Scotland’s relationship with the EU

Reform Scotland is delighted to respond to the committee’s call for evidence as part of its inquiry into Scotland’s relationship with the EU following the EU referendum.

Reform Scotland only comments on areas where we have previously carried out research or analysis. Many of the issues that the committee has raised in its call for evidence fall outside areas we have previously studied. As a result, our response focuses on ‘The domestic process for dealing with a withdrawal from the EU’. Specifically, we respond to the Committee’s call for comments on ‘the implications for the devolution settlement of withdrawal from the EU’.

Reform Scotland has welcomed the new powers due to be devolved to Scotland under the Scotland Act 2016, but has argued that it is important not to overstate the opportunities they bring.

While the rates and bands of income tax are being devolved, income tax on dividends and savings, as well as control over the personal allowance, remain at Westminster. With only one major tax, there is very little scope for reforming the tax system in Scotland. Based on GERS 2015/16, 69% of all tax revenue raised by the Scottish Parliament will be from a single source, as illustrated in the pie-chart below. This over-reliance on Income Tax offers little scope to effect real reform and so limits the opportunity to create a better environment for economic growth. Indeed, until the Scottish Parliament has control of a varied basket of taxes, we would urge the Scottish Government to peg Income Tax to the UK rate.

Source: GERS 2015-16.
As a result, Reform Scotland believes that the only way to enable the Scottish Government to create a different approach to tax, or to reform the system, is with the devolution of further taxes. We have continually argued that the Scottish Parliament should be responsible for raising what it spends and believe far more tax powers can, and should, be devolved.

While we appreciate that another Scotland Bill to devolve greater powers is unlikely to happen in the short term, we would argue that there is a case for VAT now to be devolved in full. We did not include VAT in the figures highlighted above because 50% of VAT receipts are simply assigned to the Scottish Parliament and so it is still a reserved tax controlled at Westminster. Some VAT revenues were assigned to Scotland because it would give the Scottish Government an incentive to find ways to increase those revenues, but the ability to vary the rate could not be devolved because it was not allowed under EU law.

With the UK voting to leave the EU, there is no reason why the UK Government cannot give a commitment to devolve VAT in full once we have formally left the EU. David Gauke, Chief Secretary to the Treasury, told the House of Commons on 9th December 2015 "The Smith commission set the objective that more devolved spending in Scotland should come from tax raised in Scotland. Control over setting VAT rates is not being devolved to Scotland, because EU VAT law does not allow for differential VAT rates within a member state"

By assigning VAT revenue the UK Government recognised the benefit another tax would bring to the Scottish Parliament. However, without control over that tax, there is no ability for the Scottish Government to look at reform and encourage economic growth. If the argument has been accepted that VAT is a useful tax for Scotland to have, but it could not be devolved due to EU law, once the UK leaves the EU there is no reason why it could not be devolved in full.

Devolution of VAT in full would also enable the Scottish Government to directly address a number of issues regarding the application of VAT in Scotland, especially with regard to Police Scotland.

If VAT was devolved, there would be a broader basket of tax powers, as illustrated below, enabling some elements of reform to be considered. While, it would not go as far as Reform Scotland would like, it should certainly be the next step.
It would also mean that the Scottish Parliament would go from being responsible for raising 32% of the money it spends, to 63%.