An Leas-phrìomh Mhinistear agus Ath-shlànachadh Cobhid
Deputy First Minister and Cabinet Secretary for Covid Recovery
John Swinney MSP

T: 0300 244 4000
E: DFMCSCR@gov.scot

Scottish Government
Riaghaltas na h-Alba
gov.scot

Kenneth Gibson MSP
Deputy Convener
Finance and Public Administration Committee
Room T3.60
The Scottish Parliament
Edinburgh
EH99 1SP

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Dear Convenor,

Thank you for your letter of 16 December 2022, enclosing a report summarising proceedings at the recent *Frameworks and Forecasts: Taxation in Scotland* tax conference, commissioned by the Finance and Public Administration Committee and held in collaboration with the Futures Forum.

I welcome publication of the report and the contribution it makes to the debate on taxation in Scotland. It is clear that the event provided an opportunity for participants to consider a wide range of important issues from different perspectives, including the arrangements for existing national and local taxes, the potential to devolve new powers or create new taxes and opportunities to enhance the approach taken to consultation and engagement. The event also provides important additional context to the forthcoming Fiscal Framework Review.

You asked for my comments on the issues raised in the report and an update on any proposals for work in these areas. Although I cannot comment on every proposition or issue raised, I have set out some overall reflections below.

Framework for Tax

I was pleased that the report acknowledges the important role the tax system plays in funding the public services we all rely on in Scotland. As events in 2022 have demonstrated, managing our tax system requires careful and responsible decision-making, underpinned by robust processes and a clear strategy.That is why in December 2021, the Scottish Government published Scotland's first Framework for Tax. The Framework provides the foundation from which we will design and deliver tax policies that support our economy, our national outcomes and our pursuit of a fairer, greener and more prosperous Scotland.

I note that the report also acknowledges the importance of increasing public understanding of taxation and improving engagement and public discouse. The Framework for Tax reiterates our commitment to openness and transparency, and puts proactive engagement at the heart of tax policy making. However, improving understanding and engagement in taxation is not something that can be achieved by Government alone, and I look forward to working with the Committee and stakeholders on how we can best achieve this.

Devolved tax powers

The report includes commentary on both Scottish Income Tax and Land and Building Transaction Tax (LBTT). The Scottish Government has used its powers over these taxes to create a fairer and more progressive tax system in Scotland. In arriving at our Income Tax policy for 2023-24, we have sought to carefully balance the need to raise revenue, with the impact on households and the wider economy at the current time. Our policy choices are highly progressive, and the majority of taxpayers in Scotland will continue to pay less Income Tax in the coming year than they would if they lived elsewhere in the UK, for the sixth consecutive year.

There are no plans to abolish or replace LBTT, as suggested by one of the speakers. The vital revenue raised from LBTT, including from the Additional Dwelling Supplement, supports spending on national priorities, including education and health. Progressive rates and bands for LBTT reflect the specifics of the Scottish housing market and prioritise support for first-time buyers, in line with our overall policy ambitions.

Local taxes

I note that participants discussed opportunities to review and improve the approach taken to local taxation, including consideration of Council Tax and non-domestic rates.

As you will be aware, we set out in the Scottish Budget 2023-2024 that we will work towards agreeing a Fiscal Framework with Local Government which will strengthen engagement throughout the budgetary cycle and establish a clear process to progress greater fiscal empowerment for councils.

We have also established a Joint Working Group to oversee deliberative engagement on local government funding. The Group met on 8 December 2022 to consider proposals for meaningful changes to be introduced in the short-term to Council Tax. Moving forward, the Joint Working Group will also consider approaches to longer term reform, and the development of effective deliberative engagement on sources of local government funding.

