying the links between longer-term outcomes,
its priorities and performance measures across all policy areas.”

The Scottish Government responded that “work is already underway to improve the strategic policy framework with clearer links made to the National Performance Framework in policy and priority setting documents.”

259. The Committee recommended in its report on Draft Budget 2015-16 that there is much more emphasis within the budget process and financial scrutiny more generally on examining the impact of spending on outcomes. The Committee, therefore, welcomes the inclusion of further information within the Scotland Performs update which seeks to show the link between some areas of spend and outcomes. Two narratives are provided for each of the 16 National Outcomes which include “information on the budget spent, key achievements as a result of spend and how this contributes towards the National Outcome.”

260. The European and External Relations (EER) Committee requested information from the Scottish Government on prioritisation and value for money in relation to the various budget headings within its remit. They noted that while there are difficulties in measuring and evaluating outcomes the Scottish Government has made significant progress in providing more transparent information on its international engagement activities.

261. The Committee welcomes the provision of additional information within the Scotland Performs update and believes that this is a useful resource for the parliament in improving the scrutiny of spending on outcomes.

262. The Committee would welcome an update from the Scottish Government on its work in improving the strategic policy framework so that there are clearer links to the NPF in policy and priority setting documents.

263. The Committee asks the Scottish Government what action it is taking to ensure that Scotland’s public bodies are spending their allocations well and achieving outcomes. In particular, in what ways does the Scottish Government examine the contribution which public bodies are making towards the national outcomes within the NPF.

264. The Committee welcomes the work which some of the subject committees have carried out in scrutinising the outcomes delivered by the public bodies within their respective remits and recommends that this should be done systematically as part of the budget process or wider financial scrutiny. In particular, Scotland’s public bodies must be held to account for the value for money which they are providing and be able to demonstrate how the spending decisions which they are making have an impact on outcomes.
National Indicators

265. The H&S Committee noted that of the 23 national indicators that are relevant to their remit, 8 currently show improved performance, 12 show performance being maintained and three show performance worsening. While they improved or sustained performance for most indicators they have also asked the Scottish Government to clarify what action they have taken to address the three indicators where performance is worsening.

266. The H&S Committee also examined three national indicators as part of its scrutiny of NHS Board budget plans for 2015-16—

- Increase the proportion of babies with a healthy birth weight;
- Reduce emergency admissions to hospital;
- Improve end of life care.

267. They found that two out of the three are blunt or crude indicators and do not have much influence on budgetary decisions. The healthy birth weight indicator was viewed as being blunt as it does not distinguish between high and low birth weight and the Scottish Government has agreed to include supplementary information which will address this issue. The end of life care indicator was viewed as being crude as it does not take account of the quality of care patients received in their last six months of life or patients preference for where their care is provided. The H&S Committee found little, if any, evidence that either of these indicators are having an impact on budgetary decisions.

268. In contrast, the emergency admissions indicator is having a direct influence on spending decisions. The H&S Committee found that this is because health boards are seeking to address worsening performance against this measure in most areas since 2008-9. They also found that there was much more variation in the performance of boards regarding this indicator than in relation to the other two indicators and that this may be influencing spending decisions.

269. The H&S Committee questioned whether selecting indicators where all health boards are performing relatively well will result in improved performance. Their view is that “greater impact may be achieved by in future choosing indicators where there is a wider variation in performance.”

270. The EER Committee considers that some of the indicators which are relevant to its remit “could be adapted to be more relevant.” In particular, comparing economic performance to other sub-states in the EU. They also questioned whether it is still valid to compare population growth with the EU15 over ten years after the major enlargement of the EU in 2004.

271. The RACCE Committee remains concerned that the indicators relating to the reduction of Scotland’s carbon footprint and improvement of the marine
environment continue to show that performance is worsening. They recommend that the Scottish Government should examine “how the budget can better support the policies which underpin these indicators.”

