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Ref: 646SUB 17

20feol
December 2017

A handwritten signature in cursive script that reads 'Simon Thomas'.

Thank you for your letter inviting me to attend an evidence session with the Committee in the New Year. Unfortunately due to diary commitments I am unable to attend.

Last week I published the UK Government's Third Report into the implementation of part 2 of the Wales Act 2014. I attach a copy of this report for your information which the Cabinet Secretary for Finance has laid in the National Assembly. I am sure you will agree that this report demonstrates the significant progress that is being made towards implementing the Wales Act 2014 to ensure a smooth transition to devolved taxes from 1 April.

The Government included the requirement to report annually on the implementation of Part 2 of the Wales Act 2014 to ensure that the new tax and borrowing powers are transferred in a transparent manner and that the respective legislatures are kept informed of progress. I will therefore continue to report annually on this progress until Part 2 of the 2014 Act is fully implemented. I trust that the UK Government's reports are valuable in the Committee's considerations.

A handwritten signature in cursive script that reads 'Yours, Alun'.

Rt Hon Alun Cairns MP
Secretary of State for Wales
Ysgrifennydd Gwladol Cymru

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

Third 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 2017



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FOREWORD

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

The Wales Act 2014 provides significant new powers for the National Assembly for Wales and Welsh Government that deliver true accountability into devolved governance in Wales. Three years on from its enactment we are continuing to work with the Welsh Government towards its full implementation.

Most significantly, in December last year, the UK and Welsh Governments reached an agreement on a fiscal framework for Wales. The framework sets out the Welsh Government's funding arrangements to support the implementation of the Wales Act 2014 including how the block grant will be adjusted to take account of tax devolution. The historic agreement also ensures that the Welsh Government will have a fair level of funding for the long term with the implementation of a needs based factor in the Barnett formula for Wales. The introduction of the needs based factor at Budget will result in an additional £69 million of spending power for the Welsh Government over the next three years.

The Wales Act 2017 made further provision for the devolution of tax and borrowing to the Assembly, removing the requirement for a referendum before the devolution of Welsh Rates of Income Tax and doubling the Welsh Government's capital borrowing limit. Taken together with the further devolution provided for in the Wales Act 2017 as part of the new settlement the National Assembly and the Welsh Government will be strengthened, more accountable and more mature institutions, with more levers to support economic growth in Wales.

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

CHAPTER 1

INTRODUCTION

Scope and Content of this Report

1. This is the third 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 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 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 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 Welsh Rates of Income Tax (WRIT), which would be added to the reduced UK rates. The rest of the income 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 will administer WRIT as part of the UK's income tax system. HMRC has experience of introducing a similar system when it implemented the Scottish Rate of Income Tax in 2016 and further Scottish income tax powers in 2017. The approach used for Scottish income tax forms the basis of HMRC's approach to implementing WRIT but with modifications to take account of the specific situation of Wales.
10. HMRC is committed to working collaboratively and constructively with the Welsh Government and other stakeholders throughout its implementation and future administration of WRIT. The Welsh Government pays for the costs of implementation.

Steps taken towards implementation

Project governance

11. HMRC has put in place a number of governance arrangements to ensure the effective oversight and accountability of its implementation of WRIT. These arrangements will ensure that the Welsh Government and the Assembly are fully sighted on the implementation process and its associated costs.
12. In May 2017 HMRC appointed Jim Harra, Tax Assurance Commissioner and Director General for Customer Strategy and Tax Design, as Additional Accounting Officer (AAO) for WRIT. The AAO is accountable for the implementation and collection of WRIT and will give evidence before Committees of the Assembly as required, to keep the Assembly fully informed and engaged in the implementation process². HMRC will provide an annual extract from the audited HMRC accounts on WRIT to the Assembly.

² Full details of the responsibilities of Accounting Officers are shown at Chapter 3 of the HM Treasury document, Managing Public Money: http://www.hm-treasury.gov.uk/d/mpm_ch3.pdf

