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Official Report

FINANCE COMMITTEE

Wednesday 1 May 2013

Session 4

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FINANCE COMMITTEE
13th Meeting 2013, Session 4

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*John Mason (Glasgow Shettleston) (SNP)

COMMITTEE MEMBERS

*Gavin Brown (Lothian) (Con)
*Malcolm Chisholm (Edinburgh Northern and Leith) (Lab)
*Jamie Hepburn (Cumbernauld and Kilsyth) (SNP)
*Michael McMahon (Uddingston and Bellshill) (Lab)
*Jean Urquhart (Highlands and Islands) (Ind)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Alistair Brown (Scottish Government)
John Swinney (Cabinet Secretary for Finance, Employment and Sustainable Growth)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

Committee Room 6

Scottish Parliament

Finance Committee

Wednesday 1 May 2013

[The Convener *opened the meeting at 09:30*]

Decision on Taking Business in Private

The Convener (Kenneth Gibson): Good morning, and welcome to the 13th meeting in 2013 of the Finance Committee of the Scottish Parliament. I remind everyone present to turn off any mobile phones, BlackBerrys, pagers and so on.

Agenda item 1 is to decide whether to take items 3, 4, 5 and 6 in private. Are members agreed?

Members *indicated agreement.*

Scotland Act 2012

09:31

The Convener: Item 2 is to take evidence from the Cabinet Secretary for Finance, Employment and Sustainable Growth, John Swinney, on the implementation and operation of the financial provisions of the Scotland Act 2012. The cabinet secretary is accompanied by Alistair Brown and Jonathan Sewell of the Scottish Government. I welcome the cabinet secretary and invite him to make a short opening statement.

The Cabinet Secretary for Finance, Employment and Sustainable Growth (John Swinney): Thank you, convener, and good morning. I welcome the opportunity to present the annual report on the implementation of the financial provisions of the Scotland Act 2012. The report describes the substantial progress that the Scottish Government is making on the arrangements for the implementation of the new financial powers under the act, and I welcome the parliamentary scrutiny that is at the heart of today's discussion.

I will cover two main areas in my opening statement: first, the assessment of progress; and secondly, the role of parliamentary scrutiny. Good progress is being made on the implementation, as the first report that was submitted to Parliament showed. The Land and Buildings Transaction Tax (Scotland) Bill has been introduced to Parliament, the committee has undertaken the stage 1 scrutiny process and the stage 1 debate has taken place. The Landfill Tax (Scotland) Bill has now been introduced to Parliament, and we will move on to that shortly.

Both those bills represent an opportunity to deliver fair taxation as part of our approach to those subjects, and to progress important new areas of competence for the Scottish Government. We have taken steps to establish revenue Scotland, and we continue to believe strongly that that is the right way ahead for Scotland in delivering an efficient and effective solution for Scottish needs.

Under the Scotland Act 2012, borrowing powers will be available, and a framework to accommodate those has been agreed. We will continue to press for wider responsibilities in that respect.

The implementation of the Scottish rate of income tax is progressing, and the agreement in the memorandum of understanding between the Scottish Government and Her Majesty's Revenue and Customs, with the input of this committee and the Public Audit Committee, was an important milestone in that process.

Demonstrating value for money remains essential in terms of the costs of implementation, and every effort is being made to ensure that an effective and efficient solution is developed. I welcome the readiness of Edward Troup, the additional accounting officer for the project, to appear before the committee next week, given HMRC’s role in delivering the Scottish rate of income tax project. Close operational activities are being undertaken by officials to progress that area of responsibility. Discussions are on-going on the block grant adjustment that is associated with all the powers, and the way forward for that adjustment in respect of the devolved taxes must be agreed by both Governments.

Finally, on parliamentary scrutiny, the Parliament clearly has a key role in the process. It has already considered the Land and Buildings Transaction Tax (Scotland) Bill, and we look forward to the scrutiny of the Landfill Tax (Scotland) Bill, and in due course the proposed tax management bill into the bargain.

Today’s discussion gives us the opportunity to assess progress on the wider implementation of the financial provisions, and I am delighted to answer questions from the committee.

The Convener: Thank you, cabinet secretary. As is the normal procedure at committee, I will open with a few questions before widening discussion to include colleagues round the table.

First, on the issue of borrowing, you will be aware that there has been some concern among committee members about some of the Office for Budget Responsibility’s forecasts. For example, there have been significant readjustments to the forecasts from March and December last year. Some of the forecasts remain optimistic—for example, the OBR predicted in March last year that the Scottish rate of income tax would bring in revenues that would grow by 24 per cent over the three financial years to 2016-17, whereas it is now predicting that the growth will be 25 per cent over four years to 2017-18.

The committee’s concern, which has also been expressed by witnesses, relates to the impact that that might have on revenue borrowing. As you know, Scottish ministers have the power to borrow up to £500 million cumulatively but only £200 million in any one year. It has been suggested that there may be questions as to whether the borrowing limit is sufficient to accommodate potential forecasting errors in future.

John Swinney: That is one of the most significant issues in relation to the devolution of the powers that are inherent in the Scotland Act 2012. There has been some change in the forecasts for tax income arising out of the OBR forecast, but that must be viewed in context, given that the OBR forecast also involved significant changes to income tax estimates throughout the United Kingdom. Those factors are inherent not in Scotland but in the forecasting approach and in the estimates at which the OBR has arrived.

I will make two points on how that is mitigated. First, there is an interim arrangement for the roll-out of the Scottish rate of income tax, which takes place on what might be described as a shadow basis for a number of years before the full devolution of responsibility. During that period, it will be possible to consider and assess the implications of any weakness in the OBR’s estimates.

Secondly, you correctly make the point about revenue borrowing facilities. Those facilities have been defined in the Scotland Act 2012 and provide some flexibility for the Scottish Government to address any particular shortfall that arises out of differences. Another element of that calculation relates to whether there is any significance arising from the assessment of performance against the block grant adjustment that will be undertaken through the Holtham methodology, which I am aware you discussed with Professor Holtham and others last week.

