FINANCE AND CONSTITUTION COMMITTEE

AGENDA

14th Meeting, 2016 (Session 5)

Wednesday 30 November 2016

The Committee will meet at 9.30 am in the David Livingstone Room (CR6).

1. **Decision on taking business in private**: The Committee will decide whether to take items 4 and 5 in private.

2. **UK Autumn Statement and Scotland’s Budget**: The Committee will take evidence from—

   Professor Graeme Roy, Director, Fraser of Allander Institute.

3. **Taxation Inquiry**: The Committee will take evidence from—

   Yvonne Evans, Tax Law Sub-Committee, Law Society of Scotland;

   Alan Barr, Brodies LLP, Partner and Honorary Fellow at University of Edinburgh;

   Professor David Bell, Fellow, Royal Society of Edinburgh.

4. **Draft Budget Timetable**: The Committee will consider a proposed timetable for scrutiny of the draft budget 2017-18.

5. **Land and Buildings Transactions Tax (LBTT)**: The Committee will consider a draft report on the Land and Buildings Transactions Tax.

Jim Johnston
Clerk to the Finance and Constitution Committee
Room T3.60
The Scottish Parliament
Edinburgh
Tel: 0131 348 5215
Email: James.Johnston@parliament.scot
The papers for this meeting are as follows—

**Agenda item 2**

Autumn Statement paper

**Agenda item 3**

Tax Inquiry

**Agenda item 4**

PRIVATE PAPER

**Agenda item 5**

PRIVATE PAPER
Introduction

The evidence session with Professor Graeme Roy, Director of the Fraser of Allander Institute, will involve taking evidence on the impact of the Autumn Statement on Scotland’s Budget. Professor Roy has provided a set of slides as his written submission which is at Annex A. A SPICe Briefing on the implications of the Autumn Statement for Scottish Government’s budget is provided at Annex B.
Autumn Statement 2016: why the excitement?

- UK fiscal policy dominated by George Osborne’s 2019/20 fiscal surplus target
- Brexit vote and downward growth revisions meant this would be unachievable
- But by how much would underlying economic and fiscal forecasts be revised?
- How would new Chancellor respond?
- New fiscal rules? Restatement of objectives of fiscal policy?
- Implications for distribution of public spending and taxation?
The Economic Context

• New Chancellor announced significant downward revisions to both growth & public finances over the course of the next five years

• Permanent hit to the economy from Brexit, leads to reduced tax revenues and higher expenditures………

• ……but Autumn Statement also highlighted that public finances were weaker even prior to EU referendum
The Policy Context

• Modest fiscal giveaway
  • Around £9 billion in 2020-21

• New Productivity Investment Fund

• Limited support for JAMs

• Fiscal Targets Abandoned
  • Replaced by new fiscal rules
The Economic Outlook
Modelling Brexit

• Broadly similar approach to most other forecasters

• Key Points
  • UK leaves the EU in April 2019
  • Reduction in imports and exports
  • Lower migration
  • *Savings from EU budget recycled into additional domestic spending*

• “Although little the wiser……” OBR
Economic Outlook. GDP forecast

- March 2016 Budget Forecast
- November 2016 Autumn Statement Forecast

% change on previous year:
- 2015: 2.2
- 2016: 2.1
- 2017: 1.4
- 2018: 1.7
- 2019: 2.1
- 2020: 1.7
- 2021: 1.5

www.strath.ac.uk/fraser
OBR more optimistic than average. GDP forecast

![GDP forecast chart](chart.png)

- BOE
- Independent
- OBR
Reasons for the downturn

• Delayed/cancelled business investment – driven by uncertainty and anticipation of future trading relationships

• Reduced consumer spending as a result of higher inflation from sharp depreciation in Sterling

• Net trade positive in short-term
Downward revisions to UK Growth
Key implications

• UK economy around £30bn smaller in real terms in 2020-21 than expected in March

• Unemployment rising to 5.5% in 2018 – additional 100,000 across the UK

• Sharp rise in inflation – peaking at 2.5% in 2018

• Slower growth in wages – IFS real earnings to remain below 2008 levels even by 2021
Critical will be what happens in the long run.....

Future path of productivity and potential output will be crucial – OBR hedges its bets.

Productivity growth falls over forecast period but returns to trend in mid-2020’s.
The Fiscal Outlook
£120 billion additional borrowing

Changes to public sector net borrowing since March

- March forecast
- November forecast


£ bn
Sources of the increase in borrowing

<table>
<thead>
<tr>
<th>Year</th>
<th>£ billion</th>
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<tbody>
<tr>
<td>2016-17</td>
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<td>2017-18</td>
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<td>2018-19</td>
<td></td>
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<tr>
<td>2019-20</td>
<td></td>
</tr>
<tr>
<td>2020-21</td>
<td></td>
</tr>
</tbody>
</table>

- Effect of Government decisions
- Brexit forecast changes
- Non-Brexit forecast changes
- Classification changes
- Total
The Policy Response
Fiscal Rules – George Osborne

• 1. A target for a surplus on PSNB by the end of 2019-20.

• 2. A target for PSND to be falling as a proportion of GDP in each year up to 2019-20.

• 3. Beyond that, and in ‘normal times’, a target for a surplus on PSNB in each subsequent year.
Fiscal Rules – New Chancellor

• 1. A target to reduce cyclically-adjusted PSNB to below 2 per cent of GDP by 2020-21.

• 2. A target for PSND to be falling as a proportion of GDP in 2020-21.

• Moving from a target of a budget surplus in 2019-20 to one of keeping cyclically-adjusted borrowing below 2% of GDP in 2020-21 represents a very significant loosening – around £45 billion. With borrowing forecast of £21 billion could double borrowing in 2020-21 and still meet goal.
New Fiscal Rules……

<table>
<thead>
<tr>
<th></th>
<th>Current</th>
<th>Proposed</th>
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</thead>
<tbody>
<tr>
<td>Fiscal Mandate: Borrowing</td>
<td>X</td>
<td>✔️</td>
</tr>
<tr>
<td>Supplementary Target: Debt</td>
<td>X</td>
<td>✔️</td>
</tr>
</tbody>
</table>

- 12 fiscal rules since 1997
- 10 broken or abandoned
Key Policy Announcements

• Spending
  o National Productivity Investment Fund (Housing; Transport; Telecoms; R&D)
  o £1.8bn from the local growth fund & City Deals
  o National living wage rise from £7.20 to £7.50 an hour

• Taxes
  o Another Fuel Duty freeze in 2017-18…offset by insurance premium tax rise from 10% to 12%
  o Salary sacrifice schemes scaled back

• Welfare
  o No reversal of welfare cuts
  o Universal Credit taper rate reduced from 65p to 63p
Distributional analysis

• Variety of different ways that this can be measured……but key conclusions –

• Living standards likely to be hit by lower earnings growth and higher prices – average real earnings growth of around 3.7% lower than March forecast

• Working age households particularly exposed – given freeze on working-age benefits
Recent changes in context
Implication for the Scottish budget
An increasingly complex funding settlement

• The Scottish Government’s resource budget:
  • Block grant from Westminster
  • Interaction between block grant adjustment for devolved taxes, and Scottish revenues from devolved taxes
  • Devolved tax policy in Scotland
• Capital budget: block grant + capital borrowing powers
• Both block grant and block grant adjustments are determined by decisions taken at the Autumn Statement
Consequentials announced Wednesday

![Bar chart showing resource and capital spending from 2016/17 to 2020/21. Resource spending is minimal, while capital spending increases significantly.]
Outlook for SG’s resource block grant
The revenues being transferred

<table>
<thead>
<tr>
<th>Tax</th>
<th>Revenues (2015/16, £m)</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land and Buildings Transactions Tax (LBTT)</td>
<td>£416</td>
<td>2015/16</td>
</tr>
<tr>
<td>Landfill Tax</td>
<td>£147</td>
<td>2015/16</td>
</tr>
<tr>
<td>NSND Income Tax</td>
<td>£11,214</td>
<td>2017/18</td>
</tr>
<tr>
<td>Air Passenger Duty</td>
<td>£275</td>
<td>2018/19</td>
</tr>
<tr>
<td>Aggregates Levy</td>
<td>£53</td>
<td>2019/20</td>
</tr>
<tr>
<td>VAT assignment</td>
<td>£4,982</td>
<td>2019/20</td>
</tr>
</tbody>
</table>
The Block Grant Adjustments (BGAs)

Barnett-determined block grant

Adjustment to reflect rUK revenues foregone (BGA)

Revenues raised from devolved tax in Scotland

Scottish budget

• Purpose of BGA: counterfactual estimate of tax revenues foregone by UK Government

• If revenues from devolved tax are higher than BGA, Scottish budget is better off than without tax devolution

• Similar block grant addition for new welfare powers
The effect of differential revenue growth
Explicit spending commitments

- NHS resource budget – increase by £500 million more than inflation by the end of the parliament

- Police – protect the police resource budget in real terms over the course of the parliament

- Childcare – double the number of hours of free early years education and childcare by 2021 – £500 million per year by the end of the parliament

- Spending on these three areas accounts for over half SG resource budget

- Implication is that remaining (unprotected) portfolios will see cuts of 10-14% over the period to 2019/20, depending on Scottish revenue performance
The outlook for capital spending

<table>
<thead>
<tr>
<th>Year</th>
<th>£ million, 2016/17 prices</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016/17</td>
<td>24,200</td>
</tr>
<tr>
<td>2017/18</td>
<td>24,400</td>
</tr>
<tr>
<td>2018/19</td>
<td>24,600</td>
</tr>
<tr>
<td>2019/20</td>
<td>24,800</td>
</tr>
<tr>
<td>2020/21</td>
<td>25,000</td>
</tr>
</tbody>
</table>

£ million, 2016/17 prices
Summary
Key messages - outlook

- Significant downward revisions to forecast economic growth
- Substantial uncertainty around likely scale of downturn…
- …But will imply lower wages, employment and living standards
- Substantial deterioration in public finances
- £120bn additional borrowing forecast, of which only £23bn due to policy announcements
- New fiscal rule only marginally better than previous
- Further fiscal pressures coming, mainly relating to demographics
Key messages - policy

• Only marginal changes to resource and welfare spending

• £23bn increase in investment welcome in context of historically low borrowing rates…

• …takes public sector investment to historically high levels…

• …but will it achieve a step-change in productivity improvement?

• For Scottish Government, implication is 3% cut to resource budget over period to 2020/21

• Given existing spending commitments, implies real terms cuts of 10-14% for unprotected portfolios

• More favourable outlook for capital spending, both through higher grant and borrowing potential
Financial Scrutiny Unit Briefing
Autumn Statement 2016: impact on Scotland

24 November 2016

Ross Burnside

The UK Government’s Autumn Statement was published on Wednesday 23 November 2016 and is the first UK fiscal event since the Brexit vote of June and the Cabinet reshuffle undertaken by the new Prime Minister, the Rt Hon Theresa May MP.

This briefing presents the latest Scottish spending allocations and summarises the Office for Budget Responsibility’s Scottish tax forecasts. The Scottish Government will publish its Draft Budget 2017-18 on 15 December 2016.
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  UK FISCAL EVENTS .............................................................................................................................. 6
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THE SCOTTISH BUDGET

The tables below show HM Treasury’s latest Scottish Budget figures.

