The Revenue Scotland and Tax Powers Bill
1. Thank you for inviting Reform Scotland to submit evidence to the Finance Committee as part of the committee’s consideration of The Revenue Scotland and Tax Powers Bill.

2. Although Reform Scotland has not published its own research on how a body like Revenue Scotland could and should operate, the publication, Scotland’s Economic Future, which we published in 2011, included a chapter I wrote outlining how I thought a Scottish Exchequer, could operate within Scotland. Although this was primarily focused on what would happen in the event of greater devolution, or independence, I think this is relevant when considering the creation of Revenue Scotland and I have included a summary of my chapter below.

Extract from Scotland’s Economic Future, Chapter 11. ‘Is there a need for a Scottish Exchequer?’ By Ben Thomson

3. In creating a new Scottish Exchequer, Scotland has a number of advantages. First, it starts with a blank sheet, so it is not locked into the history of development that leads to idiosyncratic practices. Second, there are plenty of examples to copy from around the world of where treasury functions have been made to work efficiently, as well as learn from the mistakes of those that have not worked. The creators of a new system should be shrewd enough to borrow the best of other systems and learn from the mistakes of others. Third, the Scots have a tradition for being bold and innovative thinkers: it comes as no surprise that President Obama quoted Adam Smith in his speech to the Westminster Parliament in 2011 or that Adam Smith is a favourite author of Deng Xiaoping, demonstrating Scots’ influence on economic thinking in the world. Lastly Scotland’s size with 5 million people should make it much more manageable to implement new systems.

4. If a Scottish Exchequer is formed it should be flexible enough to change as the relationship with the rest of the UK changes and should set the principles that will drive it. Part of the future debate should be about what those principles should be. It is my belief that an effective Scottish Exchequer should be driven by the following four principles:

Integration
5. Many of the functions of Treasury have been divided in the past into different non-ministerial government departments or quangos. The Treasury has already started the process of integrating these into bigger quangos such as HM Revenue and Customs (HMRC) but still struggles with the legacy problems of the separate entities that were merged into it. It would be easier to consolidate the full responsibility for these functions into one central entity from the start so that the system of tax collection and benefits is better integrated. In addition given Scotland’s
population it does not need a separate Companies House, Stamp Office, Registers of Scotland and Inheritance Tax office.

**Simplicity**
6. Tolles guide of tax legislation has doubled in length since 1997 to 11,520 pages, making it one of the longest tax guides in the world. It therefore comes as no surprise that 74% of MPs require accountants to help with their self-assessment tax returns. One does not need to be an expert to understand this is a system that is struggling under its own complexity. A key principle of a new Scottish Exchequer should be to simplify many of the financial structures. There is also an advantage to the rest of the UK, as UK tax guidance would no longer need to explain various Scots law differences in its forms and guidance.

**Transparency**
7. There should be clear and honest reporting that allows ministers and their civil servants to take decisions and incentivises them to be efficient. It should also allow the public to analyse clearly and judge the performance of Scottish government. Adopting, for example, a corporate accounting approach to government with a proper profit and loss account and balance sheet would focus the administration on the difference between long-term capital expenditure and balancing current expenditure.

**Efficiency**
8. There is far too much inefficiency, both between different layers of Government and within each layer of Government. The role of an efficient treasury is to determine clearly the department or level of Government responsible for spending including procurement and provide suitable ways to incentivise efficiency without creating more bureaucracy or centralisation.

9. In summary, The Scottish Exchequer should be driving the finance functions of Scottish government and its ministers, led by the Treasurer, with the task of raising and managing the public sector finances of Scotland.

**The Scottish Policy Unit**
10. One fundamental problem with the Treasury is that it is often in conflict on policy with other government departments and the Prime Minister’s Office. The Treasury has a huge influence on all other ministerial departments to ensure they live within their budgets and this creates a natural and largely healthy tension to ensure efficiency within all parts of government to spend efficiently. However there is also a deeper reason for the tension that is less healthy. At present, economic policy is set by the Treasury and the Prime Minister’s Strategy Unit (now part of the Cabinet Office) as well as each ministry also setting policy for its particular area of responsibility. All of these policy units will have economists determining what effect the impact of their policies will have on the economy and the efficiency of public services. One can understand the logic for this system but it has led to inefficiency and a lack of clear authority on long-term policy creation. This was particularly accentuated in Gordon Brown’s years as Chancellor with the economic unit within the Treasury widening its sphere of influence into departmental policy of other ministries and controlling it through the budget process. In particular there was a
culture of antagonism between the Prime Minister’s Strategy Unit and the Economic Policy Unit of the Treasury.

