Written Response by the Welsh Government to the report of the Finance Committee entitled 'Inquiry into the implementation of the Wales Act 2014 and operation of the Fiscal Framework'

The successful introduction of the three Welsh taxes devolved by the Wales Act 2014 has been a significant achievement during this Senedd term, strengthening the accountability of the Welsh Government and the Senedd to the people of Wales. The revenue from Land Transaction Tax, Landfill Disposals Tax, and Welsh Rates of Income Tax - together with non-domestic rates (which was devolved financially in 2015) - now fund around 20% of Welsh Government spending on public services.

Land Transaction Tax and Landfill Disposals Tax have been collected and administered for almost three years by the Welsh Revenue Authority, Wales' first non-ministerial department. I welcome the Committee's acknowledgement of the important contribution made by the Welsh Revenue Authority.

Our *Tax Policy Framework* (June 2017) describes what we aim to achieve through Welsh taxes, including our principles - seeking to create fair, stable taxes, which support wider policy objectives, and help to deliver equality. I am grateful for the Committee's supportive comment about the fairness of the Welsh taxes to businesses and people.

The Fiscal Framework performs a critical role by setting out the arrangements for tax devolution. Overall this has worked effectively, but there is a strong case for increasing our capital borrowing limit, and widening our scope to use the Welsh Reserve. I am pleased to note the Committee's agreement on both points.

The inclusion of a needs-based factor in the Barnett formula, agreed as part of the Fiscal Framework, has helped to deliver a fairer level of funding for Wales. To date, it has provided around £650m for devolved Welsh public services. However, in the longer term, a consistent, needs-based approach should be established for the whole of the UK.

As set out in our report *Reforming our union: shared governance in the UK* (October 2019), the operation of resourcing arrangements, including determinations of devolved administrations' spending power and borrowing limits, should be the responsibility of a public agency accountable to all four administrations jointly. I am grateful for the Committee's support for an independent process.

I welcome the Finance Committee's report on its inquiry into the implementation of the Wales Act 2014 and operation of the Fiscal Framework, and I have set out my responses to the recommendations below.

Responses to the recommendations in the report

Recommendation 1: The Committee recommends that the Welsh Government continues to build on the existing knowledge and awareness of Welsh taxes with the public, businesses and professionals to further improve awareness and engagement on fiscal devolution in Wales.

Response: Accept.

We agree it is important to continue raising awareness of Welsh taxes, and we are focusing on major fiscal events, such as the Welsh Budget, to increase understanding of the implications of fiscal devolution for people and businesses. Surveys to date have evidenced an increase in awareness of Welsh Rates of Income Tax (WRIT) by 14%. This was measured at the point just after introduction, when fiscal devolution in Wales reached its widest audience. Further research is currently in commission.

The WRIT calculator, and changes introduced in December 2020 to the Annual Tax Summary (ATS), are improving understanding by explaining how tax liability is calculated, and illustrating how the tax is spent. The ATS shows the amount of WRIT paid by Welsh taxpayers, including a link to a WRIT calculator which will provide a high level breakdown of where individual contributions have been allocated across key public services in Wales[1]. This builds on existing knowledge and awareness of Welsh taxes in Wales by helping people link tax and spend, and by highlighting some of the areas devolved to Wales, and how tax contributions are helping to support those areas.

We have strong working partnerships with the Welsh Revenue Authority and HMRC to enable quick and effective dissemination of key information through established operational channels. These include working with professional bodies and producing webinars and videos for tax professionals. The Tax Engagement Group enables us to discuss developments in tax policy with those who can represent the views of Welsh tax payers.

Further details of engagement activity over the past year is provided in Section 13 of the Welsh Government's Welsh Tax Policy Report 2021, published on 4 March.[2]

Financial Implications: None. Any additional costs will be drawn from existing programme budgets.

Recommendation 2: The Committee recommends that the Welsh Government and HMRC work closely to ensure an integrated and complementary engagement strategy on the Welsh Rates of Income Tax.

Response: Accept.

The response to recommendation 1 includes reference to the work conducted by Welsh Government and HMRC on raising awareness of WRIT. In addition, the Welsh Government and HMRC have collaborated on the communications strategy for WRIT.

