The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

SCOTLAND BILL COMMITTEE

Tuesday 27 September 2011

Session 4

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SCOTLAND BILL COMMITTEE
6th Meeting 2011, Session 4

CONVENER

*Linda Fabiani (East Kilbride) (SNP)

DEPUTY CONVENER

*James Kelly (Rutherglen) (Lab)

COMMITTEE MEMBERS

*Richard Baker (North East Scotland) (Lab)
Nigel Don (Angus North and Mearns) (SNP)
*Adam Ingram (Carrick, Cumnock and Doon Valley) (SNP)
*Alison Johnstone (Lothian) (Green)
*John Mason (Glasgow Shettleston) (SNP)
*Stewart Maxwell (West Scotland) (SNP)
*Joan McAlpine (South Scotland) (SNP)
David McLetchie (Lothian) (Con)
*Willie Rennie (Mid Scotland and Fife) (LD)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Richard Bird (British Aggregates Association)
Patrick Browne (Scottish Beer and Pub Association)
Garry Clark (Scottish Chambers of Commerce)
Campbell Evans (Scotch Whisky Association)
Mr David Gauke MP (Exchequer Secretary to the Treasury)
Dr Evelyn Gillan (Alcohol Focus Scotland)
Professor Andrew Hughes Hallett (University of St Andrews and George Mason University)
Derek Mackay (Renfrewshire North and West) (SNP) (Committee Substitute)
Jim McColl (Clyde Blowers)
Amanda McMillan (BAA Airports)
Norman Springford (Apex Hotels)
Ben Thomson (Reform Scotland)
Martin Togneri

CLERK TO THE COMMITTEE

Stephen Imrie

LOCATION

Committee Room 2

Scottish Parliament

Scotland Bill Committee

Tuesday 27 September 2011

[The Convener *opened the meeting at 09:03*]

Scotland Bill

Corporation Tax

The Convener (Linda Fabiani): Good morning and welcome to the sixth meeting this year of the new Scotland Bill Committee. All those present should turn off their mobile phones and BlackBerrys as they interfere with the sound system. We have received apologies from David McLetchie and Nigel Don, and I am pleased to welcome to the meeting Derek Mackay, as Mr Don's substitute. James Kelly and Stewart Maxwell will have to leave at some point to attend other committee meetings, but they will be back as quickly as possible so that they do not miss anything.

Willie Rennie (Mid Scotland and Fife) (LD): Don't rush. [*Laughter*.]

The Convener: Our first panel of witnesses—Ben Thomson of Reform Scotland; Garry Clark of Scottish Chambers of Commerce; and Martin Togneri of Scottish Development International—will give evidence on corporation tax, and I invite each of them to make a short statement to the committee. Perhaps we can kick off with Mr Thomson.

Ben Thomson (Reform Scotland): Certainly. I hope that committee members have received a paper that we published last week called "Devolution plus: Reform Scotland's evidence to the Scottish Parliament's Scotland Bill Committee outlining a new tax and spending framework for Scotland". I am very happy to talk about corporation tax, but I point out that we have consistently made it clear that, used in isolation, it is a very blunt instrument if you are seeking to create an environment in which there is more fiscal responsibility or more incentives for MSPs to perform. You need a basket of taxes that you can move up or down to create the right sort of environment for Scotland's economy. As I have said, corporation tax can be used, but it is a blunt instrument if used alone.

Garry Clark (Scottish Chambers of Commerce): Over the course of most of this year, but particularly over the summer, Scottish Chambers of Commerce has been consulting its members on corporation tax. We gave evidence to the previous incarnation of the Scotland Bill Committee in the third parliamentary session and have looked at some of the issues that emerged in that committee's report, specifically increased borrowing powers, air passenger duty and corporation tax.

I probably agree with much of what Ben Thomson said about corporation tax's place in a basket of taxes. On its own, it has produced some fairly volatile returns over the past few years, particularly during the recession. Our members see it as potentially benefiting their businesses over the longer term. However, we will have to see how it works in practice not only alongside other taxes but alongside the current assumption that taxes will only go down. It is not always safe to make such an assumption; after all, we do not know what the position will be in a few years' time. Our businesses also have in mind the possibility that although they might end up better off than other businesses south of the border, they could also end up worse off. Obviously people hope that that will not happen, but that is a risk with taxation that our members are very conscious of.

Generally speaking, our members have taken a pragmatic view on this issue. We certainly want to continue the debate on it, because we think that it is valid to discuss it in relation to the devolved settlement, and our members look forward to continuing to participate in the debate both today and beyond.

The Convener: Before Mr Togneri makes his opening remarks, I should point out that he is formerly of Scottish Development International. I am sorry about that, Mr Togneri.

Martin Togneri: You saved me pointing that out myself, convener. I do not represent the organisation any more, but I certainly used to work for it.

I have been involved with inward investment for more than two decades now, including seven years as chief executive of Scottish Development International and three years as head of its predecessor organisation, Locate in Scotland. Having worked in inward investment at home and overseas and having worked for inward investors as well as with the Government, trying to attract them, I have a wide range of experience of the impact of corporation tax regimes on inward investment flows.

