OFFICIAL REPORT
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Finance and Constitution Committee

Wednesday 10 May 2017

Session 5

The Scottish Parliament
Pàrlamaid na h-Alba

Wednesday 10 May 2017

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FINANCE AND CONSTITUTION COMMITTEE
14th Meeting 2017, Session 5

CONVENER

*Bruce Crawford (Stirling) (SNP)

DEPUTY CONVENER

*Adam Tomkins (Glasgow) (Con)

COMMITTEE MEMBERS

*Neil Bibby (West Scotland) (Lab)
*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)
*Ash Denham (Edinburgh Eastern) (SNP)
*Murdo Fraser (Mid Scotland and Fife) (Con)
*Patrick Harvie (Glasgow) (Green)
*James Kelly (Glasgow) (Lab)
*Liam Kerr (North East Scotland) (Con)
*Ivan McKee (Glasgow Provan) (SNP)
*Maree Todd (Highlands and Islands) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Aidan Grisewood (Scottish Government)
Derek Mackay (Cabinet Secretary for Finance and the Constitution)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament

Finance and Constitution Committee

Wednesday 10 May 2017

[The Convener opened the meeting at 10:00]

Scotland Acts 2012 and 2016 Implementation Reports

The Convener (Bruce Crawford): Good morning, and welcome to the 14th meeting in 2017 of the Finance and Constitution Committee. Item 1 on our agenda is evidence on the Scotland Acts 2012 and 2016 implementation reports. Derek Mackay, the Cabinet Secretary for Finance and the Constitution, is joined by Aidan Grisewood, who is the deputy director of the fiscal responsibility division of the Scottish Government. I welcome both of our witnesses to the meeting and remind colleagues to keep their phones in the appropriate mode.

Cabinet secretary, would you like to make an opening statement?

The Cabinet Secretary for Finance and the Constitution (Derek Mackay): Convener, because they are technical reports on the implementation of powers, I am happy to go immediately to questions for me and my official.

The Convener: As you say, most of the detail is technical. The fiscal framework that was agreed by the two Governments deliberately left some issues to be resolved over time. Those included the measurement of Scottish VAT, the classification of Scottish income tax payers and the establishment of a system to enable the appropriate devolution of the social security system to take place.

What do you see as the biggest challenges that are yet to be resolved? Are you happy with the progress that has been made? Do you foresee any difficulties or challenges that you should make the Government—sorry, the committee—aware of? I am sure that you have already made the Government aware of them.

Derek Mackay: We have already had debates on the budget issues—there has been determination on that subject—and there will be on-going debates around budget priorities, policies and commitments, as well as debates on powers that we might not have. Let us put those aside for now.

On the implementation of the acts, I have found that engagement is positive and constructive. There is generally a willingness among agencies and departments to resolve the technical issues around what has been agreed through the Smith commission, the fiscal framework and the relevant legislation.

There are challenges around the implementation of a social security system, given the huge task involved as a result of inheriting the existing systems of the United Kingdom Government. However, some elements of what is being devolved, such as air passenger duty—which will be air departure tax—might be more straightforward, and Revenue Scotland is engaging on them.

The big challenge is in the scale of some of the transfers—mainly those to do with social security. You referred to income tax, and there was an issue with the classification of all Scottish rate taxpayers. However, I am confident that that issue has been resolved and that there are processes in place to ensure that we identify all Scottish rate taxpayers. It is, of course, a matter for HM Revenue and Customs, but we want assurance that that is being delivered.

At the practical implementation level, the big challenge is to ensure a safe and secure transfer of social security powers so that we have a system that is fit for purpose and that people support. That is all being carefully planned out by the Cabinet Secretary for Communities, Social Security and Equalities.

At a political level, whenever there are issues, whether it is the transfer of resources or detailed methodology, officials are in constant dialogue. There are working groups, there are meetings of the joint exchequer committee with Treasury ministers and there is engagement with the Secretary of State for Scotland, as appropriate. There is also a specific committee to deal with engagement on social security.

My general approach is to be constructive and positive in the delivery of the implementation of the powers, but there are risks around the transfer of the powers, the scale of the transfer and understanding the bureaucracies and systems that are involved as we are designing our replacement systems. That is, of course, as well as the other challenges that we face around budgetary pressures. As the new powers come to the Scottish Parliament, we have to make sure that we have people who are in the right place to deliver them.

The Convener: Thank you for that opener, cabinet secretary. My colleagues will pick up on issues around social security, VAT, income tax, taxpayers and so on, but I want to deal with one of the smaller taxes in the basket of powers.

In the past few days, there has been a bit of speculation in the press about land and buildings transaction tax. I concede that I have not read beyond the headlines and I am not up to date on what it is really all about, so it would be useful to hear your perspective on LBTT.

Derek Mackay: My position is as it was the last time that we discussed this in the committee. The Government makes forecasts, which is not an exact science. There have been economic issues around the north-east, for example, so the overall number and value of transactions in Scotland might not have increased as earlier forecasts suggested.

We have had debates here and elsewhere about the levels of taxation. There is no evidence that the level of taxation is having an impact on the market. I have looked at the composition and structure of the tax take, which is operating in a way similar to how it operated before LBTT, although we feel that we have encouraged the first-time buyers' end of the market and so on.

The forecast and outturn figures are in the public domain. For both years that LBTT has been in place, our forecast compared to outturn for the financial years 2015-16 and 2016-17 is within £13 million of a difference, having raised £13 million less. That is a 1 per cent difference between our forecast and the actual outturn. Forecasts are adjusted based on the best information that we have at the time, and there is no doubt that there has been an impact on the economy, particularly in the north-east, because of the oil and gas downturn, which has affected overall forecasts.