Table 1: Scottish Departmental Expenditure Limits, £m

<table>
<thead>
<tr>
<th></th>
<th>2016-17</th>
<th>2017-18</th>
<th>2018-19</th>
<th>2019-20</th>
<th>% Change 2016-17 to 2019-20</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resource DEL (excluding depreciation)</td>
<td>26,088</td>
<td>26,503</td>
<td>26,555</td>
<td>26,660</td>
<td>2.2</td>
</tr>
<tr>
<td>Capital DEL</td>
<td>3,220</td>
<td>3,376</td>
<td>3,520</td>
<td>3,700</td>
<td>14.9</td>
</tr>
<tr>
<td>Total</td>
<td>29,308</td>
<td>29,880</td>
<td>30,074</td>
<td>30,360</td>
<td>3.6</td>
</tr>
</tbody>
</table>

Table 2: Scottish Departmental Expenditure Limits, £m, (real terms, 2016-17 prices)

<table>
<thead>
<tr>
<th></th>
<th>2016-17</th>
<th>2017-18</th>
<th>2018-19</th>
<th>2019-20</th>
<th>% Change 2016-17 to 2019-20</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resource DEL (excluding depreciation)</td>
<td>26,088</td>
<td>26,111</td>
<td>25,624</td>
<td>25,271</td>
<td>-3.1</td>
</tr>
<tr>
<td>Capital DEL</td>
<td>3,220</td>
<td>3,326</td>
<td>3,397</td>
<td>3,507</td>
<td>8.9</td>
</tr>
<tr>
<td>Total</td>
<td>29,308</td>
<td>29,438</td>
<td>29,020</td>
<td>28,778</td>
<td>-1.8</td>
</tr>
</tbody>
</table>

Despite the uncertainty around what would be in the UK Government’s plans and their implications for the Scottish budget, there were no reductions from the plans set out in the March 2016 UK Budget. DEL Resource figures were increased by £117m over the period to 2020 compared with the March 2016 plans. DEL Capital plans were increased by £929m over the period to 2021 compared with the March 2016 plans.

DEVOLVED TAX FORECASTS

On the same day as the Autumn Statement, the Office for Budget Responsibility (OBR) published its Economic and Fiscal Outlook (Office for Budget Responsibility, 2016a). This contains a forecast for all tax receipts collected in the UK. Alongside that, and consistent with the main UK forecasts, the OBR published forecasts for the fully or partially devolved Scottish taxes.

The Scottish Draft Budget 2017-18 will contain devolved tax rates, bands and forecasts from the Scottish Government. The OBR forecasts give an indication on what fully or partially devolved Scottish taxes are likely to generate on the basis of current rates and bands. These are presented by year below. Based on the OBR forecasts, taxes either fully or partially under the control of the Scottish Parliament will comprise over 40% of the DEL budget in 2017-18.
Table 3: OBR Devolved Tax Forecasts, £m

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax</td>
<td>4,541</td>
<td>4,590</td>
<td>11,768</td>
<td>12,220</td>
<td>12,770</td>
<td>13,432</td>
<td>14,181</td>
</tr>
<tr>
<td>LBTT</td>
<td>416</td>
<td>483</td>
<td>539</td>
<td>596</td>
<td>657</td>
<td>726</td>
<td>796</td>
</tr>
<tr>
<td>Landfill tax</td>
<td>148</td>
<td>154</td>
<td>134</td>
<td>118</td>
<td>110</td>
<td>105</td>
<td>103</td>
</tr>
<tr>
<td>Aggregates levy</td>
<td>51</td>
<td>53</td>
<td>50</td>
<td>53</td>
<td>53</td>
<td>53</td>
<td>54</td>
</tr>
<tr>
<td>Air passenger duty</td>
<td>284</td>
<td>302</td>
<td>313</td>
<td>326</td>
<td>342</td>
<td>360</td>
<td>378</td>
</tr>
<tr>
<td>Total</td>
<td>5,440</td>
<td>5,582</td>
<td>12,804</td>
<td>13,314</td>
<td>13,931</td>
<td>14,675</td>
<td>15,511</td>
</tr>
</tbody>
</table>

Source: OBR 2016b

The latest OBR forecast for revenues from the Scottish Rate of Income Tax (SRIT) in the current financial year (2016-17) is £4,590m. At the time of the Scottish Government’s Draft Budget 2016-17, SRIT revenues were forecast to be £4,900m. On the basis of this forecast, the Scottish Government’s block grant for 2016-17 was reduced by £4,900m and the Scottish Government is able to draw-down this amount to reflect the devolution of SRIT. In future years, the Scottish Government’s draw-down will reflect actual tax receipts by HMRC. However, as set out in Strengthening Scotland’s Future, in 2016-17 draw-down will not be adjusted and will remain at £4,900m even if outturn receipts are higher or lower than this. On the basis of the latest forecasts, the amount the Scottish Government is able to draw-down is £310m higher than anticipated receipts.

OTHER POLICY ANNOUNCEMENTS

INCOME TAX

The Autumn Statement restated the UK Government’s previously announced commitment to:

- raise the income tax free personal allowance to £11,500 from April 2017 and £12,500 by the end of the UK Parliament in 2020; and

- increase the higher rate threshold to £50,000 by the end of the UK Parliament in 2020.

The Draft Budget 2017-18 will present the Scottish Government’s tax plans for the coming year. The income tax free personal allowance is reserved to Westminster, however the Scottish Parliament has the power to introduce a zero-rate. In its 2016 Scottish election manifesto, the SNP stated that it would create a new zero-rate band that would “ensure that by 2021-22 the amount of income that can be earned without any income tax being paid rises to £12,750.” On the issue of the higher rate threshold, the SNP manifesto states that “we will not implement the tax cut proposed by the Tories through the increase in the Higher Rate threshold. Instead, we will freeze the Higher Rate threshold in real terms in 2017-18 and increase it by a maximum of inflation until 2021-22.” In 2016-17, the higher rate threshold is £43,000.
UK FISCAL EVENTS

The Chancellor announced his intention to move to one main fiscal event per annum, to take place in the “autumn” (no month was specified). As the OBR is legally mandated to produce twice yearly forecasts, there will be an OBR spring forecast and the Government will respond to that with a Spring Statement.

SOURCES


SNP Manifesto 2016. Available at: http://www.snp.org/manifesto
RELATED BRIEFINGS
SB 15-86 Draft Budget 2016-17
SB 16-88 The Fiscal Framework

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www.parliament.scot
Finance and Constitution Committee

14th Meeting, 2016 (Session 5), Wednesday 30 November 2016

A Scottish approach to taxation

Introduction

The evidence session on a Scottish approach to taxation is the first evidence session the Committee has held on this Inquiry. The session is intended to provide an opportunity to explore the Scottish Government’s taxation principles and the principles which could underpin a taxation system more generally. The witnesses for this evidence session are:

- Alan Barr (who is giving evidence in a personal capacity but is also a Partner with Brodies LLP and an Honorary Fellow at Edinburgh University’s Law School;

- Professor David Bell, who is giving evidence on behalf of the Royal Society of Edinburgh; and

- Yvonne Evans, Tax Law Sub-Committee, Law Society of Scotland.

All three witnesses, or the organisations they are representing at the meeting, provided written submissions to the Committee’s Call for evidence. In addition, Professor Bell has provided an additional submission. These written submissions are provided at Annex A of this paper.

SPICe have provided a summary of all the responses to the Committee’s call for evidence. This summary is provided at Annex B of this paper. Lastly, the individuals written submissions can be accessed on the Committee’s website at:

Finance and Constitution Committee Clerking Team

24 November 2016
A SCOTTISH APPROACH TO TAXATION: SCOTTISH PARLIAMENT FINANCE COMMITTEE CALL FOR EVIDENCE

RESPONSE BY ALAN BARR, PARTNER, BRODIES LLP, SOLICITORS AND HONORARY RESEARCH FELLOW, SCHOOL OF LAW, THE UNIVERSITY OF EDINBURGH

(Responding in a personal capacity)
Introduction

I welcome the opportunity to consider and respond to the Finance Committee’s call for evidence on a Scottish approach to taxation. This response has been prepared on an entirely personal basis and is not made on behalf of Brodies LLP or the University of Edinburgh. I have also contributed to the response prepared on behalf of the Law Society as one of the members of their Tax Law Sub-Committee.

General Comments

Any comment on a Scottish approach to taxation must start with an acknowledgement of the context in which such an approach must operate. At present, Scottish taxation is a devolved matter, to the limited extent that it has been devolved. This might almost inevitably appear to lead to the conclusion that the system cannot diverge too greatly from that of the system from which it has devolved. Indeed, where partial devolution of a single tax is considered (such as income tax), that will certainly be the case. With more fully devolved taxes (such as LBTT), there is an argument that divergence should be kept as limited as possible, on the grounds of efficiency and greater understanding and acceptance by taxpayers.

But adherence to some of the methodology adapted at Westminster for tax legislation seriously militates against attempts at a distinctive Scottish approach; and thus far adherence seems to have been the rule rather than the exception. There was an opportunity with Land and Buildings Transaction Tax to adopt a genuinely new approach; and that opportunity has not been taken, for the most part. (In relation to existing taxes, my comments will be particularly directed at LBTT, as that is where I have some knowledge and practical experience. The limited devolution of income tax makes such consistency, on principles at least, inevitable for the moment.)

What has therefore happened is that at present the divergences that have occurred in relation to Scottish taxes appear to some extent as further complications in what overall is seen (with great justification) as the most complicated tax system in the world. This is not an over-emphasis – the UK tax system as a whole is woefully complex. This is often acknowledged and lip service to its possible reform is paid - but virtually nothing is done about it. Then temptation to use tax as an economic and political lever may be too great to allow any political party to grasp this particular nettle.

A distinctive Scottish approach might approach this problem with a real willingness to make radical changes towards simplification – such efforts would accord exactly with most of the avowed principles of the Scottish approach.
Indeed, so far, there are some signs of the opposite happening – with Scottish taxes seen as bringing an additional layer of complexity to the overall system. In fact, this appearance may be more pronounced where there are slight divergences in rates, rules or practices which apply to the rest of the UK. There may be little justification for this unless a distinct economic or other effect is produced by the divergence.

A Scottish approach, adhering to the principles set out to demonstrate such an approach, might be achieved by a wholly different approach to enacting tax legislation. It is said that there are no principles in taxation – the law is the law in its minute complexities and if a taxpayer falls within the specific wording it s/he is charged, while a taxpayer falling outwith the exact words is not so charged.

But there is no reason why principle should not be applied to taxation; and indeed the Scottish Anti-Avoidance Rule could be seen as an example of that approach. But one fears that it will be explored in relation to the details of its specific wording in attempts to limit – or indeed expand – its boundaries. Its effects will not be clear until the first litigation on its terms, but an approach concentrating even more on the principle of the taxation intended might leave less room for doubts than currently exist.

There remains a real opportunity for such a radical approach - with a basis in a difference often put forward in relation to Scots law more generally. It is a system based on principle rather than the vagaries of case law. While such an assertion may be a little trite and is certainly not uniformly seen in Scots law, it is an approach worth preserving into tax legislation. It can and does apply in other areas of legislation – the ground-breaking Adults with Incapacity (Scotland) Act 2000 virtually commences with a selection of principles to be applied and that underlying approach to the details of the Act produces a welcome and workable system.

In my view, a significant amount of perceived problems already becoming evident in Scottish tax law derives from accepting what might be seen as an old fashioned form of drafting tax legislation deriving from Westminster. Our most significant piece of substantive tax legislation, the Land and Buildings Transaction Tax (Scotland) Act 2013, involved utilising unchanged a considerable proportion of the analogous stamp duty land tax legislation. The same applies to significant amounts of the Revenue Scotland and Tax Powers Act 2014. Constraints of time and resources may have made such an approach inevitable; it may nonetheless be seen as a little disappointing.

Reference might be made to the tax Law Re-Write project, which was applied to some (but not all) UK tax legislation between 1997 and 2010. This was widely perceived as not being particularly successful; and its abandonment before completion left the UK tax system with two distinct parents in stylistic form – re-
write style and traditional style. My (admittedly anecdotal) experience of the two different styles of drafting is that it was not attractive to current and experienced users of the system; but that people (in this case students) coming to tax legislation for the first time much preferred the new style of drafting.

In any event, I believe that serious consideration should be given to the drafting of Scottish tax legislation; and that in particular it should not be considered automatic that it should follow its Westminster predecessors in style or in substance.

**Question 1: How can the Scottish Government’s four principles to underpin Scottish taxation policy best be achieved?**

This has to some extent been dealt with in my introductory remarks; and is further addressed in the answer to question 2.

