1 Introduction

1.1 The Chartered Institute of Taxation (CIOT) is pleased to respond to the Finance Committee of the Scottish Parliament’s call for evidence, as part of the inquiry into the devolution of further fiscal powers.

1.2 We are an educational charity concerned with promoting the education and study of the administration and practice of taxation. For more details see the statement about us at section 6 below.

1.3 We have made a submission to the Smith Commission, in which we focused solely on the devolution of tax powers. Nevertheless, because there is an interaction between taxation and other issues, such as benefits, we stressed there the need for a holistic approach that takes account of them. We take a similar approach in this submission.

1.4 Our Low Incomes Tax Reform Group is commenting separately on matters affecting those on lower incomes and will be dealing with various benefits issues. We would support their submission.

2 General principles

2.1 The Scottish Government has committed itself to a tax system that has regard to Adam Smith’s four principles. When considering taxes for devolution, the principles need to be considered to determine whether or not a tax is appropriate for devolution. The principles are:

- Certainty of how the tax due is determined;
- The burden should be proportionate to the ability to pay;
- Convenience;
- Efficiency of collection.

The CIOT believes that these longstanding principles are still relevant today in helping decide on taxes suitable for devolution. However, we also believe that Smith’s principles need to be expanded to reflect today’s environment and so the CIOT would add:

- Simplicity – it is not possible to achieve certainty unless the taxes are simple and capable of being understood and dealt with by those liable to pay;
- Stability – constant change adds to complexity and damages confidence in the tax system; without stability, certainty will be undermined as further changes may be needed to achieve taxation objectives;
• Fairness – taxes should be administered and collected fairly by the responsible tax authority;
• Consultation – there is a need to consult with those liable to a tax to ensure that there is understanding of the impact and therefore the burden upon them as well as their understanding of what is proposed.

2.2 We note that, in the document entitled ‘The parties’ published proposals on further devolution’, reference is made to the need to ensure that further devolution meets certain other criteria including:

• Accountability
• Economic efficiency
• Administrative efficiency
• Policy relevance
• Legal constraints
• Impact on the UK tax base

We do not see these as being inconsistent with the principles in 2.1 and indeed they are a necessary part of them.

2.3 We consider that there are three main options for further devolution, which can probably be used in combination:

• Assigning an appropriate share of total UK revenues of a particular tax;
• Devolving full power to Scotland over a tax, including the power to change the tax base;
• Giving the Scottish Parliament the power to vary the rate of a tax (but not the power to change the rules for calculation of taxable income or gains), which is then collected by HMRC. The revenues are then passed to the Scottish Government. In this instance, the tax base remains the same.

2.4 Ideally, further devolution will not overburden taxpayers (whether businesses or individuals) with the need to make two tax returns to two different tax authorities in respect of a single transaction or source of income, or the need to calculate essentially the same income or gain using more than one method.

2.5 For our part, we would like to assist in ensuring that whatever taxes are devolved to Scotland, the resulting tax system is effective and efficient. This is part of the CIOT’s aims.

3  Further financial powers

3.1 In principle, many of the taxes currently collected by Westminster could be devolved subject to compliance with EU rules and other international law. Those rules would preclude a tax such as VAT from being devolved and may limit the powers of the Scottish Parliament in respect of some taxes, for example, excise duties.

3.2 The obvious candidates for devolution are taxes where the taxing event is clearly identifiable as being in Scotland, being taxes where, in consequence of the taxing event occurring in Scotland and nowhere else in the UK, the
taxpayer is not faced with the need to make two separate tax returns, one to Revenue Scotland and one to HMRC. Thus Land and Buildings Transaction Tax (LBTT) and Landfill Tax (LfT), which are already devolved, were good candidates. It is more difficult to devolve a tax that might apply to an activity that occurs partly in Scotland and partly elsewhere. The main example is business profits taxes.

3.3 Business profits tax (that is, corporation tax in the main but also income tax for unincorporated businesses) is due in the jurisdiction(s) in which a business has a permanent establishment(s). There are then rules that prevent double taxation where tax is also due on a residence basis in another jurisdiction. However, such rules can be administratively complex. We note that many commentators consider that devolution of corporation tax bears much greater risk than many other taxes. We agree with that judgment. Given the importance of oil and gas to Scotland, we could see a possible case for devolving corporation tax and petroleum revenue tax on upstream oil and gas production. However, there would need to be a mechanism for covering the very substantial tax relief due on abandonment costs; this might make devolution unworkable in practice.