272. In particular, the RACCE Committee notes that the funding for a number of public bodies within its remit has been reduced during the current parliamentary session. They are particularly concerned about the funding for Marine Scotland which has been reduced in real terms by 21% and Scottish National Heritage which has been reduced by 21.6% as well as Zero Waste Scotland which is discussed above in relation to SLfT. They have asked the Scottish Government to “set out how it believes these bodies can continue to deliver all of their requirements and responsibilities in the face of significant reductions” and what impact these reductions are having on the relevant indicators in Scotland Performs. The marine environment indicator is of particular concern as it has shown a downward trend throughout the current parliamentary session. The RACCE Committee believes more needs to be done to reverse this trend and has asked the Scottish Government what actions, if any, are required to ensure progress.

BUDGET PROCESSES

273. This scrutiny test is concerned with examining the integration between public service planning and performance and financial management. The previous budget adviser suggested that one aspect of this area of scrutiny is the Scottish Government’s commitment to the transformation of the public services. The Scottish Government is committed to a reform agenda built on four pillars—

- Decisive shift towards prevention;
- Greater focus on ‘place’ to drive better partnership, collaboration and local delivery;
- Investing in people who deliver services;
- A more transparent public service culture which improves standards of performance.

274. The Committee agreed in its report on the 2011 Spending Review that it would monitor the Scottish Government’s progress in delivering the decisive shift towards prevention.

A Decisive Shift to Prevention

275. The Finance Committee agreed at the start of this session of the Parliament to monitor the progress being made in delivering the decisive shift to prevention. While there is some evidence of progress the Committee has been continually frustrated by the lack of evidence of any large scale shift towards prevention.
276. The Committee sought views from stakeholders on the progress being made in reforming Scotland’s public services and delivering the decisive shift towards prevention in a call for evidence in September 2015. A total of 43 responses were received. Professor Paul Cairney, University of Stirling has combined a summary of these submissions to the Committee’s inquiry with his research on prevention policy.

277. In oral evidence the DFM reiterated the Scottish Government’s commitment to—

> “continue to protect and reform public services to ensure that they remain sustainable in the future by delivering on the Christie commission approach of prevention and service integration at a local level.”

278. In its Report on Draft Budget 2015-16 the Committee highlighted several points in relation to the three Change Funds: the Early Years Change Fund, the Reshaping Care for Older People Change Fund / Integrated Care Fund and the Reducing Reoffending Change Fund.

279. The DFM was asked about the impact of these funds and he responded—

> “A lot of good learning emerged from the change funds. They have led to significant changes. The learning from the early years collaborative, which involves participants from all 32 community planning partnership areas, has led to huge change and development in the provision of services and approaches to meet the needs of our youngest citizens”.

280. The Committee has previously raised concerns in respect of the Early Years Change Fund specifically around the lack of disinvestment. In its response to the Committee’s Report on Draft Budget 2015-16 the Scottish Government indicated that the Community Planning Partnerships (CPPs) returns, would provide the Scottish Government with an indication of the priorities for CPPs and how resources are allocated at a local level. The information requested included examples of preventative spending and disinvestment in each CPP area.

281. This year’s Draft Budget 2016-17, highlights that 10 CPPs provided examples of disinvestment or savings made. One of the aims of the Early Years Change Fund was to shift the balance of public services towards early intervention and prevention by 2016 and the Committee questions whether this limited response and quality of examples provided demonstrates the required shift has taken place.

282. The written responses to the call for evidence highlighted that there are several barriers to the change towards prevention. These include a lack of a proper definition, difficulties in assessing outcomes, inconsistent political investment, lack of financial investment, lack of clear ownership and the capacity of the third sector to take forward work. The Health and Social Care Alliance believe that real progress won’t be made until there is shared ownership and partners feel they are collectively responsible for the outcomes.
283. In general the responses raised the concern that if a decisive shift to prevention does not take place then public bodies will be faced with addressing the growing need and demand for services against the backdrop of limited and possibly reducing resources.