**Question 2: How does the current taxation regime and proposals for newly devolved taxes align against these four principles?**

**PRINCIPLE 1: TAXATION POLICY SHOULD BE PROPORTIONATE TO THE ABILITY TO PAY**

The original announcements in relation to LBTT and indeed the main plank of Scottish difference from its SDLT predecessor pointed towards immediate adherence to this principle – the abolition of the notorious “slab” or “cliff-edge” system for the rates of the tax and its replacement by a “slice” system. (The “slab” or “cliff-edge” system involves payment of the relevant tax rate on the whole consideration once a threshold has been breached; the “slice” system involves charging at the lesser rates up to each threshold and at the higher rates only on the slice of consideration above that threshold.) The impact of this welcome and radical change was somewhat diluted by the same principle being adopted in rUK at the same time as LBTT was introduced. This should not detract from that important starting point – such a system is clearly directed at proportionality to the ability to pay.
Unfortunately, the recent introduction of Additional Dwelling Supplement has detracted somewhat from that welcome change. ADS is charged on a slab system – once one is over the very low £40,000 threshold, the tax is payable on the whole consideration. Indeed, if it does not stretch the metaphor too far, there is a double cliff edge in the ADS system, as that £40,000 threshold applies absolutely not only to the property being purchased, but also to the other property owned which causes ADS to apply.

Thus if a property is purchased for £39,000 and ADS would otherwise apply, there is no ADS payable. If the property is purchased for £40,100, ADS rises from £0 to £1,203. If one is purchasing a first property for £1 million and owns another property worth £39,000, there is no ADS payable. If the other property is worth £40,100, the ADS on the new purchase is £30,000. It is a high cliff and it is unsurprising that taxpayers will take action to avoid falling off it.

It may reasonably be argued that ADS has less need to involve proportionality, as by definition it involves second properties, but as a matter of principle a “slab” system can rarely contribute to proportionality.

In relation to the limited proposed changes to Scottish rates of income tax (in fact thresholds rather than rates, with the exception of what will be a 0% rate for a small amount to extend what is in effect the personal allowance), they are a relatively minor contribution to proportionality. They might fall within a criticism as being minor differences for no strong economic reason, but they are in fact anticipated to produce quite a significant amount of overall additional revenue; and despite their addition to the complexities of the system, they may not be different enough to produce adverse behavioural effects.

I endorse the further specific points put forward by the Law Society of Scotland in their response.

**PRINCIPLE 2: TAXATION POLICY SHOULD PROVIDE CERTAINTY TO THE TAX PAYER**

In the vast majority of simple cases, there will be certainty for the taxpayer in relation to the LBTT to be paid on a transaction. This must be recognised and acknowledged. Despite the “slice” system being more complex than the “slab”, the availability of online calculators effectively eliminates that level of additional complication.
But once one moves beyond the basic transaction, including into any transaction potentially liable to ADS, a degree of this certainty disappears. Examples are numerous - the entire regime for partnerships is complex (and in some cases illogical); there are difficulties with trusts; transactions relating to leases, particularly their variation, extension and restriction and especially where the original lease dates from before the introduction of LBTT, do not produce certain results (although guidance has been extended on this matter).

These problems derive to some extent from the fact that the LBTT legislation was imported from its SDLT equivalent without changes. In the case of partnerships, the importation was without a single alteration of a regime that has attracted criticism in its current form for SDLT. In relation to trusts, the importation was somewhat odd, in that in new Scottish legislation, one is directed to consider whether a beneficiary has an interest that would have a particular effect under the law of England and Wales, before deciding whether and how LBTT is chargeable.

The introduction of ADS has decreased the level of certainty for a taxpayer. There are a number of distinct examples where what would appear to the principles of the charge are violated to a significant extent.

One example will suffice for present purposes. If one of a married couple (A) own their current main residence and the other (B) owns a holiday home, they may decide to sell their current main residence and buy a new one, this time in joint names. It would be expected that this will simply involve the couple replacing their main residence and no ADS should be charged if the purchase takes place after or at the same time as the sale. That is not the case – B does not own a main residence and so cannot replace it; and B’s ownership of another property is deemed to extend to A, so that the whole transaction is liable to ADS. This offends against the principle of certainty, but also those of proportionality and probably efficiency (as essentially artificial action may be necessary overcome this surprising result.)

On a policy level I endorse the comments of the Law Society of Scotland, particularly in relation to reform of the tax making process; and the need for a regular Finance Bill to include reforms to existing legislation as well as new proposals.

On an operational level, I endorse the comments from the Law Society of Scotland in relation to the Opinions service offered by Revenue Scotland (improvements in delivery and in particular publication of opinions in some form would be very much welcomed.)
Guidance could also be improved, but I recognise that this is very much a work in process; and that great advances have already been made in the guidance available.

**PRINCIPLE 3: TAXATION POLICY SHOULD PROVIDE CONVENIENCE/EASE OF PAYMENT**

This principle has generally been adhered to. Increased and now almost universal use of electronic communication for LBBT compliance and increasingly for payment has assisted greatly. This has involved a high degree of cooperation by Scottish solicitors, which has been generally acknowledged. The LBTT online system is generally excellent, with some simplification as compared to its rUK equivalent. The adoption of sensible arrangements in relation to the payment of LBTT so as not to delay registration of deeds was extremely welcome and is an example of a necessary recognition of the practicalities required which was no apparent from the underlying legislation.

**PRINCIPLE 4: TAXATION POLICY SHOULD BE EFFICIENT**

There need to be significant advances in the system for legislation before tax policy itself could be regarded as efficient. Good tax policy requires acceptance of its aims by the widest possible constituency of interests; and that takes time for consultation. It is appreciated that there is sometimes a conflict between the need or wish to enact tax changes swiftly and the time needed to enact what may be complex law, but the best system would involve full consultation and in particular a willingness to accept comments on draft legislation offered in the spirit of achieving the efficient implementation of tax policy.

It is appreciated that there may be difficulties in sharing details of intended policy. There is a relatively small pool of individuals in Scotland with interest and expertise in these matters, most of whom have other responsibilities. But there is I believe a genuine willingness to assist with the implementation of policy in the most painless fashion if that is possible. It will require goodwill, openness and trust on both “sides” of this small community to maximise the benefits of this cooperative approach.

**Question 3: Is there scope for a fundamentally different approach to taxation in Scotland?**

This has largely been answered above. I believe that there is such scope,
Question 4: Should future tax changes be ring-fenced and if so, how? If not, why?

Hypothecated taxes have a tendency to start in that form, but with a gradual move back into general tax receipts. But in principle there is no reason why hypothecated taxes cannot form part of an overall system. It is perhaps more appropriate that hypothecation for a particular purpose is time limited, although there is no reason why that purpose should not change from time to time.

Question 5: To what extent do potential behavioural responses limit options for tax changes in Scotland?

As part of a larger single state, Scotland is particular exposed to the possible mobility of taxpayers in response to raised taxes. But it is possible that this danger can be exaggerated; and it is of little bearing in relation to taxes in which the connecting factor is permanently located in Scotland (such as, most obviously, land). But other behavioural responses may be anticipated where (for example) there is the possibility of investment suffering lower taxes in Scotland’s contiguous neighbours.

Question 6: To what extent do the mechanisms for administering the Scottish income tax system via HMRC limit the scope for a different tax system in Scotland to develop?

While devolution is restricted to rates, the administration of income tax by HMRC should not limit the scope for change. But it other aspects of income tax were to be devolved it would be very difficult for a single tax authority to administer parallel but differing tax systems.

Question 7: Are there any other administrative limitations to the emergence of a Scottish tax system?

The resources and personnel available to Revenue Scotland and indeed the Scottish Government in relation to tax matters often seem stretched. It is a truism to say that the creation and administration of a tax system is no small undertaking; and as it develops, it is impossible to think that more resources will not be required. It is hoped that this will contrast with the position of HMRC, where contracting resources are currently causing serious administrative difficulties for users of the tax system.
ROYAL SOCIETY OF EDINBURGH

A Scottish Approach to Taxation

Response from the Royal Society of Edinburgh

Introduction

1. The Royal Society of Edinburgh (RSE) welcomes the opportunity to submit evidence to the inquiry being undertaken by the Scottish Parliament’s Finance Committee into A Scottish Approach to Taxation.

2. Through the Scotland Act 2012, the Scottish Parliament gained the ability to raise or lower Income Tax equally across all tax bands by 10p in the pound. It also gained competency over what was then Stamp Duty and Landfill Tax. The subsequent Scotland Act 2016 extended Holyrood’s remit to give it the power to set rates and bands on non-savings and non-dividend income, in addition to devolving control of other taxes such as Air Passenger Duty and Aggregates Levy. From April 2017 the Scottish Government will be assigned half of the VAT receipts estimated as arising in Scotland.

3. Over the past several years, the RSE has actively and consistently engaged with government, parliament and other interested bodies around issues of fiscal responsibility, taxation and the devolution of powers. In doing so, we have produced various Advice Papers to which we would draw the attention of the Committee:

   Air Passenger Duty (June 2016)
   The Scottish Fiscal Commission (November 2016)
   Competitive and Fair Taxation in Scotland (July 2015)
   Scotland’s Fiscal Framework (April 2015)

4. This response was prepared using the expertise of a Working Group of RSE Fellows from a wide range of institutions and with diverse backgrounds. The Advice Paper has been approved by the General Secretary of the Royal Society of Edinburgh.

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Principles of Taxation

5. The call for evidence highlights the four principles the Scottish Government has stated will underpin its approach to taxation policy, namely that the system should:
   - Be proportionate to the ability to pay;
   - Provide certainty to the taxpayer;
   - Provide convenience / ease of payment, and;
   - Be efficient.

6. Of these four principles, proportionality, certainty, and efficiency relate to the design of a tax system, while convenience / ease of payment relates to operation of the system.

7. The RSE notes that there have been many previous formulations of the principles that should underlie a good tax system. Adam Smith, a founding member of the Royal Society of Edinburgh, first laid out such principles which had their most recent expression in the Mirrlees Review on Reforming the Tax System for the 21st Century published in 2011. The review stressed that in a good tax system:
   - The negative effects of the tax system on welfare and economic efficiency should be minimised;
   - Administration and compliance costs should be low – a system that costs less is preferable;
   - Fairness (in a non-distributional sense) is achieved – for example, fairness of procedure, avoidance of discrimination, and fairness with respect to legitimate expectations;
   - Transparency is vital – it is always preferable that taxpayers understand the system.

8. The Committee is undoubtedly aware of the extensive literature on best practice for the design of a tax system, including the Mirrlees Review. The RSE would strongly recommend that such resources be utilised in the design and reform of the Scottish tax system.

Proportionality

9. The principle of proportionality would seem to go beyond the principles proposed by Mirrlees in that it introduces an element of distributional fairness. The RSE supports the idea of incorporating distributional fairness as a principle. However, we note that ‘ability to pay’ is an ambiguous concept, one which can be interpreted to be based upon either income or wealth.

10. Proportionality might mean simply that those with greater ability to pay should pay more tax, and there is a risk that a narrow reading of proportionality would suggest a system in which everyone pays in tax the same fraction of their ability to pay (a ‘flat tax’). This narrow sense of proportionality would be inconsistent with a more commonly supported principle of progressivity, whereby those with greater ability to pay, pay a higher proportion of income, or other measure of ability to pay, in tax.

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11. The RSE recommends that the Scottish Government should simply adopt a commitment to
distributional fairness, rather than an explicit principle of proportionality.

**Certainty**

12. Certainty to the taxpayer is undoubtedly important, and relates to the wider Mirrleesian
principle of lowering compliance costs. Uncertainty, and the costs of resolving the problems
that arise from it, contributes to compliance costs. The Mirrlees principles of procedural fairness
and transparency also address the issue of certainty. The RSE urges the Scottish Government to
endorse these wider-ranging principles of low compliance costs, procedural fairness, and
transparency.

**Convenience / Ease of Payment**

13. While the Scottish Government’s principle of ‘ease of payment’ is certainly part of the Mirrlees
principle of keeping the costs of compliance as low as possible, such costs are wider than those
of payment. For example, they encompass the costs of understanding the requirements of
compliance, and providing the information required to comply. The RSE again suggests that the
Scottish Government adopt the wider-ranging principle of keeping compliance costs low.

**Efficiency**

14. The principle of efficiency stated by the Scottish Government relates to the suggestion by
Mirrlees that a good tax system should minimise “the negative effects on welfare and economic
efficiency”. It should be noted that minimising the negative effects on welfare and economic
efficiency can encompass the normal requirement to minimise the distortionary impact of taxes.
It can include using the tax system to correct negative externalities that cannot be better
handled by other policies, for example the Carrier Bag Charge; and reducing opportunities for
tax avoidance. The RSE supports a principle of efficiency which encompasses all of these.

