

**FIRST ANNUAL REPORT ON THE
IMPLEMENTATION AND OPERATION OF PART 2
(FINANCE) OF THE WALES ACT 2014**

First Annual Report on the Implementation and Operation of Part 2 (Finance) of the Wales Act 2014

Presented to Parliament pursuant to Section 23(1)(b) of
the Wales Act 2014

Presented to the National Assembly for Wales pursuant to
Section 23(1)(c) of the Wales Act 2014

December 2015



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FOREWORD

The Wales Act 2014 devolves a comprehensive package of tax and borrowing powers to the National Assembly for Wales and the Welsh Government, giving them more tools to strengthen the economy and create more jobs.

One year on from its enactment, this report sets out progress in implementing the tax and borrowing powers being devolved under Part 2 of the Act. A great deal of progress has been made: business rates have been fully devolved and work is well underway to ensure Welsh taxes to replace Stamp Duty Land Tax and Landfill Tax come on stream in 2018. There is a great deal more to do, but the first year of implementation provides a solid foundation to work from.

The last year has also seen the Government map a path to a clear, robust and lasting devolution settlement for Wales. The draft Wales Bill, published in October, implements the St David's Day Agreement announced by the Prime Minister in February. It provides for a clearer devolution settlement, based on a reserved powers model, and a strengthening of devolution by devolving further powers to the Assembly and the Welsh Government.

A more accountable Assembly and Welsh Government are fundamental to the new devolution arrangements. Last month the Government announced a floor in Welsh relative funding of 115% of comparable spending in England, and our intention to remove the requirement for a referendum in order to implement the Welsh Rates of Income Tax.

These changes, and our continuing work to implement the devolution of tax and borrowing powers under the Wales Act 2014, will build a stronger Wales within a strong United Kingdom. It will mean strengthened, more accountable devolved government for Wales, with the Assembly and Welsh Government having the right tools to enable Wales to develop as a nation.

RT HON STEPHEN CRABB MP
SECRETARY OF STATE FOR WALES

CHAPTER 1

INTRODUCTION

Scope and Content of this Report

1. This report on Part 2 of the Wales Act 2014 is the first published since the Act gained Royal Assent on 17 December 2014.
2. Part 2 of the Wales Act 2014 deals exclusively with the devolution of financial powers. These include:
 - the creation of new Welsh Rates of Income Tax;
 - the disapplication of UK Stamp Duty Land Tax in Wales and provision for the introduction of a new Welsh tax on land transactions;
 - the disapplication of UK Landfill Tax in Wales and provision for the introduction of a new Welsh tax on disposals to landfill;
 - provision for borrowing by Welsh Ministers; and
 - the power to create new devolved taxes.
3. The financial provisions will be implemented over a number of years with the timetables for Stamp Duty Land Tax and Landfill Tax having been set out in the Command Paper¹ which accompanied the publication of the Wales Bill in March 2014.
4. In order that both Parliament and the National Assembly for Wales (the Assembly) are fully informed through this process, section 23 of the Wales Act 2014 requires the Secretary of State for Wales and Welsh Ministers to report annually on the implementation of this part of the Act. In order that both Parliament and the Assembly are informed of the views of both administrations: the Secretary of State for Wales is required to report to Parliament and provide a copy of the report to Welsh Ministers. Welsh Ministers are required to lay the report before the Assembly, and to report themselves to the Assembly and provide a copy to the Secretary of State. The Secretary of State is required to lay the Welsh Ministers' report before both Houses of Parliament. Both Governments will continue to report until the first anniversary of the day on which the last provisions of Part 2 come into force.
5. Section 23(7) of the Wales Act 2012 requires the annual reports to contain:
 - (a) *a statement of the steps which have been taken, whether by the maker of the report or by others, since the making of the previous report (or, in the case of the first report, since the passing of this Act) towards the commencement of the provisions of this Part,*
 - (b) *a statement of the steps which the maker of the report proposes should be taken, whether by the maker of the report or by others, towards the commencement of the provisions of this Part,*
 - (c) *an assessment of the operation of the provisions of this Part which have been commenced,*

¹ Cm 8838 *Wales Bill: Financial Empowerment and Accountability*

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/294470/Wales_Bill_Command_Paper_-_English.pdf

(d) an assessment of the operation of any other powers to devolve taxes to the Assembly or to change the powers of the Welsh Ministers to borrow money, and of any other changes affecting the provisions inserted or amended by this Part,

(e) the effect of this Part on the amount of any payments made by the Secretary of State under section 118 of GOWA 2006 (payments into the Welsh Consolidated Fund), and

(f) any other matters concerning the sources of revenue for the Welsh Government that the maker of the report considers should be brought to the attention of Parliament or the Assembly.