13. In July 2017 HMRC set up a new Welsh Tax Devolution Programme Board. The Board meets at least every two months and is chaired by a HMRC Senior Business Sponsor with representation from the Welsh Government, HM Treasury and the Wales Office of the Secretary of State for Wales. The Programme Board provides senior oversight of delivery, ensures any risks or issues that may impede delivery are effectively managed and provides a challenge to, and escalation route for, both the WRIT and Joint SDLT / Landfill Tax Project Boards (see chapter 3).
14. Sitting below the Programme Board, HMRC set up a Welsh Income Tax Devolution Project Board to manage the implementation of WRIT. The Project Board meets monthly and is a cross-governmental group of officials chaired by a HMRC Senior Business Sponsor, with representation from Welsh Treasury, the Wales Office, Department for Work and Pensions and HM Treasury. The Project Board makes decisions within delegated spending limits; provides direction and leadership for the project; and manages risks to delivery.
15. HMRC has also set up two monthly sub-groups on communications and risks that report to the Project Board. These are issue-specific groups to oversee our approach to communications and to actively manage and review risks.
16. Working collaboratively with the Welsh Government underpins HMRC's approach to delivering WRIT. To facilitate this, HMRC and the Welsh Government signed a Memorandum of Understanding in November 2017 that sets out their respective responsibilities in relation to establishing and operating WRIT efficiently and effectively. While it has no formal legal force, both Governments expect its terms to be followed.

Communications

17. As mentioned above, HMRC has set up a monthly Communications Sub-Group, with representation from the Welsh Government and the Wales Office. The Communications Sub-Group has started work designing and implementing a communications and engagement strategy to support the implementation of WRIT. Welsh language provision is a key consideration for the Sub-Group as it plans communications with taxpayers.
18. Specifically, HMRC will work collaboratively with the Welsh Government within the Sub-Group to identify and develop key elements of the communications and engagement strategy, including stakeholder analysis, key messaging and the development of bilingual communications products.

Welsh taxpayer identification

19. Correctly identifying Welsh taxpayers is of central importance to the effective and accurate operation of WRIT. Identification of Welsh taxpayers will be by reference to HMRC address records. HMRC is exploring the particular requirements for WRIT brought about by the populous border region between England and Wales and the challenges that this might pose for Welsh taxpayer identification and the implications of this for HMRC's assurance and communications activity.

IT

20. HMRC is in the process of developing the IT solution in partnership with suppliers that will set out in detail what IT changes it will have to make next year to implement WRIT.

Costs

21. HMRC estimates the overall cost of implementing WRIT will be between £5 and 10 million.
22. This is an early estimate based on our experience of implementing the Scottish rate of income tax (SRIT). They are lower than those for SRIT because HMRC is able to take advantage of system changes already made to accommodate SRIT.
23. Up to 14 December 2017, HMRC has invoiced the Welsh Government for £69,077 to implement WRIT.

Welfare

24. DWP is preparing to make the necessary changes to its infrastructure for the introduction of WRIT from the tax year commencing 6 April 2019. DWP propose to agree with the Welsh Government the financial and practical arrangements for ensuring DWP-administered taxable benefits and associated IT systems recognise and interact with WRIT, and that benefit recipients, who are also Welsh taxpayers, have the correct tax information recorded for HMRC purposes.
25. The agreement to be reached with the Welsh Government is likely to take the form of an Exchange of Letters accompanying a detailed technical Annex and will be published. Work needed to identify the IT systems and clerical processes that will be impacted by WRIT has been completed and DWP has secured the necessary approval for the changes to be made and completed by the April 2019 implementation date.

Steps to be taken towards implementation in 2018

26. Much of the activity needed to implement WRIT will take place in 2018.

27. With regards to IT, this will include changes that:
- Introduce a new “C”³ code into the PAYE system to identify Welsh taxpayers;
 - help employers to differentiate between UK and Welsh taxpayers;
 - update HMRC’s online calculators for Self Assessment and PAYE;
 - update HMRC’s Personal Tax Account;
 - support third party software developers to update their own products to recognise WRIT; and
 - update the systems used for enforcement and compliance purposes.
28. With regards to Welsh taxpayer identification, HMRC will carry out a wide range of activities during 2018 to ensure that HMRC address data is as accurate as possible before WRIT comes into operation. This will include actions to identify, cleanse and assure the accuracy of Welsh addresses on HMRC’s systems.
29. The above will be supported by a coherent and consistent programme of communications targeted at key audiences, such as employers, agents, software developers and individual taxpayers designed in conjunction with the Welsh Government. HMRC will undertake a range of internal communications to inform its staff of the changes brought about by WRIT and the impacts it will have on HMRC business.