15. The Royal Society of Edinburgh believes that the Scottish Government should prioritise making
the tax system fair, efficient, simple, transparent, sustainable and consistent with other
government policies. It is our view that there is nothing uniquely Scottish in these core tenets,
which should apply to any system of taxation, not just Scotland’s.

**Tax Reform in Scotland**

16. Applying the universal principles for a good tax system to Scotland could, however, give rise to a
reformed and distinctive Scottish tax system for several reasons:

- Scotland has a different set of productive assets and opportunities than in other
countries;
- It will also have its own particular distribution of various socio-economic characteristics,
such as age and health;

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• The distortionary costs of various types of taxes will differ from other countries, for example the mobility of highly-skilled labour;
• The Scottish Government will have scope to make value-based and normative judgements on factors such as fairness, and environmental concerns.

17. However, the Scottish Government is not designing and implementing a completely new tax system. Rather, the starting point is the inherited, and inevitably imperfect, UK system. So there could be scope for developing a more distinctive Scottish tax system by undertaking reforms to the existing system that have not so far been undertaken by the Westminster Government.

18. Moreover, under the devolved tax powers the Scottish tax system is entangled with that of the UK, so undertaking reforms within such a framework will inevitably lead to a distinctive Scottish tax system.

19. It is important to distinguish between principles for the design of an entirely new tax system (as discussed above) and the practicalities of reforming the system which comes with the newly devolved powers of taxation.

20. It is extremely difficult to reform a longstanding and ingrained structure, such as our model of taxation, through incremental steps. The significant institutional changes which have occurred over the last several years, and are scheduled to continue over the coming years, present the Scottish Government with a unique opportunity to effect real change in this area.

21. The system from which we begin is far from ideal in many respects. Efficiency is one of the key principles espoused by the Scottish Government, and the efficiency of the Scottish tax system would be greatly aided by simplification. While the UK Government clearly recognises the importance of this - illustrated through the creation of the Office for Tax Simplification in 2010 - the UK system also contains over a thousand exemptions. Such loopholes not only provide scope for individuals to ‘game the system’ and avoid tax, but also raise questions of equity as these exemptions are often only available to those with the resources to access them. The RSE recommends that the Scottish Government endeavours to make the Scottish tax system as simple as possible, minimising loopholes.

22. Reform of the tax system will need to take into account some inherent vulnerabilities in the system, and the base from which it draws. The make-up of the tax base for Income Tax in Scotland is noticeably different from that of the UK as a whole. In Scotland just 0.7% of taxpayers (17,000 individuals) pay the Additional Rate of Income Tax compared to 1.1% in the UK as a whole. In Scotland, these 17,000 people contribute 13.7% of total tax revenues. This comparative lack of high earners is a challenge for the Scottish Government.

23. While there may be a political incentive to target high earners through an increased top rate of Income Tax or Land and Buildings Transaction Tax there should be a high level of caution exercised by the Scottish Government not to shrink its tax base. High income (and generally high value-adding) individuals will have a greater level of national and international mobility than others and the possibility of them relocating to other parts of the UK exists. Of equal concern would be the possibility that in doing so they would take business, clients and staff with them. It is, however, important to note the huge uncertainty over how mobile the Scottish tax base is. Of equal importance to the Scottish Government will be adequate enforcement by HMRC around Scottish residency rules in regards to taxation.

24. Issues around distortion of Income Tax are also a problem which the Scottish Government will have to address. Distortion may arise from people working fewer hours and from people leaving the labour market. The devolution of Income Tax now means that the possibility of migration in response to tax differences and converting income into dividends must also be considered.

25. The Scottish Government must also carefully consider the implications of tax competition with the rest of the UK. Firstly, it is important to state that tax competition is neither unambiguously positive nor unambiguously negative. Such competition may force a region to lower a tax rate that is too high or too distortionary, but can also lead to ‘a race to the bottom’. Tax competition is virtually inevitable when control over tax rates is devolved to subnational regions and those regions choose to set different rates.

26. Tax competition can have both active and passive manifestations. The active manifestation sees a lower tax rate chosen in order to attract economic activity to a region or to counter the loss of activity to regions outside of the UK. The passive manifestation sees tax rates kept at the same rate as elsewhere out of fear of tax competition.

27. It should also be noted that such competition within the UK may be driven by factors outside of the United Kingdom. An example of this would be the proposed lower rate of Corporation Tax in Northern Ireland. This is being driven by Corporation Tax rates in the Republic of Ireland, but in turn creates tax competition with Scotland. The most salient factor in this discussion is the degree of mobility of resources between regions. It is important to stress how little is known about the relevant responses.

28. The increasingly intertwined and global nature of taxation means that tax bases are shared between countries, and between subnational regions, and that cooperation over tax rates and countering tax avoidance is increasingly important. The Scottish Government finds itself in the position of being a subnational actor embedded within a quasi-federal state. As mobility of the tax base is likely to be higher between regions of the same state, than between independent countries, the Scottish Government is incentivised to levy higher taxes on non-mobile areas such as land and property. We note that (aside from Capital Gains Tax on real property) the Scottish Government now has control over all property taxes, and has an opportunity to look at them in the round. Ideally, tax on property should move away from transactions to ownership, so as to incentivise the allocation of property to productive use.

29. It is understandable that the Scottish Government, or Local Authorities, would look to adopt methods to tax non-residents such as levies on the extraction of natural resources or on tourism.
This clearly allows the government to raise extra revenue, without putting the burden on citizens they later rely on for re-election. While such taxes can prove effective, we stress the importance that sustainability and room for growth of the potential tax base should be favoured over the opportunity to collect potentially short-term revenues with little political fallout. The RSE highlights Air Passenger Duty (APD) as an effective revenue raising tax – it also serves an important environmental function – which allows the Scottish Government to tax non-residents. We reiterate our position that the rate of APD in Scotland should not be reduced.

30. The RSE also notes that the Scottish attribution of VAT receipts from the UK Exchequer will not include revenues directly raised from tourism, with this being adjusted by estimating the proportion of UK tourism that is assigned to Scotland. It is unclear whether this estimate will take into account any action taken by the Scottish Government which boosts tourism. This incentivises the Scottish Government to examine something like a hotel tax in order to ensure it collects revenue from visitors. Furthermore, the attribution of VAT to Scotland will be based on a relatively small sample included in the Living Costs and Food Survey (LCF). It is highly important that the data used are sufficiently robust.

31. Tax cooperation between the Scottish and UK governments will be of fundamental importance as a result of the extent to which they share tax bases. Scottish Income Tax payers will also pay National Insurance to the UK Exchequer, for example. The RSE considers that joint reform of the Income Tax and National Insurance systems is long overdue, and now can only be achieved if the Scottish and UK governments can effectively co-operate, and avoid the type of adversarial relationship we have seen develop in recent years. Both governments must work toward this.

32. The macroeconomic context of Scottish tax policy is a significant new factor that must be considered. The nature of the new fiscal settlement means that Scotland’s tax revenues will now be very exposed to macroeconomic shocks. Revenues will also be exposed to macroeconomic trends that may cause long-term divergence between the UK and Scottish economies. In turn, the Scottish macroeconomy will be exposed to shocks that arise from, or are magnified by, the Scottish tax system. The RSE strongly urges the Scottish Government to develop its tax system on the basic principles of working to minimise the risks to Scotland’s tax revenue of macroeconomic shocks and to minimise the impact of the tax system on macroeconomic stability.

33. The devolution of new tax powers takes place in the political climate of the UK decision to leave the European Union. This has created a great deal of political and financial uncertainty. The decision also opens up the possibility of variations in VAT and Corporation Tax within the UK – a situation which previously was prohibited or constrained under EU law. It is important that the Scottish Government takes action to make its tax base as large as possible, rather than allowing special exemptions.

11 http://www.ons.gov.uk/surveys/informationforhouseholdsandindividuals/householdandindividualsurveys/livingcostsandfoodsurveylcf
34. While the fundamental principles of a good tax system remain underlying, Scotland-specific opportunities and risks exist in reforming the system. However, the uncertainties surrounding tax competition and the increasing need for international tax cooperation mean that a Scottish tax system is unlikely to be radically different from that of the UK. Where there is substantial scope for change in Scotland is in the adoption of a different approach to developing tax policy.

35. Scotland has an opportunity to move away from the annual cycle of a set-piece UK Budget announcement controlled exclusively by the Chancellor of the Exchequer and UK Treasury. The minister with responsibility for taxation does not own the system, and indeed relies on the public for the raising of tax revenue. The Scottish Government has not committed to mirroring the annual Westminster Finance Bill. The RSE welcomes this. We recommend that the Scottish Government take this opportunity to develop a different, and more strategic, method for its process of making tax policy.

36. The RSE notes the model adopted by New Zealand as an illustration of best practice. The General Tax Policy Process (GTPP) is a formalised multiphase process which follows five phases:

- **Strategic phases**: economic strategy; fiscal strategy; three-year revenue strategy.
- **Tactical phases**: rolling three-year work programme; annual work and resource plan.
- **Operational phases**: detailed policy design; formal detailed consultation and communication; ministerial and Cabinet signoff of detailed policy.
- **Legislative phases**: drafting of legislation; ministerial and Cabinet signoff of legislation; introduction of bill; select committee phase; passage of legislation.
- **Implementation and review phases**: implementation of legislation; post-implementation review; identification of remedial issues.

37. In addition to a more strategic process, the Scottish Government should take action to cultivate greater co-operation between levels of government and, within government, between individual departments. Clarity over roles and relationships is essential. Recent Scottish Government proposals to use the proceeds of a reformed Council Tax for a centralised Attainment Fund serve to cloud the roles of each level of government. The RSE stresses the importance of transparency and believes that clearly defined remits and responsibilities over which actors are taxing the public and spending public money are needed.

38. The Scottish Government could also take positive action in developing a more inclusive consultation process, which not only provides the public with opportunities to comment on specific policies, but welcomes their input around wider priorities. The RSE recognises that the Scottish Government has a good track record in consulting the public, but it must work to ensure

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12 [https://www.ctf.ca/ctfweb/CMDownload.aspx?ContentKey=16c095f4-6be3-4be7-ad2c-c2e2f252e3d5&ContentItemKey=62ed6fc7-8151-4068-8084-7dcbf99d8f1a](https://www.ctf.ca/ctfweb/CMDownload.aspx?ContentKey=16c095f4-6be3-4be7-ad2c-c2e2f252e3d5&ContentItemKey=62ed6fc7-8151-4068-8084-7dcbf99d8f1a)
that the information gathered, along with relevant research and the best available evidence base, is at the core of the development of policy.

39. A more inclusive consultation process would also serve to strengthen public confidence in the system and its institutions. Transparency over how public opinion has influenced the making of policy and clear communication over how much and why the public is being taxed should be fundamental to the system. Informed public consent must be at the centre of policymaking.

**Additional Information**

Consultation responses are produced on behalf of RSE Council by an appropriately diverse working group in whose expertise and judgement the Council has confidence. This Advice Paper has been signed off by the General Secretary.
ROYAL SOCIETY OF EDINBURGH – FURTHER COMMENTS

Principles which should underpin a Taxation System

Introduction

The RSE welcomes the opportunity to provide further evidence to the Finance and Constitution Committee following its submission on A Scottish Approach to Taxation in September.

As the evidence session, at which the RSE will be represented by Prof David Bell FRSE, will focus on the theme of consideration of principles which should underpin a taxation system, this submission will highlight the relevant key points and recommendations the RSE has made in this specific area.