I am very happy to try to answer any detailed questions that arise but, as an overview, I suggest that corporation tax is a hugely important and often underestimated driver of decisions on inward investment locations. I agree with the other witnesses that it needs to be considered as part of a basket of measures; nevertheless, it is hugely influential when companies come to decide where to locate mobile inward investment projects. The fact that in the 1990s and the first decade of this century Ireland, which has less than 1 per cent of Europe's population, attracted almost a quarter of USA manufacturing inward investment is testament to that. If corporation tax is not lowered any more than is currently planned in Scotland but is, as some have hypothesised, significantly lowered in Northern Ireland, the subsequent creation of another low corporation tax location on our doorstep would be hugely detrimental to Scotland's ability to attract future inward investment.

The Convener: I ask committee members to indicate if they would like to ask a question and the panel to indicate if they wish to chip in on anything that is being discussed with a colleague. James Kelly will open the questioning.

James Kelly (Rutherglen) (Lab): Thank you, convener. Good morning, panel, and thank you for coming in this morning. There is no doubt that the discussion around corporation tax has developed. As Mr Clark said, he consulted his members over the summer. There has been more scrutiny of the impact of how powers over corporation tax would be used, and the evidence shows that the impact of devolving corporation tax would be adverse. Those who support it have tried to move the debate on by saying that it is about devolving the power, as opposed to about the impact. What are the panel's views on that? Is it correct to try to separate the two issues or do panel members see them as being combined, in the sense that one needs to consider not only devolving the power over corporation tax but how it could be used in future before reaching any decision on whether it is correct to devolve the tax?

Garry Clark: From our members' point of view, what is done with the tax is far more important than where the decision-making powers lie. Whether decisions are made in one part of Government or another is less important. If we have localised setting of corporation tax rates, we could gain a localised advantage in terms of overall business taxes, which is attractive. However, there would be costs involved in devolving corporation tax and co-operation required from HM Revenue and Customs and others. The costs are real; the benefits are potential. Our members' view is that we have to strike a balance and consider whether we will really see corporation tax rates at a level that will generate better economic prosperity in Scotland. At the moment, that is still only potentially the case. We do not know what politicians will do in five, 10 or 20 years' time—neither do politicians.

For us, the debate is about how the powers over taxes would be used. We would like to see politicians of all parties spending more time saying what they would do with the additional powers than saying that it is better that the powers are in one place or another.

We have been supportive of the general downward trend in corporation tax rates over the past three or four years and of the UK Government's decision making on that tax. The previous Government reduced the headline rate from 30 to 28 per cent and the current Government is moving it further down, towards 23 per cent. We support that, but if we can generate a competitive advantage for Scotland from local decision making, we have to consider that.

Ben Thomson: I totally agree with Garry Clark that it is important to look at the details, but I do think that the question is in two parts, which I think is what James Kelly was asking. We would separate the devolution of the powers from what you get; otherwise you are in a situation where you are not really devolving the powers, because you are forcing the result on the person to whom you are devolving power. The first step is to devolve the range of tax powers. Let us face it: corporation tax is only £2.6 billion out of a £59 billion total spend of public sector money in Scotland, so we are talking about only 4.4 per cent of total Scottish Government spend—quite a small amount of devolved powers.

Once the powers have been devolved—and we believe that doing that should go beyond devolving power over corporation tax—it is up to every party to set out how they would use them. Some parties will say that, for the good of Scotland, they want corporation tax to be the same as it is in England but they will stimulate the economy by changing other taxes. Other parties will say that corporation tax is the key one. The electorate will then be able to decide.

Therefore, the first step is to devolve the powers. Secondly, it is up to the parties—if they believe in true devolved powers—to set out how they would use those powers. I think that it would be very useful for the electorate to start hearing how each of the parties would use the powers that the Scotland Bill would devolve.

09:15

Martin Togneri: I agree with most of Ben Thomson's points. The devolution of the power must be treated differently from the expectation of what will happen once the power is devolved. Whichever level of Government the power remains with, decisions will be taken about what the appropriate corporation tax regime should be in association with decisions about other fiscal measures. One needs to decide whether to devolve the power on the basis of where decisions about it are best made as opposed to on the basis of anticipating what the outcome might be—that is for the democratic process to decide.

The danger that devolving the power would create compliance costs that would be higher than they would be otherwise is overestimated in respect of inward investors, who make location decisions in the full knowledge that they must comply with corporation tax regimes in a wide variety of tax jurisdictions around the world. They operate quite happily in environments in other countries in which corporation tax powers are shared between various levels of Government, so I do not regard the cost of compliance with a devolved corporation tax regime in Scotland as anything that would have the slightest impact on inward investors' decisions in favour of, or against, Scotland.

James Kelly: What is your view on the evidence that has been submitted to the committee to date and other evidence in the public arena on this area and is it adequate to make an informed decision on whether we should go down the road of devolving corporation tax powers?

Martin Togneri: In my specific area of expertise, inward investment, the bulk of the evidence is very strongly in favour of devolving the power. Smaller economic systems have a strong track record of increasing their competitiveness for inward investment if they have control over the corporation tax rate and use it to create a differential between themselves and the locations with which they normally compete. A huge range of benefits apply in that regard. The evidence that various interests in Northern Ireland have submitted to various parliamentary committees about the potential to kick-start, as they put it, the Northern Ireland economy by virtue of lowering the corporation tax rate is quite compelling.

