



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

Pete Wishart MP
Chair, Scottish Affairs Committee
House of Commons
SW1A 0AA

6 December 2017

Dear Pete,

1. I am writing to inform you of a modification to the block grant adjustment for income tax for the 18-19 Scottish Government Budget which guarantees the effective operation of the fiscal framework. I understand that the Cabinet Secretary for Finance and the Constitution, Derek Mackay MSP, is writing in similar terms to the Scottish Parliament's Finance Committee.
2. You will be aware that each block grant adjustment involves two elements: an initial baseline adjustment and annual indexation thereafter. The general position as set out in the framework and the associated technical annex is that the initial baseline adjustments for each tax are equal to the UK Government's receipts from the relevant tax generated in Scotland in the year immediately prior to the transfer of the tax to Scotland (year 0). Indexation is then applied to the year 0 baseline to determine the block grant adjustment for each tax annually thereafter. All block grant adjustments will initially be based on forecasts; the Office for Budget Responsibility is responsible for forecasts of the block grant adjustments, whilst the Scottish Fiscal Commission is responsible for producing tax revenue forecasts. All figures will be revised and reconciled, and any necessary adjustment made, once outturn data for tax receipts is available.
3. For income tax, the Scottish income tax powers under the Scotland Act 2016 have been in force since 6 April 2017. The initial baseline adjustment is therefore calculated using forecast receipts from income tax in Scotland in 2016-17. As part of the 17-18 Scottish Government Budget, the Office for Budget



Responsibility was responsible for forecasts to inform both the initial baseline adjustment and annual indexation. The Scottish Government were responsible for the income tax revenue forecasts and the Scottish Fiscal Commission provided assurances on the reasonableness of these forecasts.

4. For the 2018-19 Scottish Government Budget however, HM Treasury and the Scottish Government have agreed on an exceptional basis to use the Scottish Fiscal Commission's 2016-17 forecast rather than that provided by the Office for Budget Responsibility for the baseline adjustment that informs the 18-19 block grant adjustment. This is as a consequence of different methodological approaches taken by the SFC and OBR, which without this change in approach would mean that the 16-17 baseline adjustment would not be fiscally neutral as anticipated in the fiscal framework. Such a position would not have been compliant with the Smith Commission principle that the Scottish and UK Governments' budgets should be no larger or smaller simply as a result of the initial transfer of tax spending powers. Again, the figures for the 18-19 income tax BGA and revenue forecast will be reconciled once outturn data for 18-19 income tax receipts are available.

5. HM Treasury and Scottish Government officials are currently finalising the income tax block grant adjustment calculation subject to receiving the Scottish Fiscal Commission's confirmed forecast for 16-17 income tax receipts. The Scottish Government will set out the final agreed figure in its draft Budget for 2018-19. HM Treasury officials will be happy to provide any briefing on the block grant adjustments to Committee Members as and when required.

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

Best wishes,

A handwritten signature in black ink, appearing to be "Elizabeth Truss". The signature is fluid and cursive, with a large loop at the end.

RT HON ELIZABETH TRUSS MP