Over the past several years, the RSE has actively and consistently engaged with government, parliament and other interested bodies around issues of fiscal responsibility, taxation and the devolution of powers. In doing so, we have produced various Advice Papers to which we would again draw the attention of the Committee:

- Air Passenger Duty (June 2016)
- The Scottish Fiscal Commission (November 2016)
- Competitive and Fair Taxation in Scotland (July 2015)
- Scotland’s Fiscal Framework (April 2015)

Principles of Taxation

The RSE notes that there have been many previous formulations of the principles that should underlie a good tax system. Adam Smith first laid out such principles which had their most recent expression in the Mirrlees Review on Reforming the Tax System for the 21st Century published in 2011. The review stressed that in a good tax system:

- The negative effects of the tax system on welfare and economic efficiency should be minimised;
- Administration and compliance costs should be low – a system that costs less is preferable;
- Fairness (in a non-distributional sense) is achieved – for example, fairness of procedure, avoidance of discrimination, and fairness with respect to legitimate expectations;

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18 http://www.ifs.org.uk/publications/mirrleesreview/
• Transparency is vital – it is always preferable that taxpayers understand the system.

The RSE strongly recommends that the extensive literature on best practice for the design of a tax system, including the Mirrlees Review, be considered and utilised in the design and reform of the Scottish tax system.

Scottish Government Tax Principles

The Scottish Government has stated that its approach to taxation will be guided by four principles: proportionality, certainty, convenience / ease of payment, and efficiency.

Proportionality

The principle of proportionality would seem to go beyond the principles proposed by Mirrlees in that it introduces an element of distributional fairness. The RSE supports the idea of incorporating distributional fairness as a principle. However, we note that ‘ability to pay’ is an ambiguous concept, one which can be interpreted to be based upon either income or wealth.

Proportionality might mean simply that those with greater ability to pay should pay more tax, and there is a risk that a narrow reading of proportionality would suggest a system in which everyone pays in tax the same fraction of their ability to pay (a ‘flat tax’). This narrow sense of proportionality would be inconsistent with a more commonly supported principle of progressivity, whereby those with greater ability to pay, pay a higher proportion of income, or other measure of ability to pay, in tax.

The RSE recommends that the Scottish Government should adopt a commitment to distributional fairness, rather than an explicit principle of proportionality.

Certainty

Certainty to the taxpayer is undoubtedly important, and relates to the wider Mirrleesian principle of lowering compliance costs. Uncertainty, and the costs of resolving the problems that arise from it, contributes to compliance costs. The Mirrlees principles of procedural fairness and transparency also address the issue of certainty.

The RSE urges the Scottish Government to endorse the wider-ranging principles of low compliance costs, procedural fairness, and transparency.
Convenience / Ease of Payment

While the Scottish Government’s principle of ‘ease of payment’ is certainly part of the Mirrlees principle of keeping the costs of compliance as low as possible, such costs are wider than those of payment. For example, they encompass the costs of understanding the requirements of compliance, and providing the information required to comply.

The RSE again suggests that the Scottish Government adopt the wider-ranging principle of keeping compliance costs low.

Efficiency

The principle of efficiency stated by the Scottish Government relates to the suggestion by Mirrlees that a good tax system should minimise “the negative effects on welfare and economic efficiency”\(^\text{19}\). It should be noted that minimising the negative effects on welfare and economic efficiency can encompass the normal requirement to minimise the distortionary impact of taxes. It can include using the tax system to correct negative externalities that cannot be better handled by other policies, for example the Carrier Bag Charge; and reducing opportunities for tax avoidance.

The RSE supports a principle of efficiency which minimises the distortionary impacts of taxes, corrects negative externalities, and reduces opportunities for tax avoidance.

Conclusion

The Royal Society of Edinburgh believes that the Scottish Government should prioritise making the tax system fair, efficient, simple, transparent, sustainable and consistent with other government policies. It is our view that there is nothing uniquely Scottish in these core tenets, which should apply to any system of taxation, not just Scotland’s.

Additional Information

Any enquiries about this paper should be addressed to Craig Denham, Policy Advice Officer (cdenham@royalsoced.org.uk).

A Scottish approach to taxation: Scottish Parliament Finance Committee call for evidence

The Law Society of Scotland’s response

September 2016
Introduction

The Law Society of Scotland is the professional body for over 11,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland’s solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom governments, parliaments, wider stakeholders and our membership.

We welcome the opportunity to consider and respond to the Finance Committee’s call for evidence on a Scottish approach to taxation. This response has been prepared on behalf of the Law Society by members of our Tax Law Sub-Committee.

General Comments

Over the years the UK tax system has continued to grow in complexity and compliance costs for taxpayers. Through the use of its devolved powers over taxation, Scotland has an opportunity to improve its tax system and its approach to specific taxes. Formulating good-quality and robust tax legislation requires sufficient time to properly consider proposed new, or changes to existing, devolved taxes. Our experience in relation to the Land and Buildings Transaction Tax (Amendment) (Scotland) Act 2016 (LBTT(A)(S)A 2016), which introduced the Additional Dwelling Supplement (ADS), was that the truncated timescale limited the opportunity for full consideration of the legislation. Greater scrutiny of that legislation and publication of

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20 Solicitors (Scotland) Act section 1
draft legislation for consultation could have minimised some of the problems that have since arisen in practice.

In our view, Scotland has the opportunity to adopt its own approach to drafting tax legislation, rather than following the often convoluted approach of UK legislation. This could provide greater certainty and make the system more accessible for the taxpayer. We also believe that there needs to be a structured and regular timetable for tax changes. This could include, for example, an annual or less frequent, but regular, Scottish Finance Bill, through which any issues with devolved taxes could be addressed. Sufficient time should be included in the process to ensure that draft legislation can be published for consultation. Finally, we would suggest that consideration needs to be given as to how to further enhance the resources of the Scottish Government to ensure it has the skills and expertise in relation to taxation policy.

**Question 1: How can the Scottish Government’s four principles to underpin Scottish taxation policy best be achieved?**

**Question 2: How does the current taxation regime and proposals for newly devolved taxes align against these four principles?**

We have approached our response to questions 1 and 2 by considering the Land and Buildings Transaction Tax (LBTT), including the ADS, and the ways in which we believe that it does or does not align with the Scottish Government's four principles.

**Principle 1: Taxation policy should be proportionate to the ability to pay**

Overall, LBTT is better aligned to the ability to pay than Stamp Duty Land Tax (SDLT). It is a progressive tax, with slices of the price charged at different rates on both residential and non-residential purchases. However, the 3% ADS, which
attaches to the full consideration on residential property purchased for £40,000 or more, represents a partial return to the previous “slab” system. In previous evidence on the ADS, we suggested that a form of taper should be introduced in order to minimise the “cliff edge” increase at the £40,000 threshold.

Further, as a transaction tax that is payable up front, LBTT is not necessarily proportionate to the ability to pay. The lump sum that must be paid at the time of purchase can represent a considerable additional burden for prospective purchasers already incurring significant transactional costs. This could affect ability to pay, particularly in situations where the purchaser is not cash-rich and is relying on an institutional lender to meet most of the upfront costs. Lenders may be less willing to extend loans to cover such additional costs given understandable tightening of the lending market since the last recession, and demands for increased equity funding by prospective purchasers. These problems will be exacerbated if a purchaser also has to pay the ADS.

There are other factors with the ADS which do not align with ability to pay. For example, there is only a very limited workable grace period for ADS to avoid the ADS being payable where the purchaser is in fact replacing their main residence. The LBTT(A)(S)A 2016 treats a purchase as exempt from the supplement where the sale of the previous main residence is completed before the LBTT return for the acquisition of the new main residence has to be submitted. This potentially creates a grace period in these limited circumstances.

However, as we outlined in previous evidence on the ADS, there are occasions when a purchaser has no intention of owning two properties but, due to circumstances which might be unforeseen, the transactions do not complete on the same day. We believe that a longer grace period should be introduced to allow

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delayed transactions to complete without purchasers having to pay the 3% supplement where they are replacing a main residence. Such a grace period would reduce the number of purchasers faced with paying the supplement due to unforeseen consequences and would also reduce the administrative burden of reclaiming the supplement for both the purchaser and Revenue Scotland.

It should be noted that although there is a 30 day time limit for submitting LBTT returns, in practice LBTT returns for purchases of property have to be made much earlier than that. This is because the purchaser will need to submit an LBTT tax return and make arrangements to pay the LBTT in order to be able to register title to the property. We do not believe solicitors can be asked to delay submitting LBTT returns and registering title to purchases of property in order to be able to treat the purchase of the new property as exempt from the supplement. Registration is key to ownership of property in Scotland. Registration is also essential from the perspective of lenders as securities cannot be perfected until registered.

Further, the replacement and repayment window for ADS is shorter than for the equivalent UK SDLT higher rates. Under the UK SDLT higher rates system, purchasers have 36 months rather than 18 months to claim a refund of the 3% supplement if they buy a new main residence before disposing of their previous main residence. Purchasers also have 36 months rather than 18 months between selling a main residence and replacing it with another main residence without having to pay the supplement. This again makes ADS less aligned with ability to pay.

It is also the case that with regard to the main rates, LBTT has a very much smaller “slice” at 5% (£250K- £325K), with the next rate being the very much higher 10%. This compares to SDLT at this rate (£250K- £925K). Given the increasing average cost of homes, this increases the tax burden at relatively low levels.

*Principle 2: Taxation policy should provide certainty to the tax payer*

Procedure for tax legislation
In our general comments above, we emphasised the importance of having sufficient time for consultation and scrutiny of tax legislation. We appreciate that in every tax jurisdiction situations might arise where changes may need to be made to the tax system swiftly without advance consultation. However, generally, and where there are significant changes involving complex legislation, we would welcome full discussion of principles and consultation including publication of draft legislation for consultation before the necessary parliamentary scrutiny and the eventual passing of legislation. We would also be very grateful for any procedural reform that would lead to greater certainty on when announcements for proposed changes to the devolved taxes might be made.

The UK regime works with the annual Budget and Finance Bill cycle. Each year the Chancellor of the Exchequer presents the Budget, which contains many of the tax measures for the year ahead. Traditionally the Budget has been in March, prior to the start of the tax year on 6 April. More recently, some tax measures have also been announced in the Autumn Statement, late in the calendar year. The latter in particular often contains detailed proposals and announcements, with opportunities for consultation and draft legislation made available. It is fairly well known when these announcements are likely to be made. The statutory provisions to effect these tax measures are generally set out in a single Bill: the annual Finance Bill. The UK also has the provisional collection of taxes regime which enables the UK Government to introduce changes to tax rates and tax thresholds as well as other changes to the legislation on Budget Day prior to the Finance Bill receiving Royal Assent, subject to the House of Commons approving these measures.

We suggest that Scottish Ministers consider the introduction of an annual Scottish Finance Bill, with changes to the tax regime included in the Scottish Budget or within another fixed announcement. Providing a timescale for when the Scottish Government is likely to declare tax changes would help to ensure a greater level of certainty for the business community generally. We would also encourage Scottish Ministers to consider introducing a Scottish equivalent of the provisional collection of taxes regime which might allow for a more effective mechanism for altering tax rates.
in particular, although rates can generally be changed by statutory instrument affirmative resolution procedure; but a provisional collection procedure would be preferable for rates and is also extremely effective in relation to some anti-avoidance rules and militates against forestalling.

We believe that further consideration should be given to the potential impacts on the devolved taxes of tax policy changes at a UK level. With the devolution of additional tax powers, the UK and Scottish Governments will need to work closely together to ensure that both Governments are aware of what the other is doing. This is particularly important in the context of mitigating the risk of tax changes in one jurisdiction impacting on the other. The difficulties of interaction were clearly illustrated with the first announcement of LBTT rates requiring to be swiftly changed before their introduction, following the SDLT changes announced for rUK. This kind of “back and forth” process may on occasions be unavoidable, but it is undesirable.

Certainty and LBTT

Although in many respects the LBTT legislation is an improvement on the SDLT legislation, we were disappointed that the opportunity was not taken with the LBTT legislation to draft it in a simpler way which would have made it more accessible to the tax payer; instead, the convoluted approach of the SDLT legislation was largely followed. This has led to significant problems, for example, the provisions relating to partnerships and trusts are unclear and to some extent unworkable in Scots law.