The Scottish Government is committed to fair and fiscally sustainable forms of local taxation, and to ensuring a productive approach to the ownership, management and use of land in Scotland. Ideas for a land value tax in Scotland are not new, but would represent a substantial shift in land and property taxation. The independent Barclay Review of Non-Domestic Rates considered the benefits of a land value tax compared with a tax based on the annual rental value which a property would attract in an open market. It concluded that, on balance, a property tax system based on rateable values, as is currently in place in Scotland, best fits the principles of fairness, consistency, transparency and simplicity when compared to the alternatives considered. It noted that a land value tax, for example, might hypothetically better reflect the overall value of assets than rateable value, but that there are relatively little data available to assess how it would work in practice. If land were made rateable, the resource required to administer such a change would have to be assessed carefully, and the question of the treatment of agricultural land, which is exempt from rating, may arise. We considered the agricultural exemption in the context of the Barclay Review, and concluded that there was not sufficient cause to re-define the current scope of the exclusion, in the context of the important contributions made to the economy by the agricultural sector.

The Scottish Government also recently sought views on the potential role of taxation in land reform including with regard to the recommendations set out in the Scottish Land Commission's advice in relation to land and tax and the Scottish Government's Framework for Tax. The consultation closed on 30 October 2022, we published the responses online on 22 December and we aim to publish our analysis of the responses in due course.

Separately, on the view that rates discourage businesses from investing in and developing new property, this risk was acknowledged by the Barclay Review and this is why it recommended the introduction of the Business Growth Accelerator (BGA) relief. This relief, introduced on 1 April 2018, offers relief on new builds for up to four years after first occupation, and on property improvements for twelve months. We keep all reliefs under regular review and, in response to concerns raised by stakeholders, we have expanded BGA relief a number of times since its introduction, including the inclusion of the installation of solar panels as qualifying improvements for the relief.

Future developments

I noted with interest the points raised regarding the potential for Air Departure Tax and a future devolved aggregates levy to focus more directly on environmental impacts when introduced. A consultation to inform the development of proposals for a devolved replacement for the UK Aggregates Levy closed in December. We are carefully considering the responses to the consultation in order to inform next steps and the proposals for a future Bill, but have set out our view that this tax should support our overall ambitions for the circular economy. On Air Departure Tax, whilst the introduction of the tax remains deferred, we have committed to reviewing Air Departure Tax rates and bands prior to introduction to ensure they remain consistent with our climate ambitions., particularly in light of the UK Government's changes to Air Passenger Duty.

The forthcoming Fiscal Framework Review also presents an opportunity to consider some of the issues highlighted within the report with the UK Government - including the overall complexity of the framework, the case for further devolution of fiscal powers, and the need for more flexible borrowing and reserve powers in order to manage the Scottish Budget, and deal with forecast error and volatility.

On the question of devolving futher fiscal powers to Scotland, the Scottish Government's position is that decisions which affect the amount of tax paid by people in Scotland should be taken by the Scottish Parliament. In our 2021 Medium Term Financial Strategy, we called for the devolution of full Income Tax and VAT powers, alongside National Insurance Contributions, to be considered as a priority. These additional tax policy levers would allow the Scottish Parliament to tailor taxation to better reflect Scottish economic circimstances and social context.

Full devolution of powers over Income Tax would provide the Scottish Government with the full set of levers to respond to current and future economic challenges. We have seen that the partial devolution of tax powers can lead to unintended consequences and challenges. National Insurance Contributions and Capital Gains Tax are both closely linked to Income Tax, and devolution of these powers could improve and protect the impact of Scottish Income Tax policy. It is vital that increased powers, including the devolution of the Personal Allowance, are considered as part of the Fiscal Framework Review, and I hope that my UK Government counterparts will see the sense in that.

Conclusion

I would like to thank the Finance and Public Administration Committee as well as the Futures Forum for organising the Frameworks and Forecasts: Taxation in Scotland tax conference. I look forward to working with the Committee and the Parliament on how the taxation system in Scotland can support Government's ambitions both now, and in the future.

Yours sincerely,

JOHN SWINNEY

St Andrew's House, Regent Road, Edinburgh EH1 3DG
www.gov.scot