SCOTLAND’S ECONOMIC FUTURE POST-2014
SUBMISSION FROM THE LAW SOCIETY OF SCOTLAND

Introduction
The Law Society of Scotland was established in 1949 to “promote the interests of the solicitors’ profession in Scotland and the interests of the public in relation to that profession.” This means the Society has an important and prominent role in civic Scotland and has an independent voice on fundamental issues such as the rule of law, constitutional and legal development and the fair and efficient operation of the law for all its citizens.

As the representative body of over 10,500 solicitors who collectively engage with millions of people and across a wide spectrum of issues, we are able to tap into a broad base of experience and expertise. Our Council and various committees are made up not just of legal practitioners but also non-solicitors, academics and other experts from outside the legal profession.

As the statutory regulator of the solicitor profession, we work to ensure the highest possible standards. We also have a duty of care to the public to ensure they are better aware of their rights and how they can access the Scottish justice system.

For these reasons, the Society has a particular interest in good government and the creation of law which is necessary, effective, clear, accessible and coherent. We respond to public consultations and recommend detailed amendments to political representatives during the passing of legislation. We enjoy a regular programme of engagement with MSPs, MPs, and peers from across the political divide and seek at all times to assist political decision-makers to understand the legal impact of the decisions they take.

The Society’s role in the constitutional debate
The Society has taken a close interest in Scotland’s constitutional future for many years and has contributed to many consultations, discussions and debates. Most recently, we set up a ‘Scotland’s Constitutional Future’ Working Group, which established a two-year plan in the run up to the Scottish independence referendum in September 2014.

The first stage of that plan involved a series of roundtable stakeholder events which we hosted in February and March 2013. These engagement events allowed us to hear from people outwith the solicitor profession, who informed and enhanced our understanding of the issues, opportunities and risks associated with Scottish independence. To ensure balance, we made a point of inviting representatives from both the Yes Scotland and Better Together campaigns to each event.

We also drew upon the considerable expertise within our various committees, which cover a broad range of areas, including tax law, pensions, employment and equalities. These committees include not just experienced solicitors with knowledge and experience but also non-solicitors from across civic Scotland.
Material from our roundtable events and committee discussions was collated and used to feed into a discussion paper, which was split into the following subject areas:

- What would independence mean for Scotland’s membership of the European Union and international organisations?
- What impact would there be for Scotland from a ‘no’ vote?
- What would independence mean for the economy and business?
- What would independence mean for judicial and parliamentary restructuring?

In each case, we describe the issues which were presented to us before providing some of our own commentary. We then asked questions which we believe need to be answered by either the Scottish or UK Government before the referendum. This paper was published in August 2013. For the purposes of the Economy, Energy and Tourism Committee’s inquiry, the two headings most relevant to taxation, borrowing and spending are the second and third bullet points. This briefing note is largely based on what we learned from those discussions, subject to subsequent developments in the ongoing debate.

We are currently preparing our response to the Scottish Government’s White Paper Scotland’s Future: Your Guide to an Independent Scotland and we will hold a conference on 10 April, featuring keynote contributions from senior politicians from both sides of the debate, as well as expert analysis on what the polls indicate about the views of those who will decide Scotland’s future. The conference will also explore key topics, such as currency and economics, Scotland’s membership of international organisations, political and parliamentary reform and consider what change could mean for the legal profession itself.

Further information is available on our website: http://www.lawscot.org.uk/events/scotland’s-constitutional-future

What impact would there be for Scotland from a ‘no’ vote?
The idea that each layer of government is responsible for its own taxation and spending provides government with a financial incentive and accountability. Devolution plus is one of numerous middle options between a unitary state, such as the pre-1999 UK, through to full independence. Other options include devo max, and devo more.

Devo plus proposals recommend a structure that will shift the responsibility for raising revenue to create a different balance between Holyrood and Westminster which gives both governments an incentive to act more responsibly within their respective areas of power. The aim of this proposal is, ultimately, to remove the need for a block grant.