11. The problem with the Treasury setting policy through the budget process is that it tends to predispose towards a short-term approach to government. The management of government finances is predominantly focused on the next year and does not tend to look beyond a three-year time horizon. The very nature of the Treasury means the type of civil servants who are attracted into the department are those that are risk adverse. This means that long-term reform proposals put forward by other ministries can be, and often are, squashed by the Treasury. Take for instance the policy of Foundation Hospitals supported by the Prime Minister’s Strategy Unit but strongly resisted by Treasury. Another example would be the local income tax proposal by the Scottish government that Treasury opposed.

12. Therefore, in structuring a new Scottish Exchequer it is important to have clear lines on how policy is created and managed between the different departments of government. In order to create integrated policy across government, the economic policy unit should be separated into its own department that should also integrate the policy units in other parts of government ministries.

13. This new Scottish Policy Unit (SPU) would be responsible for setting the government’s long-term strategy and monitoring the delivery of the strategy against both its results on the delivery of public services as well as its effect on the economy. The SPU should be directly responsible to the First Minister. The Scottish Exchequer should have direct input into the SPU as to the financial consequences of policy, including the macro-economic impact on the Scottish economy, but not control policy creation.

14. One of the problems with Westminster and now increasingly at Holyrood is the growth of the number of special advisers. It is partly due to a frustration amongst politicians about delivery on policies that they want from civil servants who are not accountable to the Ministers that they serve. A Scottish Cabinet Minister does not have responsibility for hiring the senior civil servants that report into the Minister. In Scotland senior civil servants are appointed by Westminster. Therefore in order to ensure that political policies are being promoted within government departments, ministers appoint special advisers to represent their political position.

15. The SPU is, particularly at the senior level, highly political; probably more so than any other government department. Therefore, in recognition of this it would make sense for the senior members of the SPU to be direct appointments by the Scottish government in power and subject to change with each new administration. The SPU would work with other departments to set the long term strategy of government, taking into account both the needs of each department but also the financial delivery, economic and social impact. This would integrate policy across all government and provide less potential contradictions between departmental policy and treasury policy. It would also remove the need for many of the special advisers as the party in power can ensure its long-term policies are being implemented through the SPU.
Regulation Department
16. The formation of the FSA and the relationship between government and the banks has been one of the exacerbating factors that caused the financial crash in 2008. The creation of one regulatory unit and its aim of principle-led rather than rule-based regulation was sensible. However, the implementation of so many regulatory mergers created a dinosaur of an organisation that became predominantly rules based. This system of regulation was particularly unsuited to proactive management of systemic risk resulting in lack of controls and quick response to the financial over-leverage in 2007.

17. Scotland already has devolved powers for regulation of the accounting and legal professions. Monetary policy under Home Rule would remain the responsibility of the UK government and the Treasury would also need to have responsibility for regulation of the banks. However, all other professions including private client and institutional fund management, pensions, insurance and broking would be better served by a more local regulatory authority that can better assess risks on a principle rather than rules basis.

18. Therefore a new Regulatory Department would be responsible for the Scottish legal, accounting and tax professions as well as any financial regulation devolved to Scotland.

The Scottish Exchequer
19. Removal of policy and regulation functions would leave the Scottish Exchequer with the functions of revenue collection, borrowing, budget allocation, welfare payments, government accounting and audit at a Scottish government level. The objective of the Scottish Exchequer is to create a balanced budget, matching expenditure with funding within borrowing limits.

20. The Scottish Exchequer would need to liaise both with the Treasury and the finance departments of each local authority to ensure that taxes set and collected at other levels of government were co-ordinated. It would also need to have a proportionate influence on monetary policy, such as setting interest rate levels and ensuring deficit controls and borrowing limits are agreed between different levels of government and properly enforced.

21. The process of revenue collection should be a highly automated service for taxpayers. The responsibility for ensuring that tax is collected should lie with the Scottish Exchequer although it might want to contract out part of the collection process, particularly the IT, to a third party. It should also build on the principles of self-assessment.

22. The Treasurer would be the head of the department directly accountable to the First Minister and Parliament for delivering a balanced budget.