We are not the only Government that says that LBTT can be quite volatile and difficult to forecast; the UK Government says the same. The Office for Budget Responsibility certainly says the same. Indeed, the OBR has said that the UK equivalent tax, the stamp duty land tax, is one of the

"more volatile sources of receipts ... In line with that, we have revised our SDLT forecasts proportionally more than for any other major tax".

Our forecast for the two years that LBTT has been in operation has been close, within 1 per cent of a difference. It is a volatile tax that is difficult to forecast. It is easier to count how much has already been received, as opposed to looking ahead, therefore we reflect on all the economic determinants to assess our forecast position.

Of course, the Scottish Fiscal Commission, in taking up the statutory function, will determine the models that it wants to use to forecast going forward, and we will rely on that.

I hope that that helps, convener.

The Convener: It helps to understand the Scottish position, but this is a relative exercise because the block grant adjustment depends on what is happening north and south of the border. What is the situation in the rest of the UK?

Derek Mackay: I have covered the years 2015-16 and 2016-17, the forecast for which taken together was £919 million and the actual outturn was £906 million—a difference of £13 million, or 1 per cent, between forecast and outturn.

The difference in SDLT for the remainder of the UK was £2.9 billion, which is a 22 per cent difference. That just makes the point that, as the OBR said, the tax is a more volatile source of receipts and that forecasts are just that—forecasts. When we compare the 1 per cent difference between our forecast and outturn with the UK Government's 22 per cent difference, or £2.9 billion, it shows that our forecasts were solid. I do not want to speculate that that means that we will always be within that range. We do not know whether that will be the case but, of course, we are reliant on the forecasts when setting out our budget position.

That is the difference between our forecast and the OBR's forecast.

The Convener: That sets the scene, cabinet secretary. I know that other members are interested in this area.

Murdo Fraser (Mid Scotland and Fife) (Con): I want to get clarity on the figures. Our adviser's note suggests that, for the year 2016-17, we are looking at LBTT liability of £494 million. For that year, the block grant adjustment figure for both LBTT and landfill tax is £600 million. That figure is exceeded if the £494 million figure and £114 million are added together. Do we know what is happening elsewhere in the United Kingdom for 2016-17? Is the block grant adjustment likely to be higher or lower than the £600 million cited?

Derek Mackay: Aidan will come in here.

Aidan Grisewood (Scottish Government): The agreed figure at the last budget was £600 million. Since then, when we get to outturns, the December 2016 budget had an updated figure of £641 million for LBTT and landfill tax together. In March 2017, we got the OBR figures and the end-result stats from HMRC on SDLT, but we have not got the block grant adjustment figure relating to that yet. We will get that figure, which is produced by the UK Government, in a few months' time. We will look at the figure and set it alongside what will be, at that point, a more final, definitive figure on our receipts, because of accruals and the like. At that point, the calculation can be made.

I suppose that there was, if you like—it depends on how you look at it—a deterioration of the block grant position at the December 2016 budget, because the sum was £646 million at that point. We now need to work through the numbers and wait to see what the UK Government's final estimate is.

Murdo Fraser: I want to make sure that I understand this correctly. The block grant adjustment will depend on the relative strength of the collection of stamp duty land tax elsewhere in the UK. Do you have a sense of how that looks now—or is it too early to say?

Aidan Grisewood: The only sense that we have of how it looks is that the final figures were slightly higher than the March budget forecast, by a few hundred million pounds. To be precise, the March budget forecast for SDLT was £11.413 billion and the final outturn was £11.73 billion. There are complications with the block grant adjustment methodology and it is for the UK Government to crank the handle on that and to confirm the figures, but I hope that that gives you an indication of the variation that we have seen over the past few months.

The Convener: Ivan, do you want to follow that up?

Ivan McKee (Glasgow Provan) (SNP): Yes, because I want to understand the figures. The £11.4 billion figure was the one that the UK Government referred to in the spring budget. Is that right?

Aidan Grisewood: Yes—the figures came from the OBR.

Ivan McKee: Ah—right. The red book has that figure as £11.6 billion. You reckon that the outturn is £11.73 billion. Given that order of magnitude, and if those numbers stand up, what difference would that make to the BGA?

Aidan Grisewood: You would have to do the sum. It is about £300 million over about £11 billion. You can get a sense of scale from that; it is well under—

Ivan McKee: It is about 2.5 per cent. Will there be a proportional impact on that figure of about £600 million?

Aidan Grisewood: Yes. We cannot be too definitive, because the final figures—

Ivan McKee: Sure, but it is that order of magnitude.

Aidan Grisewood: It is not a huge proportionate impact.

Ivan McKee: If it was of that order, it would be somewhere between £10 million and £20 million, give or take. Would the BGA be reduced by that amount?

Aidan Grisewood: That would increase the BGA, if all that flows through. However, as I say, it is too early to say what the scale will be.

Ivan McKee: Okay, but as you say, the outturn figure that you have for the block grant adjustment is about £640 million.

Aidan Grisewood: At the budget, the figure was £641 million for LBTT and landfill tax together.

Ivan McKee: Okay. That is fine.

The Convener: We will now go to Adam Tomkins, who will ask about social security issues.

10:15

Adam Tomkins (Glasgow) (Con): Good morning, cabinet secretary. I wish to ask you about the on-going project of social security devolution. I will start with a figure that the Minister for Social Security recently gave to Parliament in her statement on the new social security agency. She said that the estimated

"annual running costs will be around £150 million."—[*Official Report*, 27 April 2017; c 45.]

She was not able to say anything about where that figure came from, how it is composed or how it compares with the current annual costs of delivering social security in Scotland. Could you help us to understand that figure, its provenance and its various component parts a little bit more?