The evidence of what happened in Ireland in that regard is very compelling. I have already quoted the statistic about the degree to which Ireland, with 1 per cent of Europe's population, attracted US manufacturing investment in the 1990s and the first part of this decade. Such investment has a huge impact on corporation tax receipts. I am not giving away anything confidential, but I remember vividly talking to executives in Microsoft about the impact of corporation tax decisions on their location decisions. Microsoft located a big operation in Ireland in the 1980s and when Ireland increased its corporation tax rate from 10 per cent to 12.5 per cent in 2003, Microsoft's revenues worldwide the next year reached almost $37 billion. These figures are not exact, but I have discussed them with people in Microsoft and they are approximately correct. Of that $37 billion, about $10 billion was from sales in the European marketplace. On whatever profit they made on that $10 billion of sales, they paid in total in Europe something in the order of $320 million in corporation taxes. Of that $320 million, $300 million was paid to the Irish Government and $20 million was paid to all other European Union Governments combined.

Corporation tax has a massive effect on tax receipts and I do not think that anything better illustrates it than that example. Ireland, with 1 per cent of Europe's population, attracted 95 per cent of all the corporation tax that Microsoft paid in Europe.

Ben Thomson: The question divides into two: there is devolving the powers and there is the rate of corporation tax that is used. On devolving the powers, our argument has always been that the more you devolve tax powers, the more you make that level of Government responsible and accountable through having to raise the tax that it spends. We would therefore argue strongly that you devolve the powers.

The second question is at what level the party in power sets the rate of corporation tax. There was an interesting article by Vanessa Houlder in yesterday's *Financial Times* about corporation tax in the United States, which is fairly high, and the number of corporations that are moving to places such as Luxembourg and Belgium, where corporation tax rates are less than 5 per cent. That illustrates that corporates are incentivised to choose a location on the basis of corporation tax, where those corporation tax receipts are then realised. So the issue is well worth considering. There is a difference in rationale between lowering the rate and devolving the power.

A third issue is compliance. Since the merger of Her Majesty's Customs and Excise and the Inland Revenue to become HM Revenue and Customs, the system has been quite a guddle. There is a significant advantage in having smaller and more localised tax collection that can be personalised to the corporates that are involved. So having corporation tax collection at Scotland level would not necessarily be a negative, as there could be advantages in having compliance work done at a level at which more personal attention can be given to collecting tax.

Garry Clark: Our members have diverse views on the benefits of devolving any tax. They take their own views, and we do not have a collective view on the principle. However, they agree that the prospect of lower business taxes is attractive.

We do not see corporation tax as a silver bullet, because it is relatively limited in its application, with by no means every business paying the tax. With indigenous businesses, the benefits that arise might not be the same as could be had from attracting additional inward investment into

Scotland, which would be extremely welcome. We would need a corporation tax rate that would encourage businesses to make those decisions. Of course, such decisions are based on a host of factors, including not just the rate of corporate taxation but the skills base and transportation links.

As I have said, we take a practical view. We would like lower taxes. At UK level, there is a process of reduction towards 23 per cent. If Scotland could deliver significantly lower taxes than that, that would potentially be a benefit, but our members are also considering the flip-side—we would not want to end up with higher taxes than our neighbours.

Richard Baker (North East Scotland) (Lab): Martin Togneri talked about the corporation tax rate in the Republic of Ireland. We have heard from others that corporation tax has been one of a number of aspects of the Republic of Ireland economy that has attracted businesses such as Microsoft. However, the Scottish Government does not at present propose to reduce the rate in Scotland to 12.5 per cent, which suggests that it is not realistic to think that we would attract the same kind of benefits.

We have discussed examples of attracting foreign inward investment. I am not usually the first to praise the Scottish Government for its economic record, but one success story in the past couple of years that we are told about is the one about attracting foreign investment. We have successfully attracted many companies from abroad to set up their businesses in Scotland. A PricewaterhouseCoopers report has stated that although corporation tax is one of a range of factors in attracting businesses to Scotland, it is actually quite far down the list. Does that not suggest that, even without devolution of corporation tax, we can successfully attract businesses here?

Martin Togneri: Scotland has been successful in attracting inward investment over many years. Without looking in detail at the figures for the years since I left SDI, I cannot comment on the split between new inward investment projects and expansion inward investment projects. However, from what I have read, Scotland has continued to be successful in attracting inward investment. Scotland provides a competitive environment in comparison with many locations.

My point is simply that corporation tax is a very important driver of inward investment decisions and Scotland's competitive position would be greatly enhanced were there a corporation tax regime that was closer to, for example, the Republic of Ireland's regime. It does not have to be identical to it but, if it were closer, that would make a big difference. During the period of my involvement with inward investment, we lost many inward investment projects that would otherwise have come to Scotland on the basis of a corporation tax regime decision in favour of the Republic of Ireland.

I am not saying that Scotland is uncompetitive because of the corporation tax regime that it has just now; I am saying that Scotland would be much more competitive with a corporation tax regime that was closer to the Republic of Ireland's regime. Scotland will certainly be much less competitive if its near neighbour, Northern Ireland, gets a corporation tax regime that is closer to the Republic of Ireland's regime and Scotland does not.

On the ranking of factors that affect inward investment decisions, I find the PWC type of analysis relatively unconvincing for a number of reasons. Inward investment decisions must be considered as buying decisions. When people are asked, after they have made a buying decision on a car, for example, what the effect of price was on their decision, they normally say that the main factor was the brand, how green the car was or whether they liked the styling. Price usually comes far down the list of reasons that people report for making their decision. However, a statistical analysis of decision making shows that price is, in fact, a much more important variable than people say when they are surveyed. In inward investment location decisions, the financial regime—whether grants or the tax regime—is the equivalent of price.