6. *Annex A provides a detailed list of the paragraphs in this report which address each of these requirements. However, the report is not limited to these requirements, and may also contain any other matters that each Government believes to be relevant or useful to both Parliament and the Assembly.*

CHAPTER 2

WELSH RATES OF INCOME TAX

7. The Wales Act 2014 established that subject to the outcome of a referendum in Wales on the introduction of Welsh Rates of Income Tax, the main UK rates of income tax will be reduced by 10p for those defined as Welsh taxpayers, and the Assembly will be able to set, annually, new Welsh Rates of Income Tax (WRIT) which will be added to the reduced UK rates. The rest of the income tax structure will remain a non-devolved matter, and continue to be determined by the UK Parliament.
8. In the Spending Review and Autumn Statement 2015 we stated that we will legislate to remove the requirement to hold a referendum to implement the WRIT. The Government intends to implement this change in the new Wales Bill, which was published in draft form on 20 October 2015.
9. The UK Government will discuss the change with interested stakeholders, including the Welsh Government, in the coming months.

CHAPTER 3

WELSH TAXES ON LAND TRANSACTIONS AND DISPOSALS TO LANDFILL

Introduction

10. The Wales Act 2014 provides for the power to tax land transactions and waste disposals to landfill sites in Wales to be devolved to the Welsh Government and for Stamp Duty Land Tax (SDLT) and Landfill Tax to be disapplied in Wales. The Welsh Government have announced they will be introducing a Land Transaction Tax (LTT) and a Landfill Disposals Tax (LDT), which are expected to be introduced in April 2018. The UK taxes will cease to apply in Wales at this point and a corresponding adjustment will be made to the Welsh block grant.

Steps taken towards implementation

11. The Welsh Government has also announced they will be setting up a new body – the Welsh Revenue Authority (WRA) – to oversee the administration of its devolved taxes. The Tax Collection and Management (Wales) Bill, which will create the WRA and puts in place the legal framework for the collection and management of devolved taxes in Wales, was introduced into the Assembly on 13 July 2015.

12. The Welsh Government has announced that HMRC is the preferred partner to work with the WRA in administering the LTT. The WRA will administer the LDT, working with Natural Resources Wales on compliance activity.

13. HMRC has been developing proposals for how it will administer LTT. Its intention is to adapt its existing SDLT computer system to operate the devolved tax and to use existing experienced staff working on SDLT to carry out administration activities (for example, processing returns and following-up errors).

14. HMRC will also be undertaking some compliance work on LTT, which it proposes would be carried out by a specialist team based in Wales working closely with the operational team and the WRA. The Welsh Government has said that the WRA will undertake complex compliance and avoidance work for LTT – HMRC will work with Welsh Government to establish how the two organisations can most effectively work together on these cases.

15. HMRC's estimate of the costs of implementing their aspects of the LTT was reported to the Assembly Finance Committee in a letter from the Welsh Minister for Finance and Government Business on 4 November. The set-up costs are estimated to be between £2.5 million and £3 million and the running costs up to £1 million a year. HMRC may be required to charge VAT on some implementation activity, which would increase these figures – discussions are ongoing with the Welsh Government on this point.

16. Alongside this activity, HMRC has been working with officials from the Welsh Government to increase their understanding of HMRC's administration of SDLT and Landfill Tax and HMRC's broader tax powers. HMRC staff have also twice given evidence to the Assembly's Finance Committee in support of the Committee's inquiries into devolved tax matters.

Further steps that will be taken towards implementation

17. During the next year, HMRC will continue to refine its proposals for implementing the LTT. This will be particularly focused on agreeing how issues such as information sharing and interactions between the WRA and HMRC on compliance matters should be implemented. HMRC intends to set up a project to manage this activity and also develop a plan for 'switching off' SDLT in Wales.
18. In relation to Landfill Tax, HMRC will focus on planning for the transfer of full responsibility to the Assembly for the taxation of the disposal of waste to landfill from April 2018. A communications plan to provide information to Landfill Tax operators and users of landfill sites in Wales will be developed.
19. HMRC will also continue to help the Welsh Government and the WRA to build capability by providing further support in understanding HMRC's administration of taxes, in particular issues relating to SDLT and Landfill Tax.
20. The devolution of both taxes will be accompanied by a corresponding adjustment to the block grant. Further information on the effects of the tax powers on the Welsh block grant can be found in chapter 6 of this report.