³ Welsh taxpayers will be identified on tax coding notices via a “C” code instead of a “W” code to reflect *Cymru* rather than *Wales*

CHAPTER 3

WELSH TAXES ON LAND TRANSACTIONS AND DISPOSALS TO LANDFILL

Introduction

30. 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.
31. In summer 2017, the Assembly passed the Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act 2017 and Landfill Disposals Tax (Wales) Act 2017 that provide for the introduction of a Land Transaction Tax (LTT) and Landfill Disposals Tax (LDT) to be introduced on 1 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.
32. The Welsh Revenue Authority (WRA) was established on 18 October 2017 and will administer both LTT and LDT from 1 April 2018.
33. A joint project was set up by HMRC 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 includes representatives from HMRC and the Welsh Government (since October 2017 the WRA). Board members are involved in decision making to ensure that the project provides effective solutions and value for money. HMRC is represented on the Welsh Government's Operational Policy and Delivery Project Board. This representation gives both HMRC and Welsh Government visibility of key decisions and allows a collaborative and joined-up approach to project delivery.
34. HMRC and the Welsh Government are working closely together on tax, legal and operational issues to ensure a smooth transition to the devolved taxes. To facilitate this HMRC and the Welsh Government signed a Memorandum of Understanding on Land Transaction Tax and for the disclosure of information in 2016.
35. The Welsh Government pays HMRC's costs associated with ceasing to operate SDLT in Wales. Due to the relatively small numbers of Landfill Tax operators affected by the changes being implemented, and the fact that relatively few changes are to be required to HMRC's systems, HMRC has agreed that any costs associated with the disapplication of Landfill Tax in Wales will not be passed on to the Welsh Government. HMRC will transfer to the Welsh Government the savings from no longer administering these taxes in Wales.

Steps taken towards implementation

Project governance

36. The joint project is overseen by the Welsh Tax Devolution Programme Board (see para 14 above).
37. HMRC's internal Change, Assurance and Investment unit carried out a "Critical Friend Review" of the Joint SDLT and Landfill Tax Project on 1-2 November 2017, assessing the project as Amber-Green and concluding the project "*will be able successfully to achieve its live implementation date*". The purpose of the review was to give independent assurance on the current status of the project in respect of governance, resource and processes and that it is on course to deliver its objective of dis-applying the taxes in Wales on 1 April 2018. The project is acting on both recommendations produced by the review.
38. Welsh Government and HMRC officials have worked together to establish criteria that will be used to assess the readiness of both Governments for the disapplication of the UK taxes and the introduction of their Welsh replacements. At the time of writing it is anticipated that both Governments will be in a position to make assessments of readiness against that criteria by 31 December 2017.

Communications

39. A Joint Communications Group ("JCOMM") was set up in February 2017 to develop a collaborative approach between HMRC and the Welsh Government on communicating the tax changes. JCOMM has representation from HMRC, the Welsh Government (since October 2017 the WRA) and Land Registry and reports to the Project Board.
40. Members are working with a range of external stakeholders on the development of joint guidance explaining the transitional arrangements between the taxes, which will be published early next year. Work is also underway on updates to GOV.UK and key stakeholders in advance of the transition date.
41. ENTRUST, the HMRC appointed regulator of the Landfill Communities Fund (LCF), which will close in Wales after a transitional period, held a Wales closure workshop in Cardiff in October 2017 for environmental bodies and published updated guidance about the closure of the LCF in Wales on their website in November⁴. The Welsh Government will introduce the landfill disposals tax communities scheme from April 2018⁵.

⁴ Further information is available on ENTRUST's website: <http://www.entrust.org.uk/landfill-community-fund/wales/>

⁵ Further information at: <http://gov.wales/funding/fiscal-reform/welsh-taxes/landfill-disposals-tax/communities-scheme/?lang=en>

IT

42. Work has started on the changes required to HMRC's systems. These are: changes to HMRC's systems to prevent transactions liable for LTT being submitted and processed for SDLT; and arranging the transfer of LTT transactions data from WRA to HMRC and the Valuation Office Agency (VOA).

Costs

43. HMRC estimates the overall cost of transitioning to LTT in Wales will be £1.75 to 2 million. This is higher than the original estimate of £1 million given to the Welsh Government largely due to changes to HMRC's IT platform and increasingly sophisticated cybersecurity systems and processes.
44. Up to 14 December 2017, HMRC has invoiced the Welsh Government for £289,893 to implement the transition to LTT in Wales.