Surveys also ask slightly misleading questions. If people are asked to rank, for example, access to markets against the rate of corporation tax as a factor in their decision making, they will probably say that access to markets is more important. However—guess what?—everywhere in Europe allows access to the European market, which is the relevant market. The question is not whether access to markets is more important than the rate of corporation tax; the question is, given the fact that a company has made a location decision on the basis of improving its access to markets, what then influences that decision. That is another reason why corporation tax tends to be underestimated as an influencing factor in surveys of that nature.

Richard Baker: Nevertheless, many foreign companies choose to invest here, despite the level of corporation tax.

There is one question on which I would like to touch with all our witnesses. We are where we are with the bill and the Scottish Government has highlighted specific areas in which it is seeking additional powers as the bill passes through Westminster. From what we have heard today and from the submissions that we have received from others, I have picked up the feeling that even if people are in favour of devolving corporation tax and reducing it—some people hold that view strongly—they tend also to believe that it is a blunt instrument, as Ben Thomson said, and that if it is to be devolved, other taxation measures should be too; however, that is not the proposal that is before the committee. Do the witnesses have any comments on that?

Ben Thomson: I have just a quick one in answer to your first question. Everyone can produce evidence—the Holtham report, "Rebalancing the Northern Ireland economy" and the southern Ireland report on corporation tax—and we can probably conclude that it is inconclusive; people can always make their argument work. Scotland has had good success in attracting foreign companies, but those have often been subsidiaries. We berate the lack of headquarters in Scotland—because when times get tough, headquarters tend to be strengthened. Corporation tax also has an impact on certain sectors and headquartering. Manufacturing might be less affected, but the finance sector is certainly affected, and hedge funds and investment funds tend to go to other places. So, there is a geographical and sectoral bias in relation to corporation tax.

09:30

Your second question was about the basket of taxes. The last time that I spoke on the subject, three months ago, I was asked the same question about what could be included in the Scotland Bill. There is a real opportunity to create an enabling act: something that is not too prescriptive about devolving greater tax powers. We are running into all sorts of problems with income tax, such as the 10p tax rate, how to adjust its thresholds using the Barnett formula, and how to set up forecasting when that function is in the hands of the Treasury. Those are real problems and would be better tackled if the Scotland Bill was an enabling bill that was more about giving a mechanism for devolving tax powers further within an overall framework that is agreed by the Scottish Government and Westminster. That would enable a more flexible approach than trying at this point to nail down precisely how each and every tax comes across.

We would like the general philosophy behind this to be about Westminster devolving enough taxes to create real fiscal responsibility. So far, devolving income tax, representing 8.5 per cent of total Scottish expenditure, and corporation tax, representing 4.4 per cent of Scottish expenditure, scratches the surface of creating an environment such as that in many other places around Europe where local government raises at least 50 per cent of total public sector expenditure. We could go much further in the Scotland Bill by making it an enabling act that passes taxes across according to a general philosophy, instead of something that tries to be too prescriptive at this stage.

Martin Togneri: Corporation tax, when used as the only measure, probably is a blunt instrument, but it is an instrument. It is best deployed as one of a range of measures and much of the evidence, particularly in the summary of the paper submitted to the committee by Professor Hughes Hallett and Professor Scott, is that corporation tax has a particular impact on economic growth rates, particularly in small economies, and a particular impact on employment. Therefore, although it is one of a range of instruments, it is a particularly potent one. Given that it is best used in combination with other tools and not in isolation, whether to devolve power over it is a question that is analogous to having a job to do that needs a hammer, a screwdriver, pliers and a mallet. If the job could not be done without them all, you would not deny yourself the hammer because you could not do the job with the hammer alone; you would say that you need the hammer and the rest of the tools.

Garry Clark: On volatility, over the past five years—albeit that, even in Scotland, we have been in a deep recession—corporation tax receipts have varied between £2.5 billion and £3.5 billion per year, according to "Government Expenditure and Revenue Scotland". The variation is substantial and, in making spending plans, the Scottish Government must work out how to plug that gap. Therefore, corporation tax would be best set within a range of taxes.

That said, I do not believe that it is a matter of devolving a whole set of new tax powers to Scotland. We do not need them all because we already have many tools in our basket to influence businesses to come to Scotland or make domestic businesses more competitive: the planning system; education, in our schools and through to further and higher education; transportation systems; and business rates. All of those factors make Scotland a better place to do business. We must develop ways of using those tools better and consider the additional tools that we can bring to the toolbox to maximise the benefit for our businesses.

The Convener: I ask for quick responses to Mr Baker's next question, as we have a lot to get through.

Richard Baker: I will be very quick, convener. The position has been taken that the question whether the power should be devolved is separate from the question of the rate of corporation tax that should be set. Is there, at least, a strong likelihood that devolving power over corporation tax either to

Northern Ireland or to both countries at the same time will create tax competition within the UK?

Martin Togneri: Although the threat of a race to the bottom is often raised in discussions about devolving corporation tax in a variety of regimes, academic evidence from Switzerland and the US suggests that such a race does not exist; that worry is simply not borne out by experience.

Garry Clark: Sometimes decisions are made irrespective of what the corporation tax rate is. For example, a business that has chosen to invest in the UK might continue to invest in London or the south-east of England for a number of reasons, some of which have already been outlined, rather than to invest in Scotland simply because corporation tax here is a little bit lower.