3.4 Because ease of administration is a key objective of the tax system, it is important to take account of the capabilities of both taxpayers and their advisers to cope with multiple changes. We should not forget that Scottish taxpayers will also be UK taxpayers and will need to interface with two tax authorities. Similarly, employers and others making payments to individuals could need to report to two or more authorities in place of the single agency at present.

3.5 Subject to our comment in 3.6 below, an alternative to the full devolution of powers over a tax would be to assign the appropriate share of revenues of the tax collected to Scotland, for example as suggested in respect of VAT. This may not achieve full accountability or provide some of the powers that may be desired to further specific policy objectives (for example, it may preclude the adoption of lower rates of VAT) but does provide an indirect advantage to Scotland in that greater economic growth as a result of local policies would increase revenues. The Finance Committee of the Scottish Parliament should examine other jurisdictions (such as Germany) where assignments of revenue are part of the settlement between national and local governments and take account of issues such as the needs and ability to pay of each area.

3.6 However, we would not recommend assignment of revenues be considered until it is clear that it is possible to measure to an acceptable standard of accuracy the revenue attributable to Scotland. We do not believe it is currently possible to achieve this for VAT or corporation tax. Given that the block grant to Scotland would be reduced to reflect taxes devolved or assigned, the smaller Scottish economy would bear risk where taxes assigned or devolved cannot be accurately measured.

3.7 Some taxes may appear to be capable of devolution, but when the burdens on taxpayer and tax authorities alike are taken into account and the limits of what may be achieved in terms of policy, they may be best left out of account.

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1 It should be noted that ‘permanency’ is not necessarily required before a jurisdiction may assert taxation rights. In the UK there are domestic rules governing what is a permanent establishment (FA 2003, s. 148); this is subject to relief under a Double Taxation Treaty due to TIOPA 2010, s. 2.
4 Constraints and interactions

4.1 In the Annex, we comment briefly on most of the taxes currently in place and on issues that may arise if it were agreed that they should be devolved.

4.2 We note that the taxation system is often used to achieve policy objectives that may not really be taxation issues. These range from incentives in direct taxes to encourage investment or, in VAT, some bodies receiving funding from central government by way of refunds of tax outside the strict operation of the VAT system. It may be worth considering the extent to which similar powers could be devolved rather than devolve powers over changing aspects of the tax system².

4.3 Taxpayers who have to deal with both devolved taxes and UK taxes may try to arrange their affairs to take advantage of a lower tax jurisdiction. This may arise in particular where the incidence of the tax is based on the taxpayer’s residence – taxpayers may simply relocate. To the extent that taxpayer behaviour is influenced in this way, one jurisdiction may increase its tax take, while that in the other jurisdiction may reduce. Overall tax take may fall however, as the taxpayer is paying tax at a lower rate. The extent of devolution and the choices about methods of devolution will potentially affect the whole of the UK.

4.4 Since Scotland remains within the UK economic and currency union, there may be constraints imposed on the Scottish Parliament’s use of fiscal powers as a result of stability requirements.

5 Implications

5.1 As we note at section 3.4 above, ease of administration is a key objective of the tax system. It is important to take account of the capabilities of Revenue Scotland and HMRC to cope with multiple changes. While some taxes may be capable of devolution, the costs of collection may militate against devolution.

5.2 Revenue Scotland will start collecting some taxes in 2015 for the first time. It would be sensible to give it time to establish itself and build the required resources or expertise to collect taxes in the most efficient way possible. Under current plans, HMRC will administer the Scottish Rate of Income Tax (SRIT) from April 2016. Further devolution of taxes would require consideration of which body should be responsible for their operation. If Revenue Scotland is chosen, its complement of staff will probably need to increase substantially in a very short space of time. It will be necessary to ensure the infrastructure is in place to manage its operations, no doubt particularly including IT systems. Equally, if it is decided that HMRC will take on administration of more devolved taxes, regard will be needed to the current and likely capacity in that organisation. In simple terms, more devolution of taxes will necessitate more resources to administer them, either at Revenue Scotland or at HMRC, or possibly both.