There are various other examples of where uncertainty has arisen in relation to LBTT. For example, a seeding relief for property authorised investment funds and co-ownership authorised contractual schemes has come into force for SDLT this year (see section 133 and Schedule 16 of Finance Act 2016). However, it is not clear whether the Scottish Government intend to introduce such relief for LBTT. Many taxpayers are operating on a UK-wide basis and a lack of certainty about the Scottish approach could possibly deter investment in Scotland.
Another example is in relation to the penalties which are chargeable for the late submission of, or failure to submit, an LBTT return. Firstly, the information available for the taxpayer is not easily accessible. Secondly, in our view these penalties are disproportionate in relation to the errors that have been made, and are therefore unlikely to be what the taxpayer would expect. The maximum aggregate penalty for a late return will be 100% of the LBTT that was due, so the taxpayer is in effect paying double LBTT. That is just the maximum aggregate for the late return. If the LBTT itself is also paid late (which is likely if the return is late) then there will also be interest and the relevant applicable penalty for late payment. We are aware that the LBTT penalties are higher than the SDLT penalties and we believe they are excessive and should be reviewed.

Penalties are also chargeable even where no LBTT is payable, for example where a relief such as group relief is available. We are particularly concerned about the imposition of late return penalties in connection with leases. Tenants have to submit lease returns every three years, as well as when a lease is assigned or terminated, even if no LBTT is payable. We are concerned that late return penalties could be charged in relation to “no LBTT” lease returns where tenants are not aware of the requirement to submit a return every three years. We believe the imposition of any penalty where no LBTT is payable is disproportionate and should be reviewed.

The role of Revenue Scotland

Opinions service

Revenue Scotland offers an Opinion Service.\(^{23}\) It will, in certain circumstances, provide its opinion on the tax consequences of specific transactions. Revenue Scotland’s website states that this service is offered in “order to allow taxpayers to file with certainty”.

\(^{23}\) https://www.revenue.scot/contact-us/revenue-scotland-opinions
We have received mainly negative feedback from members about this service. Our members have reported that, following a request for an opinion, Revenue Scotland will often state that the person has not identified an uncertainty. This response can be issued a few weeks after a request is submitted. We appreciate that a request for an opinion should be specific but our members do not experience these difficulties obtaining a substantive opinion from the HMRC. This means solicitors are often able to obtain an opinion on a matter relating to UK SDLT from HMRC but cannot get an opinion on the equivalent Scottish position for LBTT (even where it relates to the same matter and the wording in the legislation may be in exactly the same form).

It is particularly important that the Opinions Service should work well in the early days of a new tax, as guidance is still being developed, and there are areas on which no guidance has been published. One of the areas of difficulty in relation to the Opinions Service has been in areas where HMRC have issued guidance but Revenue Scotland has not, but on being asked for an opinion Revenue Scotland have advised that they do not see an uncertainty. There are also extremely strict conditions applied to the form of requests, even where information omitted (perhaps because it is simply unavailable) has no bearing on the point on which an opinion is sought.

We appreciate the existence of resource constraints, but speed of response is often essential especially in relation to commercial transactions; it is often unrealistic to expect transactions to complete without certainty as to the LBTT liability.

We have also been told that in a number of cases, opinions negative to a view put forward on behalf of a taxpayer have been issued without a reasoned response for the difference of view.

The opinions that have been issued by Revenue Scotland have not been published. It would be helpful to publish anonymous opinions where they cover common general areas. Revenue Scotland should, at least, provide a list of the areas where
people have sought opinions and statistics on the numbers of opinions sought or issued. A programme of publishing anonymised opinions may in fact conserve resources, as we are certain that fresh opinions on the same or even analogous matters would be less likely to be sought in the knowledge of the position taken by Revenue Scotland already.

**Gaps in Guidance**

Similarly, there is published guidance from HMRC for certain aspects of SDLT but there is no equivalent guidance from Revenue Scotland for the same areas. This creates ambiguity and has caused difficulties for clients.

In relation to SDLT, there are some areas where HMRC has felt that there needs to be guidance. It would be helpful if Revenue Scotland could clarify if it would take the same approach as HMRC in these areas, particularly where there is no obvious reason why there would be any difference (as there is, for example, no difference in the underlying property law concepts and/or the wording of the legislation is identical or materially the same). We have reports of a number of areas, for example in relation to the meaning of ‘substantial performance’, where Revenue Scotland has indicated that it does not agree with HMRC’s approach but has not published its own view. Taxpayers are keen to have certainty in relation to their tax affairs, and it is really essential that guidance in these areas is issued.

There are quite a large number of areas where guidance is limited or unclear – examples include the meaning of substantial performance, details for apportionments where these are required, the “Prudential” principle in contracts for purchase and construction and a significant number of questions on leases and in particular their variation (although guidance has been expanded on leases, especially on transitional issues).

**Principle 3: Taxation policy should provide convenience/ease of payment**
Overall, we believe that Revenue Scotland has been successful in administering and collecting LBTT. Our members have found the SETS online system easier to use than the HMRC SDLT system. It requires much less information to be provided than the SDLT online system, and all the information is relevant to the tax which some of the SDLT information is not. It is possible to amend LBTT returns online and to submit returns in advance, which is not possible for SDLT returns.

The publication on a monthly basis of Revenue Scotland’s aggregated figures for LBTT and ADS is very helpful. However, it would be helpful to have more detail on these figures such as LBTT broken down by band, and by lease take and purchase take. This would further enhance transparency and allow for proper consideration of the impact of the tax on Scottish taxpayers.

**Principle 4: Taxation policy should be efficient**

We have significant concerns relating to the efficiency of LBTT is in relation to cross-border transactions. The differences between LBTT and SDLT, which will both have to be paid in such transactions, have made such transactions more complex for the taxpayer.

Changes could be made to enhance efficiency in relation to the three-yearly review of leases. An LBTT return should not be required after three years where there has been no substantial change. Further, we understand that Revenue Scotland does not intend to issue reminders about lease returns and, particularly as the LBTT lease regime is a change from SDLT, people not familiar may not make the returns and then suffer a penalty even if there is no LBTT to be paid.
Question 4: Should future tax changes be ring-fenced and if so, how? If not, why?

We do not object in principle to the hypothecation of taxes. However, whether it is appropriate will depend on the type of tax, the areas chosen for hypothecation and how it is proposed to work in practice.

Question 6: To what extent do the mechanisms for administering the Scottish income tax system via HMRC limit the scope for a different tax system in Scotland to develop?

As only powers over rates and thresholds have been devolved, we do not think that it would be efficient for Scotland to have its own system for administering the Scottish income tax. However, the amount of Scottish income tax collected will depend on HMRC practice and therefore intergovernmental relationships will be crucial. In particular, Scottish Government access to relevant HMRC data will need to be improved so that the Scottish Government can have greater confidence in the amount of Scottish income tax collected. The HMRC Annual report should in particular contain a chapter on devolved taxes.

Question 7: Are there any other administrative limitations to the emergence of a Scottish tax system?

Sufficient resources need to be in place to support the emergence of a Scottish tax system. Potential limitations include: continued austerity and a lack of funding to support the new system; limited technical expertise within the Scottish Government and the need for resources to support and train those working in the new system.
A Scottish approach to taxation: Summary of Written Evidence

Reflecting the devolution of tax powers via the Scotland Act 2016, the Finance Committee issued a call for evidence on a “Scottish approach to taxation”. The call for evidence, which closed on 30 September 2016, sought views on the following questions:

• How can the Scottish Government’s four principles to underpin Scottish taxation policy best be achieved?
• How does the current taxation regime and proposals for newly devolved taxes align against these four principles?
• Is there scope for a fundamentally different approach to taxation in Scotland?
• Should future tax changes be ring-fenced and if so, how? If not, why?
• To what extent do potential behavioural responses limit options for tax changes in Scotland?
• To what extent do the mechanisms for administering the Scottish income tax system via HMRC limit the scope for a different tax system in Scotland to develop?
• Are there any other administrative limitations to the emergence of a Scottish tax system?

This paper summarises the written responses to the consultation in terms of responses to the questions above.

39 responses were received: 22 from private organisations, 10 from individuals and 5 from COSLA/local authorities. Revenue Scotland and PCS also provided a response.

To inform their response, the CIOT and the ATT undertook a survey of all their members. They noted in their response that they have approximately 2,000 members in Scotland of whom 165 responded to the survey, which they summarise in their own joint submission with the LITRG. The MBWI also held an open, free meeting where three speakers talked about the questions from the Call for Evidence and carried out a survey of their members. It submitted 16 individual survey responses to the Committee in its submission.

1. HOW CAN THE SCOTTISH GOVERNMENT’S FOUR PRINCIPLES TO UNDERPIN SCOTTISH TAXATION POLICY BEST BE ACHIEVED?

In 2012 the Scottish Government set out the four governing principles based on Adam Smith’s four maxims that would govern its proposals for the future of taxation in Scotland. These are:

• Be proportionate to the ability to pay;
• Provide certainty to the taxpayer;
• Provide convenience / ease of payment, and;

25 The CIOT is an educational charity concerned with promoting the education and study of the administration and practice of taxation. The LITRG is an initiative of the CIOT to give a voice to the unrepresented taxpayer. The primary charitable objective of the ATT is to promote education and the study of tax administration and practice with a strong emphasis on the practicalities of the tax system.

• Be efficient.

Respondents were asked how these principles could best be achieved. The submissions covered a range of issues including:

• The appropriateness of the principles;
• How the principles should be assessed;
• Whether the four principles can be achieved; and
• Any additional principles or objectives which should be considered.

Are the principles appropriate?

While more than three quarters of respondents agreed that the four principles broadly formed an appropriate basis for a tax system, most had comments on their practical appropriateness and their assessment. For instance the CIOT, LITRG and ATT agreed that “these are important principles for a sound tax system” but ICAS noted:

“The Scottish Government has set out its overarching principles but we believe that there is a need to distinguish between very high level principles and objectives”

In relation to individual taxes, the CIOT, LITRG and ATT stated the need for the Government to be clear on the objective of each tax “as that should influence its design.” ICAS noted that:

“…for example, the key objectives are likely to be to raise funds, bring accountability, support other policies such as economic growth, and redistribute resources. These need to be decided, ranked in order of importance, and they can then be married up to the four overarching principles.”

Alan Barr\(^\text{27}\) supported a principle-based approach in tax legislation as he considered that this may leave less doubt than currently exists in the interpretation of the law. Dr Luca Cerioni\(^\text{28}\) in addition saw the achievement of these principles as crucial for

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\(^27\) Partner, Brodies LLP, Solicitors and Honorary Research Fellow, School of Law, the University of Edinburgh, responding in a personal capacity.

\(^28\) Dr Luca Cerioni is a lecturer in Tax Law, School of Law, University of Edinburgh.
both fairness and attractiveness for individuals and businesses. PWC\textsuperscript{29} confirmed the principles had been welcomed by businesses.

The STUC\textsuperscript{30} stated:

“The STUC endorses the four principles but is concerned that, combined, they fail to form a robust framework around which a tax system can be constructed to effectively support the Scottish Government’s laudable social and economic objectives.”

Sandra Eden added:

“Whilst the four canons identified by Adam Smith are plausibly attractive, it is not straightforward to incorporate them into a tax system. There are a number of reasons for this, one of which is that they do not always pull in the same direction.”

How should the principles be assessed?

Dr Luca Cerioni noted the importance of understanding whether the principles should be achieved at the level of each individual tax, for a portfolio of taxes, or at the level of the whole tax system. The CIOT, LITRG and ATT for instance supported the application of the principles to a portfolio of taxes as this allowed for some departure from one or more of the principles for individual taxes (or an aspect of a tax).

Some respondents criticised the proportionality principle in particular. Aberdeen City Council said:

“The principles, particularly the first principle regarding ability to pay, are to some extent subjective and, therefore, will be open to interpretations as to whether or not a particular tax meets the criteria.”

The RSE noted:

“The principle of proportionality would seem to go beyond the principles proposed by Mirrlees\textsuperscript{31} in that it introduces an element of distributional fairness. The RSE supports the idea of incorporating distributional fairness as a principle. However, we note that ‘ability to pay’ is an ambiguous concept, one which can be interpreted to be based upon either income or wealth.”

\textsuperscript{29} PWC is a multinational professional services network. It runs a UK-wide Paying for Tomorrow campaign. It involves both citizen and business juries to engage with a variety of groups.

\textsuperscript{30} The STUC represents over 580,000 trade unionists, the members of 39 affiliated trade unions and 20 Trades Union Councils.