We probably do not have as much information on that as we would like. We do not know exactly how corporation tax would apply in Scotland, what the thresholds would be, whether there would be a sliding scale of rates, whether we would continue to have a small-profits rate or whether we would still have exemptions and tax breaks. All that will have to be taken into account, but at the end of the day, businesses will still choose to invest in London, the south-east and various other tax jurisdictions even though Scotland might have a lower tax rate.

Ben Thomson: Given that it represents only less than 5 per cent of the total tax take, we must not get carried away with the idea that corporation tax is the be-all and end-all. I do not think that it is a very good tax. After all, businesses are going to become more global in their manufacturing, distribution and where they are headquartered, and that will happen irrespective of national boundaries. Corporation tax is becoming difficult to pin on corporations that are, more and more, choosing to pay tax wherever they want in the world—which, of course, will be in environments that have the lowest tax. I see that all the time in businesses; indeed, I am dealing with Luxembourgish and Belgian companies on exactly that issue.

Taxes such as sales tax, property taxes and taxes on employees are easier to create and monitor because people reside in a certain area, sales happen in a certain place and property actually exists. If you had the basket of taxes that we have been suggesting, you could work out where taxes were going in the future as the world changes, and adapt them to suit the company that is coming in. The message that we keep coming back to is the need for flexibility not just in taxation, but in all the other things that surround it, which are the really attractive factors that bring in businesses. Unless you have the powers to do things in the round, you cannot create an environment that will be best suited to attracting inward investment.

Martin Togneri: My one caveat to Ben Thomson's remarks is that transfer-pricing regulations limit the degree to which companies can use low-tax regimes for brass-plating. Microsoft might well pay a huge amount of its corporation tax in Ireland, but it also undertakes a huge amount of its European activity in that country. It is a major research and development and software manufacturing hub, but that would not have been the case had the ability to move profits between regimes not been regulated by transfer-pricing measures. Microsoft cannot enjoy a low-tax regime with a brass-plated operation; it has to conduct real economic activity in order to get the benefit.

Richard Baker: We could debate that point for a long time.

The Convener: Not just now, Mr Baker.

Richard Baker: Indeed, convener.

Willie Rennie: I am interested in compliance issues. Mr Togneri kindly gave us some information about inward investors; he said that they are used to dealing with different countries around the globe and so have expertise in dealing with different compliance regimes. What about indigenous businesses? What is your experience—from hearing from your members and from your work—of the additional compliance costs on indigenous businesses within the UK, which perhaps have operations in Scotland as well as in England, Wales and Northern Ireland?

Martin Togneri: Others probably have more expertise than I have on domestically headquartered companies. My take is, first, that domestically headquartered companies have to comply with a whole range of taxation and other compliance issues—not just corporation tax—so to submit the necessary returns to satisfy a devolved regime's corporation tax requirements would not be a hugely significant extra burden. The real issue is that successful domestically headquartered—I prefer that term to "indigenous", which always makes me think of fauna and flora—companies tend to want to expand internationally very quickly when they are relatively young. The specific issue with regard to corporation tax is that successful domestically headquartered companies in Scotland also operate internationally and therefore have to comply with a range of corporation tax regimes in the countries in which they operate. I really do not think that compliance costs are a big issue.

Garry Clark: Compliance costs need to be taken in the round. Obviously there will be compliance costs in the devolution of income tax to Scotland through the Scotland Bill, too. There will be additional costs in administering the tax in Scotland, which will ultimately be passed on to the taxpayer. The costs will be more or less burdensome on different businesses, but they are a real issue.

As I said before, the benefits are still only potential. If there is a substantially lower rate of corporation tax in Scotland than there is in other parts of the UK or internationally—we are now in a global marketplace—the potential benefit will far outweigh the costs of compliance. However, if we end up with the same tax rate, a marginally different tax rate or a higher rate in Scotland, those compliance costs would obviously be magnified. The costs will be a burden to a greater or lesser extent for different businesses, but they are real, while the benefits are only potential. That is why businesses want to hear more about what the politicians are actually going to do with tax. We have heard a lot about tax coming down. That is almost taken as a given, but it is by no means guaranteed.

Willie Rennie: On a scale of one to 10, how anxious would you say your members are about the compliance and complexity issues?

Garry Clark: They are not hugely anxious. As I said, the disbenefits could be vastly outweighed by the benefits.

Ben Thomson: Often, the primary focus in relation to tax seems to be on the actual rate of tax. Two other things are equally important to businesses: simplicity and service. I do not know how many of you are familiar with "Tolley's Tax Guide". I have had to deal with it and I can tell you that it is now three times longer than it was 15 years ago and the font has gone down from 12 point to 10 point, so my reading glasses have had to be magnified.

The advantage to having more localised taxation is that you can set up helpdesks and have personal liaison officers who can help with both personal and corporation tax. Politicians can argue not just about the headline rate of tax but about how the taxation system can be simplified. One of businesses' concerns is the general level of bureaucracy and the cost of hiring people. I do not see how devolving a system to Scotland would necessarily make that more complicated; actually, I can see there being a real benefit in selling the simplicity of the tax system in Scotland as being one of the advantages of devolving the powers.

Willie Rennie: Given your experience of "Tolley's" over the past 15 years, the direction of travel is towards more complexity. Do you really believe that that will be turned around if taxes are devolved?