[1] Welsh Annual Tax Summary calculator:
https://gov.wales/calculate-welsh-income-tax-spend
[2] *Welsh Tax Policy Report 2021* (March 2021):
https://gov.wales/welsh-tax-policy-report-2021

The main message to Welsh customers about WRIT is the importance of keeping their address details up to date, to ensure that HMRC can accurately identify Welsh taxpayers on their systems. Reminders for customers to do this are delivered through HMRC's regular communication with taxpayers, for instance through prompts on their digital services. Customers are also required to provide or confirm their address details on Self-Assessment returns. HMRC has guidance on gov.uk specifically about WRIT, including for customers who have more complex residency situations. HMRC monitors the amount of customer contact they receive in relation to WRIT, and figures are provided to the Welsh Government in quarterly Business Intelligence Reports.

We will continue to work closely with HMRC to ensure that future any communications needs are identified.

Financial Implications: None. Any additional costs will be drawn from existing programme budgets.

Recommendation 3: The Senedd also has a role in educating, engaging, and informing the Welsh public on fiscal devolution and the Committee recommends that the Senedd Commission considers how it can contribute to this in the Sixth Senedd.

Response: Accept.

The Welsh Government supports the important role played by the Senedd in educating, engaging and informing the Welsh public on fiscal devolution. The Welsh Government will continue to collaborate and share best practice with the Senedd Commission with regard to engaging citizens on fiscal devolution in Wales.

Financial Implications: None. Any additional costs will be drawn from existing programme budgets.

Recommendation 4: The Committee recommends that the Welsh Government provides an update on how it is progressing considerations around targeting certain groups to boost tax revenues with the wider objectives of making Wales a fair and inclusive nation that delivers for all of its current and future citizens.

Response: Accept.

Section 1 of the Welsh Government's Welsh Tax Policy Report 2021, published on 4 March, provides an update on the actions it is taking to strengthen the Welsh tax base by supporting Welsh citizens[3].

The Welsh Government will continue to undertake research to provide a better understanding of the Welsh tax base. As part of this on-going research, a detailed analysis of the tax base for Welsh Rates of Income Tax (WRIT) is provided at Annex two of the Welsh Tax Policy Report.

Financial Implications: None. Any additional costs will be drawn from existing programme budgets.

[3] *Welsh Tax Policy Report 2021* (March 2021):
https://gov.wales/welsh-tax-policy-report-2021

Recommendation 5: The Committee believes that the Welsh Government should have the legislative powers to respond quickly to tax policy changes but recommends that any future primary legislation underpinning these powers provides that the powers are only used in appropriate circumstances, such as to avoid distorting behaviour or when new avoidance or evasion opportunities need to be addressed immediately.

Response: Accept.

The Welsh Government welcomes the Committee's interest in the development of a potential bill to enable changes to be made at short notice to the Welsh Tax Acts by regulation. The Welsh Government agrees that such powers should be only used in a number of specified circumstances.

Following the publication of the summary of responses to the *Tax Devolution: Enabling changes to the Welsh Tax Acts* consultation[4] on 21 December 2020, officials are drafting legislation in readiness should the next Senedd choose to take this forward. The ability to make changes to tax legislation quickly is intended to enable the Welsh Government to respond to scenarios where it is desirable for the change to have effect immediately or very soon thereafter. A change of this kind may be appropriate where the Welsh Treasury and the Welsh Revenue Authority need to promptly 'close-down' tax avoidance schemes, or to enable the Welsh Government to respond to tax policy changes made by a UK government to predecessor UK taxes (that is, one where we have an equivalent devolved tax). In this scenario, the legislation would provide Welsh Ministers with a proportionate mechanism to protect Welsh revenues.

Financial Implications: None. Any additional costs will be drawn from existing programme budgets.

Recommendation 6: The Committee recommends that the Welsh Government provides an update on its work exploring the feasibility and impact of replacing council tax and Non Domestic Rates with a local land value tax. Recognising the impact COVID-19 may have had on this work, this should be provided to the Finance Committee of the Sixth Senedd.

Response: Accept.

Reforming Local Government Finance in Wales: Summary of Findings, published by the Welsh Government on 24 February, provides the latest update on our considerations about the reform of local government finance in Wales[5].