Steps to be taken towards implementation in 2018

45. The transition to the devolved taxes is due to take place on 1 April 2018. This is also the *Principal Appointed Day* when the new reserved powers model of Welsh devolution comes into force.
46. A meeting of the Joint Exchequer Committee (Officials) will take place in January to assess HMRC and the WRA's joint readiness for the transition to the new taxes, followed by an exchange of Ministerial correspondence. Subject to agreement to transition, HMRC will make Appointed Day Orders to switch off SDLT and Landfill Tax in Wales.
47. HMRC and the WRA will publish joint transitional guidance for conveyancers on the transition from SDLT to LTT and further guidance on cross-border transactions⁶ in early 2018. This will be supported by other targeted communications to key stakeholders, updates to GOV.UK, and messages to make clear the respective roles and responsibilities of the tax authorities as the WRA starts to open for LTT and LDT registrations.
48. HMRC will complete and test the IT solution required to support the transition.
49. Following the establishment of the WRA, HMRC and the WRA will put in place a Memorandum of Understanding, information sharing agreement

⁶ Cross border transactions are those where the England-Wales border passes through the title of a property

and joint approach to compliance on the devolved taxes to enable effective collaborative working following transition.

50. Landfill site operators that only operate in Wales will be deregistered from Landfill Tax. The LCF will enter a two-year transitional period to enable LCF projects in Wales to be completed and for all remaining LCF funds in Wales to be spent. The transitional period will run from 1 April 2018 to 31 March 2020. Legislation setting out the disapplication of Landfill Tax and closure of the LCF will be laid early in 2018.

CHAPTER 4

BORROWING POWERS

51. 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

52. The UK and Welsh Governments have agreed further detail on the Welsh Government's borrowing powers in the Welsh Government's new fiscal framework⁷, which was agreed in December 2016.

53. The fiscal framework agreement sets out that:

- The Welsh Government's overall capital borrowing limit will increase from the £500m provided for in the Wales Act 2014, to £1bn from 2018-19 onwards. The Welsh Government's annual capital borrowing limit will increase to £150m from 2019-20.
- The Welsh Government will be able to borrow for capital expenditure from the National Loans Fund, or through a commercial loan – and following implementation of the UK government's St David's Day

⁷https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/578836/Wales_Fiscal_Framework_Agreement_Dec_2016_2.pdf

announcement, the Welsh Government will also be able to issue bonds.

- The Welsh Government's resource borrowing powers will remain as set out in the Wales Act 2014, and the Welsh Government will have access to additional budget management tools through the creation of a new Wales Reserve from April 2018 (see 'Other Activities Towards Implementation' in chapter 7 below).

54. The UK government has subsequently legislated in the Wales Act 2017 to increase the Welsh Government's capital borrowing limit to £1bn.

CHAPTER 5

POWER TO CREATE NEW TAXES

55. With the agreement of both governments, further existing taxes can be devolved through secondary legislation and the Assembly can be granted powers 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.

56. In relation to new Wales-specific taxes, the Command Paper⁸ published alongside the Wales Bill in 2013 set out the UK government's intended assessment criteria. 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.

57. The Paper also set out the detail that the Welsh Government would need include in any proposals for new taxes, including on:

- estimated revenue and economic impact;
- estimated impact on UK revenue or interaction with UK-wide taxes;
- expected impacts on business and individuals (including a distributional impact);
- assessment against all relevant legislation and directives, including the Human Rights Act, EU State Aid rules, Equality Act etc; and
- collection and compliance plans.

Steps towards implementation

58. Accordingly, UK and Welsh Government Ministers have agreed to put in place a process for assessing Welsh Government proposals for new Wales-specific taxes.

59. The Welsh Government published a shortlist of ideas for new Welsh taxes in its draft Budget. It plans to propose one of the following new taxes to the UK government in 2018 to test the powers to introduce new taxes:

- A levy to support social care
- Vacant land tax
- A disposable plastic tax
- A tourism tax

⁸ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/294470/Wales_Bill_Command_Paper_-_English.pdf

CHAPTER 6

EFFECT OF NEW POWERS ON THE WELSH BLOCK GRANT

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

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

- From 2018-19 a needs-based factor will be included in the Barnett formula, to determine changes to Welsh Government block grant funding in relation to spending devolution.
- This needs-based factor will be 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% will be set.
- Changes to block grant funding in relation to tax devolution will be determined through the Comparable model.
- The mechanism for adjusting the block grant will include 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 will be applied to Stamp Duty Land Tax, Landfill Tax, and each band of Income Tax.

62. The fiscal framework also provides for treatment of policy spillover effects, where the policy decision of one government has an impact on the tax or spending of the other. It was agreed in the framework that the UK and Welsh Governments:

- Would account for all direct effects, either through a block grant adjustment or separately once identified. These are financial effects that directly and mechanically occur as a result of one government's policy decision, before any associated behavioural change.
- Would only account for behavioural effects in exceptional circumstances, where the effects are material and demonstrable, and both governments agree that it is appropriate to do so. These are financial effects that result from people changing behaviour following a policy decision.
- Would not account for second round effects. These are the wider economic impacts that may result more indirectly from policy decisions.

