Implementing the Smith Agreement- UK Government’s Draft Legislative Clauses

Written Submission by Scottish Chambers of Commerce

INTRODUCTION

Scottish Chambers of Commerce represents a network of 26 Chambers of Commerce across Scotland, which in turn have around 11,000 business members. These are businesses of all sizes and across all sectors and together they employ half of Scotland’s private sector workforce.

In order to ensure the Smith Agreement is successfully implemented alongside the UK government’s draft clauses it is essential that:

- The implementation process is coherent and practical.
- The tax system delivers greater accountability.
- Businesses are given full visibility and all information required.

Politicians must take this opportunity to ensure that the devolved settlement for Scotland is considered and appropriate. The critical issue is that any changes to the devolved settlement must deliver a benefit to business and our economy.

TAXATION

We believe that there has been too much focus on Scottish Government spending in Scotland and not enough consideration given to how revenues are raised to pay for this. We are therefore supportive of the concept of extending the revenue raising powers of the Scottish Parliament, provided such powers enable Scotland’s politicians to create a more competitive business environment in Scotland.

The process of extending the fiscal powers of the Scottish Parliament has already begun. The Scotland Act 2012 delivered new powers to Scotland, including the Land and Buildings Transaction Tax and the Landfill Tax, which have now been set for 2015-16, and over Income Tax, which is due to take effect in 2016-17. These taxes supplement the existing fiscal powers of the Scottish Parliament in terms of Income Tax (the Scottish variable rate of +/-3%, which has never been used) and Business Rates. The Council Tax is also administered locally in Scotland by local authorities, though this has been frozen for the past 7 years as a result of a deal between councils and the Scottish Government.

Prior to the Scotland Act 2012, the Labour, Conservative and Liberal Democrat Parties in Scotland created the Commission on Scottish Devolution, chaired by Sir Kenneth Calman, to develop
proposals to extend the devolution settlement in Scotland. In addition to the proposals enacted by the 2012 Act, the Commission also proposed that Air Passenger Duty and the Aggregates Tax be devolved to the Scottish Parliament.

The present Scottish Government has also long proposed the devolution of Corporation Tax to Scotland, with a view to reducing the rate by 3% relative to the overall UK headline rate, having published a discussion paper on the subject within a devolved context and developing this in their White Paper on independence.

The basket of taxes that is available to the Scottish Parliament is important, not only in terms of the new powers available to it but also in respect of the manoeuvring room this creates to allow policymakers to better utilise existing powers. For example, gaining new powers might make the Parliament more likely to vary Business Rates.

In considering our response, it is worth considering each of these taxes in turn.

**Air Passenger Duty**

Scottish Chambers of Commerce has long taken the view that Air Passenger Duty (APD) is a tax which impacts negatively upon Scotland’s connectivity, our tourism industry and our ambitions to internationalise and grow our exports. There is a very strong case to reduce or, as many of our competitor nations have done, eliminate this tax at a UK level. However, despite intensive lobbying by Scottish Chambers of Commerce and the aviation industry for an extended period of time, the only UK Government concession on the tax came in the 2014 Budget Statement when the Chancellor announced a reduction in APD for very long haul destinations.

Against this background, the opportunity to devolve APD to the Scottish Parliament has a clear attraction. The Calman Commission in 2009 considered the practicality of devolving APD to the Scottish Parliament and concluded that:

> “Assuming the devolution, and thus the potential application of different rates in Scotland than elsewhere in the UK, did not conflict with EU law, we think the devolution of APD would not be associated with administrative or economic inefficiencies and is therefore potentially achievable.”

The Silk Commission in Wales also reached a similar conclusion there.

Indeed, within the UK there is already a precedent for devolving APD. The Finance Act 2012 devolved to the Northern Ireland Assembly the power to set APD rates on direct long haul flights from Northern Ireland for destinations in APD bands B, C and D.