284. The Committee has agreed to hold a short inquiry and take evidence from stakeholders during February 2016 and report to Parliament before the end of the current session. The report will also inform the Committee’s Legacy Paper.

**SCOTTISH PARLIAMENTARY CORPORATE BODY**

285. The Committee is required to consider the budget proposal from the Scottish Parliamentary Corporate Body (SPCB). The SPCB has a prior call on the Consolidated Fund, meaning that its budget is allocated before the Scottish Government makes any other allocations. The SPCB budget provides for the costs of the Parliament and also the costs of the Ombudsman and Commissioners which fall within the definition of SPCB supported bodies.

286. The SPCB budget was submitted to the Committee on 2 December 2015 and the Committee took oral evidence on the budget at its meeting on 9 December 2015.148

287. The SPCB has identified a total budget requirement, including capital charges and non-cash items, of £96.7m for 2016-17. This represents an increase in cash terms of £6.8m (7.6%) compared to the current year budget of £89.8m. The Presiding Officer has set out a background to the budget setting approach taken by the SPCB, stating that—

“Over the current parliamentary session, we have continued to hold down costs through a combination of the recurring savings arising from our earlier change management programme…and from on-going pay restraint, below the level of inflation for staff”.149

288. The Presiding Officer goes on to state—

“As 2016-17 is an election year, the budget is strongly focused on projects to set up the required facilities for Members at the start of the new Parliamentary Session. The project portfolio will be reviewed again ahead of the 2017-18 budgeting round.”

289. The SPCB’s budget proposal contains an increased contingency from £1m in 2015-16 to £4m in 2016-17. This is for one off costs associated with the 2016 election and a “prudent contingency for emergencies and emerging cost pressures
from additional powers that the Scottish Parliament will assume during the next session”. Liam McArthur confirmed that £0.5m of the contingency was budgeted for the anticipated costs of the additional powers which are likely to result from committee and chamber time along with additional pressure on the research resource.

290. The Committee welcomes clarification on the contingency provisions in respect of the additional powers and asks to be kept up to date as the devolution of the new powers progresses. The Committee recommends that once the extent of the new powers is known the SPCB ensures sufficient resource is allocated to enable effective scrutiny.

291. The revenue projects budget for 2016-17 shows a decrease of 23.1%, from £3.9m to £3m. This follows an increase of 62.5% from £2.4m to £3.9m in the 2015-16 budgets. The Committee recalled that when the increase of 62.5% was discussed in evidence last year, Liam McArthur stated “the indicative forecast for 2016-17 sees the figure fall from £3.9m back down to £2.2m.”

292. The Committee questioned why the figure in the 2016-17 budget proposals had only fallen to £3m and not the expected £2.2m. Liam McArthur responded that it had been assessed that the provision of new IT equipment and facilities management equipment to new and returning Members should be undertaken in the first year of the new parliamentary session. This was factored into the current budget proposal and had led to the increase.

293. From 6 May 2016, the Staff Cost Provision of the Members’ Expenses Scheme will increase from £62.3K in 2015-16 to £85K for 2016-1. The Committee sought clarification on the detail of the changes that had been agreed in relation to the Members’ Expenses Scheme and how it compared with similar provisions in Wales and Westminster. Liam McArthur confirmed that information from the other parliaments had been used to inform the discussion on uprating the Staff Cost Provision but cautioned against direct comparisons being made due to differences in how each parliament’s allowances schemes are structured.

294. The MSP pay budget for 2016-17 is calculated on the basis that MSP pay will be uprated on 1 April 2016 by the mechanism directly linking MSP salaries to public sector pay rises in Scotland (the Annual Survey of Hours and Earnings (ASHE) index). The ASHE index at November 2015 provides for a salary increase of 2.7%. ASHE was used for the first time for the 2015-16 salaries and replaced the previous link to MP salaries. The budget of £11.9m represents an increase of £420K (3.7%) on the 2015-16 budget.