Derek Mackay: It is for that portfolio to explain the individual costs of the operation of the social security system. What I will negotiate with the UK Government is the transfer of resources, recognising that it will not cover every cost, although part of the fiscal framework agreement is on that transfer of resource, which, as you know, is happening incrementally over this parliamentary session. It is for my colleagues in the communities portfolio to go into further detail about the arrangements for the agency and its expenditure. My engagement concerns the implementation of the new powers to ensure that we have the transfer of resource and the necessary functions from the UK Government.

Adam Tomkins: So you cannot tell us anything about where that £150 million figure came from.

Derek Mackay: Those figures will be understood by the Minister for Social Security and the Cabinet Secretary for Communities, Social Security and Equalities. I do not have the detail right now on the operation of the agency. My prime function is to ensure that there is adequate transfer of resource and function from the UK Government.

Adam Tomkins: I have a couple of questions about that transfer of resource. I am trying to understand where exactly we are on the journey in our preparedness to take on responsibility for the delivery of devolved welfare and social security benefits in a couple of years' time.

Have Scottish claimants of the devolved benefits been identified by the Department for Work and Pensions? We know that there have been issues around the identification of Scottish taxpayers, and we now need to identify Scottish recipients of devolved benefits. Has that been done?

Derek Mackay: Again, I need to refer you to the cabinet secretary regarding that level of detail. That is not something that I specifically deal with.

Adam Tomkins: So you do not know whether any data on that has been shared with the Scottish Government.

Derek Mackay: I am sure that the cabinet secretary and the minister, Jeane Freeman, will be able to go into far more detail about the arrangements for benefits and payments than I could provide now.

Adam Tomkins: I thought that you said in your answer to my first question about the £150 million that it was your responsibility to ensure the smooth transfer of resources from the UK to the Scottish Government to prepare for social security devolution. My questions are about that process of transfer.

Derek Mackay: Yes, but the UK Government is not transferring the exact costs of administering the system. We have a deal around the transfer of resource, which has been negotiated through the joint exchequer committee. That is what I am undertaking: that political deal for the transfer of resources. The lead cabinet secretary and minister will deal with the arrangements for social security in Scotland and the delivery of the payments. I have engaged with the implementation of the powers. The resource that is transferring to us does not necessarily absolutely match the cost of delivering the new powers and service. That was a political deal.

Adam Tomkins: Is it your understanding that the cost of delivering the devolved powers will be greater than the present cost of delivering those welfare benefits?

Derek Mackay: Yes, that is very possible.

Adam Tomkins: Can you help us to understand the nature of the additional cost?

Derek Mackay: We will not know the full extent of that yet. We know that we will be transferring something like 15 per cent of social security spending, with 85 per cent remaining at Westminster, so we are taking part of the system and part of the payments into Scotland, creating those new systems and that bureaucracy so as to be able to deliver it. There will be on-going monitoring and analysis of what that will cost. We are setting out how we want to design the system and some of the principles around that.

The value of transfers is £2.8 billion, but it is too early at this point to state the exact cost of the new social security agency as it is delivered over the session.

Adam Tomkins: But delivering that £2.8 billion-worth of social security benefits will cost more after devolution than it costs at the moment, before devolution. Is that correct?

Derek Mackay: I am saying that, because we are taking parts of a system from the UK Government, it is quite possible that it will cost more than what we are spending at the moment, as we currently administer very few payments of that type. We anticipate the cost being more than what has been agreed in the fiscal framework, just for social security.

Adam Tomkins: Just to help me to understand this, if the mere fact of devolving the responsibility to deliver those benefits has an additional cost, how does the no-detriment principle apply to that? Is it a cost that will have to be borne by the Scottish Government?

Derek Mackay: Essentially, of course, we want to be as efficient as possible. No detriment applies because of the wider deal on the fiscal framework—there is no overall detriment to expenditure in Scotland in relation to how we use those powers. I was not party to the negotiation with the UK Government, but we could have continued that negotiation. However, we believed that we have a transfer of resources that is adequate for us to deliver those functions. That is what has been agreed with the UK Government.

Adam Tomkins: But the additional cost of delivering those social security benefits in a devolved setting, over and above the cost of the way in which they are delivered now, will have to be borne by the Scottish Government.

Derek Mackay: Yes. Essentially, it is a devolved function, so we are paying for it.

Adam Tomkins: I have one final question on this point. From where you sit, given your portfolio responsibilities, do you believe that we are on course for the transfer of operational responsibilities by April 2020?

Derek Mackay: I believe that all the necessary workstreams are under way and there is a commitment to deliver on the part of both Governments.

Adam Tomkins: I understand that there is a commitment to deliver, but are we on course to deliver?

Derek Mackay: In my view, I see no information that suggests that we are not.

Adam Tomkins: I will take that as a yes. The cabinet secretary nodded. [*Laughter*.]

Derek Mackay: I am trying to express my confidence in the engagements that we have that we are going to deliver the agreement over the course of this session of Parliament in the way that we have set out—yes.

James Kelly (Glasgow) (Lab): Following on from that question, I am interested in the time lines of the transfer, which is happening in two tranches. Can you talk us through the transfer process for tranche 1 and its key time lines in relation to discretionary housing payments, for example?

Derek Mackay: Again, the cabinet secretary would be able to go into more detail than I can on individual payments, powers and elements. I have engaged with the top-level agreement around the transfer of powers and resource. If you want further detail, I encourage you to invite Angela Constance or Jeane Freeman to go over the specifics.