Ben Thomson: There is a real appetite among the electorate for somebody to come in and say that the taxation system is far too complicated. I will have to check the statistic, but I think that something like 85 per cent of MPs have to get an accountant to do their self-assessment tax returns. I certainly have to get one, because it is just far too complicated. People will see real benefit in someone saying that they will cut through all that and simplify the tax system. Parliament might not take them, but if it had the devolved powers to do those things, that would be one of the benefits that could be offered both to corporations and individuals.

09:45

Willie Rennie: There has been a desire to do that at UK level too, but the opportunity has not been taken because there has also been a desire to target and close loopholes to make the UK tax regime more effective. I am not sure that Scotland would want to be any less targeted—or would it?

John Mason (Glasgow Shettleston) (SNP): That is a UK failure.

Ben Thomson: The UK has a problem with its historical legacy. As with software, there is a problem when we keep adding more and more. A previous Chancellor of the Exchequer was—dare I say it?—good at creating lots of taxes, certainly in the business world. We have tax incentive schemes with all the bells and whistles that sound good but which have reams of complications underneath, which confuses businesses. We are starting to see some of the problems with, for example, enterprise zones, business expansion schemes and film schemes. Those are slightly coming back at us, because they are so complicated. There would be a benefit if a political party said that it was prepared to create a much simpler taxation scheme. Scotland has only 5 million people, and it would be much easier to introduce a simpler scheme during the setting up of a new system than it would be to introduce it to a historical system with all its complications.

John Mason: Mr Clark mentioned HMRC, and Mr Thomson then said that it was "a guddle". That is concerning because, from what we understand, we will be dependent on HMRC in relation to income tax, corporation tax and all sorts of revenues. We understand that the Office for Budget Responsibility has more of a relationship with HMRC than it does with the Treasury, even. How robust is HMRC?

Garry Clark: Almost daily, our members raise issues with us about HMRC. However, it is part of the framework that the bill sets out, and it would probably be part of the framework for any devolution of corporation tax. Given that that is the environment that we have been placed in, we need to ensure that HMRC works better. I am attracted by Ben Thomson's wish for a move to a far less complex tax regime. That would be vastly appealing to our members, even with the same rates of tax. If the system was more straightforward, it would certainly cause fewer problems. It might encourage businesses to site here if they could comply easily with the local tax systems. Our members regularly have issues with HMRC, so it needs to work better. In recent years, it has made moves to improve its customer service although, judging by some of the e-mails that we get, that has not necessarily borne fruit.

John Mason: Those are some of the practicalities, but when HMRC comes out with total figures, can we trust them?

Garry Clark: I am not sure that I am qualified to comment on that.

The Convener: Does either of the other gentlemen feel qualified to comment?

Ben Thomson: If you are looking for statistics, one that I read in a paper—so I am not sure that it is totally true—is that HMRC has the lowest employee satisfaction of any Government department. That might be symptomatic. Two large departments were merged. In principle, it is good to have greater co-ordination, but the historical factors in trying to merge existing departments have created a bit of a dinosaur. That is similar to what happened with the Financial Services Authority.

In principle, it is good to have one central regulator, but when six different regulators are merged, all of which were formed from previous mergers, we start to get a complicated and unwieldy beast. I think that there would be an appetite for cutting through a lot of that. Scotland's advantage is that it is starting with a clean sheet, because it does not have a tax-collecting system. If you are starting from square 1, it is possible to create something that is much more straightforward and simple.

John Mason: Is HMRC collecting the tax that it should be collecting?

Ben Thomson: There are various reports on the amount of taxation that is not collected properly, although I do not have the statistics on that. Two problems have been identified in the press: HMRC has been widely criticised for taxing at the wrong rate and for having to give rebates. Those difficulties are symptomatic of an organisation that is not firing on all cylinders. As I said, the system is a bit of a guddle.

Martin Togneri: I do not think that I ever heard inward investors complain about HMRC's requirements being particularly difficult to comply with. If anything, the most frequent complaint about tax authorities that I heard from inward investors was about the US Internal Revenue Service. Most of them happened to be US companies, which complained—to me, certainly—more vociferously about having to comply with the IRS's requirements than they did about having to comply with those of the HMRC.

I am not a tax expert but, as I understand it, one reason is that, under the US tax system, if a company decides to repatriate profits that have been made overseas, the US tax authorities make their decisions about whether to levy US corporation tax on those foreign income streams on the basis of the weighted average of the amount of tax that the companies have already paid overseas. If a company has already paid in excess of the US rate overseas, no extra tax is levied, but if it has not, extra tax is levied. That made it an attractive proposition for companies to balance their overseas portfolios so that they had more of their investments in low-tax locations because most of the major markets that they operated in—certainly in the 90s and the first decade of this century—had effective corporation tax rates that were in excess of the US rate. If a company had big operations in Germany or the UK, which at the time had higher effective corporation tax rates than the US, and it wanted to repatriate the profits but did not have operations in low-tax regimes, it would end up paying more US tax than it had anticipated. In my experience, inward investors complained more about the IRS than they did about HMRC.

Garry Clark: Some of our accounting members have said to us that if HMRC adopted a slightly more flexible approach in its dealings with businesses and individuals, it would probably collect a lot more tax rather more quickly than it does at the moment.