There are clearly risks that will have to be considered, but a variety of factors must be borne in mind in that process.

The Convener: I will switch briefly to the landfill tax and continue to focus on predictions. The OBR’s forecast for landfill tax receipts assumes a constant share of UK landfill tax receipts over three years and has not really looked at UK policy. Have you discussed that with the OBR? Again, it has adjusted its forecast quite significantly over the past year. It has predicted a reduction of 33 per cent in revenues to 2016-17, and the prediction for the current financial year has decreased by 27 per cent from March last year to March this year. What discussions have you had to try to ensure that we improve the forecasting, given the impact that it could have?

John Swinney: As the committee will understand, the OBR is an independent organisation, and in that context it is entirely legitimate for the Scottish Government to enter into discussion with it about its approach to forecasting methodology. Officials have discussed that question with the OBR.

I found the original OBR forecasts on landfill tax to be inexplicable. Any rudimentary assessment of performance in the policy area of waste to landfill in Scotland would identify that the trajectory for landfill tax must be going down, because of the effectiveness of recycling initiatives and the increasing propensity throughout the country for more recycling activity and less landfill. To set out a prediction going from £115 million in 2011-12 to £157 million in 2016-17 is beyond my comprehension.

I am pleased that a more sensible approach has been taken in the most recent forecasts. However, to take the forecasts for 2016-17, the variation of 33 per cent between the OBR's positions in March 2012 and March 2013 is a bit concerning as regards the effectiveness of that particular element of its forecasting methodology. Those figures run entirely contrary to the pattern of policy implementation and effectiveness in this area.

The Convener: Do you have similar concerns regarding LBTT? As you will know, revenue from stamp duty land tax in Scotland fell by more than half in the period to 2011-12 yet, a year ago, the OBR was predicting an 85 per cent increase in receipts over the subsequent four or five years. It has now reduced that to an increase of about 47 per cent over four years. Is that another area of concern with regard to predictions?

John Swinney: The issue is slightly more complicated in this case because the Scottish Government has opted to pursue the approach of replacing stamp duty land tax, rather than simply carrying on with the existing UK arrangements and undertaking them within devolved responsibility. I accept that it will be a more challenging proposition for the OBR to forecast effectively what tax will be generated from the changes that we have made. That is certainly different from predicting a continued roll-out of stamp duty land tax, although some of the estimations about the rise in receipts from stamp duty land tax seem to be on the overoptimistic side of things, given what we know about the patterns of the property market in recent years.

The character of the land and buildings transaction tax is different and distinctive from that of stamp duty land tax, and a lot of care will have to go into any predictions that are undertaken in that respect. That is material to the discussion around the block grant adjustment mechanism that would be adopted to deal with the implementation or devolution of stamp duty land tax responsibilities to the Scottish Government. In that respect, rather than operating on a forecasting methodology, it would be a great deal wiser for us to use a mechanism that assesses actual performance on the generation of receipts under stamp duty land tax so as to drive the discussion around block grant adjustment.

The Convener: Given your obvious concerns about forecasting and the concerns of witnesses who have given evidence to the committee, are there any proposals for you to do your own forecasting, or to have a body similar to the OBR in a Scottish context, which could make forecasts based on Scottish data, as opposed to using proportions of UK figures?

John Swinney: That point was made by a number of members of the Parliament in our stage 1 debate on the Land and Buildings Transaction Tax (Scotland) Bill. The Parliament will be moving for the first time into a territory that we have not previously occupied in relation to the forecasting of revenues, with the exception that the Government, in concert with our local authority partners, makes an assessment of receipts from non-domestic rates income. As a consequence of the land and buildings transactions tax, the landfill tax and the Scottish rate of income tax, we will acquire a set of revenue-raising responsibilities. My view is that Scotland will require an independent forecasting body that can provide independent assessment to the Government and the Parliament of what might be generated as a consequence of those taxes. I am considering how that should be established.

09:45

The Convener: Is there a timescale for the establishment of such an organisation?

John Swinney: I would want it to be in place to be able to give meaningful input to the process in the run-up to the implementation of the proposals in 2015.

The Convener: I want to switch briefly to the block grant adjustment mechanism. I understand that the indexed deduction method will be used, whereby the initial deduction will be indexed to an external variable, such as the relevant tax base. I understand that the net effect on the Scottish block as a result of adding receipts from the Scottish rate and subtracting the block grant adjustment will therefore depend on the growth in the Scottish rate tax base in Scotland, which means that a proportion of funding for Scotland will depend on relative economic performance. Historically, in the past three or four decades, Scotland has underperformed against the UK. How confident are you that the provision will benefit Scotland?

John Swinney: First, I point out that your point about the indexation methodology in connection with the block grant adjustment relates only to the Scottish rate of income tax. As the committee will recall and as I think I mentioned the last time I gave evidence to you, the UK Government's command paper took a different approach to the block grant adjustment mechanism for the devolution of stamp duty land tax and landfill tax. Therefore, the methodology relates only to the Scottish rate of income tax.

At the heart of the proposal is an approach that links Scotland's tax base to the performance of the Scottish economy and therefore creates the incentive and encouragement to ensure that the Scottish economy expands and makes a dynamic contribution to the tax base, which supports and contributes to the financing of public services and the public sector in Scotland. There is therefore an inherent incentive for the Scottish Government to ensure that our economic policies and interventions are designed to expand the tax base of Scotland and to encourage a tax take that in essence reflects the successful outcome of administering policies in that direction.