James Kelly: Sorry, I was not trying to be awkward in any way. I thought that I was asking a reasonably straightforward question. The report that you have provided says that

"Tranche 1 ... was commenced on 14 July 2016",

and it then lists the sections that are covered by tranche 1. I am just looking for a more specific answer about what the process is for that transfer and what the timescales are.

Derek Mackay: Aidan Grisewood will come in with the detail.

Aidan Grisewood: Our responsibility for discretionary housing payments takes effect from April 2017—some of those bespoke discretionary payments are taking effect this year.

There is a range of benefits that the DWP currently administers that are more complicated to deliver. It would be for our social security colleagues to give more detail on them, but, essentially, it requires a much more complicated process of transition and work with the DWP to ensure that those are delivered successfully by 2021.

James Kelly: Going back to tranche 1, there are around 10 sections on the list. You said that discretionary housing payments came into effect in April 2017. Are you saying that the other sections have different time lines, or did they come into effect in April 2017 as well?

Aidan Grisewood: It is the powers that we are talking about. There are the discretionary payments through local authorities, so the housing payments will take effect from then, and then there are extra powers on top of that and over the same timescale.

James Kelly: To give another example, what about

"powers to create other new benefits"?

Has the legislative transfer been effected for that?

Aidan Grisewood: There would be new legislation to provide new benefits. The forthcoming social security bill will lay that out in more detail. A distinction is being made. Discretionary or new benefits do not suffer the consequences of the complexity of the DWP administering them at the moment and so there is a smooth transition process, which is why they were selected to go earlier.

James Kelly: Right. Taking discretionary housing payments as an example again, are the systems in place to allow that to go ahead?

Aidan Grisewood: My understanding is that that works through the local authorities anyway, so in a sense existing systems will be used for discretionary housing payments.

James Kelly: Just to be clear, are you saying that local authorities have the power now to make discretionary housing payments?

Aidan Grisewood: It is about who is responsible for that. It is about the authority being passed to the Scottish Parliament from the UK Parliament.

James Kelly: I am not trying to be awkward, but you said that local authorities had the power to make those discretionary housing payments. All I am trying to establish is whether they have the power to do that now, or is there still some work to be carried out to ensure that that happens?

Aidan Grisewood: No—they currently have the power and are making discretionary housing payments. It is more about the devolution of responsibility from the UK Government to the Scottish Government and, therefore, the funding around that being determined from the Scottish rather than the UK Parliament.

James Kelly: Is the funding in place for it?

Aidan Grisewood: Yes.

James Kelly: Moving on to tranche 2, for which the transfer of legislative and executive competence will be completed by April 2020, the report says:

"Thereafter, agency agreements would be put in place as necessary."

Does that mean that further work will be required after the executive competence has been transferred, in order to give effect to sections 22 and 23 of the Scotland Act 2016?

Aidan Grisewood: That is my understanding—that is correct. That completion provides enabling powers and then judgments will be made, working closely with the UK Government, as to when the specific tranche 2 benefits will transfer, making sure that there is a smooth transition and that the interests of benefit recipients are fully protected. There is enabling legislation to give the legislative competency to the Scottish Parliament for it to move quickly when it deems that it has reached that point.

James Kelly: Concern has been expressed that it is going to take four years, but would it be fair to say that it is actually going to be more than four years by the time that all the appropriate systems and processes, and the agency agreements, are in place?

Derek Mackay: You are going into levels of detail that, although entirely appropriate and fair, are really a matter for the communities portfolio if you want to probe that further. The detail around implementation is for the cabinet secretary or minister in that portfolio. I am happy to arrange that, convener, if you want more detail on that. A statement has been made to Parliament further outlining the role of the social security agency, and we have a range of commitments as to how we will use the new powers but, if you want more detail at that portfolio level, it can be given.

James Kelly: I am not going to ask any further questions, convener. I will just say that there are obviously concerns as to why it will take four years. I understand that it is complicated, but four years is an awfully long time and, from what has been said, it is actually going to take more than four years. That is a matter of concern.

Derek Mackay: I do not think that we are saying that. We obviously want a safe and secure transfer of powers from the UK Government to Scotland, to ensure that people get the payments that they are entitled to and that we have the flexibility to do things differently. There are arrangements in place and being formed as to how the social security agency will be delivered and there is engagement with local government. My point is that if, as it is entitled to, the committee wants more detail on what we are proposing on the agency and payments, it would be more appropriate to get that from Angela Constance and Jeane Freeman.

The Convener: Okay.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): I want to go back to the identification of Scottish taxpayers and the numbers that were involved. Although HMRC initially failed to identify approximately 420,000 Scottish taxpayers, you said in your opening remarks that you are confident that the matter has been resolved quickly. What does assurance look like? Is it simply about reporting? Is data shared between Governments? Do you have access to the data? Who verifies the data on an on-going basis so that we have accurate numbers?

10:30

Derek Mackay: It is fair to say that we are concerned by the issue of classification and identification. It is for HMRC to provide that service to us; it has gone through the data methodically and it is confident that it has identified all Scottish-rate taxpayers. My understanding is that there has been some independent third-party analysis to ensure that the arrangements are in place.

Other processes can be undertaken. For example, we encourage taxpayers to check their own tax codes. We are confident, from our engagement through officials, that HMRC has identified all Scottish-rate taxpayers. We will put in place a service-level agreement to ensure that the level of service is adequate, but we do not believe that there is a large-scale issue with the outstanding identification of any Scottish-rate taxpayers.

Aidan Grisewood: There is always movement in the tax base. There was a particular issue with regard to the 420,000 taxpayers, and HMRC acted to resolve that. It ran a short-term fix and then made a change to its information technology system to capture those taxpayers. It is about making reasonable efforts and asking how much data can reasonably be captured at any one point. At this point, we are very sure that HMRC is making reasonable efforts to capture the taxpayer data set.