Stewart Maxwell (West Scotland) (SNP): I have a couple of quick questions. You will be aware that the income tax proposals in the Scotland Bill rely on Treasury forecasting. What do you think about the Treasury's reliability in forecasting accurately the amount of income tax that would be generated by Scotland in future years?

Ben Thomson: I have never rated Treasury forecasts as being particularly good. Statistical analyses would show that Governments are not particularly good at long-term forecasting.

Reform Scotland does not think that the income tax proposals in the Scotland Bill are particularly good. That is not just because of Treasury forecasting. If a decision were taken to cut the rate, the impact on growth would be determined by the Treasury's forecasts of that, although I believe that an adjustment will be made to take account of the receipts that are collected, which was not the case with the original proposals.

The other thing about the income tax proposals is that every time a threshold was changed, the Barnett formula would have to be readjusted, which would be a real black art. At least the Barnett formula is simple, but every time anything changes there has to be a renegotiation. We would get into a position in which the Scottish Government would be set against the Treasury every time proposals were made, which we think is not healthy.

Income tax is a very blunt instrument, and the bill would affect only the ability to set it, not the ability to collect it. As Martin Togneri pointed out, that is like giving someone a screwdriver without any of the other tools in the toolbox. For all those reasons, the current 10p proposal, which would generate about £5 billion—8.5 per cent of total Government spending—only scratches the surface and is full of complications.

Garry Clark: I agree with almost everything that Ben Thomson has said. Treasury forecasts have been notoriously unreliable for many years—especially recent forecasts, as we have seen. Obviously, the United Kingdom coalition Government's proposal to raise the threshold for paying income tax towards a £10,000 base affects the calculations on how valuable the proposed devolution of Scottish income tax would be.

We have found it fairly difficult to find accurate figures for exactly how much corporation tax is generated in Scotland. The £2.5 billion to £3.5 billion figures to which I referred earlier were GERS figures; HMRC has its own ideas. The science involved in working out exactly what the financial implications will be for the Scottish Government is difficult.

Stewart Maxwell: Is it the case that there would not be one-off negotiations at the start but, rather, there would have to be negotiations almost every single year because of arguments about forecasting, changes in rates and so on? In effect, there would be an on-going argument about what exactly the figures should be, as Mr Thomson said.

Ben Thomson: I agree. If you were going to pass across a tax, you would want to give across the whole power so that things were clear and simple. The Scotland Bill would create on-going tension between the Treasury and the Scottish Government around income tax. There is always tension between the Treasury and the Scottish Government, as the Treasury sets the budget, but there would be tension around not only the setting of the budget, but around creating the formula. The formula would have to be continually adjusted, and both sides would see that continual adjustment as something of a black art.

Stewart Maxwell: There seem to be two possible solutions. The Treasury could have some responsibility to the Scottish Government or the Scottish Government could have some responsibility to the Treasury, but there is no proposal to that effect. The Treasury would remain responsible solely to the UK Government. Alternatively, there could be a cleaner and simpler system in which all the tax was transferred to the Scottish Parliament, so there would not be arguments about such things. You hinted at that.

Ben Thomson: The basis of our philosophy is that the level of government that is responsible for spending a particular tax should be responsible for raising that tax. Under our proposals, if responsibility for national insurance and VAT were given to Westminster and all the other taxes were devolved, there would be a clean and simple system that would cover what Westminster had to spend on Scotland—on defence and aspects of welfare and foreign policy financing—and which would leave Scotland to raise what it would spend. That would make things nice and clean, and we would not have the Barnett formula. If the Barnett formula has to be continually readjusted, we will always run into the difficulty of the Treasury and the Scottish Government having to find a way to readjust it to fit what happens in reality.

Garry Clark: That is correct. It illustrates why, at the moment, it is very difficult to take a hard and fast position on any of the proposals in the Scotland Bill or the additional proposals outwith it. That is one of the reasons why we and our members are keen to continue to engage in the debate for as long as it takes.

Joan McAlpine (South Scotland) (SNP): Richard Baker referred to a PricewaterhouseCoopers report that underplayed the significance of corporation tax as a motivator for inward investment. That is quite interesting, because last year PricewaterhouseCoopers produced another report on corporate taxes and economic growth which found that, right across the Organisation for Economic Co-operation and Development countries, corporation tax had a very significant effect on a number of investment decisions. I know that we have talked about the headline rate of corporation tax, but what is interesting about the earlier PricewaterhouseCoopers survey is the effect that lower corporation tax had on research and development, capital formation and entrepreneurial activity. What do you think corporation tax could achieve in those areas?

10:00

Garry Clark: There is no doubt that corporation tax will have an effect to a greater or lesser degree; much will depend on the rate. The rate's being equal to the Irish rate of 12.5 per cent would clearly have a stronger influence on business decisions than its being the notional rate of 20 per cent that the Scottish Government has talked about in recent weeks.

If you are thinking about entrepreneurial activity or R and D, you need to look at what tax breaks would be available for specific R and D related activities. As Martin Togneri said, in the early years of Irish low corporation tax, the rate was reduced to 10 per cent for manufacturers before it went up to a standard rate of 12.5 per cent. That might be a factor. In respect of entrepreneurial activities, capital gains tax might be a factor, but nobody has spoken about devolving that yet.

Martin Togneri: My experience and knowledge of the matter, as far as it goes, is that lowering corporation tax is generally beneficial to economic growth and employment generation. On its specific impact on things such as research and development or entrepreneurship—this comes back to the point that others and I have made already—it is probably best not used in isolation. I believe that lowering tax would have a beneficial effect on R and D and entrepreneurship, but so would other things.