² Subject always to consideration of EU State Aid rules.
5.3 Time will be needed to implement any further devolution. By way of reference, a time span of approximately three years will have elapsed between the Scotland Act 2012 and April 2015 when LBTT and LfT are implemented. This is to ensure proper consultation, sound drafting of legislation and developing the practicalities of the tax’s administration.

5.4 The block grant will no doubt be reduced to take account of further tax devolution. This means that devolution of taxes may result in some extra risk for the Scottish Government’s budget. This depends, however, on which taxes are devolved. LBTT revenues can be volatile; devolution of a tax with a broader fiscal base, such as income tax, could help reduce this risk. The more taxes that are devolved, the less the budget will depend on the block grant – this will increase accountability, and mean that the Scottish Government’s budget will be more dependent on the policy decisions taken within Scotland and the future economic performance of the Scottish economy.

5.5 In respect of the block grant, it is important that the formula for reduction is transparent. Additionally, there must be co-ordination between the UK and Scottish Governments in relation to taxes.

6 The Chartered Institute of Taxation

6.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

6.2 The CIOT draws on our members’ experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT’s comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

6.3 The CIOT’s 17,000 members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification.

The Chartered Institute of Taxation
18 November 2014
Annex – Brief comments on specific taxes

1 Income tax

1.1 The rates of taxation are already partly devolved to Scotland and the parties’ proposals include options such as increasing the extent of the tax that can be controlled through rates by Scotland or full control of rates and bands.

1.2 If income tax were fully devolved such that Revenue Scotland becomes responsible for everything including PAYE, it is likely to add considerably to the burdens of many individuals and businesses (who may have to operate two tax systems). Thus, in the same way that the EU legislates to harmonise certain aspects of tax, further devolution should attempt as far possible to maintain a common tax base limiting devolution to rates and bands possibly with some minor variation in respect of certain specific issues, such as capital allowances.

1.3 Some of the detailed issues that will need to be considered include:

- Interaction of income tax and Class 4 national insurance contributions (NIC) if NIC remains reserved;
- Similar issues relating to Class 1 contributions for both employer and employee;
- Treatment of dividends paid to working directors;
- The problems with retaining the taxation of investment income in the UK system, which can result in two persons in Scotland with the same income paying different amounts of tax because of rates differences;
- Various administrative issues;
- Transitional issues, for example losses carried forward will reduce future revenues.

1.4 We recall that during the Calman Commission consultations, questions were raised about the effect that devolution might have on reliefs from double taxation in agreements with other countries. It may be appropriate to seek clarification from major trading parties on this issue if for example there is full devolution.

1.5 The current SRIT devolution adopts a simple system based on residence to determine whether Scotland gets any income tax or not. Although it naturally brings some administrative burdens around defining residence, it does not really present any significant avoidance problems because of the probable limited differentials in tax rates. If the whole of income tax, that is not just a proportion of rates and bands, were devolved, it is likely that a more complex system would be needed similar to that that applies to business profits tax (see below).

2 Capital Gains Tax (CGT)

2.1 We suggest that liability to tax in respect of any UK-situs assets should be determined by the residence of the taxpayer, irrespective of where in the UK the asset is located. One option might be to give the Scottish Parliament the power to vary the rate of CGT for Scottish residents, as for the SRIT.
2.2 An alternative would be to determine liability based on situs of the asset, but we suspect this would be more complicated in practice. In terms of legislation and administration, it would probably be fairly straightforward to give the Scottish Parliament the ability to raise Scottish CGT on Scottish-situs assets. Currently, however, UK CGT depends on residence of the taxpayer, which means that unless there was full devolution of CGT and a corresponding change in the UK CGT rules such that the UK Parliament relinquishes its right to tax, taxpayers处置ing of assets with situs in Scotland would have to make two tax returns, including a claim for double taxation relief.

3 National insurance contributions (NIC)

3.1 This is a major contributor to UK income. It was originally intended to fund certain but not all social benefits so there is no direct link between contributions and the cost of funding benefits. In Scotland, collections of NIC per GERS³ are calculated at £8.5 billion while expenditure on benefits is estimated at £22.4 billion so substantial benefits costs are paid for out of other tax revenues.