\textsuperscript{31} This refers to the Institute for Fiscal Studies’ Mirrlees Review which brought together a group of international experts and early career researchers to identify the characteristics of a good tax system for any open developed economy in the 21st century, assess the extent to which the UK tax system conforms to these ideals, and recommend how it might realistically be reformed in that direction.
Sandra Eden wrote stated that ability to pay is a “slippery notion” and asked:

“Is this judged at the level of each tax or the system as a whole? Is it judged at the level of the household or the individual, taken as a snapshot or across a lifetime? Is it judged by reference to income, or income and ownership of wealth, or by expenditure?”

The CIOT, LITRG and ATT added:

“We would argue that ability to pay does not just take account of income, it also takes into account other resources, such as wealth and necessary expenditure (which can be affected by factors such a family size and disability) (...) In addition, Adam Smith’s principle refers to people making contributions in proportion to their respective abilities. This suggests that those with more wealth should pay more tax, but is not an argument in favour of high taxation of the wealthiest.”

A number of respondents, for instance Professor Adrian Sinfield and the Poverty Alliance and the NPI, discussed whether the principles should be assessed against household income on the basis that:

“Household income is the measure by which both poverty and inequality are assessed. It is household income that determines living standards.”

Can the four principles be achieved?

The written submissions highlight that the principles, as they currently stand, may not be achievable and there may not be a sense of what achieving them means. ICAS stated for example:

“In order to achieve the four principles there needs to be clarity of purpose around the objectives of taxation and the extent to which the different objectives are balanced against one another. For instance, is Scottish taxation policy aiming to raise funds, drive the economy, redistribute wealth, drive particular behaviours, and/or provide accountability?”

Aberdeen City Council suggested the best way to achieve the four principles was:

“By undertaking a review of all current taxes to ensure that they meet the four principles, and to test all future proposals to implement or amend taxes in Scotland against the four principles to ensure compliance. This may best be achieved by creating a Scottish Tax Commission to undertake the reviews and give expert independent advice to the Scottish Government.”

24% of surveyed CIOT and ATT members viewed the four principles as achievable, whereas 41% were undecided. Respondents raised a number of issues around their applicability to the tax system. The CIOT, LITRG and ATT for instance said:
“We think that the Scottish Government should take care to balance them, since in some cases they may conflict, both with each other and with other important considerations.”

Reform Scotland gave an example to illustrate this:

“Increases in higher rates of tax which lead to lower tax takes, or deter inward investment, are not efficient.”

Additional principles and objectives

Many respondents suggested that other considerations beyond the four principles could be included, and there may be value in distinguishing between very high level principles and objectives. Additional principles were suggested, including:

- Clear accountability which connects decision making and spending of public funds with taxes raised (e.g. ICAS).
- Simplicity and stability (e.g. ICAS, CIOT, LITRG and ATT).
- Accountability (e.g. COSLA, Scottish Human Rights Commission).
- Balance of risk (e.g. COSLA).
- Ease of compliance (PWC).
- Transparency (e.g. RSE, PWC, CIOT, LITRG and ATT).
- Fairness (e.g. PWC, CIOT, LITRG and ATT) or distributional fairness (potentially in lieu of proportionality) (The Poverty Alliance and NPI).
- Being supportive through consistent advice and help for taxpayers (e.g. PWC).
- Tax justice through a universal and “just” application/enforcement (PCS).

The Poverty Alliance and the NPI stated they were surprised fairness had not been included in the core principles of the tax system given the Scottish Government’s emphasis on it. They stated:

“A “fifth principle” committing the Scottish Government to tax justice is necessary to deliver the other four principles.”

The Poverty Alliance and the NPI recommended that any new tax policy be assessed against the following measures:

- The Solidarity Target introduced in 2007.
- In-work poverty.
- Income inequality.

The Scottish Human Rights Commission additionally recommended that a human rights based approach to tax be adopted, explicitly taking into account international human rights treaties and standards in the formulation of fiscal policies. They suggested the following rights be included:

- The right to participation and transparency.
• The right to equality and non-discrimination.
• The principle of accountability, which requires monitoring, review and oversight of what is actually going on.

2. HOW DOES THE CURRENT TAXATION REGIME AND PROPOSALS FOR NEWLY DEVOLVED TAXES ALIGN AGAINST THESE FOUR PRINCIPLES?

In order to answer this question, some respondents looked at the UK tax system as a whole, whereas others focussed solely on the devolved taxes.

In relation to the UK tax system as a whole, Sandra Eden stated for example:

“Figures from the ONS show that that direct tax (largely income tax and NICs) is progressive whilst indirect taxation is regressive and that the combined effect is roughly proportional to income.”

Professor Adrian Sinfield\(^{32}\) agreed that the UK tax system “appears basically proportional with a tendency to the regressive rather than the progressive” stating that in 2014-15 the top fifth of the income distribution paid 34.4% of their income in taxes while the bottom fifth paid 37.4%. He further noted that it may not even be possible to assess the proportionality of the current tax system as a result of the numerous tax reliefs, subsidies and other arrangements that exist, some of which HMRC does not estimate such as salary sacrifice (the swapping of cash pay for a non-cash benefit).

The respondents who assessed individual reserved taxes noted that Insurance Premium Tax, Vehicle Excise Duty and consumption taxes least fulfil the proportionality principle.

In relation to devolved taxation specifically, Scottish Lands & Estates noted:

“[The] devolution of the recent taxation powers was done very swiftly thereby resulting in limited scrutiny and without clear cognizance of these guiding principles. We feel it is too early to judge how closely aligned the new powers are against these principles.”

Members of ATT, CIOT and LITRG were surveyed and asked to assess individual taxes according to the four principles. Table 1 shows their ranking of the devolved taxes.\(^{33}\)

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\(^{32}\) Professor Emeritus of Social Policy, University of Edinburgh.

\(^{33}\) This includes the taxes in the Scotland Act 2016.
Table 1 Percentage of respondents who say the tax is aligned with the principle (CIOT, LITRG and ATT survey)

<table>
<thead>
<tr>
<th>Tax</th>
<th>Ability to pay</th>
<th>Certainty</th>
<th>Convenience</th>
<th>Efficiency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Council Tax</td>
<td>9%</td>
<td>82%</td>
<td>90%</td>
<td>53%</td>
</tr>
<tr>
<td>Business rates</td>
<td>11%</td>
<td>55%</td>
<td>67%</td>
<td>40%</td>
</tr>
<tr>
<td>Land and Buildings Transaction tax</td>
<td>47%</td>
<td>69%</td>
<td>69%</td>
<td>50%</td>
</tr>
<tr>
<td>Scottish Landfill Tax</td>
<td>22%</td>
<td>37%</td>
<td>38%</td>
<td>29%</td>
</tr>
<tr>
<td>Income Tax</td>
<td>49%</td>
<td>45%</td>
<td>72%</td>
<td>38%</td>
</tr>
<tr>
<td>Air Passenger Duty</td>
<td>22%</td>
<td>53%</td>
<td>64%</td>
<td>41%</td>
</tr>
</tbody>
</table>

All the respondents who discussed Council Tax criticised its regressive nature. The CIH also criticised the dependency of the reform of Council Tax reform on the Council Tax Reduction Scheme and other mitigation measures to make it affordable rather than it being an affordable tax in the first place.

A number of respondents such as Alan Barr and the Law Society noted LBTT is broadly in line with the four principles. Exceptions included:

- LBTT is not necessarily proportionate to the ability to pay given that it is a “lump sum” (Law Society).
- A degree of certainty disappears in complex cases e.g. partnerships, trusts and transactions relating to leases (Law Society).
- Delays in LBTT clearances of up to four months limit efficiency and pose particular problems for commercial transactions (PWC).
- The requirement every three years to make a LBTT return and review the tax chargeable in relation to land transactions causes inefficiencies and could be improved (Alan Barr).
- ADS is not proportionate to the ability to pay. As noted by Alan Barr: “if it does not stretch the metaphor too far, there is a double cliff edge in the ADS system”.
- The principle of “certainty” was not met with the unexpected introduction of ADS (ICAS).

Other points on the whole tax system were raised, including:
• The closure of HMRC offices, the withdrawal of face-to-face HMRC Enquiry Centres and the loss of experienced staff had all increased uncertainty and compromised efficiency. The PCS viewed this as a growing problem.
• Efficiency and certainty through the increased digitization of tax collection and advice risked compromising efficiency for taxpayers who cannot use computers unless they were taken into account. Revenue Scotland for instance is aware of this and makes it possible to post paper returns.
• HMRC’s policy of granting tax amnesties did not always meet the “ability to pay” principle.
• The general anti-avoidance rule in the Revenue Scotland and Tax Powers Act 2014, according to ICAEW, does not align with certainty because the “scope of the rule, and the discretion given to Revenue Scotland in its application, are too wide.” Revenue Scotland on the contrary thought that its powers and the review and appeal of its decisions had helped create certainty for taxpayers.

3. IS THERE SCOPE FOR A FUNDAMENTALLY DIFFERENT APPROACH TO TAXATION IN SCOTLAND?

All the respondents who answered this question agreed that there is scope for a different approach to taxation in Scotland. However, PWC highlighted that all tax systems are constrained by:

• The demographic and socio-economic characteristics of the taxpayer base.
• Administration and enforcement costs accruing to the Government.
• Compliance costs for businesses – one respondent noted these are often underestimated.
• Tax competition and unwanted behavioural responses.
• Confidence in the tax system (e.g. fairness, transparency and accountability of spending).

In addition, many respondents such as Donal McGregor stated that the interactions between devolved taxes and the rest of the (reserved) fiscal system affected the scope for a different approach in Scotland. For instance PCS stated:

“The incomplete package of tax powers is potentially, although not wholly, limiting.”

Respondents who supported a distinctly Scottish taxation system tended to consider that:

• The system of collecting public revenue requires a major rethink (MBWI).
• Scotland should be allowed to evolve to fit Scottish preferences, institutions and economic circumstances rather than importing models from abroad (STUC).

6% of surveyed CIOT & ATT members were in favour of a determinedly distinct approach. 22% and 26% favoured drawing significantly on UK taxes but with
specific Scottish characteristics, or varying in their distinctiveness from UK taxes, depending on the tax respectively.

The STUC also believed there was scope for a different approach but stated:

“There has been scant indication that the Scottish Government is treating taxation as a coherent system – its approach has been piecemeal and bereft of compelling evidence. Its response to the Commission on Local Taxation was especially disappointing.”

The STUC further noted that the quality of tax debate had so far been poor and:

“...serious evidence is rarely deployed in support of calls to cut business and personal taxes; positions are often deeply entrenched and ideological; superficial or irrelevant comparisons are frequently made with the tax systems of other nations.”

Roughly half the respondents did not support or expressed concerns over a distinct Scottish approach to tax. For example, just under half (46%) of surveyed CIOT & ATT members thought it would be more advantageous for Scottish taxes to align as closely as possible with their UK counterparts.

The RSE believed Scotland should prioritise making the tax system fair, efficient, simple, transparent, sustainable and consistent with other government policies rather than necessarily aiming for a distinct approach. It recommended utilising the literature on best practice for the design of a tax system, including the Mirrlees Review, to design and reform the Scottish tax system.

Many respondents expressed concern that divergence would increase the complexity of the tax system (e.g. Alan Barr). Alan Barr cautioned against minor tax divergence from the rest of the UK in Scotland as this may add complexity without any real justification. He noted that careful thought should be given when considering such a change. PWC also noted:

“Divergence from UK should only occur where necessary for policy or practical reasons e.g. to enhance certainty or simplicity (PWC).”

Numerous respondents highlighted that the UK tax system has long been criticised for its complexity and high compliance costs. The RSE for example highlighted that the UK system contains over a thousand exemptions. There was widespread support for a distinctly Scottish approach in terms of simplifying the tax system. While it was recognised this was challenging as it involves dismantling legislation, Alan Barr nevertheless believed there could be “radical changes” towards simplification.
Suggestions to improve simplicity and certainty firstly included ensuring a, regular, full and genuine process of consultation with interested parties. SCVO supported the use of participatory budgeting as a means of enabling communities to engage with the Government and Parliament.

