

**THE UK GOVERNMENT'S FIFTH ANNUAL REPORT ON
THE IMPLEMENTATION AND OPERATION OF PART 2
(FINANCE) OF THE WALES ACT 2014**

Fifth 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

January 2020



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CONTENT

	Page
Foreword	1
Introduction	2
Welsh Rates of Income Tax	4
Welsh Taxes on Land Transactions and Disposals to Landfill	8
Borrowing Powers	9
Power to Create New Taxes	10
Effect of New Powers on the Welsh Block Grant	11
Other Activities Towards Implementation	12
Other Reporting Requirements	13
Conclusion	14
Annex A: Reporting Requirements in the Wales Act 2014	15

FOREWORD



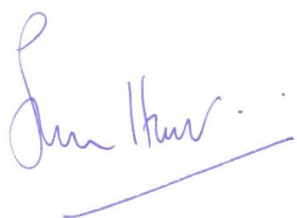
This report sets out the progress in implementing the devolution of tax and borrowing powers under Part 2 of the Wales Act 2014.

Five years on from its enactment, the last of the financial provisions in the Act have been implemented following the introduction of Welsh rates of income tax on 6 April 2019. This follows the significant progress made last year which saw the transition from Stamp Duty Land Tax and Landfill Tax, to Land Transaction Tax and Landfill Disposals Tax in Wales.

This is a testament to the positive collaboration between the UK government and the Welsh Government. The implementation of these new devolved taxes has placed greater accountability at the heart of the Welsh devolution settlement and ensured that the Welsh Government has more responsibility for how money is raised and spent in Wales.

This year has also seen the UK government and Welsh Government agree a Memorandum of Understanding to increase the Welsh Government's overall capital borrowing limit from £500m to £1bn as set out in Wales Act 2017.

These new fiscal powers for the Welsh Government, to use if they so choose, form a key part of the devolution settlement in Wales.

A handwritten signature in blue ink, appearing to read 'Simon Hart', with a horizontal line underneath.

**RT HON SIMON HART MP
SECRETARY OF STATE FOR WALES**

CHAPTER 1

INTRODUCTION

Scope and Content of this Report

1. This is the fifth 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 have been implemented over a number of years. Stamp Duty Land Tax and Landfill Tax were devolved in line with the timetable set out in the Command Paper¹ which accompanied the publication of the Wales Bill in March 2014. The agreement of the Fiscal Framework for Wales enabled the introduction of Welsh Rates of Income Tax (WRIT) from April 2019.
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; and
 - 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 2014 requires the annual reports to contain:

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

(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,

(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 reports are 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 the Welsh rates of income tax, the main UK rates of income tax applied to non-savings/non-dividend income would be reduced by 10p for Welsh taxpayers, and the Assembly would be able to set, annually, new WRIT, which would be added to the reduced UK rates. The rest of the tax structure remains a non-devolved matter and continues to be determined by the UK Parliament.
8. The Wales Act 2017, which received Royal Assent on 31 January 2017, removed the requirement to hold a referendum, paving the way for the introduction of WRIT in April 2019.
9. HMRC, with full collaboration and input from the Welsh Government successfully introduced WRIT for Welsh taxpayers on 6 April 2019. HMRC administers it as part of the UK's income tax system.

Steps taken towards implementation

10. WRIT came into effect on 6 April 2019, with income tax customers resident in Wales now paying Welsh rates set by the Welsh Government and National Assembly for Wales, in the Welsh Rate Resolution².
11. HMRC has continued to make further changes, on elements of the Self-Assessment system, and to deal with 'relief at source' (RAS) pension schemes, both of which will be delivered in the 2019-20 tax year. Details are set out in the relevant sections below.

Project governance

12. HMRC put in place governance arrangements to ensure the effective oversight and accountability of its implementation of WRIT. The Welsh Government is represented at every level of governance, ensuring it is fully sighted on the implementation process and costs, and involved in relevant decisions. These governance arrangements include:
 - The appointment of an Additional Accounting Officer in HMRC who is accountable for the implementation and ongoing collection of WRIT³;

² The Welsh Rate Resolution for the 2019-20 tax year was approved by the Assembly on 15 January 2019 and set the income tax rates in Wales at the same level as in the rest of the UK (excl. Scotland).

³ Full details of the responsibilities of Accounting Officers are shown at Chapter 3 of the HM Treasury document, Managing Public Money: <https://www.gov.uk/government/publications/managing-public-money>

- A Programme Board of senior officials to provide oversight of HMRC's Welsh tax devolution work;
 - A Project Board to manage the implementation of WRIT; and
 - Specific risk and communication sub groups to manage those elements of the project.
13. These governance arrangements are continuing to oversee the final changes being made, including to HMRC's Self-Assessment systems.
14. A separate Project Board is managing the changes needed to accommodate RAS pension schemes for both WRIT and Scottish income tax.