Setting tax and revenue
23. The objective in setting tax is to create a fair system, which helps create an environment for fiscal growth and is simple to administer. For the Scottish Exchequer to be able to create such a system it will need full control over a range of
taxes so that it can use certain taxes as fiscal levers but adjust others to ensure a balanced budget. In addition it would make sense to transfer tax powers that can influence economic growth.

24. The extension of powers under the Scotland Act would make it hard for a Scottish Exchequer to create much in the way of fiscal levers or to simplify the current system of tax. The main proposal is to leave income tax collection and the setting of bands to Westminster and for Holyrood to have a fixed band of 10% that it can increase or decrease. This system will need to be constantly adjusted as thresholds change which will affect the budget formula and put the Treasury into constant negotiation with the Scottish Exchequer. Neither does it create a range of taxes to create a fiscal package suitable for economic growth.

25. The opportunity for a Scottish Exchequer is to create a much simpler tax system particularly for personal taxes such as income tax, capital gains, inheritance tax and corporation tax removing many of the anomalies and attracting business growth. In addition the structure of Home Rule should transfer those revenues that particularly relate to business development in Scotland such as the revenue of the Crown Estate that is a key institution for developing tidal and wave energy. The Scottish Exchequer should be solely responsible for collection of taxes and payment of welfare for Holyrood, but would agree with the SPU how taxes might be made simpler and which taxes should be adjusted downwards to stimulate the economy and which taxes adjusted upwards to ensure a balanced budget.

**Tax and revenue collection**

26. In 2005 the UK did the sensible thing and combined the two separate agencies of HM Customs and Exercise with the Inland Revenue to form HMRC. However, this process could go much further and a Scottish Exchequer could ensure that all revenue responsibility came under its direct control. The HMRC is responsible for about 84% of all revenue raised by Westminster. The merger of the different functions was budgeted to reduce staff by 12,500 (14%) and costs by 8% and in 2011 there was a further reduction of 12,500 staff. However the merger has not been without huge integration problems.

27. It would be most efficient if a Scottish Exchequer were responsible for 100% of all revenue raised directly within the department. Certain functions for the collection of revenue could be raised under contracts with third parties. One huge advantage Scotland has in this respect is that it starts from a clean sheet in creating a tax revenue collection department and can use the benefit of IT created in other countries.

28. Each tax payer, whether corporate or individual should have a unique tax code, mostly logically one’s existing National Insurance number, that is cross referenced across all the system (including benefits) to ensure that tax collection is both efficient and fair. This will be particularly important for income tax to establish residency tests to pay Scottish income tax, and corporation tax to tax profits on the Scottish business of companies.

29. Tax help desks and on line guides should be provided to help the tax payer to easily address any problems that they encounter.
30. Wherever possible, tax should be deducted from source as this tends to meet much less resistance from the tax payer and is more efficient. Tax, benefits and bank accounts should be cross referenced so tax avoidance and benefit scams are reduced to a minimum.

**Summary of Recommendations**
- There should be a Scottish Policy Unit and Regulation Department separate from the Scottish Exchequer and these departments would replace the Finance and Justice departments. The SPU would be responsible for setting the government’s long-term strategy and monitoring the delivery of the strategy against both its results on the delivery of public services as well as its effect on the economy. The SPU should be directly responsible to the First Minister and the senior civil servants should be appointees made by each new government. The Regulation Department would be responsible for all regulation already devolved and subsequently transferred to Scotland.
- A new Scottish Exchequer should have responsibility for both funding and expenditure directly and not through agencies. A review of all government tax, law and registration services should be undertaken as a first step. If work such as the collection or administration of a particular tax is transferred, it should be on an arm’s length basis whether to another government, third or private sector organisation with a service contract for delivery. In addition, the Scottish Exchequer should be responsible for the delivery of any welfare payments that are transferred to Holyrood.
- One of the aims of the Scottish Exchequer would be to simplify tax collection and benefits whilst improving the quality and availability of guidance. Local tax help centres should be established in each local authority area. Each individual and corporation should have a unique tax and benefits code.
- The Scottish Exchequer should report financially under corporate style accounting standards providing an annual report each year with a full report of the finances for the previous two years including a balance sheet, profit & loss account and cash flow statement.
- There should be a separate internal audit process to review and monitor the Scottish Exchequer.
- The Scottish Exchequer should be responsible for setting broad budgets for the expenditure of governments departments. But departments should then take responsibility for spending to achieve their policy and operational objectives, which would limit ring fencing and detailed budget allocations within departments.