The Law Society amongst others raised concerns that Scottish tax law would follow “the often convoluted approach of UK legislation”. Alan Barr commented on this issue in the following terms:

“In my view, a significant amount of perceived problems already becoming evident in Scottish tax law derives from accepting what might be seen as an old fashioned form of drafting tax legislation deriving from Westminster. Our most significant piece of substantive tax legislation, the Land and Buildings Transaction Tax (Scotland) Act 2013, involved utilising unchanged a considerable proportion of the analogous stamp duty land tax legislation. The same applies to significant amounts of the Revenue Scotland and Tax Powers Act 2014.”

Furthering this point, Sandra Eden stated:

“I am again not suggesting that the present tax system, parts of which are excessively complex, unfair or ineffective, should not be changed. I am arguing against fiddling.”

Respondents discussed the risk that a distinct Scottish system, including one with increased complexity and compliance costs, could reduce Scotland’s appeal as a location to do business and have a negative impact on the Scottish economy. One respondent suggested that companies may be deterred from investing if they had to offer tax equalisation packages to offer same net pay in Scotland and rUK. Johnston Carmichael added:

“A number of our clients are flexible and ready to move should the costs of retaining a Scottish base become penal.”

PWC pointed out:

“Competition is of course also not simply a matter of rates, but also reflects the relative simplicity and certainty of a tax system.”

KPMG additionally highlighted the risk that a distinctly Scottish approach could expose taxpayers to a form of judicial double taxation, for example through:

- The interaction between the higher rate threshold of income tax and the upper earnings limit for employees in relation to national insurance contributions.
- The interaction between Annual Tax on Enveloped Dwellings (ATED) and LBTT.

The majority of the surveyed members of the MBWI considered that a radically new system of collection of public revenue is possible in the current state of devolution.
The RSE recognised it would be difficult to reform the UK tax system through incremental steps but stated that the significant institutional changes which have occurred present the Scottish Government with a unique opportunity to effect real change.

A number of respondents e.g. Sandra Eden, KPMG, Alan Barr and the Law Society pointed out that real change has already occurred, for example, through the introduction of LBTT as a progressive rather than a slab system. Furthermore, KPMG noted:

“The fact that the UK Parliament subsequently reformed SDLT along similar lines illustrates how taking a fundamentally different approach can not only result in a better designed tax system for Scotland, but can also improve the tax system of the RUK.”

Future divergence was also considered achievable. For instance KPMG noted the Scottish Government will be able to introduce a 0% starting rate on income tax, thereby effectively raising the full personal allowance. However, the STUC highlighted:

“…raising the personal allowance is an expensive and poorly targeted measure if reducing inequality is the goal. It distributes the majority of the benefits to those in the upper half of the household income distribution and fails to assist the very poorest who don’t pay income tax.”

A small number of respondents such as Reform Scotland pointed out the heavy reliance on income tax limited the scope to effect real reform and could expose the budget to significant volatility risk. Because of the risk of tax competition, Reform Scotland urged the Scottish Government to peg income tax to the UK rate.

As LBTT is already in place and due to the risk of behavioural responses, the only possible fundamental change Dr Luca Cerioni foresaw in the Scottish tax system was the replacement of LBTT with a general Property Value Tax as this involves an immobile tax base and would represent a significant change.

Some respondents suggested specific changes to the Scottish tax system including:

- Make taxes as flat as possible and avoid high marginal rates as a means of improving economic performance (Taxpayer Scotland).
- Introduce a Land Value Tax (this could start with a Tax on Derelict Land and Properties) (Stuart Bates). The CIH took the view that a Land Value Tax could be a tool to prevent the boom and bust cycle of the housing economy and preventing the artificial inflation of land prices.
- Introduce a tax on wealth combined with a generous allowance for donations to charities. One respondent noted this setup was “very attractive to high-value philanthropists” (Factory).
- Reduce VAT for repairs, maintenance or renovations of existing homes (CIH).
- Provide similar LBTT reliefs for local authorities as for Registered Social Landlords (CIH).

The SRC made suggestions on behalf of the retail sector in Scotland and called for:

- Reform of business rates and the removal of the Large Business Rates Surcharge.
- Ensure firms which pay the Apprenticeship Levy directly benefit from it.
- Shelve plans to put in place a deposit return scheme for drinks containers.

COSLA and the STUC supported the devolution of tax powers to local authorities and cities. STUC highlighted that countries that collect more tax at a local level consistently have higher total tax revenues than others as a share of GDP. West Lothian Council observed that local authorities already had a lot of experience administering and collecting revenue streams such as council tax, water and sewerage charges and non-domestic rates.

Aberdeen City Council and North Lanarkshire Council acknowledged however that caution should be taken when introducing further devolution as:

- Local authorities are relatively small and having different taxes in different areas could be detrimental.
- The devolution of taxes to cities and regions could potentially create a divergence between those areas that are able to grow income and those that face a decreasing tax base.

CIOT, LITRG and ATT suggested the four principles be given permanency by incorporating them in a written constitution.

CIPFA advocated that the Scottish Approach to Taxation be outlined in a clear and concise framework with:

- A definition or purpose of the approach in Scotland.
- An expanded and comprehensive set of principles for taxation.
- Clear links to the objectives laid out in Scotland’s Programme for Government.

Many respondents stated that:

- There should be a clear road-map for future tax and regulatory changes (e.g. 5 or 10 years) (e.g. ICAS) set out for instance in a regular Scottish Finance Bill (Law Society).
- New taxes and reliefs should be based on clear policy (Sandra Eden).
- Appropriate time should be given to consult relevant bodies and taxpayers on draft legislation. Lack of consultation was seen as a cause for some of the problems around ADS (e.g. Alan Barr).
- Tax legislation should be written in clear, unequivocal language (e.g. Dr Luca Cerioni).
Grahame Steven\textsuperscript{34} however raised the point that:

“MPs find it difficult to challenge the work of tax experts since they rely on them to create tax legislation.”

A high number of respondents called for a public body, for instance a Scottish Office of Tax Simplification, which would:

- Review existing tax policy and scrutinise new tax proposals against the four principles.
- Simplify tax legislation.

Revenue Scotland mentioned that the Devolved Tax Collaborative had been set up in 2013 by the Scottish Government as a forum for taxpayers, agents, academics and representative groups with an interest in the development of the devolved taxes.

Many respondents called for improved guidance on tax such as the publication of “advance tax rulings” available before a taxpayer undertakes transactions with potential tax implications.

A number of respondents, while recognising it was a work in progress, criticised Revenue Scotland’s Opinions Service. For instance the Law Society said:

“We have received mainly negative feedback from members about this service. Our members have reported that, following a request for an opinion, Revenue Scotland will often state that the person has not identified an uncertainty. This response can be issued a few weeks after a request is submitted.”

Suggestions to improve the Opinions Service included:

- Better delivery.
- Better guidance covering individual cases and also policy matters as a whole. Revenue Scotland stated that guidance already includes worked examples and is regularly reviewed in light of user feedback, but recognised that more detailed legislative provisions and guidance may be required.
- The publication of anonymous opinions and “binding rulings”.
- Appropriate expertise within Revenue Scotland.

Beyond tax legislation itself, ICAS pointed out that the fiscal framework is “an inherently opaque feature of the overall Scottish funding arrangements”. Until it operates in practice there is necessarily uncertainty about how a Scottish approach to taxation will impact on the available funds.

\textsuperscript{34} Grahame Steven is a lecturer in Accounting from Edinburgh Napier University.
4. SHOULD FUTURE TAX CHANGES BE RING-FENCED AND IF SO, HOW? IF NOT, WHY?

There was less support for hypothecation or ring-fencing than criticism of it. Reasons for supporting ring-fencing included:

- It provides accountability and transparency by giving taxpayers a clear indication about the destination of their taxes (e.g. Dr Luca Cerioni).
- It can build confidence in the tax system and increase willingness to pay (e.g. North Lanarkshire Council).

However, the majority of respondents however did not support hypothecation. Reasons for this included:

- The literature suggests it is not a good idea (Sandra Eden).
- It reduces the government’s ability to respond to changes in economic conditions particularly when they are entirely dependent on highly cyclical tax revenues.
- It brings greater complexity and may increase administrative costs and burdens.
- It requires good forecasting/improvements to forecasting.
- If central government ring-fences local government money, according to COSLA this: “this fetters local discretion and is confusing in terms of democratic accountability for communities and voters”.

The Law Society concluded:

“whether [ring-fencing] is appropriate will depend on the type of tax, the areas chosen for hypothecation and how it is proposed to work in practice.”

COSLA was particularly concerned about the ring-fencing of additional revenue accruing from the council tax reform as this was for central, not local priorities. It felt this contributed to the erosion of the link between local tax and the local electorate.

On the other hand Aberdeen City Council was not against potentially ring-fencing local taxes by local authorities themselves.

5. TO WHAT EXTENT DO POTENTIAL BEHAVIOURAL RESPONSES LIMIT OPTIONS FOR TAX CHANGES IN SCOTLAND?

The focus here was on unwanted responses following a tax change and mostly on taxes with a mobile tax base. Dr Luca Cerioni made a distinction between:

- Behavioural responses that were expected and could be incorporated into forecasts, the quality of which depended on robust research and modelling. This required adequate expertise and resourcing.
There can be unintended consequences of tax change which can be significant.

All the respondents who answered this question stated there was a risk that taxpayers would respond to tax changes. They generally acknowledged this risk was particularly large for high earners. Aberdeen City Council for example stated that the migration of a single major employer could have a material impact on the local economy.

Nevertheless, North Lanarkshire Council believed that tax changes should be communicated well in advance as uncertainty could have a negative effect on the confidence of stakeholders.

The RSE cautioned the Scottish Government against putting in place reforms that caused a shift in the tax base outside Scotland. Dr Luca Cerioni stated this risk should be the overriding concern when implementing a tax because this risk “by definition, would also contravene the four taxation principles.” In contrast, another respondent expected the four principles to “outweigh any consideration of behavioural responses”.

6. TO WHAT EXTENT DO THE MECHANISMS FOR ADMINISTERING THE SCOTTISH INCOME TAX SYSTEM VIA HMRC LIMIT THE SCOPE FOR A DIFFERENT TAX SYSTEM IN SCOTLAND TO DEVELOP?

Views differed on whether HMRC or another body should take forward new taxes. Dr Luca Cerioni suggested the Scottish Government assess HMRC’s performance with the Scottish Rate of Income Tax to decide whether it wanted to rely on HMRC for the collection and payment of any new tax.

Others considered:
- Further income tax devolution should be accompanied by the devolution of HMRC’s administration to Scotland (e.g. Stuart Bates).
- Groundwork should be undertaken now to ensure that Revenue Scotland could easily adapt to new powers in future (Reform Scotland).

ICAEW raised the point that in the event of independence:

“…a Scottish tax system administered by Revenue Scotland would become a necessity. The longer we have a system integrated with HMRC the more difficult it will be to separate unless this possibility is designed in as and when taxes are devolved.”

7. ARE THERE ANY OTHER ADMINISTRATIVE LIMITATIONS TO THE EMERGENCE OF A SCOTTISH TAX SYSTEM?

Overall, respondents tended not to see administration as a limitation to the emergence of a Scottish tax system. Some respondents raised a range of limitations
which could inhibit the emergence of a Scottish approach to taxation. Such issues included:

- Identifying “Scottish” taxpayers in difficult cases.
- The need to ensure that the Scottish Government and HMRC/Revenue Scotland have the required resources, skills and expertise to function.

Reductions in HMRC spending were seen as deeply problematic by PCS and at risk of compromising the principles of a Scottish tax system. It stated:

“Cuts to HMRC have demoralised staff, created difficulties for service users and fostered structural inefficiency in tax debt collection and enforcement. The impact of this on the wider economy cannot be underestimated.”

A number of respondents additionally saw lack of taxpayer understanding of fiscal policies as a limitation. For instance the CIOT, LITRG and ATT stated:

“We think that there are a number of potential limitations on the emergence of a Scottish tax system. We would emphasise in particular the limitations imposed by a lack of taxpayer understanding of not only the Scottish tax system, but also the UK tax system. The differences in degree of devolution and administration body are not clearly understood. Taxpayer education will be essential to ensure greater taxpayer understanding and engagement with the Scottish tax system.”

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SPICe Research
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