1. I am glad to have the opportunity to help the Committee, and in particular to supplement evidence which I gave you. It was a great privilege to Chair the Commission which produced a unanimous Report, and I am pleased that it was taken up and became the basis of the Scotland Bill. The process of the Bill has provided a locus for further debate and most of the issues now being discussed were covered in the Commission’s Report.

2. You asked about Marine Conservation. While the Commission was sitting, the UK Government promoted a Bill to improve the management of the marine environment. Because some matters relating to this subject are devolved to Scotland and some are reserved, there had to be some very detailed discussions and negotiations between the Scottish and UK Governments.

The Commission welcomed this process of discussion and negotiation as a good example of intergovernmental working, and we welcomed the agreement reached between governments, whose balance we did not wish to upset. We saw, however, a strong case for the devolution of marine nature conservation within this framework and we recommended that this be done at the earliest opportunity, but taking into account the experience of the operation of the new regime.

The relevant UK and Scottish marine legislation was enacted after our report was published so it was not possible for us to see how it worked in practice, or what lessons could be drawn from experience of its operation. The timing and taking forwards of our recommendation is a matter for governments to discuss, taking into account progress with the implementation of the legislation and how it has worked in practice. It is important to note that the UK Government have indicated that they will keep the new system under review and consider devolving further marine conservation powers to the Devolved Administrations once the current arrangements have been assessed. This is very much in the spirit of the Commission’s Report.

3. Members asked about Natural Resource Taxation, and how the Commission had reached its conclusions. I have now had the opportunity to refresh my memory on the detail of the advice that the Commission received from the Independent Expert Group of economists, of which Professor Kemp from Aberdeen University was a member, and to whom the Committee referred. The 2009 paper produced by the Independent Expert Group and principally authored by Professor Kemp “Natural Resource Taxation and Scottish Devolution” informed the Commission’s views and was referenced in the final report. His letter in the Scotsman, referred to in the evidence session, was written a year after the Commission had published its Report.

The Committee might find it helpful to refer to the Conclusions of that Group and I have attached them to this letter (Annex 1). You will see that the Group did not advise the Commission to devolve oil revenues. It noted that assigning them would be possible, but would carry certain risks such as volatility for the Scottish Budget;
whether to do so related directly to the debate about the appropriate constitutional relationship between Scotland and the UK. The Commission found this analysis helpful and concluded that we could not recommend either devolution or assignment of natural resource taxation. Assigning them would add greatly to the volatility of the Scottish Budget—recent year on year fluctuations alone in oil tax revenues have been equivalent to around 20% of it—without increasing the accountability of the Scottish Parliament. This volatility is much more readily absorbed by the much larger UK budget. As you will realise, it would be quite misleading to characterise this as the Commission rejecting the expert advice we received.

4. The specific recommendation of the Commission about income tax on savings and distributions was

“Income tax on savings and distributions should not be devolved to the Scottish Parliament, but half the yield should be assigned to the Scottish Parliament’s budget with a corresponding reduction in the block grant.”

As you will know, most income tax on savings and distributions is deducted at source by banks and others and remitted directly to HMRC. This is a very efficient system for tax collection: most taxpayers need take no action at all. The Commission took the view that segregating the Scottish part of this tax base so as to devolve it would result in disproportionate administrative and compliance costs for banks and others, such as those dealing with individual and corporate shareholdings as well as savings.

But the Commission felt there was nevertheless a certain logic in sharing out all of the Scottish income tax base between the Scottish and UK Parliaments, and so proposed assignment of a proportion of the yield from savings and distributions. The UK Government however did not include this in the Scotland Bill mainly because of issues of complexity and costs to third parties. While I would always hope that the Commission’s view would have been accepted I do not regard this omission as detrimental to the Bill.

5. Finally there was one point on which I think I could have been more helpful to the Committee if I had realised in advance it was to be raised, and that is why we recommended that the “tax room” available to the Scottish Parliament was to be ten points, or “ten pence in the pound.”

The basis of our recommendation was that income tax should be shared between the Scottish and UK Parliaments. This approach, and the evidence base for it, is well recognised and is common across many developed countries. The question is how to share the taxable capacity between the different levels of government. The question is how to share the taxable capacity between different levels of government. Given that we had concluded that there should be, for simplicity, a single Scottish tax rate, we also concluded that 10p in the pound was an appropriate starting point: it meant that the basic rate of tax (which is the rate that is relevant for all Scottish taxpayers and the only rate paid by the majority) is, as it were, split equally between the UK and Scottish taxation at the outset of the scheme. Obviously
that might change in future if the two Parliaments take divergent tax decisions, as is their right.

I hope these observations are helpful to the Committee. If further information is required, please let me know.

Kenneth C. Calman
10th October 2011
ANNEX 1.

Conclusions of the IEG on Natural Resource Taxation

10.1. It is possible to construct and implement a basis for identifying accurately the “Scottish” share of UK oil taxation. This is to say that oil and gas taxation revenues accruing to activities within Scotland’s territorial waters could be assigned if it was necessary or desirable to do so. There are several possible arrangements to achieve this of varying complexity and ease of implementation.

10.2. Devolving, rather than assigning, oil and gas taxation policies to the Scottish Parliament would add complexity as separate taxation regimes applying in Scottish and the rest of the UK’s water would produce transitional and other problems. While these would be justified for an independent Scotland the costs may be unduly high for a devolved Government situation. Only if there is a substantial difference in taxation policies between the two Governments would this be appropriate.

10.3. Established economic theory suggests that, in order to achieve intergenerational equity, sufficient revenues from oil/gas taxation should be invested to at least maintain the nation’s capital stock. This reflects that the exploitation of reserves now means that they will not be available to future generations. Such depletion can be counterbalanced by investing sufficient revenues either in an investment vehicle such as an oil fund or in long term capital investments. This does not necessarily mean that all assigned revenues to the Scottish Government would have to be invested.

10.4. The assignment of a Scottish share of these revenues would have major implications for the Scottish Budget. It would expose the Scottish Parliament to significant revenue variations, given the inherent volatility of oil and gas taxation revenues. Oil and gas taxation revenues from the UKCS will also diminish over time given the finite nature of the resource. Substantive borrowing and investment powers could enable these revenue variations to be mitigated. For example, investments in an oil fund above the level to maintain the nation’s capital stock could be made when the prices were high.

10.5. Ultimately, the treatment of the Scottish share of UKCS revenues and whether they should to accrue to Scotland of UK Government relates directly to the current debate about the appropriate constitutional relationship between Scotland and the rest of the UK. Their assignment could be justified by the derivation principle if a proportion of the Scottish Budget was to be comprised of Scottish tax revenues.

10.6. The assignment of a Scottish share of oil tax revenues might be expected to have major implications for the grant from the UK Government which currently forms the basis for the Scottish Government’s budget. The grant could be clearly reduced, and a formula would need to be designed which did so in an equitable manner. This subject is beyond the scope of the present paper.