The Convener: One issue that set alarm bells ringing when Professor Holtham gave evidence to us last week was that, two or three sessions of Parliament ahead, there could be a recalibration of the block grant—assuming for the purposes of the question that Scotland remains within the United Kingdom. If the policies that the current Government and successive ones implement are successful and the Scottish economy grows by, say, 0.7 per cent more than the UK average, over 15 years the Scottish economy will have grown by 10 per cent more than the UK's. Of course, the opposite could be the case, and it could be 10 per cent lower.

Professor Holtham suggested that there could be a recalibration, which could mean adjusting the block grant dramatically to take that into account. The block grant could be reduced substantially or, if we did not do so well and assuming that the UK Government of the day was feeling particularly generous, it could significantly increase the block grant. All that would have major political implications for the Scottish Government of the day, which could be blamed for a big reduction in the block grant or unjustifiably given the benefit of a significant increase. Is that a potential reality or does the devolution of the Scottish rate of income tax mean that we sink or swim by our own efforts regardless and that the recalibration issue will not come up in future years?

John Swinney: The block grant is an administrative feature of the UK system, not a statutory feature, so any UK Government could decide to change it at will. Professor Holtham is correct that such a scenario could happen. There is nothing to prevent that and there are no significant obstacles to the administrative act that would enable it. That is part of the reality that people have to think about when they consider the approach and outlook of the United Kingdom.

The devolution of the Scottish rate of income tax gives the Scottish Government a certain greater opportunity to improve economic performance in Scotland—of course, in recent years, economic performance in Scotland has been broadly comparable to that in the rest of the United Kingdom—but it does not give Scotland all the tools that would enable it to implement a distinctive economic approach. A certain amount of discretion is devolved as part of the Scottish rate of income tax, but not a range of different interventions or opportunities for interventions that would enable us to take the Scottish economy on a different course that would strengthen its performance to a significant extent.

There is undoubtedly a possibility that the block grant could be adjusted at some later stage. The mechanism could be changed entirely. That is an administrative power of the UK Government if we remain in the United Kingdom. Even the devolution of responsibilities under the Scotland Act 2012 does not devolve significant economic responsibilities to the Scottish Government.

The Convener: We are basically at the whim of the UK in that regard, then.

The provision on the Scottish rate of income tax is that, for the non-savings income of a Scottish taxpayer, the tax rate would be reduced by 10p in the pound and the Scottish Government would be allowed to increase that, decrease it or retain it at the same level. Our budget adviser pointed out that, given that there is a £10,000 taxation threshold, if we looked to boost employment in Scotland and were to create 50 jobs at £20,000 a year, those jobs would have a taxable base of about £500,000, which would deliver £50,000 to the Scottish Government. However, if we had 10 people on £100,000 a year, that would give a taxable income of £900,000, of which £90,000 would go to the Scottish Government.

Would that influence Scottish Government policy such that you would try to create more high-earning jobs, which could adversely affect many people who are on the margins of employment or want to go into low-paid work? As you know, the committee undertook an extensive inquiry into the employability of people on the margins of employment and we had a debate on that in the chamber. How would Scottish Government view that, given that we do not have many taxation levers other than that instrument?

John Swinney: I cannot conceive that the current Scottish Government policy framework could be followed if we did what you suggested. I am all for attracting high-earning jobs to Scotland—they make a significant contribution to the Scottish economy—but the wider objectives of Scottish Government economic policy are to maximise economic participation by Scotland's citizens, so the possibility that we might get a better tax take from securing high-earning jobs than from a larger number of low-earning jobs would not drive policy. We lay a heavy emphasis on maximising economic participation and activity by every citizen who is fit and able to make that contribution.

The policy process would be strengthened if we had responsibility for the welfare and benefits regime, because the incentive to get people into employment would be ever more reinforced by our getting the benefit of not having to spend taxpayers' money in Scotland on supporting people on benefits because they had gone into employment. To me, that is the completion of an utterly logical circle, as it would create an incentive within the economy for Government to work to secure employment for every citizen because a consequence would be a corresponding reduction in the benefits bill.

The rather ludicrous situation that we find ourselves in just now is that Scotland can have a higher employment rate than the rest of the UK, and a lower unemployment rate, but we do not get the fiscal benefit of the impact of that because the benefits system is entirely reserved to the United Kingdom Government. In terms of our wider policy agenda, it is logical to argue that having all these responsibilities in the Scottish Parliament would be a sensible way in which to proceed.

The Convener: I fully accept that, and I fully accept the Government's position on the matter. The problem is that a future Administration could aim to maximise revenue by focusing on high-earning employment. It could distort things if it did that because it wanted to increase its revenue base in order to spend in other areas of the economy.

John Swinney: There is a range of measures that Governments must take, and this Government takes a range of different approaches. For example, the strong financial support that the Government gives to the university and college sector in Scotland contributes to assisting with the attraction of individuals with high earning potential to Scotland, but equally it assists people who are trying to acquire new skills and capabilities to participate in the economy. That is an example of how we deploy our policy interventions to assist in maximising the economic contribution of all citizens in Scotland.

The Convener: Thank you, cabinet secretary. I open up the session to members.

Jamie Hepburn (Cumbernauld and Kilsyth) (SNP): Professor Holtham, who has featured quite prominently in the exchanges thus far, made the following observation at the committee last week. I will read out what he said, and then you can perhaps respond. He said:

"I am not too keen on the 10p proportional tax across the piece. The Silk commission recommended having 10p of each tax band, which would be a better procedure, because it would allow you to alter the marginal rates of different taxpayers differentially, if you want to. It would also give your income tax receipts a little more elasticity. For those reasons, I think that there are serious limitations to the 10p proportional tax measure in the Scotland Act 2012."—[*Official Report, Finance Committee*, 24 April 2013; c 2525.]

Do you agree with the perspective that there are those limitations?

John Swinney: There are limitations in the power that has been provided. I agree with the point that Professor Holtham makes, but as I am sure Mr Hepburn will appreciate, the proposition was not on offer in terms of the proposals that the Government has taken forward.