The latest report draws together a summary of research into the feasibility of a local land value tax (LVT) to replace council tax and non-domestic rates alongside our research into other options for the local taxes in Wales. While an initial study by Bangor University, commissioned by the Welsh Government, concludes a local LVT could raise sufficient revenues to replace the current local taxes, it also concludes the data infrastructure requirements for implementing a local LVT are not currently met. We conclude at this stage that a local LVT has the potential to meet our primary objective of raising revenues for local services in a more progressive way. However, there would be an enormous number of policy

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[4] *Tax Devolution in Wales - Enabling changes to the Welsh Tax Acts* (July 2020): https://gov.wales/enabling-changes-to-welsh-tax-legislation

[5] *Reforming Local Government Finance in Wales: Summary of Findings* (February 2021): https://gov.wales/reforming-local-government-finance-wales-summary-findings

choices to consider and narrow down to ensure a local LVT delivered an improved system compared to the existing local taxes. There would also be a significant task in creating the legal framework, information infrastructure and operational arrangements.

The *Summary of Findings* also covers a number of ideas for reform which were expressed to the Committee during its evidence gathering. These include research by the Institute for Fiscal Studies on options for council tax reform, including revaluation and rebanding or proportional systems. The *Summary of Findings* also includes initial consideration of alternative approaches to valuation methodology. On non-domestic rates, it draws together the various ideas proposed for future consideration if more radical options such as land value tax are not favoured. Aside from land and property taxation, the *Summary of Findings* also includes an initial consideration of whether local taxes could be based more closely on other indicators of ability to pay, such as household incomes.

Financial Implications: None. Any additional costs will be drawn from existing programme budgets.

Recommendation 7: The Committee recommends that the Welsh Government responds with its view on the feasibility of the devolution of a capital gains tax and whether this could replace the need to seek competence on the vacant land tax.

Response: Accept.

The rationale for seeking competence for a vacant land tax is driven by the Welsh Government's commitment to bring vacant land and stalled sites back into economic use. In assessing the feasibility of the devolution of additional taxes, we would need to be clear on the rationale for seeking such powers.

There would be a much wider set of policy considerations in relation to seeking devolution of capital gains tax on property transactions. The proposal would risk creating unintended consequences for the property market in Wales, and there would also be practical challenges to operating such a scheme in Wales, as well as considerations about the impact on Welsh Government revenues.

We know from our experience to date in seeking competence for vacant land tax that devolution of additional tax powers is not an easy or straightforward process. Our current focus remains on securing the devolution of what should be a more straightforward tax in terms of rationale and impact.

Financial Implications: None. Any additional costs will be drawn from existing programme budgets.

Recommendation 8: The Committee recognises the importance of tracking the impacts of WRIT over time and recommends that the project to deliver longitudinal data should be a key priority for the Welsh Government and HMRC.

Response: Accept.

As part of regular working level engagements to support the devolved administrations in pursuing their policy and analytical objectives, the Analytical Working Group (comprising representatives of HMRC, the Welsh Government, the Scottish Government, the Office for

Budget Responsibility, and the Scottish Fiscal Commission) is considering possible designs and methodologies for a longitudinal dataset.

This work was paused in recent months due to HMRC prioritising the development of the WRIT Ready Reckoner, and the focus on supporting the forecasts of devolved income tax in the Welsh and UK Government Budgets, on 2 and 3 March 2021 respectively.

The longitudinal dataset, in agreement with the Analytical Working Group, is expected to form part of HMRC's Devolved Team workplan for the spring and summer months of 2021, before the next fiscal event cycles begin in the autumn.

Financial Implications: None. Any additional costs will be drawn from existing programme budgets.

Recommendation 9: The Committee recommends that the Welsh Government provides an update on how it is reviewing HMRC's activities to minimise coding errors and monitoring the database of Welsh taxpayers to identify migration across the Wales-England border throughout the year.

Response: Accept.

As part of its responsibility for delivering WRIT, HMRC has an ongoing education and compliance programme to address C code issues, as well as articles and reminders in regular employer bulletins. HMRC is required to identify Welsh taxpayers and assure the taxpayer population remains up to date. HMRC takes a number of steps to keep its address data current, and to corroborate it with other sources.