295. The Committee has heard previously on the work that has been undertaken to reduce the amount of rates paid by the Parliament as part of the property costs
element of the budget. The current rates bill is £3.9m which accounts for half the total property costs.

296. The Committee welcomes confirmation from the Chief Executive that negotiations continue in respect of a further reduction to the rates bill and looks forward to hearing the outcome of these negotiations.

AUDIT SCOTLAND

297. Audit Scotland is required to prepare, for each financial year, proposals for its use of resources and expenditure. It is the responsibility of the Scottish Commission for Public Audit (SCPA) to examine these proposals and report on them to Parliament.

a. Audit Scotland submitted its budget proposal for 2016-17 and its associated fee strategy on 24 November 2015. The SCPA took evidence from Audit Scotland on 10 December 2015 and focused its scrutiny on the following areas—

- Audit Scotland’s work on revising its fee strategy;
- The volume and respective costs of audit work undertaken for the Accounts Commission and the Auditor General for Scotland; and
- The potential impact of the Smith Commission Agreement proposals on Audit Scotland and how prepared Audit Scotland is to deliver its responsibilities in relation to Revenue Scotland, HM Revenue and Customs (HMRC) and delivery of the Scottish Rate of Income Tax.

298. Audit Scotland’s budget proposal requests a total requirement of £6,582,000 for 2016-17. This total comprises a resource requirement of £6,382,000 and capital funding of £200,000. The resource requirement is an overall cash reduction of £56,000 (0.9%). While the capital funding is shown as having decreased by £1,330,000 (86.9%) this reflects the one off investment made in Audit Scotland’s new office premises during 2015-16.

299. The bulk of Audit Scotland’s income comes from the fees charged to local government, the NHS, Scottish Water, central government and further education for audit work. In 2016-17 Audit Scotland estimates an income from fees totalling £18,177,000. Audit Scotland states that it has frozen fees for the 2015-16 audits at 2014-15 levels and expresses this as a 1.6% reduction in real terms.

300. In its report on Audit Scotland’s budget 2015-16 the SCPA welcomed Audit Scotland’s review of its fee strategy. The SCPA expressed its concern and disappointment that the review of the fee strategy would not now be completed
until November 2016. The SPCA noted the revised timetable for completion of the review and has undertaken to seek an update from Audit Scotland on progress before the end of the Session.

301. The SCPA welcomed additional information from Audit Scotland on the breakdown of the volume and respective costs of audit work undertaken for the Accounts Commission and the Auditor General. This information will now be included in Audit Scotland’s future budget proposals.

302. The SCPA notes the work being carried out by Audit Scotland in preparation for its responsibilities in relation to the new financial powers which are to be devolved to the Scottish Parliament. It is concerned that no assessment has been made to ensure Audit Scotland’s governance framework remains fit for purpose.

303. The SCPA welcomes the work being undertaken by Audit Scotland to ensure its in-house teams continue to provide value for money and looks forward to receiving the final report when it becomes available.

304. The Committee notes the report from the Scottish Commission for Public Audit.

CONCLUSIONS

305. The Committee considered the issue of *affordability* and whether revenue and expenditure are appropriately balanced. The Committee supports the Scottish Government’s proposal to set SRIT at 10p for 2016-17. However, the Committee believes there is a need for a wide ranging debate across Scotland on taxation once the new financial powers arising from the Smith Commission are introduced. The Committee will consider this as part of its legacy paper.

306. The Committee has recommended that consideration of *prioritisation* should be an on-going aspect of budget scrutiny and wider financial scrutiny by the subject committees. The Committee asks to what extent the Scottish Government is content that Scotland’s public bodies are adopting a priority-based budgeting approach and to provide some examples of where this is working well and some examples where it is not working as well as it could be.