Jamie Hepburn: I want to explore the block grant adjustment mechanism in relation to the three different taxes. We are talking about the Scottish rate of income tax and how the block grant might be adjusted. A comment was made last week—it was Professor Holtham who first made the observation—that the UK tax base as a whole will be used for future alterations. Is that correct?

John Swinney: I am not sure exactly what terminology Professor Holtham used, but the letter from the Secretary of State for Scotland to the Minister for Parliamentary Business in March 2012 said that the non-savings, non-dividend income elements of the UK tax base would be the comparable factor for the application of the Holtham methodology. Therefore it is not the entire UK tax base; it is the narrower component of income tax that is about the non-savings, non-dividend income element.

10:00

Jamie Hepburn: The secretary of state made that point, but we are still talking about the UK-wide tax base. At last week's meeting, concern was expressed about what would happen if the tax base changed dramatically between Scotland and the rest of the United Kingdom. There is clearly an incentive for this Parliament to grow the tax base in Scotland through economic growth, but other factors can affect the tax base, such as demographic change. Dramatic growth is forecast in the UK population over the next 20 or so years, whereas the Scottish population is not expected to grow so dramatically. If we are still part of the UK and still using the proposed mechanism, will any good work in growing the Scottish economy potentially be undermined by virtue of the effect of demographic change on the block grant adjustment?

John Swinney: In essence, I think that that creates the incentive to encourage population growth in the Scottish economy and maximise Scotland's attractiveness as a place in which to invest, live and work. We will have the opportunity to benefit from the fruits of that activity—albeit in a limited way, but certainly more than we are currently able to do.

The logic of that takes us to the argument for the devolution of the entire tax base, through the proposals that the Government will put to the public in the referendum, so that we can take charge of all areas of responsibility and be better able to manage some of the comparative risks that the committee has been considering with witnesses in its work on this area. That is where the logic of the argument goes, I think. However, within the scope and parameters of the tax powers that are on offer to the Scottish Government as part of the Scotland Act 2012, there is every incentive for us to deliver strong economic performance.

Jamie Hepburn: Population growth or lack of it will be hugely influenced by policies on immigration, migration and the rest of it. Scotland does not currently have control of such policies. In a sense, does not this Parliament have its hands tied behind its back a little?

John Swinney: That is why I made the point about the importance of our having the breadth of responsibilities that is inherent in the proposals that the Government will put to the public in the referendum. Only with that full range of economic responsibilities can we deliver the type of opportunities that members of the public expect to see in Scotland.

Jamie Hepburn: You have set out your favoured methodology for adjustment in relation to stamp duty land tax, which will be replaced by LBTT. I agree that using forecasts is fraught with difficulty and using actual receipts makes a lot of sense. What stage have discussions reached in that regard? How likely is it that your preferred methodology will be used?

John Swinney: Discussions with the United Kingdom Government are on-going; the joint Exchequer committee met on 14 February and had further discussion on such points. Officials were asked to take forward that work for further discussion, as is recorded in the reports of the UK Government and the Scottish Government.

On timescale, the issues become more significant, given that in June we expect to receive the United Kingdom Government's budget figures for the Scottish Government for the financial year 2015-16, which will be the first year in which stamp duty land tax and landfill tax will be relevant considerations for our budget. The issue of getting a complete picture of the financial arrangements for 2015-16 becomes quite pressing in June.

Jamie Hepburn: You have said clearly that the Scottish Government has a range of policy objectives to reduce the amount of waste that goes to landfill and increase the amount that is recycled. Clearly, the policy objective of landfill tax is to facilitate the reduction in the amount of waste that goes to landfill, so its objective is, in essence, to reduce the amount of income being accrued from sending waste to landfill. You have said that the OBR projections take no account of that, but is there an issue involving the one-off adjustment to the block grant, given that we are seeking to reduce the amount of income from landfill tax? The one-off adjustment could be higher than the amount of tax being taken in. If that is the case, surely there would be a case for looking at that adjustment mechanism again in the future.

John Swinney: I simply record for the committee what was in the command paper, which was that there was a one-off adjustment—that was the basis of the UK Government's proposition. I am happy to explore and discuss questions around that with the UK Government.

The key point is the decision on the block grant adjustment and what factors are borne in mind in that process. Landfill tax will still be paid in Scotland, despite all our efforts on recycling. Landfill activity will still be undertaken in Scotland. There are additional provisions in the Landfill Tax (Scotland) Bill that explain measures that the Government will take to apply a tax charge for illegal dumping, for example, which regrettably takes place in Scotland. That will also feature in our approach to the realisation of tax revenues.

We must discuss with the UK Government what is the most appropriate adjustment to make to the block grant—I have shared with the committee my view about how that can be undertaken—and then consider what implications our policy approach has for the generation of revenues.

Malcolm Chisholm (Edinburgh Northern and Leith) (Lab): I, too, want to ask about the block grant. It seems to me that most schemes of fiscal devolution stand or fall by the fairness or otherwise of the block grant. Income tax is the most interesting one—I will come on to that—but I want to comment briefly on the land and buildings transaction tax. The last time that you were at the committee you suggested that your favoured approach would be to look at the five years leading up to 2016. What is your understanding of the UK Government's prediction? Is it still saying that it wants to look at predictions for the five years following that? Would that be predictions based on the continuation of the current system, or predictions based on our new arrangements?

John Swinney: The issue is still being actively discussed by the Scottish and UK Governments, so Mr Chisholm will forgive me for not setting out the UK Government's position. I understand that the Chief Secretary to the Treasury will be at the committee in a couple of weeks, so I am sure that he will respond on those points. However, it certainly remains my view that the most reliable way of taking forward the issue is to look at a five-year average in the run-up to the implementation of the devolution of the tax responsibility.

Malcolm Chisholm: I said in the debate last week that I agreed with you on that, so I will not change my mind. That would certainly be a good question to ask the chief secretary.