At present, the Scottish Government is responsible for raising 7% of all tax income in Scotland, but is responsible for 60% of all expenditure (GERS 2011/12). Although the Scotland Act 2012 has allowed some additional taxes to be devolved to Scotland by 2015, this will see layers of government in Scotland raising around 20% of all tax income raised in Scotland. Under some concepts of enhanced devolution, Scotland would be responsible for raising 60% of the budget in terms of public expenditure, which would include income tax, some or all oil revenues and corporation tax.
In terms of welfare, spending amounted to the largest proportion of public expenditure at UK and Scottish level. Under the current arrangements, the UK Government raises the money for the welfare budget. Some of this, e.g. housing benefit, is spent in areas of devolved competence. Other analyses of enhanced devolution involved looking at the fiscal pact, the social pact and economic pact between citizen and government. The devolution of further powers for the Scottish Parliament should be done on a principled basis rather than simply trying to satisfy a preconceived objective of devolution to the Scottish Parliament. Some things are not and cannot easily be devolved. Any decisions on what further devolution there will be needs to be taken on the basis of stability, practicality and principle.

Principles of further devolution which would require consideration include fiscal policy, welfare, and constitutional rights (including the allocation of funding from general taxation across the UK), the relationship between taxation and expenditure, representation and the role of Scottish MPs voting on purely English matters and how that constitutional position would be sustained in the future.

As much as people in Scotland deserve to know the consequences of a ‘yes’ vote in the referendum, we believe the electorate deserve to know as far as possible the consequences of a ‘no’ vote. The leader of the Scottish Conservative Party has indicated that there will be no cross-party announcement on further devolution for Scotland before the referendum, although the UK Labour and the Liberal Democrat parties have announced that they are working on a post-referendum pact on further powers for Scotland, which could see much greater devolution of tax and welfare powers from Westminster.

We would ask the following questions:

- What powers would the Liberal Democrat, Conservative and Labour parties propose to devolve to the Scottish Parliament in the event of a ‘no’ vote?
- What timescale for further devolution would be proposed by the Liberal Democrat, Conservative and Labour parties?
- To what extent are the Liberal Democrat, Conservative and Labour parties prepared to agree a joint programme for additional powers? How would such additional powers be defined and delivered?
- What changes would be needed to the devolved institutions in the event of further devolution?

What would independence mean for the economy and business?

In terms of currency, the Scottish Government has made its proposed course of action clear which is to adopt the pound sterling within a formal currency union with the UK (Scotland’s Future, Chapter 3, page 110). However, the Chancellor, George Osborne MP, in his speech on the prospect of a currency union on 13 February 2014, stated that he “could not as Chancellor recommend that [we] could share the pound with an independent Scotland”. In the paper “Scotland Analysis: assessment of a sterling currency union” published on the same day, HM Treasury makes it clear that it “would advise the UK Government against entering into a currency union”. Unless the UK Government revises its views, an independent Scotland would be left with a number of currency options such as: unilateral use of the pound sterling outside the scope of a currency union; adoption of the Euro as an EU member state;
unilateral use of the Euro outside the scope of monetary union; or adoption of a new Scottish currency.

The outcome of the negotiations with the EU would determine whether an independent Scotland would be legally committed to join the Euro – as are all Member States with the exception of the UK and Denmark – or benefit from the same derogations as the latter. An independent Scottish Government may be legally committed to join the Euro but still decide not to meet and sustain the membership criteria over a certain period of time, as is the case with Sweden. It was acknowledged that the European Central Bank requires Member States to nominate financial regulators and to take part in EU wide exchange system.

As Mark Carney, Governor of the Bank of England said in a speech to SCDI on 29 January 2014, “A durable successful currency union requires some ceding of national sovereignty”.

It would be a matter of political decision for the Scottish Government as upon what terms it would accept a currency union if one were negotiated. Similarly, it would be a political decision to pursue one of the other currency options e.g. the Euro. In respect of tax and independence, Scotland would be able to design its own tax structure, but the content of any future tax code and the relationship between income, capital taxes and corporation and minor taxes would have to be very clear.