Communications

15. Through the Communications sub-group, HMRC continued to issue messages about WRIT in the build up to, during and after they came into effect on 6 April 2019. Specific communications were issued to tax agents, employers, payroll and software developers, Members of Parliament and the National Assembly for Wales, and HMRC staff. More generic communications were issued on social media and on GOV.UK.
16. An evaluation report on the effectiveness of the communications was agreed by the Project Board in June 2019. The report concluded that "audience response and behaviour has not shown any issues with our key messages, timings or any significant increase in customer contact, providing validation of the effectiveness of the communications approach."
17. A further communications plan has been produced that is specific to taxpayer Self-Assessment.

Taxpayer identification

18. As noted in last year's report, in November 2018 HMRC sent letters to over 2 million customers resident in Wales. This included those who earn below the threshold to pay income tax. Total figures for the number of Welsh taxpayers during the 2019-20 tax year will not be known until 2021, after the deadline for completing Self-Assessment returns and following end-of-year reconciliation.
19. Prior to the start of the 2019-20 tax year, HMRC issued new Welsh tax codes⁴ to those in paid employment and subject to PAYE. Whilst HMRC issues individuals with their tax codes, it is the responsibility of employers to operate the tax codes they have been issued. In some cases, these tax

⁴ Welsh tax codes are prefixed by the letter "C"

codes were not operated correctly. HMRC worked with the employers most affected by this issue to ensure the correct tax codes were being applied. HMRC continues to actively engage with employers to ensure the correct tax codes are being applied for Welsh taxpayers.

20. The Welsh taxpaying population will not be static: people move to and from Wales and people become or cease to be taxpayers for a variety of reasons. HMRC is taking a number of steps to ensure the ongoing accuracy of the Welsh taxpayer population, including:

- performing scans of HMRC address data to correct missing or partial postcodes;
- carrying out regular updates of the postcode information held by HMRC, including adding new Welsh postcodes to its list of Welsh postcodes;
- continuing to corroborate HMRC customer records with a range of third-party data sources; and
- issuing communications to remind taxpayers to notify HMRC of any change of address.

Self-Assessment

21. Self-Assessment is a system HMRC uses to collect income tax on income that is not captured by the PAYE system. There are three ways a customer may report earnings for Self-Assessment:

- quarterly filing throughout the tax year;
- online, where returns are due by midnight 31 January following the end of the tax year (31 January 2021 for the 2019-20 tax year); and
- paper, where returns are due by midnight 31 October following the end of the tax year (31 October 2020 for the 2019-20 tax year.)

22. HMRC made all changes to allow for quarterly filing before WRIT came into effect on 6 April 2019. Further changes to the online and paper systems are being made to ensure that Welsh taxpayer status is recognised. For the online system, this means customers can confirm their status as Welsh taxpayers; that any changes of address made by the customer are reflected in the online tax calculators; but that all status and address changes remain subject to validation by HMRC prior to any official change in tax status.

Relief at source pension schemes

23. From April 2018 pension providers have been required to apply the basic rate of tax relief for Wales, Scotland or the rest of the UK as appropriate for RAS pension contributions. It is HMRC's responsibility to notify pension providers of the correct rate to apply. To do this HMRC has to advise the schemes of the main place of residency for each individual member within a scheme. This development has been phased and initially processes and functionality were developed with the Scottish Government, before the introduction of WRIT. From January 2019 it was agreed that further development for RAS would be split between Wales and Scotland. To accommodate the inclusion of WRIT into the already established processes, three specific areas were amended for WRIT: the Annual notification report (delivered December 2018 for January 2019), changes to the taxpayer RAS calculations to include Welsh taxpayers (April 2019), and the digital look-up service for RAS to accommodate Welsh taxpayers (delivered May 2019). Costs of implementing the changes to accommodate RAS pension schemes are included in the overall estimate in paragraph 24.

Costs

24. HMRC estimates the overall cost of implementing WRIT will be between £7.5m and £9.5m.

25. As of 20 September 2019, HMRC has invoiced the Welsh Government £6.54m to implement WRIT.

26. Operating costs are estimated at £319,000 per year.

Steps to be taken towards implementation

27. The vast majority of work needed to implement Welsh rates of income tax has already been completed. HMRC will complete the outstanding changes needed to the Self-Assessment online and paper systems, before the end of the 2019-20 tax year. This will be supported by an effective and focussed communications strategy.