Income tax is the more interesting one. Jamie Hepburn has touched on that. I suppose the fundamental question is whether you think that it is possible to have a fair block grant adjustment based on the indexation system that is being proposed.

John Swinney: I think that that is a possibility—and that is why we strongly argued against the mechanism that was suggested by the Calman commission. I submitted to the committee that considered the Calman proposals in the previous session—the Scotland Bill Committee—that there was a deflationary bias in the commission's proposals, because of the very direct link with public expenditure, not the tax base.

I appreciate and recognise the fact that the United Kingdom Government has moved its position from the Calman commission proposal and has agreed to the Holtham methodology. That is a welcome step forward. Provided that we do the necessary detailed work to take that forward, we have the basis for achieving a fair block grant adjustment in relation to the Scottish rate of income tax.

Malcolm Chisholm: I am glad that there seems to be a lot of consensus on that. Jamie Hepburn was suggesting that there could be extraneous factors that did not operate in the same way in Scotland and in England. I am not sure whether I agree with him on population, which could be related to economic policy, and we basically have the same immigration policy as England, so there is no unfair advantage one way or the other in that respect. Can you think of any other extraneous factors that might apply to the development of the tax base in England, but not in Scotland?

John Swinney: I do not think that there will be factors of that nature. However, we must be aware that the approach that we are taking, which is inherent in the legislation, carries with it more risk than the previous situation. The only risk in relation to the block grant is if a UK Government decides to reduce it, which is what has happened with the budget that has been announced.

If it is predicted that, in the current financial year, a sizeable element of our income—about £4.7 billion—is dependent on tax decisions that we take, over which there will undoubtedly be different levels of performance, expectation and realisation, more risks are of course inherent in the financial management and support of public services in Scotland, although that is an inherent part of the Scotland Act 2012.

My view is that we mitigate those risks by having a wider range of financial powers to enable us to act and respond to those circumstances. That is where I very much agree with Mr Hepburn's perspective, that we have responsibility on tax, but we do not necessarily have the ability to make as many interventions as I would like in order to counterbalance some of the risks. That is the way in which we should consider those points.

Malcolm Chisholm: You accept that there are potential benefits, but you would like to have a wider range of tax powers. That is allowed for, even under the 2012 act, in relation to the devolution of further fiscal powers.

John Swinney: Yes, although I am not readily aware of which ones are on offer. Air passenger duty, for example, is a significant issue. Anyone who talks to anyone with an interest in travel, tourism and business tourism in Scotland will recognise the significant attention that is focused on air passenger duty, which the Calman commission recommended be devolved, although that has not arrived. It is not immediately obvious, let us say, where the additional tax powers are coming from.

Malcolm Chisholm: I was intrigued by the way in which you said that the devolution of the whole tax base was what was on offer in the referendum. I thought that that was called devo max.

John Swinney: It is what I would call independence, Mr Chisholm.

Malcolm Chisholm: We had better not get too involved in that.

In the report that you have presented to us, you state, with regard to the transitional period for income tax:

> "For the first two or three years, the adjustment will be notional".

I was not entirely clear what that implies.

John Swinney: That is what I described to the convener as a shadow process. Essentially, a prediction will be made about the block grant adjustment based on the Holtham methodology. However, if performance during the year does not follow what was expected, there will be no detriment to the Scottish tax base during that interim period.

10:15

Malcolm Chisholm: The word "notional" implies that the deduction will not happen, but my understanding is that there will be a deduction, which will be corrected if it is wrong.

John Swinney: If “notional” does not convey the matter adequately, I apologise to the committee. What Mr Chisholm has just explained is what will happen.

Malcolm Chisholm: Finally, can you say anything about how the timescales of the adjustment will operate? I do not quite have a sense of how that will work in practice.

John Swinney: I think that the adjustment will be made at the end of the financial year, but I ask Alistair Brown to confirm.

Alistair Brown (Scottish Government): Sorry, is Mr Chisholm asking about the transition period?

Malcolm Chisholm: Yes.

Alistair Brown: The UK Government’s command paper said that the transition period would be two or three years, with the period beginning April 2016. We know that 2016-17 and 2017-18 will definitely be transition years, but there is a question over whether 2018-19 will be a transition year.

John Swinney: Sorry, I think that Mr Chisholm’s question is: at what point will any retrospective adjustment process take place? Will that happen at the close of the financial year?

Alistair Brown: That will happen when the data is available from income tax receipts.

Malcolm Chisholm: That could involve quite a time lag, then.

Alistair Brown: That could be after month 10 of the year following the year in question.

Malcolm Chisholm: Presumably, a time lag could have implications for any borrowing that might be required.

Alistair Brown: Are you asking about the period following the transition period?

Malcolm Chisholm: No, I am still talking about the transition period. Would there not be a need to borrow if there was a shortfall in income tax receipts during the transition period?

Alistair Brown: During the transition period, a shortfall in income tax receipts would not lead to a reduction in the Scottish budget. That is what we mean by “notional”.

Malcolm Chisholm: However, when would the correction be made? Would it be made as soon as the shortfall became apparent?

John Swinney: Perhaps I have not explained that clearly enough. Essentially, a prediction will be made and agreed, and that will be honoured by the UK Government. Once the financial year is complete and all the data is available, the data will validate whether the prediction was correct. However, nothing will happen as a consequence of that, as that is the nature of the transition period. Within the transition period, I suppose, we will understand whether the methodology is working in the fashion that had been predicted.

The Convener: Just to make things a little more interesting, I want to ask whether that will still apply if the Scottish rate of income tax is changed to, say, 11p or 9p. If we decided that the rate should be set at 9p or 11p, would the block grant still be reduced by an equivalent amount?

John Swinney: Yes, that is correct.