**Assets and liabilities, and shared services**
The division of assets and liabilities will be determined on a fair and proportionate basis by negotiation between the Governments. General principles of public international law including for example the Vienna Convention of Succession of States in State Property, Archives and Debts, suggest that:

1. immovable property for public purposes located in the successor state transfers without compensation to that state; and
2. division of assets has to be negotiated.

Many commentators take the view, with the UK Government, that the rest of the UK will retain the UK’s international personality. As confirmed by HM Treasury on 13 January 2014 in the paper UK debt and the Scotland Independence Referendum, the continuing UK Government would “in all circumstances honour the contracted terms of the debt issued by the UK Government”. It becomes a residual guarantor for the UK’s public debt and it continues to hold the external property of the state.

The paper goes on to state that an independent Scottish state would become responsible for a fair and proportionate share of the UK’s current liabilities but a share of the outstanding stock of debt instruments that have been issued by the UK would not be transferred to Scotland. The Scottish Government in the White Paper states that “…on independence Scotland will accept a fair share of existing UK debt. The amount of debt that we will accept will be subject to negotiations. We will also be entitled to a fair share of UK assets (page 55).” An entirely new agreement between the continuing UK Government and Scotland would be needed and the full spectrum of liabilities, past, future and contingent would need to be considered in negotiations.
Subject to agreement between the rest of the UK and Scotland as to which cross-border or shared services would apply there are some constitutional principles which can be identified. These include:

i. Any arrangements or agreement should be clearly set out between the states e.g. the agreement between the UK Government and the Irish Government which resulted in the North/South Co-operation (Implementation Bodies) (Northern Ireland) Order 1999 (1999/859).

ii. The agreement should be approved by both Parliaments and set out in the context of law which should be subject to Parliamentary scrutiny in both Parliaments.

iii. The agreement and the activity flowing from the agreement should be accountable to both Parliaments.

iv. All joint bodies should publish annual reports and their operation should be transparent.

A Tax System for Scotland
The recently devolved taxes (land and buildings transaction tax (LBTT) and landfill tax (SLfT)) as legislated for by the Scotland Act 2012 have allowed the opportunity to shape a Scottish tax made to apply to Scots law and practice (subject to certain limitations imposed by the restrictive timescales for creating and implementing the taxes, which have led to an element of cutting and pasting from Westminster legislation).

Until now, tax law and guidance has been issued by the UK Government and HMRC which has not been tailored to Scots law and practice, and which has resulted in the need for practical solutions to be developed in order for the taxes to function in Scotland. Often, this relies upon the goodwill of practitioners who understand what the tax intends to achieve in order to ensure compliance.

However, LBTT and SLfT are only part of the complex network of personal, business and charity taxes that make up the UK tax system. Even in relation to these taxes, there is much to consider, including issues that may not necessarily have been foreseen. Individuals and businesses will require certainty that the provisions they have made will either still be effective or will be effectively transitioned in the event that additional taxes are devolved and all the more so if Scotland becomes independent.

If Scottish rates of tax were markedly lower than the rest of the UK, it raises the question of whether Scotland would be able to raise sufficient revenue to maintain adequate public services, including health, welfare and education services. Whereas if they were much higher, Scotland may no longer seem like a desirable place in which to live compared with other parts of the UK and businesses may be discouraged from investing in Scotland if the rates were viewed as anti-competitive. (Of course, the converse may prove to be true: lower tax rates could lead to a better business environment and also attract inward investment, whereas higher rates could lead to better public services.)

Setting up a new tax system in Scotland could take years to achieve (if it is done properly) and the practicalities require considerable thought. In many areas of law,
where responsibility is largely devolved, there are pockets of expertise throughout the UK. However, until recently tax management has been centralised to London and the expertise in relation to its administration is largely confined to there. It will be interesting to see how these issues are tackled in the event that more taxes are devolved and greater resources are required.