CHAPTER 4

BORROWING POWERS

21. The provisions in the Wales Act 2014 enable Welsh Ministers to borrow for the following purposes from April 2018

- The Act retained the Welsh Government's existing in-year current borrowing powers of up to £500m, whereby Welsh Ministers can borrow from the National Loans Fund (NLF) via the Secretary of State for Wales in order to provide a working balance to the Welsh Consolidated Fund (WCF) or to manage in-year volatility of receipts (where actual income differs from the forecast receipts for that month);
- The Act extended the circumstances under which the Welsh Government can access current borrowing. This enables the Welsh Government to borrow across years to deal with differences between the full year forecast and outturn receipts for devolved taxes. This across years borrowing must again be from the NLF via the Secretary of State for Wales, can be up to £200m each year (within the existing £500m overall cap) and must be repaid within 4 years.
- The statutory capital borrowing limit was set by the Wales Act 2014 at £500 million. This limit was set to reflect the c.£200 million of devolved tax revenues from April 2018 and also to enable the Welsh Government to proceed with improvements to the M4 (should it choose to do so) in advance of an element of income tax being devolved. Within the overall limit, HM Treasury agreed that the Welsh Government can borrow up to £125 million each year (from 2018-19 onwards).

22. In advance of implementing the Welsh Government's new borrowing powers in April 2018, the Government has agreed that the Welsh Government can use its existing, more limited, borrowing powers to proceed with improvements to the M4 (should it choose to do so). The amounts that the Welsh Government can borrow during this period are subject to HM Treasury agreement. This arrangement therefore provides the Welsh Government with the option to begin investing in the M4 in anticipation of devolved tax revenues. As this effectively gives the Welsh Government early access to their new borrowing powers, any amounts borrowed under these existing powers will count towards the £500 million cap.

23. In addition to borrowing from the NLF as above and from commercial banks, the St David's Day Command Paper ² committed that the Welsh Government will be able to issue bonds to borrow for capital expenditure.

Steps towards implementation

24. The UK and Welsh Governments are now working to agree a detailed process for enabling borrowing from the National Loans Fund. We will also be taking forward the creation of Welsh Bonds in due course.

² Cm 9020 *Powers For a Purpose: Towards a Lasting Devolution Settlement for Wales*

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/408587/47683_CM9020_ENGLISH.pdf

CHAPTER 5

POWER TO CREATE NEW TAXES

25. With the agreement of both governments, further existing taxes can now be devolved and the Assembly is able to introduce new Wales-specific taxes. These powers support the ongoing evolution of devolved responsibilities and provide the Assembly with a new means of achieving policy outcomes, as well as potentially raising additional revenues.

Steps towards implementation

26. A process for creating new taxes and/or devolving existing taxes was set out in the Command Paper that accompanied the Wales Act 2014 (see footnote 1).

27. A range of criteria for assessing proposals for new taxes was set out in the Command Paper and the UK Government is committed to working with the Welsh Government to assess any such proposals in a timely manner.

28. This power came into force on the same date as the Wales Act 2014.

CHAPTER 6

EFFECT OF NEW POWERS ON THE WELSH BLOCK GRANT

29. A fundamental principle of tax devolution is that an element of the block grant is exchanged for the ability to levy taxes. The arrangements for block grant adjustments in relation to the Wales Act 2014 will be agreed by the Joint Exchequer Committee.
30. The Command Paper (see footnote 1) set out the arrangements for a block grant adjustment in relation to the WRIT, reflecting a recommendation of the Silk Commission. Under these arrangements, the initial adjustment reflects the tax foregone by the UK Government, and this is then grown via the indexed deduction mechanism originally proposed by the Holtham Commission. The full details of these arrangements can be found in the Command Paper. The UK and Welsh governments will discuss the implementation of this mechanism alongside the introduction of the WRIT.
31. As the Silk Commission didn't make a recommendation for the block grant adjustment mechanism in relation to the fully devolved taxes (Stamp Duty Land Tax and Landfill Tax), the Command Paper set out a potential approach. This involves an initial adjustment (again reflecting the tax foregone by the UK Government) and then a small percentage reduction in all subsequent Barnett consequentials (to reflect the proportion of Welsh Government spending that is funded by the two taxes). Since the paper was published, a funding floor in the level of relative funding provided to the Welsh Government has been introduced. We will therefore continue to discuss the approach to these block grant adjustments with the Welsh Government, in order to agree a fair adjustment mechanism that works alongside both the Barnett Formula and the funding floor.