Gavin Brown (Lothian) (Con): First, I have a brief process question. How will the Scottish rate of income tax be set in practice? My understanding is that the decision on the rate must be communicated to the UK Government by the end of December. Traditionally, the Scottish Government produces a draft budget in September, with stage 1 of the budget bill being considered in January and stage 2 being considered in February. How would the rate decision fit into the budget process, or do we need to make various changes to that process?

John Swinney: That is a material issue that I was concerned about in the formulation of the memorandum of understanding, which the committee considered. Gavin Brown is correct that the UK Government’s preference was that notification of the proposed Scottish rate should take place in advance of the tax year in question—if I remember correctly, it originally said that that should happen the previous November. Clearly, that would be out of kilter with the parliamentary process for the finalisation of our budget. Essentially, the memorandum of understanding has left sufficient scope for the issue to be resolved by agreement in this Parliament as to how to proceed. I would welcome the opportunity to discuss with the committee, and perhaps more broadly with Parliament, how we intend to proceed on that question. I certainly have not come to any conclusion about how that would be undertaken. It is essentially a parliamentary matter that I wish to discuss with the committee and others.

Gavin Brown: I have a couple of questions about borrowing. In your report to Parliament, you refer to some discussions around the national loans fund. In paragraph 17, you state:

> “no arrangements have yet been made in relation to borrowing by the Scottish Government by way of commercial loans from banks or other lenders.”

Can you expand on that a bit? Are you going to explore at least the principles of such borrowing any time soon so that you have a clear understanding of how good, bad or useful it might be in comparison with the national loans fund process?

John Swinney: As part of preparing for the implementation of the measures, we will take forward all the relevant discussions. I imagine that discussions of that type will take place. Whether we will pursue that approach is a different matter altogether.

Gavin Brown: Yes, but my question was not whether you will pursue it. You have to report to us annually on this and your view is that the report that we will get in a year's time will say that you have examined the issue and have some understanding of how a commercial loan from a bank or other lender might look.

John Swinney: We are now into the realms of predicting what will be in my report in 12 months' time. We will certainly report fully to the committee at that stage.

Gavin Brown: I am not asking you to say what will be in the report. Are there plans to have those discussions sooner rather than later?

John Swinney: We will take forward the implementation of the arrangements, and whatever ground we cover I will report to the committee.

Gavin Brown: Obviously, tax receipts fluctuate year on year, but they also fluctuate month by month. Is any work being done on your side or elsewhere on what the monthly forecasts might be, particularly for income tax? For example, January and April are traditionally bigger months. Are you looking at what your monthly cash-flow needs might be?

John Swinney: There will be no necessity for us to do that because essentially the Treasury will take the cash-flow strain of that on a month-by-month basis. The issue for us is essentially year to year in relation to any utilisation of revenue borrowing facilities.

Gavin Brown: Okay, so that is not an issue.

John Swinney: It is not an issue.

Gavin Brown: The final issue I want to look at is LBTT. We have talked about the OBR forecasts for what would have been SDLT had it continued. Is any work being done either by the OBR or the Scottish Government on the likely tax take from LBTT? Obviously, it depends entirely on the thresholds and rates that are applied. What work is being done to try to predict the tax take?

John Swinney: As I understand it, the OBR is not looking at the land and buildings transaction tax propositions from the Government. However, we are of course doing that work, which is obviously a material part of how I will formulate a view on thresholds, rates and other considerations. Subject to the Land and Buildings Transaction Tax (Scotland) Bill being passed by Parliament, those arrangements also require particular approval by Parliament.

Gavin Brown: Is that work that can be shared with Parliament and wider Scotland so that we can look at how various models operate?

John Swinney: I will certainly consider that. I also have to consider when that would be appropriate because I have to set a rate and secure parliamentary approval for it and I do not want to give a definitive view as to what approach I will take on that. First, I need to not only consider how that would impact on my ability to set rates but be confident that how the type of work to which Mr Brown is referring was undertaken would not have some prejudicial impact on the marketplace.

John Mason (Glasgow Shettleston) (SNP): A major player, which is has been mentioned briefly, is HMRC and the Scottish Government's relationship with it, especially as regards the handling of the Scottish rate of income tax. I assume that that relationship is developing between the Scottish Government and HMRC. How would you describe that relationship? Is it warm or cool?

John Swinney: It is very co-operative and productive. I have met Edward Troup, the additional accounting officer, and my officials sit on the programme and project boards in HMRC that are taking forward the Scottish rate of income tax preparations at an operational level. Those officials feed into an overall fiscal responsibility implementation programme board, which is chaired by the director general for finance in the Scottish Government, who is my principal adviser on these questions. Any issues that arise out of the HMRC dialogue would come to me in that fashion.

The progress that was made on the memorandum of understanding was welcome. HMRC was involved in that process and we reached a satisfactory agreement around those questions, so I have no issues about that at present.

John Mason: Okay, thank you.

I have been a little bit nervous all along about the fact that HMRC could incur costs and then pass them on—largely to us. The report from Michael Moore's side of the fence refers to the Scottish rate of income tax project and says:

> "The cost for the project has been estimated at £40m-45m for implementation, including around £10m in IT costs."

Are we happy with the methodologies and costings in the report?

John Swinney: I sound a note of caution on that point, because, if my memory serves me right, the figure of £40 million to £45 million figure is originally from the Calman report—from November 2010—when the assessment will have been undertaken at a pretty high level. I give the committee the very clear assurance that my officials are monitoring closely and carefully all aspects of costs incurred in relation to the programme.

The arrangements that we have in place mean that we are able to challenge and to seek alternative verification of costs that are associated with the programme. I certainly do not want the committee to take the view that the Scottish Government is just waiting to be told what sort of number is going to come along and that we will just accept that. A strong and rigorous process of challenge will be applied to ensure that I am confident that the expenditure that is being talked about is justified.

John Mason: Is it correct that the Scottish Government will end up paying all the costs?

John Swinney: That is correct.