The data set will always change over time; there is no ideal set out there for comparison, hence the point about making comparisons with third-party data sets. That is not necessarily because they are fuller than HMRC's data sets; it might be because a comparison can flag up anomalies or issues that HMRC can address.

There was a big issue with the 420,000 taxpayers, but there are smaller-scale issues such as missing addresses and some postcodes here and there not being captured. Each of those results in iteration after iteration in a continuous improvement process. We stay close to that process to seek assurance that the work is being undertaken, and we have regular review meetings with HMRC to understand the current position and the work that it is undertaking to improve the data set.

We also look at our offering. For example, we looked at the Scottish Government payroll to see whether we needed to flag up any issues for HMRC to address. HMRC has done the same with other large employers. Last year, it undertook some communications activity, and it is looking again at how communications campaigns around the individual personal tax account can fit in with that. HMRC is trying to promote personal accounts on the basis of efficiency. It is positive for taxpayers to be able to see their tax position, and rolling out personal accounts will improve efficiency because people who set up an account can update their address.

I emphasise that there is only so far that we can go on the data sets. Ultimately, people have to update their addresses, and there is a challenge with regard to ensuring that as many people as possible do so.

HMRC is also developing a compliance strategy, which should be completed fairly soon, on the back of the rates that were set in the budget. It concerns a range of measures that will be undertaken to ensure that people are not shifting and that there is no activity that would lead to tax avoidance. We have regular review meetings with HMRC, which has assured us that it is taking the matter very seriously and that there is a continuous improvement process in place. In addition, the National Audit Office and Audit Scotland have reviewed the processes, and they recently gave evidence to the Public Audit and Post-legislative Scrutiny Committee on progress.

Willie Coffey: Okay. We have two papers in front of us, one from you, cabinet secretary, and one from the now former Secretary of State for Scotland. Paragraph 41 of the cabinet secretary's paper says—[*Interruption*.] Sorry?

Adam Tomkins: He is still the secretary of state.

Derek Mackay: Just for clarity, ministers continue in post even if there is an election.

Ivan McKee: You are getting ahead of yourself, Willie.

The Convener: On you go, Willie.

Willie Coffey: That is very helpful, because I think that we should be asking Mr Mundell a couple of questions. Now please let me ask this question.

According to paragraph 41 of Derek Mackay's paper, HMRC has said that it has identified 2.6 million Scottish taxpayers, but paragraph 10 of the current secretary of state's report says that 2.45 million letters were issued and 420,000 were missed—a total of 2.85 million. The difference between the secretary of state's assessment of the number of taxpayers and what HMRC has told the cabinet secretary for his paper seems quite big to me.

Aidan Grisewood: We can come back with more detail on that if need be. There is the difference with regard to the 2.6 million, because that is HMRC's understanding of the number of taxpayers out there and is what originally flagged that 420,000 had been missed. There is also the question of the extent to which people who are flagged as being taxpayers ultimately pay tax, because of self-assessment, and that led to a further change in the numbers. I suspect that the figures have been interpreted differently and that that is what has caused the mismatch. We can certainly work with our UK Government counterparts to clarify that, if that would be helpful.

The Convener: Before we go on, I should thank Willie Coffey for asking that question. I do not think that it is good enough to have different interpretations of the number of taxpayers that we have—we need some assurance in Scotland about exactly how many taxpayers we will have. I had not spotted that in the reports, so I am glad that Willie raised it, and it is something that we might need to consider following up on. If we do not have a solid base to start with and if there is disagreement about what that base is, we will have an issue in Scotland about not knowing how many taxpayers we have. That is just not good enough.

Willie Coffey: That was going to be my next question, convener.

The Convener: Sorry, Willie.

Willie Coffey: What is the total number of Scottish taxpayers as we understand it and as the secretary of state might understand it? Perhaps the committee might consider inviting the secretary of state to come in and answer the same questions that we are asking our own cabinet secretary. What is the correct total? Initially, we were dealing with an anomaly of 420,000, but we now have two papers in front of us that still show a difference of 270,000. I think that we need to scrutinise that a bit more carefully.

Derek Mackay: To be fair, both Governments have the same source, which is HMRC. We pay HMRC to carry out a function; it delivers a service to us; and it identifies the taxpayers and follows through on compliance and collection. We will happily engage on the matter. I cannot answer for the UK Government, but there is no policy dispute here—we can certainly explore the point. As I have said, HMRC is the source for both Governments, and it might well just be a descriptor at a particular point in time.

As I said in answer to the earlier question, I am satisfied that HMRC has undertaken efforts to ensure that it has identified Scottish taxpayers and that those are the people from whom we are collecting tax. The earlier issue that was identified in 2015 has been addressed, but we will certainly take up the point about the difference in position. As for the secretary of state being here to answer for his report, that is a matter for him.

The Convener: Liam Kerr has some follow-up questions.

Liam Kerr (North East Scotland) (Con): My first question arises from Mr Coffey's questions. Mr Grisewood said that income tax relied on people notifying HMRC of a change of address, but the National Audit Office has said that there remains a risk of people not updating their addresses. As a result, we get the anomalies that have been identified. How is that being addressed, given that, as I understand it, no further spending commitment has been made on communications to people? Moreover, how do we ensure that there is no artificial manipulation if the tax rates diverge?

Aidan Grisewood: As you have said, a risk remains in this respect, and trying to encourage people across the piece to update their addresses is an on-going issue.

