1. The Finance Committee seeks views on the general principles of the Revenue Scotland and Tax Powers Bill. Since I am an economist, most of whose work on taxation has been theoretical, I shall comment mainly on the bearing of general economic principles of tax policy on the bill, and then add some remarks on particular points in the administrative and legal arrangements to be established by the Act that seem to me particularly interesting. I devote particular attention to evasion.

2. Besides being a Professor of economics, I am a member of the Council of Economic Advisers to the Scottish Government, and a member of its Fiscal Commission Working Group. That subcommittee produced a report ‘Principles for a Modern and Efficient Tax System’, in which we set out our recommendations for the institutions and forms of a tax system. I refer to that report below.

3. The Bill is explicitly to create an agency, Revenue Scotland, to collect two taxes, the tax on land and buildings transactions and the landfill tax, devolved under the Scotland Act 2012. Revenue Scotland will also advise the government on tax matters. It has in other respects potentially larger and wider responsibilities. Whether Scotland becomes independent or not, Revenue Scotland will have other taxes to administer as more taxes, perhaps all, are devolved. It will have to follow principles appropriate to a wide range of taxes, and it will have to build up an expertise able to deal with increasingly complex tax rules and regulations.

4. The Scottish Ministers have said that Scotland’s taxes should satisfy Adam Smith’s famous criteria, to have certainty, convenience, and efficiency and be proportionate to the ability to pay. It is not to be expected that all these requirements, if accepted, can be satisfied perfectly and simultaneously. Our biggest decisions, what career to follow, where to live, how much to save, are taken on the basis, in part, of what we expect to happen years later. It makes no sense to suggest that a government should, even if it could, fix tax rates ten years from now. Good auditing of taxpayers, necessary if tax is to be well-related to income, conflicts with convenience. But we understand that these aspirations could guide tax designers. The system should not sacrifice one of the criteria without gain to another.

5. The proposed form of Revenue Scotland is, in many respects, an acceptable compromise among the four criteria. True, it provides little certainty now since actual tax rates and penalties are to be determined by regulation, and they are at this stage therefore quite uncertain. But it is inevitable that tax rates will be changed from time to time, and probably best that when a change is required, for instance because of a change in the macro-economy, that change can take place quickly. The Bill seeks to make that possible, and I think is right to do so.

6. The use of digital tax-returns makes report of transactions convenient, and certainly the two devolved taxes under explicit consideration should be convenient to
report and pay, though perhaps not to audit. For some other taxes, the design of tax return forms for convenience is an art which cannot be easily fixed by an act of parliament. The American requirement that the Internal Revenue Service state how much time they estimate it will take to complete the tax return, on average, seems an example that could with advantage be copied. One might be able to think of other measures of convenience that could be imposed on the tax agency. Thinking of future tax possibilities, it might have been good to have had such requirements in the Bill.

7. Efficiency is a concept that, for economists at least, means something more precise and restrictive than it did for Adam Smith. As a (joint-)author of an “efficiency theorem” in tax theory, I am strongly attached to this property, but it is a property of the whole production of the economy, as influenced by the tax system as a whole. A main requirement is that there should not be taxes on transactions between producers, except to counter externalities such as atmospheric pollution and congestion. While there is nothing in the proposed Act that need hinder the principle, one of the devolved taxes, the land and buildings transaction tax seems bad for efficiency when a building is created by one business and sold to another. Taxing property transactions is also a source of inefficiency. There is little the Scottish Government or Parliament can do about it, since they have been given so few tax powers.

8. When Adam Smith suggested that taxes should be proportionate to ability to pay, I doubt that he thought that meant proportional. But I believe there are good reasons for having most taxes proportional to the expenditure or receipt being taxed – except for labour income and capital income. That is because the major sources of inequality are associated with labour skills and capital acquisition. (Taxes may also vary with age and household position, but that is another story.) It is reasonable to have progressive taxes on income, at least in the upper ranges; but not on property transactions, even if one must have such a tax. Perhaps that is all outside the remit of the Committee. A proportionality principle could have been inserted in the Bill, though that would have meant going beyond the expressed aim of defining Revenue Scotland, though not beyond the title of the Bill.

9. There could also have been a principle of continuity: no jumps in the tax rate, as will the property transactions tax in the UK at present. I was pleased to see that the Scottish Ministers are proposing to observe that principle in the Land and Buildings Transactions Tax.

10. My other main comment in this submission is about the general anti-avoidance rule. My sympathies are very much with this measure, but I see possible difficulties, which might trouble me less if I had more knowledge of legal practice in this area. The particular clause that caught my attention was in paragraph 58 of the Bill, where one of the criteria for identifying tax avoidance is that “obtaining a tax advantage is the main purpose, or one of the main purposes of the arrangement”. I read that as meaning it is only required to be one of the main purposes, and I wonder if that is too stringent. I know that Brussels recommends such a form of words, but it makes me wonder about buying duty-free goods, for example (not yet concerning a devolved tax, of course).
11. In the case of the land and buildings transactions tax, I would think the Revenue would like to prevent the transaction being split into smaller parts, so as to reduce aggregate tax. Splitting and selling simultaneously would clearly be tax avoidance we want to stop. What about selling part this year, say to a developer, who starts on that piece, and selling the rest next year, so that the developer can continue? How long could the time interval be before the transactions are not “artificial”? If the developer cannot borrow enough originally, I suggest one might not want to penalize. And I do not see how one catches the case of two brothers each buying half the site, then building together.

12. This particular problem goes away if one has proportional taxation. But the Committee may wish to consider whether under other taxes, the proposed rule will penalize too many people. I note that the defence of established practice and prior approval could hardly apply in the first few years, since Revenue Scotland will be starting a new tax history.

13. It is sensible to determine tax rates and penalties by regulation, rather than stating them in the Act. One or two numbers remain the Bill. I noticed that paragraph 169 defines a maximum penalty of £3,000, and paragraph 195 mentions a fine of £300. Should the penalty in paragraph 169 not be proportional to the total tax at issue, so as to be an effective incentive even in large-tax cases? In any case, the figures will need to be adjusted from time to time, and may therefore be best handled by regulation.

14. I do not know what implications the use of regulations has for parliamentary discussion, but assume the Committee will consider that.

15. I would like to comment on the use of search warrants. These are, I am sure, very necessary from time to time. It is a consequence of the legislation being Scottish, I suppose, that it will not be possible to seek a search warrant for any premises or persons outside Scotland. That is some small loss compared to the present situation, for there will certainly be taxpayers, with liability for property transactions, who have business premises in England. The only remedy I can suggest is for the Scottish Ministers to negotiate an arrangement for property entry analogous to extradition or the European Arrest Warrant, but with speed of action built in. I would not be entirely surprised to hear that my point is mistaken and such an Entry Warrant already exists.

16. There may be other aspects of the Bill the Committee would like to discuss with me, but in the main, I found much in the Bill to admire, and nothing else I would want to dispute.