John Mason: I think that I have raised this before, but I still do not understand why that is. I thought that the idea was that if Westminster made a decision, it paid the costs, and if the Scottish Parliament made a decision, we paid the costs. The Scottish rate of income tax is a Westminster decision and yet we are paying the costs.

John Swinney: I have considerable sympathy with Mr Mason's point. However, without prejudicing my position, which is one of complete agreement with him, I think that the UK Government would cite two issues—if I can perhaps volunteer its opinion on this occasion; the committee can check with the chief secretary in a couple of weeks whether I have it right.

One point is to do with the statement of funding policy, which the UK Government writes and which is obligatory for the Scottish Government. However, I am not a signatory to it, so I have never consented to it. The Secretary of State for Scotland signs up to it on Scotland's behalf, which I find wholly unacceptable.

The statement of funding policy says that if a Westminster Government introduces a measure that has financial implications for a devolved Administration, Westminster will pay for it, so that is what I have argued. However, the statement also contains a paragraph—put there by the UK Government—that states that the costs of devolution will be met by the devolved Administration. That paragraph is one of the arguments that has been used, despite the fact that the statement says that if Westminster decides to do something that has financial implications, Westminster should pay for it.

10:30

The other justification that the Westminster Government uses is that the original set-up costs for the Scottish variable rate in 1999 were paid by either the Scottish Executive or the Scottish Office—I cannot remember exactly at which stage they were paid, but they were certainly paid by what became the devolved organisation. That is the UK Government's defence of its position, but I do not agree with it.

John Mason: I might raise that again at a later stage.

As Malcolm Chisholm mentioned, chapter 6 of Michael Moore's report addresses the idea of

"creating new taxes and/or devolving existing taxes".

There is almost a hint about that in the report, which states:

"This power came into force on the same date as the Scotland Act 2012. To date, it has not been used"—

as if we should be using it. What is the Government's thinking about that? Assuming that we do not get independence for the time being—

The Convener: Assuming what?

John Mason: Sorry, convener. Will you wait until the three current taxes are out of the way before considering the possibility of introducing new taxes, or is the Government already thinking about new taxes?

John Swinney: The Government is proceeding with a great deal of implementation work on the proposals, and that is our priority.

We certainly have the capability and capacity to take further measures if we so choose. My view is that the constitutional agenda is very much focused on achieving a successful outcome in the referendum in September 2014. Following that, the Government will obviously be able to exercise a wider range of financial responsibilities.

John Mason: The report contains a foreword from Michael Moore, and I wonder whether you agree with some of his points. For example, on page 1 he says:

"these measures will enable the Scottish Government to fund around a third of the spending it controls; more than double the proportion currently funded".

I am not sure that everybody agrees with those figures. Do you agree with them?

John Swinney: I cannot quite think how that sum works out.

John Mason: Yes, it seemed surprisingly high to me.

John Swinney: The budget for which I have responsibility is of the order of £28 billion, and the total tax take from those measures will be approximately £4.7 billion, so I am not sure who does the maths in the Scotland Office.

John Mason: Michael Moore also says that there are

“two governments working together in the interests of Scotland”

and that

“Scotland will continue to have the best of both worlds.”

I am not sure about that, either.

John Swinney: I do not agree with the secretary of state on that point.

The Convener: On that note, I call Jean Urquhart, who will be followed by Michael McMahon.

Jean Urquhart (Highlands and Islands) (Ind): The cabinet secretary said that we cannot crystal-ball gaze regarding what will happen in September 2014, although I am perhaps more optimistic than the deputy convener about what will happen.

From reading the papers, it appears to me that there is huge frustration with the Scotland Act 2012, given that we are where we are with September 2014 looming ahead. It seems that we are deconstructing one tax system and reconstructing it in Scotland; it is a bit like building a house wall by wall and having to apply for planning permission for every bit that we do.

Do you think that the cost of £40 million to £45 million for Scotland is worth it, in the light of 2014?

John Swinney: Let me start with the point of principle. I have made it very clear that I think that the Scotland Act 2012 is a missed opportunity. After the work of the Calman commission and the wider debate on devolution of responsibilities, the UK Government could have devolved a much wider range of powers to the Scottish Government while maintaining the United Kingdom, which is clearly its policy preference.

Jean Urquhart needs to remember that all those proposals emerged out of the desire of the three UK political parties to come up with a coherent response to the election of the first Scottish National Party Government in 2007. This situation is the product of that aim. That did not have much discernible effect on the 2011 election—or perhaps it did, by refuelling the Government’s re-election by a significant margin. Politically, therefore, that is not my agenda.

That brings me to my second point, which is that I am obliged to implement the provisions by the Scotland Act 2012. I think that Parliament and the public would expect me to fulfil my responsibilities to do that, and to do so in an efficient fashion. On the £40 million to £45 million cost, I want to reassure the committee that my officials have been directed to exercise the strongest possible scrutiny of those figures, because ultimately the Scottish taxpayer is going to have to pay and I have to be able to justify the cost to the public. However, as I said, I think that the act represents a missed opportunity, in political terms.

Jean Urquhart: According to the papers, we have had one bill for £14,000 so far. Do you approve the invoices as they come in?

John Swinney: HMRC was paid £183,294 in 2012-13 to undertake work on the switch-off of stamp duty land tax and the implementation of the Scottish rate of income tax. We have budgeted for £3.5 million in 2013-14, but HMRC estimates that it will incur about £1.5 million of costs in that process. Obviously, we have other costs in relation to revenue Scotland. The payment of £183,294 has been approved and paid—we try to pay our bills within 10 days to help the economy, and we have a very good record of doing that. We are satisfied that those are justifiable costs.

Jean Urquhart: Finally, I am not word perfect on the memorandum of understanding, but you have said that we have a good relationship with HMRC in our work to achieve the best outcome. I guess that that is a political relationship. If the UK Government were to increase or change the rate of income tax, what communication would you receive about that? Would you know in advance whether the UK Government was going to change the rate of income tax?