Steps towards implementation

63. The UK government applied the new fiscal framework funding arrangements to the Welsh Government's block grant for the first time at Autumn Budget 2017.

64. This included the block grant deductions in relation to Landfill Tax and Stamp Duty Land Tax devolution in 2018-19, and the addition of the needs-based factor in the Barnett formula in relation to spending decisions from 2018-19 onwards. It does not include deductions for the Welsh Rate of Income Tax which will be devolved in 2019-20. Deductions for the Welsh Rate of Income Tax will be set out at Autumn Budget 2018.

65. The tax adjustments were based on the forecasts for the relevant taxes that the OBR published alongside the Autumn Budget, and will result in the following deductions from the Welsh Government's block grant:

£m	2018-19	2019-20
Total deductions for tax	269	277

66. The application of the Barnett needs-based factor will result in the following additions to the Welsh Government's block grant:

£m	2018-19	2019-20	2020-21
Non-ringfenced fiscal RDEL	6.9	9.1	
Ring-fenced RDEL (depreciation)	0.6	1.2	
Ring-fenced RDEL (student loan impairments)	0.7	1.4	
CDEL	7.7	17.9	23.9
<i>o/w Financial Transactions Capital</i>	1.2	2.1	1.7
Total additions from Barnett needs-based factor	16	29.6	23.9

CHAPTER 7

OTHER ACTIVITIES TOWARDS IMPLEMENTATION

Forecasts by the Office for Budget Responsibility (OBR)

67. The OBR began publishing forecasts of taxes collected in Wales alongside the Autumn Statement 2014, and will continue to publish these forecasts twice a year, as part of their statutory duty to produce tax forecasts for the whole of the UK.

68. As agreed in the fiscal framework, the OBR's forecast of tax collected in Wales at the point of devolution will be used to inform the baseline deduction to the Welsh Government's block grant for each devolved tax. The Welsh Government's block grant will subsequently be indexed based on changes in corresponding UK government taxes – these will be based initially on the OBR's forecasts, and then reconciled to outturn data once available.

69. The fiscal framework also sets out a requirement for the Welsh Government to use independent forecasts of the devolved taxes they are due to collect. As agreed in the framework, they will be able to decide whether to use the OBR's forecasts or to put in place alternative independent arrangements.

70. While putting these arrangements in place, the Welsh Government will be able to produce their own forecasts of devolved taxes, which will be subject to independent scrutiny. The Welsh Government did so for Welsh Landfill Tax and Land Transaction Tax at their draft budget in October.

71. The Welsh Government stated in their draft budget that their preference would be to use the OBR's forecasts for devolved taxes in future. UK and Welsh Government officials continue to explore potential options.

Wales Reserve

72. 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.

73. The Welsh Government's new fiscal framework sets out further details for a new Wales Reserve, which will combine their cash reserve and access to the Budget Exchange facility.

74. The Wales Reserve will become operational alongside the devolution of SDLT and Landfill Tax in April 2018. There will be no annual limit for payments into the Wales Reserve, which will be able to hold up to £350m in aggregate. The Welsh Government will have an annual drawdown limit from their Reserve of £125m for resource, and £50m for capital.

CHAPTER 8

OTHER REPORTING REQUIREMENTS

75. 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.

76. This report is the third 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.

77. 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 will bring forward an Order to implement WRIT from 2019-20.

78. 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.

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

CONCLUSION

80. 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).
81. This year has seen further progress towards full implementation of the Wales Act 2014. The UK government is working closely with the Welsh Government to ensure the necessary arrangements are in place to manage the transition to devolved taxes from 1 April 2018.
82. The fiscal framework agreed between the UK and Welsh Governments sets out how the Welsh Government's block grant will be adjusted to take account of tax devolution. In addition, the Wales Act 2017 also made provision in relation the tax and borrowing powers of the Welsh Government. The removal of the referendum on income tax and the agreement of the appropriate block grant adjustment will enable the devolution of WRIT from 2019-20.
83. 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 2018.

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: Paragraphs 11-25
Chapter 3: Paragraphs 36-44
Chapter 4: Paragraphs 52-54
Chapter 5: Paragraphs 58 & 59

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 26-29
Chapter 3: Paragraphs 45-50

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