307. The Committee welcomes the work which some of the subject committees have carried out in scrutinising *value for money* and the outcomes delivered by the public bodies within their respective remits and recommends that this should be done systematically as part of the budget process or wider financial scrutiny. In particular, Scotland’s public bodies must be held to account for the value for money which they are providing and be able to demonstrate how the spending decisions which they are making have an impact on outcomes.
308. Finally, the Committee looked at **budget processes** and the integration between public service planning and performance and financial management. In particular, the Committee continued to examine the Scottish Government’s progress in delivering the decisive shift towards prevention. The Committee has agreed to hold a short inquiry on prevention and take evidence from stakeholders during February 2016 and report to Parliament before the end of the current session. The report will also inform the Committee’s Legacy Paper.
ANNEXES

ANNEXE A: INDEX OF ORAL EVIDENCE SESSIONS

23rd Meeting, 2015 (Session 4), Wednesday 23 September 2015
Ben Thomson; Lucy Hunter Blackburn; Hazel Gough, Scottish Technical Committee, Chartered Institute of Taxation; Charlotte Barbour, Director of Taxation, Institute of Chartered Accountants of Scotland; Gwyneth Scholefield, Director, PricewaterhouseCoopers.

24th Meeting, 2015 (Session 4), Wednesday 30 September 2015
Dr. Gerry McCartney, Head of Public Health Observatory, NHS Health Scotland; Stephen Boyd, Assistant Secretary, Scottish Trades Union Congress; Ruchir Shah, Policy Manager, Scottish Council for Voluntary Organisations.

26th Meeting, 2015 (Session 4), Wednesday 28 October 2015
Edward Troup, Second Permanent Secretary, and Sarah Walker, Deputy Director and Head of Devolution Team, HM Revenue and Customs.

27th Meeting, 2015 (Session 4), Wednesday 04 November 2015
Professor David Bell, University of Stirling.

29th Meeting, 2015 (Session 4), Wednesday 18 November 2015
Dr. Keith Nicholson, Chairman, Eleanor Emberson, Chief Executive, and Robert Buchan, Senior Principal Tax Specialist, Revenue Scotland.

30th Meeting, 2015 (Session 4), Wednesday 25 November 2015
Kennedy Foster, Policy Consultant, Council of Mortgage Lenders; Philip Hogg, Chief Executive, Homes for Scotland; Chris Stewart, Chairman, Scottish Property Federation; Lady Susan Rice C.B.E, Chair, Professor Andrew Hughes-Hallett, and Professor Campbell Leith, Scottish Fiscal Commission.

31st Meeting, 2015 (Session 4), Wednesday 02 December 2015
Professor David Bell, and David Eiser, Research Fellow, University of Stirling.

32nd Meeting, 2015 (Session 4), Wednesday 09 December 2015
Liam McArthur MSP, Scottish Parliamentary Corporate Body, Paul Grice, Clerk/Chief Executive, and Derek Croll, Head of Financial Resources, Scottish Parliament. Rain Newton-Smith, Director of Economics, CBI Scotland; David Watt, Executive Director, Institute of Directors Scotland; David Lonsdale, Director, Scottish Retail
Consortium; Susan Love, Policy Manager, Federation of Small Businesses.

1st Meeting, 2016 (Session 4), Wednesday 06 January 2016

Robert Chote, Chairman, Office for Budget Responsibility
Lady Susan Rice C.B.E, Chair, and Professor Campbell Leith, Scottish Fiscal
Commission

2nd Meeting, 2016 (Session 4), Wednesday 13 January

Paul Johnson, Director, Institute for Fiscal Studies
John Swinney, Cabinet Secretary for Finance, Constitution and Economy, Sean Neill,
Acting Deputy Director of Finance, and Graham Owenson, Head of Local Government
Finance and Local Taxation Unit, Scottish Government.

