

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

Second 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 2016



© Crown copyright 2016

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3 or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: psi@nationalarchives.gsi.gov.uk.

Where we have identified any third party copyright information you will need to obtain permission from the copyright holders concerned.

This publication is available at www.gov.uk/government/publications

Any enquiries regarding this publication should be sent to us at correspondence@walesoffice.gsi.gov.uk

Printed in the UK on behalf of the Controller of Her Majesty's Stationery Office

FOREWORD

The Wales Act 2014 was a significant first step in delivering truly accountable devolved governance in Wales. Two years from its enactment, this report sets out the progress in implementing the tax and borrowing powers devolved under part 2 of the Act.

I firmly believe that the Welsh Government should take on more responsibility for how money is raised in Wales as well as how it is spent. The Wales Act provided for the devolution of powers over stamp duty and landfill tax to the National Assembly and the UK Government is continuing to work with the Welsh Government to ensure a smooth transition to the implementation of these new devolved taxes.

The devolved taxes are, however, only a part of the fiscal devolution we are taking forward for Wales, with the devolution of Welsh Rates of Income Tax (WRIT) completing this process. The Wales Bill, currently progressing through Parliament, meets the commitment we made at Autumn Statement 2015 to remove the requirement for a referendum before the devolution of WRIT and subject to the Bill being enacted we will begin work with the Welsh Government to ensure the effective implementation of the WRIT.

There are of course practical issues to agree with the Welsh Government, particularly how the Welsh block grant is adjusted to take account of tax devolution. The Chief Secretary to the Treasury has held constructive meetings with the Cabinet Secretary for Finance and Local Government, under the Joint Exchequer Committee (Wales), to consider the funding arrangements that will be put in place once the new tax powers are devolved. Both Governments have a strong appetite to reach agreement as we recognise this is a crucial step in the maturity of the Assembly.

These tax and borrowing powers form a key part of the new devolution settlement in Wales based on the firm foundations of a reserved powers model provided for in the Wales Bill.

**RT HON ALUN CAIRNS MP
SECRETARY OF STATE FOR WALES**

CHAPTER 1

INTRODUCTION

Scope and Content of this Report

1. This is the second report on the implementation of Part 2 of the Wales Act 2014 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,*

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

(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,

(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 Government of Wales Act 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 Wales Bill currently progressing through Parliament will implement this commitment.
9. The Government is in discussion with the Welsh Government over how it will assume these powers in light of this decision including how the Welsh Government's budget will be adjusted to take account of tax devolution.

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 dis-applied in Wales. The Welsh Government has announced it 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 Land Transaction Tax and Anti-Avoidance of Devolved Taxes (Wales) Bill was introduced to the Assembly on 12 September 2016. The Landfill Disposal Tax (Wales) Bill was introduced to the Assembly on 28th November 2016.

12. The Welsh Government is setting up a new body – the Welsh Revenue Authority (WRA) – to oversee the administration of its devolved taxes. The Tax Collection and Management (Wales) Act 2016, which provides the legal framework to collect and manage devolved taxes, including the establishment of the WRA, received Royal Assent in April.

13. The Welsh Government had indicated that it was considering asking HMRC to administer LTT, but has now confirmed that the WRA will administer LTT and LDT, working with Natural Resources Wales on LDT compliance activity, and with HMRC providing expertise and knowledge through loans and secondments to develop and enhance the WRA's LTT compliance expertise.

14. HMRC and the Welsh Government are working closely together on tax, legal and operational issues to ensure a smooth transition to the devolved taxes. The Welsh Government pays HMRC for the costs of implementation.

15. A joint project has been set up by HMRC to manage the disapplication of both SDLT and Landfill Tax and the transition to LTT and LDT in Wales. The joint projects board includes representatives from HMRC and the Welsh Government. Board members are involved in decision making to ensure that the project provides effective solutions and value for money.

16. Early work on the project has focused on how existing HMRC systems and processes will be affected by the disapplication of SDLT in Wales

from 2018. No IT systems change is required to transition to LDT; a joint communications exercise will inform key stakeholders of the changes.

17. HMRC is represented on the Welsh Government's Operational Policy Project Board, part of the Welsh Revenue Authority Implementation Programme to establish WRA. This representation gives both HMRC and Welsh Government visibility of key decisions and allows a collaborative and joined-up approach to project delivery.

Further steps that will be taken towards implementation

18. In 2017, detailed plans will be drawn up for technical changes to existing systems to disapply Stamp Duty Land Tax in Wales and work will be done to produce estimated costs for this work, including estimates from suppliers. A joint communications plan will be developed with WRA to inform stakeholders of the changes.
19. 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 joint communications plan will be developed to provide information to Landfill Tax operators and users of landfill sites in Wales.
20. 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.
21. The devolution of both taxes will be accompanied by a corresponding adjustment to the block grant.

