



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Bruce Crawford MSP (Convener)  
Devolution (Further Powers) Committee  
The Scottish Parliament  
Edinburgh  
EH99 1SP

7<sup>th</sup> March 2016

Dear Bruce,

#### FISCAL FRAMEWORK

Thank you for inviting me and the Secretary of State to appear at your Committee meeting of 3 March 2016. I found it very valuable and I hope we were able to give helpful evidence to you and your members.

2. I committed to write to you on two specific issues: tax baseline adjustments and the availability of the Report to be produced by the end of 2021.

#### Block grant baseline adjustments for tax

3. Further details on the approach to block grant adjustments will be set out in the fiscal framework technical annex in due course, but the key points are:

- we will ultimately use outturn figures for the year prior to devolution to determine the baseline adjustment;
- we will then apply the indexation mechanism to determine the adjustment for the first year of devolution;

4. As such, rather than trying to agree an estimate of tax foregone by the UK government in the first year of devolution (which is very difficult if the Scottish Government changes tax policy in this year, as we discovered previously with the Land and Buildings Transactions Tax), we are instead applying the agreed



indexation mechanism to the outturn in the year immediately prior to devolution. This use of outturn (plus indexation) provides a more robust starting point for the new funding arrangements.

5. However, as was noted by the Committee, outturn for the year prior to devolution may not be available when the baseline adjustment is originally applied. We will therefore provisionally use a forecast and subsequently reconcile this to outturn once this information is available.

6. In the case of income tax, for example, we will provisionally use a forecast of relevant Scottish income tax revenues in 2016-17 to set the baseline block grant adjustment, which will subsequently be reconciled to outturn once this is available. To determine the Scottish Government's block grant for 2017-18, we will also apply the agreed indexation mechanism to changes in UK government income tax revenues (excluding Scotland) between 2016-17 and 2017-18.

7. This is analogous to the way in which the Barnett Formula operates with reference to a baseline block grant. For example, at the recent Spending Review a baseline block grant was set for 2015-16 (the year prior to the new Spending Review period) and the Barnett Formula was applied to changes in planned UK government spending in future years.

#### Availability of the 2021 report to the Scottish Parliament

8. We will need to agree the precise arrangements for the independent report with the Scottish Government and make sure those independent experts authoring the report are content with those arrangements. I hope personally that we will be able to involve both Parliaments in the review process, but it is too early to set that out definitively.



9. I hope this responds to the questions raised by your Committee and that you continue in your important role of scrutinising the Scottish Government's new Fiscal Framework and the Scotland Bill.

10. I am copying this letter to the Secretary of State for Scotland.

Yours,

A handwritten signature in blue ink, appearing to read "G Hands", written in a cursive style.

GREG HANDS