There was a communication campaign, but the focus is now shifting towards a more generic campaign on individual accounts with HMRC. That presents an opportunity, and HMRC is considering the extent to which that work can be intensified in Scotland in order to get a double benefit from encouraging people to have online accounts and, through that process, encouraging them to update their addresses. That is the communications strategy element of the work that is being carried out. In addition, HMRC's large business unit is working directly with employers to raise awareness of the need to update addresses. There is a link through to that, too.

As for your second question, HMRC is, on the back of this work, developing a compliance strategy for Scotland. However, I am not at liberty to say what is in it, because it has not been completed.

Derek Mackay: I will make one point that might help members' understanding. Because the tax position is based on residence, that is a major driver with regard to where people pay their tax. That is an important point: when HMRC focuses on compliance, it will look at issues of residence.

On Liam Kerr's point about flipping addresses, HMRC will clearly focus on that and look at the evidence on where someone lives most of the time. However, I do not want to go into any detail in that respect, because I do not want to describe ways in which people can avoid paying tax. Of course, you would not expect me to do that, but I will say that residence is the key issue here.

Aidan Grisewood: On HMRC's overall compliance strategy, the sums at stake and the tax differentials are far smaller here than the scale of the issues it normally faces with regard to the compliance of high-rate taxpayers and extremely wealthy individuals and the potential opportunities and incentives for them to avoid tax. As the scale of those numbers is huge and the incentives much bigger, HMRC inevitably tends to target resources on the high level of compliance instead of on small variations in tax rates.

Liam Kerr: Staying on the issue of income tax, I note that, for this year, HMRC's running costs for the Scottish rate of income tax are £1.5 million. I think that I am right in saying that it estimates that running costs will increase to about £5 million if the Scottish rate of income tax is different to that in the rest of the UK. Will you explain why that is? That would be a big jump.

Aidan Grisewood: That estimate is a maximum figure. It depends on the scale of the change, so it is a contingency figure.

Liam Kerr: That was going to be my next question. Is there a de minimis figure? How different does the Scottish rate have to be for an extra £3.5 million of costs to be incurred? Is the cost incremental?

Aidan Grisewood: It depends on the scale of the change. If there were wholesale change, with different bands and rates, that might mean implementation costs of a whole different order of magnitude. Furthermore, if those changes were to happen late in the day—say, just before the start of the financial year—that would incur greater cost, because of the intensity of the work that would need to be done. Extra work would have to be done simply to work through and update the systems that would not necessarily have had to be done for business-as-usual practices or for some small change. To be fair, I should say that a small change would have a very small cost.

Derek Mackay: HMRC essentially bases the cost on the policy difference and then returns to us with the figure.

Liam Kerr: Just for clarity, are you saying that, if there were a small divergence in the tax rate, a cost would be incurred and that that cost would, presumably, need to be budgeted for?

Aidan Grisewood: Yes.

Derek Mackay: Yes, we pay HMRC to carry out a function. It costs that work and returns to us with a figure.

The Convener: Every time the UK Government changes the tax, there is a cost. I do not think that there is any great surprise in that.

If that topic was difficult, VAT is, from what I am beginning to understand, even more challenging. Maree Todd will pick up on that issue.

Maree Todd (Highlands and Islands) (SNP): I wish to ask about the methodology involved in calculating the VAT assignment, now that it is going to be such an important part of our budget. I understand that, in the past, with the "Government

Expenditure and Revenue Scotland" figures, having an estimate was sufficiently robust, but now we need something a bit more accurate and robust, given that it will be such an important part of our spend.

10:45

Derek Mackay: As members will know, the agreement relates not to actual spend or receipts in Scotland but simply to that assessment—an estimate that leads to the assignment of a proportion of VAT. We are still working on the methodology of how that will be applied for 2019-20, but perhaps Aidan Grisewood can say where that work has got to.

Aidan Grisewood: Our analysts and HMRC analysts are carrying out quite a bit of intensive work on developing that methodology by drawing on and enhancing existing work on a regional model of VAT. As part of that, we have used data from expenditure surveys to get an assessment of expenditure in Scotland by different categories of goods, from which we have been able to derive an overall estimate of assigned revenues through VAT.

That work has been boosted by a UK-wide survey, which has been paid for specifically for Scotland in order to get a better sample size. That will help to reduce the number's volatility, which is something that we need to do and which is partly a consequence of using a survey rather than actual data.

A lot of complex work is being carried out on particular sectors where there are issues such as reliefs to consider. The financial services sector, in particular, has complicated VAT arrangements, and bespoke work is going on to consider all that, too.

Maree Todd: One of the concerns that we have had in the past is that using and extrapolating from household surveys might not capture the increased spend that comes from tourism, which is a significantly greater contributor to the economy up here in Scotland than it is in the rest of the UK. There are a lot of policy aims for increasing tourism. If, for example, we reduced air departure tax, we would expect an increase in the number of tourists; we would expect those people to spend more money in our shops; and that would lead to an increased VAT take. Are we going to capture all that in the new methodology?

Aidan Grisewood: Yes. My understanding is that a specific, bespoke piece of work is being carried out on expenditure by tourists, which will be used as a bolt-on to overall expenditure. As you have said, that aspect is not captured in household surveys, and this is exactly the sort of additional work that is being done to cover some of the potential holes in the existing approach. Given the timescales, we have more time to spend on VAT, but getting that comprehensive survey is quite a big task.

The transition period is built into the fiscal framework. Everything does not necessarily go live on day 1; there is an opportunity to have a transition period during which VAT revenues are protected but we can look at and understand the figures. We can then come to a view on the appropriate deployment of the methodology.

Maree Todd: I presume that, if we Brexit along with the rest of the UK in 2019, there will be an opportunity for VAT to be fully devolved to Scotland. After all, it is European law that prevents its full devolution.