Research has also shown that the imposition of APD has a negative impact on Scotland’s economic performance. A study undertaken by York Aviation estimated that by 2016, the cost of APD to Scotland in terms of passenger numbers will be 2.1 million passengers per year, with £210 million

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1. *Devolving Corporation Tax in the Scotland Bill*, September 2011
6. *Finance Act 2012*, s.190
per year less being spent by inbound visitors and a loss of £50 million on other tax revenues.\textsuperscript{7} At a UK level, a report by PwC estimated that the abolition of APD could result in an immediate boost to UK GDP of 0.45\% in the first year, with an ongoing positive benefit thereafter.\textsuperscript{8} This report also estimates that abolition of APD could in fact result in a positive return for the Exchequer in terms of the effect on other revenues through improved trade links and higher levels of employment. It seems likely that Scotland could enjoy a share of these benefits if the tax was devolved and reduced or eliminated.

Devolution of Air Passenger Duty to Scotland has been proposed by the Scottish Government\textsuperscript{9}, the Scottish Conservatives\textsuperscript{10} and the Scottish Liberal Democrats\textsuperscript{11}.

There is also a clear linkage between APD and a number of existing Scottish Government responsibilities, including tourism and economic development.

We believe that the evidence supports the proposition that devolving APD would boost Scotland’s international connectivity, export potential and tourism industry. As a result, \textbf{Scottish Chambers of Commerce recommends that Air Passenger Duty should be devolved to the Scottish Parliament.}

\textbf{Income Tax}

Since its creation in 1999, the Scottish Parliament has had the power to raise or lower Income Tax in Scotland by up to 3\%.\textsuperscript{12} This power has never been used. The Scotland Act 2012 extends the powers of the Scottish Parliament further in respect of Income Tax, creating the Scottish Rate of Income Tax (SRIT), due to be implemented in 2016-17.\textsuperscript{13} This will result in the basic, higher and additional rates of UK Income Tax being reduced by ten percentage points for Scottish taxpayers, with the Scottish Parliament then free to set the SRIT at any level it sees fit, which it will be required to do on an annual basis. Since then, the Scottish Government and each of the major political parties have set out a series of proposals to devolve Income Tax powers beyond this.

Awareness amongst businesses of the impending changes as a result of the 2012 Act is growing but the full implications, including how likely politicians will be to use the new powers, are not yet known.

Given that there has been no opportunity yet for the 2012 Act changes to be implemented, \textbf{Scottish Chambers of Commerce therefore takes a neutral view on the devolution of further powers on Income Tax.}

\textbf{Corporation Tax}

\textsuperscript{7} \textit{The Impact of Air Passenger Duty in Scotland, York Aviation}, October 2012
\textsuperscript{8} \textit{The economic impact of Air Passenger Duty}, PwC, February 2013
\textsuperscript{10} \textit{Commission on the Future Governance of Scotland}, May 2014
\textsuperscript{11} \textit{Federalism: the best future for Scotland}, October 2012
\textsuperscript{12} \textit{Scotland Act 1998}, s.73
\textsuperscript{13} \textit{Scotland Act 2012}, s.25
The Scottish Government has proposed the full devolution of Corporation Tax (CT)\(^\text{14}\) but none of the other major political parties support such a move, the Scottish Liberal Democrats going furthest by suggesting that proceeds raised through CT should be assigned to the Scottish Parliament.\(^\text{15}\)

CT is a business tax and it is essential that any decisions on the future of this tax take into account the practical implications for businesses in Scotland and, indeed, across the UK. Since the Scottish Government published its first proposition on the devolution of CT in 2011, the tax landscape in the UK has altered considerably, with the main rate of CT having fallen from 26% in 2011-12 to 21% in 2014-15 and due to fall further to 20% in 2015-16.\(^\text{16}\)

Corporation Tax is one element of the landscape of doing business in Scotland and, whilst it is often used as an example of the kind of policy that could be used by the Scottish Government to attract foreign direct investment into Scotland, this is true within the context of a range of material considerations, such as the availability of skilled workers, transport and digital connectivity, the planning system and the availability of finance to support the development of a new venture in Scotland. Of course, many of these powers are already devolved to the Scottish Parliament.