28. Further work will be conducted in 2020-21 to ensure Welsh rates of income tax are reflected in the Annual Tax Summary.

29. There may be further implementation costs in future years, in the event the Welsh Government and National Assembly for Wales decide to vary the tax rates.

CHAPTER 3

WELSH TAXES ON LAND TRANSACTIONS AND DISPOSALS TO LANDFILL

30. The Wales Act 2014 provides for the power to tax land transactions and disposals to landfill sites in Wales to be devolved to the Welsh Government and for Stamp Duty Land Tax (SDLT) and Landfill Tax (LT) to be dis-applied in Wales.
31. In summer 2017, the Assembly passed the Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act and Landfill Disposals Tax (Wales) Act providing for the introduction of a Land Transaction Tax (LTT) and Landfill Disposals Tax (LDT), which came into force on 1 April 2018. The UK taxes ceased to apply in Wales at that point and a corresponding adjustment was made to the Welsh block grant.
32. A joint project was set up by HMRC and the Welsh Government in 2016 to manage the disapplication of both SDLT and Landfill Tax and the transition to LTT and LDT in Wales. The Joint Project Board included representatives from HMRC and the Welsh Government. The Project Board oversaw IT changes, a joint communications plan, the implementation of robust business readiness measures and the acceptance of a joint data sharing agreement between HMRC and the Welsh Revenue Authority (WRA). All work was completed this year and the Project Board closed in July 2019.
33. The Welsh Revenue Authority (WRA) has taken full responsibility for management of these devolved taxes. HMRC will continue to collaborate with WRA, sharing information and developing joint compliance approaches.
34. Now that SDLT and Landfill Tax are devolved to Wales, a joint compliance approach will be vital in cases of joint interest, e.g. in transitional or cross-border cases or where tax in one jurisdiction may affect a tax in the other. HMRC and Welsh Government officials have continued to work collaboratively to discuss issues of mutual interest on their respective taxes and this collaboration is working well.

CHAPTER 4

BORROWING POWERS

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

- The Act retains 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 extends 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 or from commercial banks. Within the overall limit, HM Treasury has agreed that the Welsh Government can borrow up to £125 million each year (from April 2018 onwards).

Steps towards implementation

36. In December 2016, the Welsh Government's fiscal framework included changes to the Wales Act 2014 capital borrowing provisions:

- In March 2019, the UK government and Welsh Government agreed a MOU to increase the overall capital borrowing limit from £500m to £1bn (as legislated in Wales Act 2017). The annual capital borrowing limit was also increased to £150m from April 2019; and
- In addition to borrowing from the NLF or commercial banks to fund capital expenditure, the Welsh Government would be able to issue bonds. In December 2018, the UK Government therefore made an Order under section 121(4) of the Government of Wales Act 2006 to amend 121(1A) of that Act.

37. At Autumn Budget 2018, the UK government announced it would consider whether the capital borrowing cap should be increased by up to £300m at the Spending Review to support the delivery of M4 improvements. In June 2019, the Welsh Government announced that it would not proceed with the project and an increase in the capital borrowing cap was accordingly not considered at the Spending Round in September 2019.

CHAPTER 5

POWER TO CREATE NEW TAXES

38. With the agreement of both Governments, further powers can be devolved through secondary legislation to the Assembly to introduce new Wales-specific taxes. These powers provide the Assembly with a means of achieving policy outcomes, as well as potentially raising additional revenues. The Command Paper published alongside the Wales Bill in 2014 has further details on new tax proposals.

Steps towards implementation

39. In January 2018 UK and Welsh Government Ministers agreed a process for assessing any Welsh Government proposals for new Wales-specific taxes⁵. This process is governed by the Joint Exchequer Committee (JEC)⁶ and managed by the officials' group which supports it (JEC(O)).

A Vacant Land Tax

40. The Welsh Government notified the Assembly of its intention to propose a Vacant Land Tax in February 2018 and wrote to Treasury Ministers in March 2018 to inform the UK Government of the Welsh Government's intention to formally start the Wales Act 2014 process.

41. Work is ongoing on the Welsh Government's proposal to allow it to be assessed according to criteria, including those set out in the Command Paper published alongside the Wales Bill in 2014.

⁵ This process was previously set out in the Fourth Annual Report on the Implementation and Operation of Part 2 (Finance) of the Wales Act 2014.

⁶ The Welsh Joint Exchequer Committee (JEC) is an intergovernmental ministerial forum for Welsh Ministers and UK Government Ministers to oversee the transfer of financial powers. The JEC met for the first time on 20 October 2014.