Derek Mackay: That is a possibility, but it was not something that we negotiated under the previous acts and it would be in the hands of the UK Government.

With regard to the methodology, a recommendation has not been put to politicians yet, because the matter is still being worked on by officials. What is important is that we capture actual receipts as best we can in Scotland—that is what we want to achieve.

The Convener: I know that Patrick Harvie has a supplementary question on this area, but Adam Tomkins has a specific supplementary.

Adam Tomkins: My question is on the last point that Maree Todd asked you about, cabinet secretary. As I recall—Patrick Harvie was there, too, so he will correct me if I am wrong—the Smith commission recommended the assignment of a share of VAT receipts to the Scottish Government, not the devolution to the Scottish Government of a share of VAT. It would be unlawful under European Union law for VAT to be devolved, as each member state is required to set only one rate of sales or consumption tax. Given that we are leaving the European Union, what discussions have there been between your officials and the Treasury, or between you and Treasury ministers, on devolving VAT?

Derek Mackay: We have engaged on a range of matters but not specifically on VAT, although we have made wider points about the impact of VAT on areas such as tourism and hospitality and the refurbishment of property and VAT issues in relation to the emergency services.

Adam Tomkins: In December, your Government published a paper called "Scotland's Place in Europe", which included a lengthy chapter about the devolution of additional powers. As I recall, it did not say anything much about VAT. Is that because you do not want VAT to be devolved?

Derek Mackay: No. I would be more than happy for the Scottish Government to have control over VAT. I am telling you specifically about my engagement with the UK Government on VAT, as that is what you asked about, and how VAT relates to other matters.

Adam Tomkins: Given that you want VAT to be devolved, why have you not had any conversations with the UK Government about that in the 10 months since the EU referendum?

Derek Mackay: As Adam Tomkins well knows, we take a maximalist position on the devolution of powers to Scotland. I have accurately answered his question on my engagement with UK ministers on VAT. Specifically, I referred to Scotland's emergency services having to pay VAT and not being able to reclaim it, which is a great loss to them, and other parts of the Scottish economy that would be supported if we could vary VAT rates.

Of course we support the devolution of VAT to Scotland. Adam Tomkins is correct to highlight that the deal to implement the new powers under the Scotland Act 2016, which we are discussing today, involved—as he accurately describes—the assignment of a share of VAT based on estimates rather than devolution of the power itself. It would not surprise Mr Tomkins to know that we would like that economic lever and others to be transferred to Scotland under any circumstances.

The Convener: If we leave the European Union, that is.

I will bring in Patrick Harvie now.

Patrick Harvie (Glasgow) (Green): I was going to come to the subject of VAT anyway, but given that Adam Tomkins has opened it up, I might as well reverse the order of my questions.

Just before the meeting got under way, I had a wee skim back over the Smith commission's final report—I do it every time I need a laugh. The report itself does not go into a great deal of detail about the rationale for what was recommended, but obviously the EU rules were part of the discussion. At the time, I made the argument that I was pretty unconvinced about the assignment of a proportion of a tax, because it does not give the Scottish Government or the Scottish Parliament any additional policy levers or fiscal policy flexibility. Since then, has the Government's thinking developed at all on whether there is any benefit to the Scottish Government in policy terms of the assignment of a proportion of VAT? What is the point of it?

Derek Mackay: I suppose that the point is that there is more accountability and that more economic growth can be delivered, which is good for the economy. It enables us to estimate how far what is actually received in Scotland contributes to public expenditure.

Patrick Harvie is correct—we would rather have had the power devolved in a way that would give us full command of it, which would enable us to use it to support the economy and to provide for full transparency and accountability. What is being implemented is what was agreed, which is the assignment, rather than the devolution of control, of VAT.

Patrick Harvie: So it achieves greater accountability in one part of Government policy—economic growth—but it has no relevance at all to other parts of Government policy.

Derek Mackay: I am making the point that that is one benefit of the assignment—albeit that it is based on estimates—to Scotland.

I agree with Patrick Harvie that, rather than not being able to determine the tax and simply receiving what is estimated to be Scotland's share of it, it would be better to have devolution and control of VAT, because it could be used in a way that supports the Scottish economy and as part of a range of tools that the Scottish Government could use to direct our economy and our fiscal decisions in a more appropriate way.

Patrick Harvie: So, if nothing else changes, the assignment of that large chunk of VAT raised in Scotland does not really affect the Scottish budget, because the block grant adjustment takes that money back again. It will affect the Scottish budget only if there are changes over time, either in the amount of VAT that is raised in Scotland or if there are errors in the methodology that is used to calculate it.

If the approach to the methodology is not really a fundamental change, but is, roughly speaking, an attempt to bring more accuracy to the current approach, would there be any consequence of taking as the baseline a potentially turbulent year in which, for example, the UK's future relationship with Europe becomes clear through the publication of a Brexit deal, with economic consequences that affect the amount of VAT that is raised in that year?

Derek Mackay: I will ask Aidan Grisewood to cover that scenario in as fair a way as possible.

Aidan Grisewood: The key thing, again, is that the block grant adjustment is always about the performance of Scotland relative to the rest of the UK. If there was an economic shock, for any reason, there would not necessarily be a particular impact on Scotland, as long as it affected the rest of the UK and Scotland equally. If the effect was divergent—if it was a different type of shock in the two places—that would be a consideration in relation to when the baseline was set.

Those are the sorts of issues that we need to agree on very clearly. As you said, on the one hand it could be quite straightforward in terms of the methodology, but there are some quite fundamental issues around it all in terms of agreeing the final set of arrangements with the Treasury about how it will work forward and, indeed, in advising Mr Mackay on that as well.