There is no definitive record/data set of Welsh taxpayers against which to judge identification. The Welsh taxpayer address base is a constantly moving target as people move into and out of Wales. However, the checks of its address data against third party data sets has enabled HMRC to corroborate, with external sources, the addresses it holds for up to 98% of the population. We have agreed to undertake another third party data 'clash' exercise this year, with the results of the scan expected in summer 2021.

Work on this issue is continuously improving and HMRC's approach to the incorrect application of C codes is focusing increasingly on targeted communications to employers. The results of this work have been positive, and in January 2021 the error rate had reduced to 2.8%, compared to 10.4% in June 2019. The Welsh Government regularly reviews HMRC activities in this area, and updates are provided at Welsh Rates of Income Tax Board meetings. Welsh Government officials hold HMRC to requirements set out in the Memorandum of Understanding and Service Level Agreement, and challenge where necessary to ensure work on this issue continues to improve. HMRC is confident the numbers should reduce again before the next scan, later in 2021.

Financial Implications: None. Any additional costs will be drawn from existing programme budgets.

Recommendation 10: Noting the Welsh Government's view that the timing of UK fiscal events is a matter for the UK Government, the Committee recommends the Welsh Government continues to address the need for greater certainty through multi-year funding allocations and clarity of the timing of UK fiscal events with the UK Government.

Response: Accept.

The Welsh Government welcomes the Committee's recognition of the issues caused by single year funding allocations.

The most recent multi-year Spending Review was in 2015, despite the UK Government announcing one in both 2019 and 2020. A multi-year spending review would allow us to plan our own budget over a longer time horizon, and provide greater certainty to our partners and stakeholders. That said, the need to react to the COVID-19 pandemic has meant there has inevitably been an emphasis on short term budget planning over the last year.

The uncertainty around the timing of UK fiscal events has implications for the Welsh Government's own budget planning, and has made it more challenging to ensure the provision of adequate opportunity for scrutiny in the Senedd. The impact of these uncertainties is greater now the budget process has to take account of devolved tax revenues. This was recognised in the joint review of our arrangements with the Office for Budget Responsibility (OBR), published on the OBR's website, which highlighted that we had to complete the whole 2020-21 budget cycle without an updated macro-economic forecast.

The implications of uncertainties around the timing of UK fiscal events have also been recognised more widely. The OECD, in its review of the OBR, recommends that *'the dates for the Government's fiscal events and accompanying OBR forecasts should be fixed in legislation'.*

The Welsh Government will continue to make the case to the UK Government for multi-year spending reviews and to push for more certainty and notice regarding the timing of UK fiscal events.

Financial Implications: None. Any additional costs will be drawn from existing programme budgets.

Recommendation 11: The Committee recommends that the Welsh Government provide an update as to how it is ensuring HM Treasury is delivering on the accepted recommendation by the UK Parliaments Public Accounts Committee that the lack of transparency over funding decisions is addressed.

Response: Accept in principle

The Welsh Government would fully support increased transparency over funding decisions. We have made this case to HM Treasury repeatedly and discussed the issue in our evidence to this Committee. Indeed, we would go further than increased transparency, as we believe the current system should be replaced by jointly-agreed funding arrangements, ending bilateral deals and agreements to bring consistency and clarity to the fiscal arrangements within the UK.

We recognise HM Treasury has published some additional information on spending outside of the Barnett formula in the most recent Statement of Funding Policy. The Welsh Government will continue to raise this issue, as enhanced transparency will aid accountability, clarity and fairness. However, it is for HM Treasury to ensure it meets any commitments made to the UK Parliament's Public Accounts Committee.

Financial Implications: None. Any additional costs will be drawn from existing programme budgets.

Recommendation 12: The Committee recommends that the Welsh Government aides transparency of funding by publishing its calculations on consequentials from UK spending announcements.

Response: Accept.

The Welsh Government provides the Committee with details of consequentials following UK Government fiscal events. It can be difficult to estimate the impact on the Welsh Government budget from UK Government announcements outside fiscal events. They can involve funding from existing budgets or may be offset by reductions elsewhere. However, this is often unclear at the time of the announcement. As detailed in the response to Recommendation 11, we continue to raise with the UK Government the issue of transparency of spending announcements and consequentials.

Financial Implications: None. Any additional costs will be drawn from existing programme budgets.

Rebecca Evans MS
Minister for Finance and Trefnydd