3rd Meeting, 2016 (Session 4), Monday 18 January

Barry White, Chief Executive, and Peter Reekie, Deputy Chief Executive and Director of
Investments, Scottish Futures Trust.
John Swinney, Cabinet Secretary for Finance, Constitution and Economy, Andrew
Watson, Deputy Director for Financial Strategy, Graham Owenson, Head of Local
Government Finance and Local Taxation Unit, and Scott Mackay, Finance Business
Partner, Scottish Government.

4th Meeting, 2016 (Session 4), Wednesday 27 January 2016

Record of decisions in private

Gavin Brown proposed that “the Committee recommend that the Scottish Government
should conduct a Business and Regulatory Impact Assessment in relation to the large
business supplement.”

The proposal was disagreed to by division. For: 1 (Gavin Brown); Against: 5 (Lesley
Brennan, Kenneth Gibson, John Mason, Mark McDonald, Jean Urquhart), Abstentions:
0.

ANNEXE B: INDEX OF WRITTEN EVIDENCE

The Scottish Rate of Income Tax

- Alexander Reid (20KB pdf)
- Andrew Watson (20KB pdf)
- Ben Thomson (28KB pdf)
- CBI Scotland (508KB pdf)
- Chartered Institute of Taxation (116KB pdf)
- Chartered Institute of Public Finance and Accountancy (108KB pdf)
- Federation of Small Businesses (232KB pdf)
- HM Revenue and Customs (36KB pdf)
- Institute of Chartered Accountants of Scotland (40KB pdf)
- Institute of Directors (340KB pdf)
Finance Committee
Report on Draft Budget 2016-17, 2nd Report, 2016 (Session 4)

- Johnston Carmichael (24KB pdf)
- Low Incomes Tax Reform Group (400KB pdf)
- Lucy Hunter Blackburn (244KB pdf)
- Mr and Mrs Sussames (84KB pdf)
- NHS Health Scotland (184KB pdf)
- PricewaterhouseCoopers (108KB pdf)
- Ranny Hall (60KB pdf)
- Reynold Galbraith (8KB pdf)
- Ron Kane (140KB pdf)
- Scottish Building Federation (684KB pdf)
- Scottish Council for Voluntary Organisations (132KB pdf)
- Scottish Government (736KB pdf)
- Scottish Retail Consortium (492KB pdf)
- STUC (88KB pdf)
- WA Johnston (156KB pdf)
- Youngs Sea Food (140KB pdf)

The Land and Buildings Transaction Tax

- Aberdeenshire Council (12KB pdf)
- Audit Scotland (64KB pdf)
- Chartered Institute of Taxation (127KB pdf)
- Council of Mortgage Lenders (120KB pdf)
- Highland Council (217KB pdf)
- Homes for Scotland (94KB pdf)
- Institute of Chartered Accountants of Scotland (136KB pdf)
- National Association of Estate Agents (217KB pdf)
- North Ayrshire Council (9KB pdf)
- PricewaterhouseCoopers (107KB pdf)
- Scottish Property Federation (349KB pdf)
- Scottish Water (156KB pdf)
- West Lothian Council (92KB pdf)