CHAPTER 7

OTHER ACTIVITIES TOWARDS IMPLEMENTATION

Forecasts by the Office for Budget Responsibility (OBR)

32. The OBR began publishing forecasts of Welsh taxes alongside the Autumn Statement 2014 and will continue to publish these forecasts twice a year. The forecasts at the Autumn Statement 2015 reflected the taxes that will be devolved to the Welsh Government under the Wales Act 2014, including 10 pence of each income tax band.

Cash Reserve

33. The Command Paper (footnote 1) set out that the UK Government will provide the Welsh Government with the ability to pay surplus tax revenues into a cash reserve to help manage the volatility in its budget resulting from its new tax powers.
34. The cash reserve will become operational alongside the devolution of SDLT and Landfill Tax in 2018.

CHAPTER 8

OTHER REPORTING REQUIREMENTS

35. In addition to the areas covered discussed in previous chapters **(make footnote - steps taken towards implementation, steps yet to be taken and effect of provisions on the block grant)**, section 23 of the Wales Act 2014 requires annual reports on Part 2 of the Act to include:

- an assessment of the operation of the provisions of Part 2 that have been implemented;
- an assessment of the operation of any other powers to devolve taxes to the Assembly or to change the powers of the Welsh Ministers to borrow money, and of any other changes affecting the provisions inserted or amended by Part 2;
- a statement of the effect of Part 2 on the amount of any payments made by the Secretary of State under section 118 of the Government of Wales Act 2006 (payments into the Welsh Consolidated Fund); and
- any other matters concerning the sources of revenue for the Welsh Government that the maker of the report considers should be brought to the attention of Parliament or the Assembly.

36. This report is the first following the Act receiving Royal Assent in December 2014. It should be noted that, in accordance with section 29(2)(b) of the Act, all provisions of Part 2 came into force two months after enactment with the exception of the sections relating to the WRIT and borrowing by Welsh Ministers. The borrowing provisions will require Orders from HM Treasury before they are fully implemented. An assessment of the operation of the borrowing provisions will therefore follow in future annual reports. The Government has committed to removing the requirement for a referendum in order to implement the WRIT and intends to make this change in the forthcoming Wales Bill.

37. In addition to the Wales Act 2014 provisions, Non-Domestic Rates were fully devolved on 1 April 2015 as recommended by the Silk Commission. While the Welsh Government already sets the rates (so no legislation was required in the Wales Act 2014), the revenues generated didn't previously have a direct impact on the funding available to the Welsh Government. From April 2015, under full devolution, the Welsh Government retains all Non-Domestic Rates generated in Wales rather than a population share of changes in UK Government spending funded by English Non-Domestic Rates.

CONCLUSION

38. Section 23 of the Wales Act 2014 stipulates that the Annual Report on the implementation and operation of Part 2 of that Act should be laid on or before the anniversary of the date on which Royal Assent was received (17 December 2014).
39. The past year has seen the first steps in moving toward the full implementation of the Act. Legislation is being scrutinised by the Assembly that will take forward the implementation of devolved taxes on land transactions and disposals to landfill and the UK Government has committed that the Welsh Government will be able to issue bonds in future to borrow for capital expenditure.
40. In addition, the UK Government has set out its intention to remove the requirement for a referendum on the devolution of a portion of income tax as provided for in the Wales Act.
41. The next annual report on the implementation of Part 2 of the Wales Act 2014 will be published, in accordance with Section 23(3)(b) of the Act, before 17 December 2016.

Annex A – Reporting Requirements in the Scotland Act 2012 and where they are addressed in this report

1. *a statement of the steps that have been taken, whether by the maker of the report or by others, since the making of the previous report (or, in the case of the first report, since the passing of this Act) towards implementation of the provisions of this Part,*

Chapter 2: Paragraph 8

Chapter 3: Paragraphs 11-16

Chapter 4: Paragraphs 22-23

Chapter 5: Paragraphs 26-28

2. *a statement of the steps that the maker of the report proposes should be taken, whether by the maker of the report or by others, towards the implementation of the provisions of this Part,*

Chapter 2: Paragraphs 9

Chapter 3: Paragraphs 17-20

Chapter 4: Paragraph 24

3. *an assessment of the operation of the provisions of this Part that have been implemented,*

see Chapter 9

4. *an assessment of the operation of any other powers to devolve taxes to the Assembly or to change the powers of the Welsh Ministers to borrow money, and of any other changes affecting the provisions inserted or amended by this Part,*

see Chapter 9

5. *a statement of the effect of this Part on the amount of any payments made by the Secretary of State under section 118 of GOWA 2006 (payments into the Welsh Consolidated Fund), and*

see Chapter 9

6. *any other matters concerning the sources of revenue for the Welsh Government that the maker of the report considers should be brought to the attention of Parliament or the Assembly.*

see Chapter 9