



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

Bruce Crawford, MSP
Convenor of the Finance and Constitution Committee
The Scottish Parliament
Edinburgh
EH99 1SP

31 October 2019

Dear Bruce,

VAT ASSIGNMENT

1. I am writing to confirm that the transition period for Scottish VAT assignment will be extended by one year with full implementation now in April 2021.

Background

2. The Smith Commission determined that a share of Scottish VAT should be assigned to the Scottish Government's budget. VAT assignment increases the link between the Scottish Government's funding and the performance of the Scottish economy, which reflects the decisions the Scottish Government takes in areas such as economic development, skills, planning, tax and infrastructure investment. VAT assignment is therefore integral in making the Scottish Government more accountable for the fiscal impact of their policy decisions.

3. As part of the fiscal framework the UK and Scottish governments agreed further details about the arrangements.

4. First, that the Scottish Government would take on the marginal risk that Scottish VAT per head grows differently from corresponding UK Government VAT revenues. This means the Scottish Government's budget is still shielded from UK-wide fluctuations in VAT but reflects Scotland-specific changes that are influenced by their decisions as set out above.

5. Second, that we would assign the Scottish share of VAT receipts using a "methodology that will estimate expenditure in Scotland on goods and services that are



liable for VAT". This approach is necessary because the VAT system does not split receipts by country, and asking businesses operating across the UK to change their reporting arrangements accordingly would involve creating a very significant new burden.

6. Officials in the UK and Scottish governments have therefore jointly developed a methodology that is based on international best practice, has been tested extensively, and discussed with key stakeholders. Details of the VAT assignment methodology were agreed and published by the UK Government in November 2018. The methodology was also jointly presented in March 2019 to stakeholders including the Scottish Fiscal Commission, Fraser of Allander and the Office for Budget Responsibility. In the next few months HM Revenue and Customs (HMRC) are due to publish further details on behalf of the joint official-level working group.

Extension of the transition period

7. Earlier this year, Derek Mackay wrote to my predecessor outlining concerns that VAT assignment imposed a disproportionate level of financial risk on the Scottish Government. We also discussed at our first meeting in August and I am aware that your Committee share at least some of these concerns.

8. I still consider the VAT assignment methodology to be fundamentally sound. It is a comprehensive and sophisticated method for calculating VAT receipts on goods and services across the Scottish economy. However, I have listened to the concerns that have been raised. In particular, while this methodology allows HMRC to calculate Scottish VAT receipts accrued on several hundred components of Scottish expenditure, it is also necessary to identify and manage potential uncertainty in the underlying survey data. The UK and Scottish governments are currently developing and testing solutions to mitigate this uncertainty.

9. While I am sure our officials would be able to complete this work before autumn 2022, which is when we would use the methodology to determine Scottish VAT outturn for 2020-21, I will instead extend the transition period by 12 months so we implement in April 2021.



10. To meet this timetable, officials will complete further work on the survey data to inform OBR forecasts at Spring Statement 2020 (and be available to the Scottish Fiscal Commission at the same time). This will enable the forecast process to be tested before these new VAT forecasts feed into our respective Budgets in autumn 2020.

Next steps

11. This extension demonstrates our commitment to working collaboratively with the Scottish Government to implement the Scotland Act 2016 and fiscal framework in a way that delivers the right outcome for Scotland. I believe VAT assignment would be ready for implementation in April 2020 so fully expect commencement to proceed in April 2021. Before VAT assignment commences the Scottish Government will continue to have access to the full range of budget management tools set out in the fiscal framework. I will also be writing to Derek Mackay shortly on his request for further budget management flexibility.

12. I understand officials will be visiting the Committee to explain the technical detail of the methodology in the coming months. If you have any questions in the meantime, they are happy to provide further information.

13. I am copying this letter to the Secretary of State for Scotland and the Financial Secretary to the Treasury.

Best wishes,

A handwritten signature in blue ink, appearing to read 'Rishi Sunak'.

RT HON RISHI SUNAK MP