The Scottish Futures Trust

- Aberdeenshire Council (207KB pdf)
- Allianz Global Investors (325KB pdf)
- Angus Council (87KB pdf)
- Audit Scotland (321KB pdf)
- BAM Construction Ltd (209KB pdf)
- Burness Paull LLP (71KB pdf)
- CECA Scotland (221KB pdf)
- City of Glasgow College (697KB pdf)
- Dumfries and Galloway Council (178KB pdf)
- Equitix Limited (156KB pdf)
- FES Limited (227KB pdf)
- Fife Council (162KB pdf)
- Galliford Try Investments (690KB pdf)
• Glasgow City Council (504KB pdf)
• GVA James Barr (89KB pdf)
• Hadden Construction Limited (68KB pdf)
• Highland Housing Alliance (147KB pdf)
• Homes for Scotland (158KB pdf)
• Hub North Scotland (70KB pdf)
• Hub South East Scotland Ltd (322KB pdf)
• Jmarchitects (136KB pdf)
• Kier Construction (152KB pdf)
• NHS Ayrshire and Arran (78KB pdf)
• NHS Borders (265KB pdf)
• NHS Dumfries and Galloway (64KB pdf)
• NHS Lothian (85KB pdf)
• NHS National Services Scotland (79KB pdf)
• NHSGGC (176KB pdf)
• Norddeutsche Landesbank (147KB pdf)
• North Lanarkshire Council (193KB pdf)
• PPP Forum (106KB pdf)
• Rankinfraser Landscape Architecture (63KB pdf)
• Reiach and Hall (126KB pdf)
• Rettie and Co (139KB pdf)
• Robertson Group (211KB pdf)
• Ryderarchitecture (206KB pdf)
• Scottish Ambulance Service (64KB pdf)
• Scottish Contractors Group (353KB pdf)
• Scottish Council for Development and Industry (23KB pdf)
• Scottish Futures Trust (1.34MB pdf)
• Scottish Government (66KB pdf)
• South Lanarkshire Council (269KB pdf)
• Walters and Cohen Architects (125KB pdf)
• West Lothian Council (102KB pdf)
• WWF Scotland (404KB pdf)

Prevention

• Aberdeenshire Community Planning Partnership (95KB pdf)
• Angus Council (1.27MB pdf)
• Apex Scotland (40KB pdf)
• Argyll and Bute Community Planning Partnership (136KB pdf)
• Cancer Research UK (408KB pdf)
• Care and Repair Edinburgh (228KB pdf)
• Joint Submission: CCPS CJVSF HSEU (412KB pdf)
• Children 1st (124KB pdf)
• Children in Scotland (268KB pdf)
• Core Solutions Group (380KB pdf)
• Dundee Partnership (216KB pdf)
• East Ayrshire Community Planning Partnership (228KB pdf)
• Falkirk Council (96KB pdf)
• Glasgow City Council (164KB pdf)
• ICAS (180KB pdf)
• Improvement Service (128KB pdf)
• Lloyds TSB Foundation for Scotland (148KB pdf)
• Mental Health Foundation (132KB pdf)
• Mentor Scotland (320KB pdf)
• Midlothian (144KB pdf)
• NESTA (272KB pdf)
• NHS Ayrshire and Arran (160KB pdf)
• NHS Forth Valley (648KB pdf)
• NHS Lothian (152KB pdf)
• NHS National Services Scotland (105KB pdf)
• North Ayrshire Council (600KB pdf)
• Orkney Islands Council (104KB pdf)
• Police Scotland (180KB pdf)
• Princes Trust Scotland (284KB pdf)
• Royal College of Nursing (280KB pdf)
• Renfrewshire Council (796KB pdf)
• Robert Hunter (64KB pdf)
• Royal Pharmaceutical Society (320KB pdf)
• Scotland’s Community Justice Authorities (264KB pdf)
• SFHA (188KB pdf)
• Shetland Partnership (132KB pdf)
• South Lanarkshire Community Planning Partnership (128KB pdf)
• Stirling Council (88KB pdf)
• Strathclyde Partnership for Transport (196KB pdf)
• The ALLIANCE (240KB pdf)
• The Grow Trust (196KB pdf)
• The Robertson Trust (92KB pdf)
• West Lothian Council (184KB pdf)

ANNEXE C: REPORTS FROM OTHER COMMITTEES AND THE SCOTTISH COMMISSION FOR PUBLIC AUDIT

• Economy, Energy and Tourism Committee
• Education and Culture Committee
• European and External Relations Committee
• Health and Sport Committee
• Infrastructure and Capital Investment Committee
• Justice Committee
• Local Government and Regeneration Committee
- Rural Affairs, Climate Change and Environment Committee
- Scottish Commission for Public Audit
- Welfare Reform Committee