3.2 To the extent that reserved revenue streams are not sufficient to meet existing benefits payments, any settlement would have to create a mechanism to meet in whole or part any deficit or to devolve some or all of the expenditure.

4 Value added tax (VAT)

4.1 Value added tax has to comply with the European Union’s Principal VAT Directive. Among other implications, it means that the same rates have to apply throughout the UK. There are a few exceptions provided for in the Principal VAT Directive but it is unlikely that they would be applied to a part of a Member State such as Scotland.

4.2 VAT revenue could be assigned in full or in part but rates of tax would not be capable of devolution⁴. Clearly attributable VAT revenues could increase or decrease depending on the performance of the Scottish economy. However, we would not recommend assignment of VAT revenues until it is clear that it is possible to measure to an acceptable standard of accuracy the VAT revenue attributable to Scotland.

5 Corporation tax and business income tax

5.1 We have already noted that business taxes present problems because there is always the possibility that two jurisdictions may or should have taxing rights.

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⁴ In Germany, VAT is apportioned among the ‘lander’, that is the states that form part of the Federal Republic.
5.2 Business income tax (as opposed to corporation tax) may be less of an issue in this context as it could be levied according to individual residence irrespective of business location. However trading partnerships would raise particular difficulties especially those with partners resident in both Scotland and the rest of the UK.

5.3 If corporation tax were to be devolved in full, a complex system similar to that operating in respect of taxation across international borders may have to be developed in the UK to ensure that tax accrues to the jurisdiction in which the tax arises.

5.4 The result might be a big increase in burdens on businesses that would have to keep separate accounts for Scotland and the rest of the UK. Given that corporation tax only generates about £2.9 billion in revenue in Scotland, there is a significant danger that any benefits from having such powers might outweigh the costs of implementing such a system.

5.5 There have been differences in deductions such as capital allowances based on location in the past so in principle it is possible to allow Scotland to create its own capital and similar allowances regime but this would be subject to compliance with EU and other law, for example that prohibiting state aid.

6 Oil taxation

6.1 We recognise that this has been an emotive issue in the past but it seems to us that it is important here to have greater regard to the likely future development of this industry both as a result of technology changes and over a greater geographical area (for example, because of ‘fracking’ and wind turbines).

6.2 Statistical data show that revenues have been volatile and this has implications for the stability of the tax base. However, equally, it is a significant source of revenue from Scotland which many believe should be reflected in any devolved settlement.

6.3 There are significant abandonment liabilities; companies will need assurance that they obtain full and effective relief for these liabilities should part of the oil tax system be devolved.

6.4 We do not have sufficient data or knowledge about this industry to suggest specific solutions.

7 Customs and excise duties

7.1 Both these taxes are governed by EU directives and by EU law generally, for example, the fundamental freedoms prevent discriminatory taxation of cross border trade.

7.2 The proceeds of customs duty go to the EU not the UK. A collection fee is however levied that could be devolved.
7.3 Because excise duties are intended to be a tax on the consumption of goods in a territory albeit the tax may not be at the final stage of the consumer chain, they are, subject to certain constraints in EU law, in principle ideal taxes to devolve.

7.4 Excise duties are major contributors of revenue (about £2.1 billion). Under EU law, there are both upper and lower rates above and below which Member States may not go. Some Member States have applied for and been allowed derogations. There is also some scope for expanding the products subject to duties, for example, some Member States tax coffee and chocolate.

7.5 In order to pursue legitimate aims, such as health, Member States may apply certain parafiscal taxes. Thus, it would be possible to retain UK rates but to allow the imposition of regional parafiscal charges for a specific purpose, for example to fund health expenditure that is ring-fenced for that purpose.

7.6 However, there are challenges for such a policy as is evident from the examples of cross-border shopping on the Irish border and across the Channel. Having two indirect taxes regimes would also be particularly burdensome for businesses that operate across borders.

7.7 Fuel duty is a significant source of revenue (per GERS, Scotland pays about £2.2 billion). It is an excise duty so in principle the comments above on excise duties apply to it.

8 Other indirect taxes

8.1 Other indirect taxes that are attributed to Scotland in GERS include aggregates levy (AL - about £45 million), vehicle excise duty (VED - about £481 million), insurance premium tax (IPT - about £207 million) and air passenger duty (APD - about £234 million).