Patrick Harvie: Given the concern about one industry—tourism—which has already been flagged up as a particularly significant source of VAT in Scotland, and for which we have not yet got a counting methodology, there is the potential for that kind of asymmetric consequence.

Aidan Grisewood: Yes, if there is volatility year to year. Getting the system up and running and getting the transition years in place will give us a good indication of the extent to which there is volatility.

Patrick Harvie: Have you confirmed yet which years those will be?

Aidan Grisewood: We have not.

Patrick Harvie: When do we expect to know?

Aidan Grisewood: We have got a JEC planned for the summer.

Patrick Harvie: Sorry?

Derek Mackay: There is a joint exchequer committee planned for the summer, which will be informed by the joint working of officials.

Patrick Harvie: Do you expect that meeting to make the decision about the timetable?

Derek Mackay: Not necessarily.

Patrick Harvie: There is not very long to go.

Derek Mackay: No, but the point that you are raising around the baseline and the methodology is a valid one with regard to the potential impact for all future years of where the baseline is set in relation to a particular point in the economic cycle. We need to consider what we set as the baseline start position and the methodology—Mr Harvie has made a valid point around what that would mean going forward, depending on where we are in an economic cycle. That is part of the consideration as well as seeing through the spirit of the agreement.

Patrick Harvie: We are talking about a block grant adjustment that is almost half the size of the income tax one—is that right? Is that roughly where we are at? I see Mr Grisewood nodding. On top of that, we are already concerned about potential inaccuracies in the counting of income tax payers. If there was any kind of ambiguity or inaccuracy in the methodology or a similar concern as a result of the implementation date, we would be talking about a very substantial roll of the dice in terms of future Scottish budgets.

Derek Mackay: That is exactly why we have to be absolutely sure about the methodology, but also the point in the economic cycle that we set as the baseline.

Mr Harvie touched on the Brexit issue. Independent analysis says that there will be an economic impact on gross domestic product, tax receipts and inflation. We cannot forecast exactly what that will look like, but it will have an important impact. It is a valid point. We need to be clear on the benchmarking point and the methodology to ensure that we do not disadvantage Scotland's budget.

11:00

The Convener: To ask a slightly tongue-in-cheek question, does that not beg the question of whether the no-detriment principle applies to Brexit?

Adam Tomkins: That is an exam question that even I would not set.

Derek Mackay: There were known knowns, known unknowns and then there was Brexit.

The Convener: Ash Denham will deal with issues on the Scotland reserve.

Ash Denham (Edinburgh Eastern) (SNP): Paragraph 72 of the Scottish Government's report says:

> "Detailed arrangements for reporting and repaying borrowing and the operation of the Scotland Reserve are being agreed with the UK Government."

Do you know whether or when the arrangements for that process will be agreed? Are you able to put that on the record now?

Derek Mackay: I can cover the practice on the budget. We understand what our borrowing limits are and what the Scotland reserve should look like. There was an issue when we generated more tax in the financial year than we had anticipated that we would do and we put that amount in the cash reserve. However, as I say, we understand what our limits are.

On capital borrowing, decisions for the current financial year will be taken much later in the year. Aidan can go through the detail on that.

That is what the budgetary position is with regard to the functions that we have executed and the decisions that we will take going forward. From a budget perspective, we do not have any plans to use resource borrowing.

Aidan Grisewood: The final arrangement is more about the technical details, as Mr Mackay set out. The high-level principles are all there—the annual caps and the aggregate caps on capital and resource. Part of the final agreement is about the precise application of the details, such as how we define the rolling four-year period of economic shock. We need to agree all those issues so that, when we get into the detail, we are all on the same page on future arrangements, but there is no doubt that the high-level agreement stands.

Ash Denham: If the detailed arrangements are not yet fully agreed, what scope is there for the committee to scrutinise those details when they are agreed?

Derek Mackay: We could return to the committee when each of the elements is agreed, if that would be helpful. We normally inform the committee about such matters in our intergovernmental relations report on my engagement with the UK Government.

We can return to discuss what has been agreed and the committee can choose what it wants to probe further.

The Convener: Neil Bibby wants to raise general economic issues.

Neil Bibby (West Scotland) (Lab): We have just touched on the matter that I wanted to raise. We are all aware that economic performance relates to revenues in future years. The latest economic growth figures show that growth in the rest of the UK has been higher than it has in Scotland. Do you envisage that trend continuing? If so, are you concerned for revenues in Scotland?

Derek Mackay: We want to support the economy and encourage economic and GDP growth. I do not necessarily want to rehearse all the politics, but we know that the Fraser of Allander institute identified Brexit as an issue. Consumer confidence is also an issue. There are clear challenges in the north-east with the oil and gas downturn, and that includes the onshore supply chain.

That said, we have been strong on productivity, female employment and youth unemployment, so there are many positives, too. We have had a strong record on foreign direct investment. We are doing more in that area by recalibrating our economic strategy and through our work on internationalisation and so on. A range of actions are under way to support the economy, including the infrastructure spend on a whole host of areas.

Of course we are concerned about the GDP stats for the last quarter. In early summer, we will hear the next quarter’s stats. From my point of view, through the budget, we have made a number of positive investments to support the economy and we want to continue that approach.

As I say, we have a high level of employment and a low level of unemployment. The challenge in Scotland’s economy have been down to, in large measure, oil and gas. There are signs of recovery and growth opportunities. I hope that that will help with the figures in the future.

The Convener: I thank the cabinet secretary and the official for coming along today and giving us evidence on the two Government reports. The next committee meeting will address stage 2 of the Air Departure Tax (Scotland) Bill.

Meeting closed at 11:05.

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