FINANCE COMMITTEE CALL FOR EVIDENCE

REVENUE SCOTLAND AND TAX POWERS BILL

SUBMISSION FROM PROFESSOR JOHN KAY

1. ‘Revenue Scotland’ is a grand title for a body that administers two modest taxes. I am assuming that the present discussion takes place on the basis that we are beginning to define a tax policy to be operated by a body that might in future have more extensive responsibilities than it has today.

2. Two broad considerations should be fundamental to all discussion. Throughout the world, most tax revenue comes from three sources
   • an income tax on income from both employment and (some) savings
   • a general sales tax applied at one or two rates to a wide range of goods and services
   • a tax on earnings paid by both employers and employees

3. In the UK today, these are income tax, VAT and national insurance. For a government to raise significant revenue, or to have a substantial revenue department, it needs to be involved with at least one of these.

4. My second general comment is that experience suggests that the level of government at which it is most efficient to raise revenue tends to be higher than the level of government at which it is most efficient to plan expenditures. For example, given the extent of cross border activities of many companies it would be sensible to operate corporation tax at a European - or better still a global - level, and until we move in this direction measures to attack tax avoidance and evasion by multinational companies are hardly serious. A European single market really requires a Europe wide VAT regime while the proliferation of state sales taxes in the US creates an inefficient mess.

5. In consequence, there is almost always and everywhere central government funding for local authorities and within a federal system there is usually redistribution to the states. One implication is that decentralisation of tax policy and administration is probably likely to reduce the efficiency both of administration and of the system itself. Against this there is an opportunity to create from scratch a regime more effective than one that has accumulated barnacles over many years. Experience within government of systems designed from scratch to replace existing structures has often, however, been one of unfulfilled promises, especially where IT is involved.

6. Smaller units of government are best placed to levy taxes which can be clearly associated with a specific place, and where it is costly to move the location to a different physical place, which is how Calman settled on property transactions and landfill. Using these criteria, Calman did not have many choices.

7. While it is entertaining for Scotland to look to Adam Smith’s canons of taxation, we should perhaps recognise that in Smith’s day the overall tax burden was only a small fraction of what it is today. I suggest that our core concerns should be efficiency, fairness and administrative feasibility. These are not separate criteria, and are often complementary rather than, as often suggested, conflicting; for example, poorly
administered taxes are a source of unfairness, and taxing essentially similar activities at different rates creates both inquiry and economic inefficiency.

8. In my view, efficiency in tax collection should follow the maxim ‘first do no harm’. We should not hold out many hopes that the structure of taxation (as distinct from the revenues from it) will make the world a better place. Fiscal neutrality - which means that as far as possible business and personal decisions should be the ones people make in the absence of taxation - should be a general principle, with exceptions carefully considered, well designed, and rare. Much of the complexity of tax structures, which leads to violations of both efficiency and fairness, is the product of well-intentioned attempts to promote widely agreed social goals. The tendency across the world in recent decades has been to favour fewer, simpler rate structures and I agree with this thinking.

9. Fairness in taxation has both a horizontal dimension - people similarly placed should pay similarly - and a vertical dimension - what people pay should properly reflect their different circumstances. Horizontal equity, in this sense, contributes to economic efficiency, and administrative effectiveness is a precondition for it. I think that Smith’s ‘proportionate to ability to pay’ is inadequate even as a starting point for vertical equity. And there is a difference between a tax system that collects perhaps 3% of national income and one that collects perhaps 40% of national income. We should always remember, in reviewing taxation history, that until the Second World War most people paid no direct taxes and not much tax of any kind. ‘Ability to pay’ is not a precise, and perhaps not a helpful concept. Consider, for example the tension in determining the tax and benefit status of families, the tension between the two approaches of “tax should reflect the whole of an individual’s circumstances” and ‘people have a right to be taxed as individuals”. Should tax reflect peoples’ choices? Perhaps not, but what if they are bad choices? Is having children, or undertaking higher education, a choice? If not, what is? My belief is that these decisions are not well made by people advocating abstract principles rather than pragmatic assessments.

10. In thinking about fairness, I believe we should focus on the fairness of the system as a whole rather than of each individual component. For example, we could give VAT the appearance of progressively by elaborate differentiation of commodities by reference to their apparent luxuriousness. But the goal is much better achieved, in every possible way, with a simper VAT and a progressive income tax.

11. I offer only one general observation on administrative efficiency. It is difficult to collect any tax which requires people to consciously make a tax payment. Tax is efficiently collected when the payment is combined with some other beneficial transaction - receiving a wage or salary, shopping, buying a house- and preferably if the tax is small relative to the benefit.

12. I shall end this note with brief observations on the two specific taxes this committee is considering. Stamp duty land tax and its successor is a bad tax by most criteria. It has two virtues - location specificity makes it a useful local tax, and it is the least unpopular way of taxing property ownership. It is a poor mechanism for achieving progressively, though it may be one of the hardest to avoid and the only one the Scottish Government has.

13. Landfill tax, as a tax on externalities, is a rare case of a tax with the potential to increase economic efficiency. I hope the Committee will resist the thought that ever more
elaborate attempts at engineering its complexity would make it better still. Such exercises too often achieve the opposite of the intended result.