CHAPTER 4

BORROWING POWERS

22. 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 Act provides for the Welsh Government to borrow up to £500m to fund capital investment. This borrowing can be from the NLF, commercial banks or bond issuance. Within the overall limit, HM Treasury has agreed that the Welsh Government can borrow up to £125 million each year (from 2018-19 onwards) and can also have early access to borrowing powers to proceed with improvements to the M4 (should it choose to do so). The amounts that the Welsh Government can borrow for this purpose prior to 2018-19 are subject to HM Treasury consent.

Steps towards implementation

23. The Welsh Government has confirmed it would like to be able to take advantage of early access to borrowing powers in order to fund improvements to the M4. The Chief Secretary to the Treasury has agreed that the Welsh Government will be able to make requests to borrow from 1st January 2017.

24. Prior to April 2018, as set out in 'Powers for a purpose: towards a lasting devolution settlement for Wales', the UK Government will also legislate to extend the sources of capital borrowing available to the Welsh Government so that it can issue bonds.

CHAPTER 5

POWER TO CREATE NEW TAXES

25. With the agreement of both governments, further existing taxes can now be devolved through secondary legislation 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.
26. In relation to new Wales-specific taxes, the Command Paper published alongside the Wales Bill in 2013 set out the UK government's intended assessment process. This included the extent to which the new tax:
- affects UK macro-economic or fiscal policy and/or the single market
 - may be non-compliant with EU legislation
 - increases tax avoidance risks
 - creates additional compliance burdens for businesses and/or individuals
 - is aligned with devolved responsibilities.

Steps towards implementation

27. This power came into force on the same date as the Wales Act 2014 and has not yet been used.

CHAPTER 6

EFFECT OF NEW POWERS ON THE WELSH BLOCK GRANT

28. 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 are currently being agreed by the Joint Exchequer Committee (Wales) (JEC(W)).

29. The two governments are seeking to agree new funding arrangements including:

- The adjustment to the block grant alongside tax devolution
- How this adjustment interacts with the Barnett formula and the funding floor
- Whether the Welsh Government's capital borrowing limits should be changed
- The tools the Welsh Government needs to manage its budget

30. The JEC(W) was established in 2014 to oversee the transfer of financial powers to the Welsh Government. It comprises the Cabinet Secretary for Finance and Local Government, representing the Welsh Government, and the Chief Secretary to the Treasury, representing the UK Government. It has met three times so far during the autumn of 2016 to consider these new arrangements, with communiques² issued after each meeting.

²<https://www.gov.uk/government/news/ministerial-meeting-on-the-welsh-governments-new-funding-arrangements>

<https://www.gov.uk/government/news/second-ministerial-meeting-on-the-welsh-governments-new-funding-arrangements>

<https://www.gov.uk/government/news/third-ministerial-meeting-on-the-welsh-governments-new-funding-arrangements>

CHAPTER 7

OTHER ACTIVITIES TOWARDS IMPLEMENTATION

Forecasts by the Office for Budget Responsibility (OBR)

31. 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 2016 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

32. 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.

33. The cash reserve will become operational alongside the devolution of SDLT and Landfill Tax in 2018.

CHAPTER 8

OTHER REPORTING REQUIREMENTS

34. In addition to the areas covered in previous chapters (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.
35. This report is the second 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 made by Treasury Ministers to be fully implemented. An assessment of the operation of the borrowing provisions will therefore follow in future annual reports.
36. As noted above, the Wales Bill, which is currently progressing through Parliament, removes the requirement for a referendum before implementing the Welsh Rates of Income Tax. The implementation of WRIT will therefore require an Order made by Treasury Ministers.
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. This year has seen further progress towards the full implementation of the Wales Act 2014. The Government is working with the Welsh Government to ensure the smooth transition to devolved taxes. The arrangements for block grant adjustments are currently being agreed by the JEC(W).
40. In addition, the Wales Bill, which is currently progressing through Parliament, removes the requirement for a referendum before the devolution of income tax to the National Assembly for Wales. The Government is in discussions with the Welsh Government over how it will assume these powers in the future, including the effect on the Welsh Government's budget.
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 2017.

Annex A – Reporting Requirements in the Wales Act 2014 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 11-17
Chapter 4: Paragraphs 23
Chapter 5: Paragraphs 26

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: Paragraph 9
Chapter 3: Paragraphs 18-21
Chapter 4: Paragraph 24

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

see Chapter 8

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 8

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 8

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 8