CT is also a potentially volatile tax in terms of revenues and, of course, many smaller businesses are not subject to the tax at all, instead being subject to Income Tax and/or Capital Gains Tax. That said, it is likely that the reduction of the rate of CT in Scotland could be a very useful tool in establishing Scotland as an attractive and competitive place to do business.

It is important to remember that in surveys undertaken by SCC in terms of the comparative importance of taxes to members businesses, Corporation Tax routinely features behind other business taxes such as Business Rates.

There are potential risks and opportunities in devolving Corporation Tax to Scotland and businesses have conflicting views on how attractive such a move would be. Under the circumstances, Scottish Chambers of Commerce takes a neutral view on the devolution of further powers on Corporation Tax.

Business Rates

Non-Domestic Rates, or Business Rates, have been devolved to the Scottish Parliament since its creation in 1999, yet it remains a tax which businesses ranked of amongst the highest importance during the recent referendum campaign.\(^\text{17}\) Despite the fact that this tax is devolved, the Scottish Government has since 2007 chosen to mirror the Business Rates poundage set for England, though it has applied reliefs and supplements to Business Rates that vary from those used south of the border.

This reluctance to pursue a different path in terms of an already devolved tax is interesting but perhaps understandable due to the fact that this, until the Land and Buildings Transaction Tax and Landfill Tax come into force in April 2015, is the only revenue raising tool currently utilised by the Scottish Government. At a time when the Scottish block grant has been reducing in real terms, there is therefore a high degree of pressure upon the Scottish Government to expand the revenues raised from this tax, which have increased by 28% since the time of the last revaluation in 2010 and is projected to raise almost £2.8 billion in 2015-16.\(^\text{18}\)

\(^{15}\) Federalism: the best future for Scotland, October 2012  
\(^{16}\) HMRC Guidance – Rates and allowances: Corporation Tax, April 2013  
\(^{17}\) Business attitudes to Constitutional Change, Professor David Bell, May 2014  
\(^{18}\) Scottish Budget – Draft Budget 2015-16, October 2014
Our contention is that by developing the widening basket of taxes on the revenue side of the Scottish Budget, this will create more room for the Scottish Government to address a tax which is of paramount importance to many Scottish businesses.

There is also an opportunity to consider how the process of further devolution could be used to empower not only the Scottish Parliament but also local authorities. The Scottish Government is legislating to enable local authorities to introduce local Business Rates rebates but the effectiveness of such a measure will be contingent upon councils deriving some potential financial benefit from encouraging new or enhanced economic activity in their area. This would require the Scottish Government to enhance the offering to local authorities in this regard, currently delivered through the Business Rates Incentivisation Scheme – a scheme which has experienced some initial difficulties.

Aggregates Levy

The Aggregates Levy has previously been highlighted as a tax which raises a modest amount of revenue but would be relatively easy to devolve. This was highlighted by both the Calman Commission and the Silk Commission, in respect of Scotland and Wales respectively. The Silk Commission noted that those businesses which paid the Aggregates Levy often felt closer to the devolved Government than the UK Government and that this was one factor which may make the devolution of this tax more attractive. In 2012-13, this tax raised £45 million in Scotland.

Devolution of this tax has been proposed by the Scottish Government, the Scottish Liberal Democrats and by the Scottish Labour Party. On balance, Scottish Chambers of Commerce believes that there would be little risk attached to devolving the Aggregates Levy.

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19 Community Empowerment (Scotland) Bill, SP Bill 52, Session 4 (2014)
20 Announcement of Business Rates Incentivisation Scheme, Scottish Government, 8 December 2011
22 Empowerment and Responsibility: Financial Powers to Strengthen Wales, Recommendation 5, November 2012
25 Federalism: the best future for Scotland, October 2012
26 Powers for a Purpose – Strengthening Accountability and Empowering People, March 2014