



The Scottish Parliament  
Pàrlamaid na h-Alba

## Finance and Constitution Committee

Cabinet Secretary for Finance and  
the Constitution

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27 September 2017

Dear Cabinet Secretary,

### Scottish Approach to Taxation

The Finance and Constitution Committee agreed, shortly after its establishment as a Committee at the beginning of the current parliamentary session, to undertake an Inquiry into a Scottish approach to taxation. The remit for the Inquiry was:

“As a result of the devolution of taxation powers via the Scotland Act 2012 and 2016 the structure of devolved public finance will shift from a focus upon expenditure to consideration of revenue-raising and the principles which should underpin the Scottish approach to taxation. Reflecting this shift in the nature of devolved public finance, the Finance Committee wishes to initiate a debate on the approach which should be followed in developing a Scottish approach to taxation. Notably, the Scottish Government has stated that four principles will underpin its approach to taxation policy. These four principles are that taxation policy should:

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

Accordingly, the Finance Committee has agreed to undertake an Inquiry on a Scottish approach to taxation”.

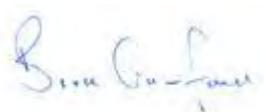
The Committee has undertaken a number of oral evidence sessions and gathered written evidence on this subject from a wide range of witnesses and stakeholders. Notably, the Committee’s decision to undertake this Inquiry pre-dated the referendum on UK membership of the European Union. Whilst the Committee has been keen to undertake work in this area, priorities and workload have shifted as a

consequence of the referendum result and the role of the Committee in leading scrutiny, within the Parliament, of the European Union (Withdrawal) Bill.

The Committee noted with interest the First Minister's Programme for Government statement, where she stated that the Scottish Government will publish a discussion paper on income tax, ahead of the publication of the Scottish Government's draft budget 2018-19, in order to open up a debate about the best use of devolved tax powers. The Committee will not have scope to undertake further work on the Scottish Approach to taxation inquiry within the timescale for this debate. Therefore, in order to make a contribution to this debate I attach at annexe A to this letter the Official Reports of the Committee evidence session on this issue and a link to the written evidence we have received. A summary of the written evidence received is attached at Annexe B.

I hope that this material can make a positive contribution to the debate on income tax that you intend to undertake ahead of the publication of the draft budget.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Bruce Crawford".

**Bruce Crawford MSP**  
**Convener**

**Link to Official Reports of Finance and Constitution Committee evidence sessions on a Scottish Approach to Taxation**

Finance and Constitution Committee meeting – 3 May 2017:

<http://www.parliament.scot/parliamentarybusiness/report.aspx?r=10926>

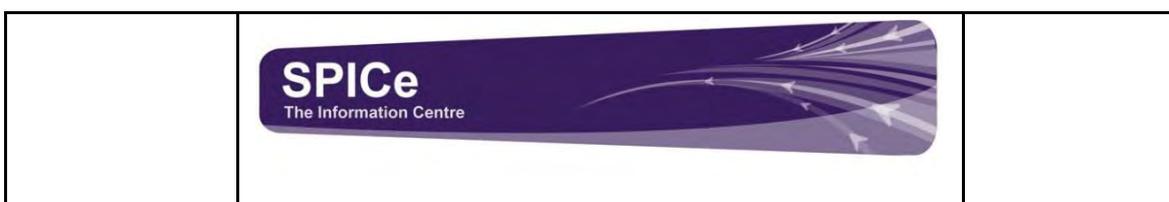
Finance and Constitution Committee meeting – 19 April 2017:

<http://www.parliament.scot/parliamentarybusiness/report.aspx?r=10896>

**Link to Written Evidence received**

A link to the written submissions the Committee received in its call for evidence:

<http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/100253.aspx>



**Finance and Constitution  
Committee 30 November 2016**

**A Scottish approach to taxation: Summary of Written Evidence**

Acronyms

ATT: Association of Taxation  
 Technicians CIH: Chartered Institute of  
 Housing  
 CIPFA: Chartered Institute of Public Finance &  
 Accountancy CIOT: Chartered Institute of Taxation  
 ICAS: Institute of Chartered Accountants of Scotland  
 ICAEW: Institute of Chartered Accountants in England and Wales  
 LBTT: Land and Buildings Transaction Tax  
 LITRG: Low incomes Tax Reform Group  
 MBWI: Maryhill Branch of the Women for  
 Independence NPI: New Policy Institute  
 PCS: Public & Commercial Services  
 Union PWC: PricewaterhouseCoopers  
 RSE: Royal Society of Edinburgh  
 SCVO: Scottish Council for Voluntary Organisations  
 SRC: Scottish Retail Consortium  
 STUC: Scotland's Trade Union Congress

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:<sup>1</sup>

- 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?

<sup>1</sup> <http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/100253.aspx>

- 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<sup>2</sup> 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:<sup>3</sup>

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

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<sup>2</sup> 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.

<sup>3</sup> <http://www.gov.scot/news/speeches/taxation07062012>

## **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<sup>4</sup> 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<sup>5</sup> in addition saw the achievement of these principles as crucial for both fairness and attractiveness for individuals and businesses. PWC<sup>6</sup> confirmed the principles had been welcomed by businesses.

The STUC<sup>7</sup> 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, of Edinburgh University Law School, 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.”

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<sup>4</sup> Partner, Brodies LLP, Solicitors and Honorary Research Fellow, School of Law, the University of Edinburgh, responding in a personal capacity.

<sup>5</sup> Dr Luca Cerioni is a lecturer in Tax Law, School of Law, University of Edinburgh.

<sup>6</sup> 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.

<sup>7</sup> The STUC represents over 580,000 trade unionists, the members of 39 affiliated trade unions and 20 Trades Union Councils.

## 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<sup>8</sup> 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.”

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:

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<sup>8</sup> 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.

“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<sup>9</sup> 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.<sup>10</sup>

**Table 1 Percentage of respondents who say the tax is aligned with the principle (CIOT, LITRG and ATT survey)**

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

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.

<sup>9</sup> Professor Emeritus of Social Policy, University of Edinburgh.

<sup>10</sup> This includes the taxes in the Scotland Act 2016.

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<sup>11</sup> 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

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<sup>11</sup> Grahame Steven is a lecturer in Accounting from Edinburgh Napier University.

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.

#### **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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