10. Finance Committee, 30 September 2015, OR Col. 8
11. Finance Committee, 23 September 2015, OR Col. 13
12. Finance Committee, 23 September 2015, OR Col. 13
13. Finance Committee, 30 September 2015, OR Col. 7
14. Finance Committee, 30 September 2015, OR Col. 5
15. Finance Committee, 23 September 2015, OR Col. 35
16. Finance Committee, 30 September 2015, OR Col. 7
17. Finance Committee, 30 September 2015, OR Col. 8
18. Finance Committee, 13 January 2016, OR Col. 30
19. Finance Committee, 13 January 2016, OR Col. 30
20. Finance Committee, 23 September 2015, OR Col. 2
21. Finance Committee, 23 September 2015, OR Col. 11
22. Finance Committee, 23 September 2015, OR Col. 6
23. Finance Committee, 30 September 2015, OR Col. 8
24. Finance Committee, 30 September 2015, OR Col. 21
25. Finance Committee, 4 November 2015, OR Col. 48
26. Finance Committee, 4 November 2015, OR Col. 48
30. Finance Committee, 23 September 2015, OR Col. 36
31. Finance Committee, 28 October 2015, OR Col. 31
32. Finance Committee, 30 September 2015, OR Col. 35
33. Finance Committee, 13 January 2016, OR Col. 33
34. Finance Committee, 28 October 2015, OR Col. 27
36. Finance Committee, 28 October 2015, OR Col. 30
37. Finance Committee, 23 September 2015, OR Col. 45
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88 http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Scottish_Property_Federation_LBTT.pdf
89 http://www.gov.scot/Publications/2015/12/7588 page 6
90 http://www.fiscal.scot/media/media_437935_en.pdf page 21
91 http://www.fiscal.scot/media/media_364407_en.pdf
92 http://www.fiscal.scot/media/media_437935_en.pdf
93 http://www.fiscal.scot/media/media_437935_en.pdf
94 Finance Committee, 6 January 2016, OR Col. 61.
95 http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Written_Agreement_-_Revised_April_2015.pdf
96 Finance Committee, 13 January 2016, OR Col. 35
97 Finance Committee, 13 January 2016, OR Col. 35
98 Finance committee, 13 January 2016, OR Col. 46
100 Finance Committee, 13 January 2016, OR Col. 52
101 Finance Committee, 13 January 2016, OR Col. 52
102 Finance Committee, 13 January 2016, OR Col. 57
103 http://www.fiscal.scot/media/media_437935_en.pdf
104 Finance Committee, 6 January 2016, OR Col. 50
105 http://www.fiscal.scot/media/media_437935_en.pdf
106 http://www.fiscal.scot/media/media_437935_en.pdf
107 Finance Committee, 6 January 2016, OR Col. 51
109 Finance Committee, 13 January 2016, OR Col. 49
112 Finance Committee, 18 January 2016, OR Col. 49
113 http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Cabinet_Secretary_for_Finance_Constitution_and_Economy_to_Convener_dated_3_February_2015(1).pdf
115 http://www.scottish.parliament.uk/S4_FinanceCommittee/Final_Budget_Adviser_Report_Scotland_WEBUPDATED.pdf
116 SCOTTISH GOVERNMENT DRAFT BUDGET 2016-17.pdf page 9
118 Finance Committee, 18 January 2016, OR Col. 21
119 OR, 18 Jan, Col 44
120 OR, 18 Jan 2016.
126 http://www.gov.scot/Publications/2015/02/3131/2
127 Finance Committee, 18 January 2016, OR Col. 51
128 http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Cabinet_Secretary_for_Finance_Constitution_and_Economy_to_Convener_dated_3_February_2015(1).pdf
132 Public Audit Committee, 13 January 2016, OR Col. 7
133 Public Audit committee, 13 January 2016, OR Col. 7
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