Much thought has already been given to the possibility of devolving greater tax powers to Scotland, including by the Calman Commission and by Reform Scotland, which in 2011 published a proposal for a devolution plus option. The proposal left the UK Parliament primarily with VAT and national insurance and devolved most other taxes to the Scottish Parliament where the majority of expenditure takes place. Under this proposal, sufficient borrowing powers would also need to be devolved, leaving the Scottish Parliament to meet its own spending commitments and removing the need for the block grant.

VAT and national insurance were identified for separate treatment for the following reasons: VAT must be constant anyway within each member state in Europe and has less direct influence as an economic lever than many other taxes. National insurance is historically associated with pensions and sick pay, which Reform Scotland proposed should remain a Westminster responsibility.

Some tax advisers have suggested that the best approach is to keep things the same for a number of years. In the event of independence, it would be vital to maintain certainty for individuals and businesses while giving the Scottish Government sufficient time to consult on a new system of taxes and implement it systematically. It would also be important to establish the underlying principles of the new system, such as the importance of meaningful consultation and transparency, from the outset.

Constructing a new tax law (whether in the context of independence or additional powers) could result in simplification and a creative system designed to assist taxpayers and avoid a silo culture between the revenue authority and spending departments. Given the generally positive experience we have had with the devolved taxes so far, it would be worthwhile to identify other areas of law where related tax provisions could be more aligned with Scots law, for example, in relation to trusts. As a general proposition, whatever the outcome of the referendum, a tax system which is tailored to Scotland and Scots law is essential.

The Scottish Government’s White Paper speaks of the Scottish tax system being designed “based on a clear set of principles” (page 118). Later it refers to the principles being Simplicity, Neutrality, Stability and Flexibility, which reflect some of Adam Smith’s four maxims of Certainty, Convenience, Efficiency and Proportionality (ability to pay). The Scottish Government’s stated approach to taxation following the passage of the 2012 Act refers specifically to the Smith maxims, and the Society wishes to see all four retained as policy objectives for the future.

The Society welcomes the cross-cutting approach to the administration and collection of both LBTT and Scottish Landfill Tax (SLfT), by the involvement respectively of Registers of Scotland (RoS) and the Scottish Environment Protection Agency (SEPA). This is an example of a practical and simple approach to the
reduction of compliance effort and cost for both the Government and the taxpayer, and chimes well with the comments of both the Fiscal Commission and the Institute for Fiscal Studies.

In relation to tackling unacceptable tax avoidance, the starting point is to have clear and straightforward legislation however to supplement this, we are generally supportive of the introduction of an effectively targeted General Anti-Avoidance Rule (GAAR), as we think it has the potential to keep anti-avoidance provisions relatively simple (unlike the existing array of individual anti-avoidance measures currently in the UK tax system). Clear and detailed guidance confirming that a range of commonly encountered commercial transactions are not considered to be caught by the GAAR will be absolutely essential to allow the GAAR to operate without introducing too much taxpayer uncertainty which in turn could put Scotland at a competitive disadvantage.

Such guidance will also need to be updated frequently to take into account changes to the way in which commercial transactions are undertaken as a result of changing economic circumstances. We believe there should be a requirement for Revenue Scotland to produce guidance about the types of transactions which are accepted according with established practice and which therefore would not be caught by the GAAR.

It is not for the Society to comment on the political objectives or tax rates issues raised in the White Paper, except to say that differential rates and thresholds create complexity. For example, there are at present different thresholds for UK Income Tax and for UK National Insurance Contributions. In the same vein, the Society would welcome consistent definitions for Scottish tax purposes of key concepts such as "trade" and "business".

On the tax issues in general, the Society welcomes the ambition of a modern and effective Scottish tax system, and in practice, the willingness displayed by the Scottish Government and Revenue Scotland so far to engage with us and others. We look forward to continuing to help deliver this ambition.

Law Society of Scotland
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