CHAPTER 6

EFFECT OF NEW POWERS ON THE WELSH BLOCK GRANT

42. A fundamental principle of tax devolution is that an element of the block grant is exchanged for the ability to levy taxes. The UK government and Welsh Government agreed a fiscal framework in December 2016 to underpin the Welsh Government's new funding arrangements, including block grant adjustments for tax devolution, and their interaction with the Barnett formula and Welsh Government's funding floor.

43. The Welsh Government's fiscal framework provides for the following block grant funding arrangements:

- since April 2018, a needs-based factor has been included in the Barnett formula, to determine changes to Welsh Government block grant funding in relation to spending devolution;
- this needs-based factor is set at 115%, based on the range suggested by the Holtham Commission and the funding floor set at the UK government's Spending Review in 2015;
- while relative Welsh Government funding per head remains above 115%, a transitional factor of 105% is used;
- changes to block grant funding in relation to tax devolution are determined through the Comparable model;
- the mechanism for adjusting the block grant includes an initial baseline deduction, to reflect tax revenues forgone by the UK government at the point of devolution; and then subsequent indexation via the Comparable model, based on changes in corresponding UK government tax revenues;
- the Comparable model has been applied to Stamp Duty Land Tax, Landfill Tax, and each band of Income Tax.

Steps towards implementation

44. As set out in the fourth annual report in December 2018, these arrangements are now being operated to determine the Welsh Government's block grant funding for 2018-19 onwards.

45. The resulting funding is set out in HM Treasury's annual Block Grant Transparency publication, the most recent of which was published in December 2018⁷.

⁷ <https://www.gov.uk/government/publications/block-grant-transparency-december-2018>

CHAPTER 7

OTHER ACTIVITIES TOWARDS IMPLEMENTATION

Wales Reserve

46. The 2014 Command Paper (footnote 1) set out that the UK Government would provide the Welsh Government with a cash reserve to help manage the budget volatility resulting from its new tax powers.
47. In 2016, the Welsh Government's fiscal framework set out further details for a new Wales Reserve, which combined the cash reserve and the Budget Exchange facility⁸.
48. The Wales Reserve became operational alongside the devolution of Stamp Duty Land Tax and Landfill Tax in April 2018. The Wales Reserve can hold £350m with no annual cap on payments into the Reserve. The Welsh Government have an annual drawdown limit of £125m resource and £50m capital.

£m	December 2019
Resource	305.5
Capital excluding Financial Transactions	8.8
Financial Transactions Capital	14.3
Total Reserve	328.6

Wales Reserve total

⁸ Budget exchange is a mechanism that previously enabled the Welsh Government to carry forward a proportion of their funding from one year to the next.

CHAPTER 8

OTHER REPORTING REQUIREMENTS

49. 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.

50. This report is the fifth 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.

51. Section 17 of the Wales Act 2017 removed the requirement for a referendum before the implementation of WRIT. This section came into force two months after Royal Assent of the Act, on 31 March 2017. The Treasury brought forward an Order to implement WRIT from 2019-20.

52. HM Treasury made regulations bringing into force section 20 (borrowing by the Welsh Ministers) from 1 January 2017. Section 18 of the Wales Act 2017 amended section 122A of the Government of Wales Act 2006 to double the Welsh Government's capital borrowing cap from £500 million to £1 billion. This section also came into force on 31 March 2017.

53. As set out in the fiscal framework, the annual limit on the amount of capital expenditure has also been increased. Following the introduction of WRIT, the annual limit has been set at 15% of the overall borrowing cap, which is equivalent to £150 million a year.

CHAPTER 9

CONCLUSION

54. 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 made on or before the anniversary of the date on which Royal Assent was received (17 December 2014).
55. This year has seen the introduction of the last of the financial provisions in the Act following the successful implementation of Welsh Rates of Income Tax on 6 April 2019.
56. In March 2019, the UK government and Welsh Government agreed a MOU to increase the overall capital borrowing limit from £500m to £1bn (as legislated in the Wales Act 2017).
57. The next annual report on the implementation of Part 2 of the Wales Act 2014 will be made, in accordance with Section 23(4) of the Act, on, or as soon as practicable after 6 April 2020.

Annex A: Reporting Requirements in the Wales Act 2014

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: Paragraphs 10-26
Chapter 3: Paragraphs 30-34
Chapter 4: Paragraphs 36 & 37
Chapter 5: Paragraphs 39
Chapter 6: Paragraphs 44 & 45

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 27-29

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