8.2 There are unresolved disputes about AL and APD. Devolution of these taxes prior to resolution of the problems potentially offends against the principle of legal certainty so unless a compromise can be found which deals with those risks, they do not at this stage appear suitable for devolution, although we recognise as the Calman Commission did that they would otherwise be easy taxes to devolve.

8.3 There is an interaction between VED and the driving licence records of the DVLA. That link should not preclude devolution but like all smaller taxes a question arises whether or not they can be collected efficiently. That issue does not apply to a tax such as landfill tax because SEPA is admirably placed to collect it efficiently as part of its other functions.

8.4 IPT on risks insured in Scotland could be devolved but it might create significant burdens on insurers that would have to do two returns for what is in fact not a great deal of money relative to Scotland’s total funding requirements so an issue arises as to whether it is worth it.

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8.5 There is one other small tax (ATED – annual tax on enveloped dwellings). We have no data on how much has been paid in respect of Scottish properties but we would assume that it has not been very much. The tax was created as an anti-avoidance measure in relation to SDLT and broadly applies to dwellings with a value over £2 million held by companies. However, that threshold will reduce to £500,000 over the next two years and so may have greater impact. Given it relates to SDLT, which has been devolved (and indeed replaced), it seems logical that ATED should also be devolved, with the Scottish Government able to choose whether or not to operate a similar tax or apply alternative (or existing\(^6\)) measures to prevent avoidance of LBTT, although it would be possible to retain ATED as a UK-wide tax but require HMRC to pay the tax in respect of Scottish properties to the Scottish Government.

9 Inheritance tax

9.1 Inheritance tax (IHT) is broadly speaking payable if a person who is domiciled (or deemed domiciled) in the UK\(^7\) dies leaving an estate that after deductions and exceptions exceeds the inheritance tax threshold. In addition, it is payable by those not-domiciled in the UK, who own Scottish situs assets.\(^8\)

9.2 Domicile is not the same as residence, but is a legal concept. If it were desired to devolve IHT, it would be necessary to tax individuals domiciled in Scotland or to rely on some other basis for the purposes of determining whether a person is subject to IHT in Scotland or the rest of the UK. Use of domicile may result in many disputes as to where in the UK a particular individual is domiciled. The alternative is likely to prove complex.

9.3 In particular, individuals who have lived in the UK for at least 17 out of the previous 20 tax years are deemed to be domiciled in the UK from the start of their 17th tax year of residence for IHT purposes. The operation of this rule in the context of devolving IHT raises difficulties where, for example, an individual has been UK resident and then Scottish resident and records have not been maintained.

9.4 In the vast majority of estates (by number rather than value), it is likely that there would be no practical difference between basing IHT on residence as opposed to domicile. But in the small number of larger estates there is likely to be more complexity, for example the application of double tax relief where an estate is also subject to an equivalent tax outside the UK.

10 Local taxes

10.1 The Scottish Government already controls both council tax and business rates.

10.2 However, substantial local government expenditure is funded out of the grant funding. This is received by the Scottish Government and then used to fund

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\(^6\) LBTT (S) Act 2013, s. 47.
\(^7\) Technically, an individual is not domiciled in the UK, but in one of the three constituent jurisdictions: Scotland, England and Wales or Northern Ireland.
\(^8\) It is the case that some avoid the tax by owning Scottish heritable property through off-shore structures, so that they ensure the assets they own are not Scottish 'situs' assets. Thus, in Scotland, the use of companies to own heritable property was widely adopted to avoid IHT, rather than SDLT.
both specific and non-specific expenditure of local authorities in Scotland.

10.3 When the Scottish Government consulted on the possibility of replacing council tax with a local income tax, concern was expressed that one consequence would be a cut in the block grant from Westminster because the money provided to support council tax payments by people on low incomes (council tax benefit as it was at the time) would no longer be paid.

10.4 This is not an area that we deal with but we mention it here to remind parties of the need to pay attention to all details of how funds currently flow to Scotland and how they could be replaced by Scottish taxes in whole or in part.

10.5 It is worth noting that Wales has both revalued its properties for Council Tax purposes and created an extra band as a means of reducing the extent to which properties at the upper end of the banding system pay less tax per value of the property than others in lower bands.