John Swinney: I cannot imagine getting a telephone call from the Treasury in advance of the budget to say that it was going to change the rate of income tax. To be fair and transparent with the committee, if I recall correctly, I have on two occasions had a telephone call in advance of the budget providing me with what would be described in the trade as a heads-up from the Chief Secretary to the Treasury about changes to the financial envelope within which we were operating. The calls were not to give precise figures, but were simply courtesy calls—which I appreciate—about the fact that changes affecting the Scottish Government’s budget were likely to emerge from the UK Government’s budget. However, I could not conceive of that becoming a phone call to say that the tax rate was changing, even two minutes in advance.

Jean Urquhart: Could that change your approach to setting the tax rate in Scotland?

John Swinney: Yes, it could. That comes back to Mr Brown’s point about the proper timescale and process that this Parliament must go through in exercising its responsibilities. Clearly, decisions of that type can have a knock-on effect on the financial provisions in the Parliament. We must be mindful of those implications.

Jean Urquhart: Those problems will not exist if we have independence.

John Swinney: That is absolutely correct.

The Convener: On proper timescale and process, in the UK Government's most recent budget, it decided, 10 days before the start of the financial year, that our revenue budget would be cut by £54 million. What kind of impact do such decisions have on you?

John Swinney: Such decisions mean that I have to take remedial action. In essence, I got probably half a day's notice that change was coming, but there were no specific numbers. Obviously, I have to resolve such issues. In the interests of transparency, I should say that I intend to make some input to Parliament in the next couple of days on addressing that issue. Given the parliamentary timescale, that will more than likely be through an inspired parliamentary question. Since you asked me the question, I should disclose my knowledge of that.

Michael McMahon (Uddingston and Bellshill) (Lab): I suppose that I am looking for a heads-up, cabinet secretary.

John Swinney: It depends on the issue.

Michael McMahon: We have had a lot of discussion about process and technicalities to do with the block grant adjustment, as well as hypotheticals, forecasts and what have you. You have made it clear that you want an expansion of the tax base, but I think that you are on record as saying that, regardless of the devolution settlement or the hypothetical of independence, you do not intend to seek increases in personal taxation. Am I correct? Is that still your position?

John Swinney: That is my general view.

The Convener: That appears to have exhausted members' questions, but I have a couple just to finish off, before the cabinet secretary heads for the hills. The command paper "Strengthening Scotland's Future" sets out proposals for a Scottish cash reserve. I understand that the Scottish Government is discussing how the proposed cash reserve would operate in practice—in particular, the circumstances in which funds that had been set aside in previous years from Scotland's budget or tax receipts could be released to support current expenditure. Where are you with that?

John Swinney: We have been in discussion with the Treasury about that. We have now agreed the arrangements for establishment of the cash reserve, and the Chief Secretary to the Treasury has given his consent to our making contributions to that cash reserve, if we choose to do so, in the current financial year.

The Convener: Has there been a decision about the extent of the reserve? How much money can be in it and can it be built up over a number of years to a certain level?

John Swinney: The reserve can hold a maximum of £125 million. Obviously, any decisions about contributions to it will be made as part of my routine financial management during the financial year.

The Convener: The budget adviser also made the point that there is agreement between the Governments that

"indexation should be based on 'comparable' adjustment to the UK income tax base."

Our problem is that when we took evidence last week from various eminent professors, what that meant was not really clear. For example, the budget advisor's interpretation is that it could be indexed against growth and comparable income tax receipts in the UK, but another interpretation is that it could be indexed against the growth and level of income subject to income tax in the rest of the UK. What does the Scottish Government understand that to mean?

10:45

John Swinney: The relevant paragraph of the Secretary of State for Scotland's letter to Bruce Crawford, dated 20 March 2012, states:

"This approach to indexing would recalculate the block grant adjustment year by year by indexing it to movements in the Non Savings Non Dividend income tax base in the rest of the UK ... The net effect on the Scottish block as a result of adding receipts from the Scottish rate and subtracting the block grant adjustment will therefore depend on the growth in the Scottish rate tax base in Scotland ... relative to growth in the Non Savings Non Dividend income tax base in the rest of the UK."

That seems to me to be quite a clear illustration of what we are comparing against, but as I said, a volume of detail about the block grant adjustment is required to get us to a position of comfort about the workings of that mechanism. If practical issues that need to be clarified arise from discussions in committee, that will be a helpful contribution for my officials to have in discussions on behalf of ministers.

The Convener: Thank you very much. If we are getting different answers from our expert witnesses, it is important to have clarification.

John Swinney: I reiterate that the committee is welcome to flag up particular issues to us. We will be approaching the matter from the perspective of having a clear and well-defined explanation of all the relevant factors, so that we have absolute clarity about how the arrangements will work. It is in our interests to do so, and it is clearly in the committee's interests, into the bargain.

The Convener: Thank you.

In its stage 1 report on the Land and Buildings Transaction Tax (Scotland) Bill, the committee sought clarification from the Scottish Government as to whether parliamentary agreement will be required on the block grant adjustment. The response confirmed that the Scottish Government will seek Parliament's agreement on the arrangements for the block grant adjustment. What is the timescale for that?

John Swinney: I cannot give a definitive timescale, but I can reiterate the point that I made in response to—I think—Jamie Hepburn's question. In June, the UK Government will set out its budget numbers for the financial year 2015-16. Those numbers will be affected by the block grant adjustment mechanism. I flagged up to the UK Government that if it is planning to announce that information in June—it is my understanding that it is—it has to be mindful of the necessity that the block grant adjustment will have to be made in that context. As I said earlier, the terms of our agreement mean that both Governments must sign up to the block grant adjustment mechanism.

The Convener: Thank you very much. That concludes evidence this morning. I thank the witnesses for their contributions.

10:49

Meeting continued in private until 11:09.

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