The impact of corporation tax specifically is much more likely to be on broader measures such as economic growth and employment. You can encourage research and development with specific R and D tax credits or grants of various sorts. You can encourage entrepreneurship by making changes to the capital gains tax regime or through entrepreneurial education. I do not think that the potential for lowering corporation tax to impact on R and D and entrepreneurship is as important as its potential to impact on economic growth and employment generally.

Ben Thomson: All sorts of reports have been produced. The one thing that hits me between the eyes is that, despite all the problems in southern Ireland, the biggest thing that they have clung to, against fierce opposition in Europe, is that they want to keep their corporation tax low. If they did not feel that that was absolutely vital to their economic growth they would have given it up, given the pressure that they were under. To me, that really hammers home the point that low corporation tax is important for economic growth.

Joan McAlpine: I was struck by the evidence in Mr Clark's submission that some of his members had commented that they had lost contracts to Irish companies because of the lower corporation tax there. Can you expand on that? Was it quite a significant problem?

Garry Clark: We have had quite a lot of that, particularly over the past year and particularly in the construction sector.

Joan McAlpine: I see. I take it that that would be exacerbated if corporation tax were to be devolved to Northern Ireland, too.

Garry Clark: That is quite possible. It has certainly been apparent in the construction sector and is manifesting itself through our procurement system.

Joan McAlpine: Over the summer, HMRC published a paper on corporation tax in which it estimated that it raised £2.6 billion in Scotland, but it then suggested that lowering the rate according to the Scottish Government's proposals would wipe out that £2.6 billion—it basically did not calculate a beneficial effect from lowering corporation tax in Scotland. What do you think of the idea that the £2.6 billion would be entirely wiped out?

Ben Thomson: I tried to work out the numbers. They are inconsistent. If the whole tax take is £2.6 billion, it should not go from £2.6 billion to nothing if the tax is reduced from 26 per cent to 12.5 per cent; something should be collected. I do not think that anyone has got to the bottom of the figures. I can only suggest that one figure excluded corporation tax on oil companies—I think that the £2.6 billion excluded it—and the other did not. That is the only reason I can possibly give, but you probably need to ask HMRC for the reason.

Martin Togneri: The only light that I can shed on that debate is to say that a methodology that does not take account of the potential benefits, but only of the costs, is flawed.

To go back into my limited understanding of Irish history, the analysis that I saw when the Irish put their corporation tax rate up to 12.5 per cent was the following. The Irish Government proposed to maintain its previous regime, which was 10 per cent on manufacturing exporters and 50 per cent on the service sector. However, the EU objected to that not because it had a problem with the Irish setting whatever rate of corporation tax they wanted, but on the basis that it was not appropriate to discriminate between the manufacturing sector and the service sector.

The Irish examined their corporation tax take and decided that they needed to bring in something like €500 million in corporation tax receipts to balance their books. They considered what single rate of corporation tax would raise €500 million, given the structure of corporations and profits in Ireland, and they came to a figure of 12.5 per cent. A small number of years later, they were generating $300 million from a single inward investor's tax take.

Reducing corporation tax rates clearly has the potential to have a beneficial impact and to offset any cost impacts.

Derek Mackay (Renfrewshire North and West) (SNP): I have specific questions for each of the panel members.

I am interested in the consensus that is coming across that a range of tools and a basket of taxes are welcome to encourage economic growth. I ask Ben Thomson whether anyone argues that the fewer levers we have the better.

We have talked about potential benefits. Are Mr Clark's members concerned about the potential risks of not having control of corporation tax in Scotland if, for example, Northern Ireland has control of it and uses it to become more competitive? Would it be a threat to Scotland's economy if we were unable to compete in a similar fashion?

Mention has been made of companies headquartering in Scotland. We have suffered in the past from being seen as a branch economy rather than a place to site headquarters. I ask Mr Togneri whether having a more competitive corporation tax rate would help to secure future decisions on where to locate headquarters.

Ben Thomson: On whether anyone argues that there should be fewer levers, it depends what the objective is for the Scotland Bill. If we start off by asking how we create the best system to incentivise MSPs and others to work most efficiently, it is theoretically sensible to have a basket of tools. However, if the objective for the bill is to deliver as few powers as one can get away with, devolving only one or two taxes makes sense.

I cannot speak to what people's objectives are. However, if your objective is to create an environment that really stimulates the economy, you need a basket of taxes. You cannot do it with one or two blunt instruments and no ability to do anything else.

I do not think that the powers on income tax—the only major tax in the Scotland Bill so far—will ever be used, because they would provide the Scottish Government with only one tool and, therefore, what it did with that power would be very much in your face. If I were to ask all of you round the table where you would go on income tax, you would probably say, "I won't answer the question." Very few people would say that they would lower or raise income tax, because the follow-on question is, "What would you do with the other taxes?", and you do not have any other taxes to do anything with. The theoretical argument, therefore, is that if you really want a system that will work in Scotland, there should be a basket of taxes. If you see the objective of the Scotland Bill as being, "How few powers can we transfer to keep everyone quiet?", the current proposals work very well.

Richard Baker: What is your definition of "quiet"?

Garry Clark: As has been highlighted, we have talked of the existing dangers to our economy from construction companies in Ireland winning contracts in Scotland, as we look to move into a rebuilding phase in the economy. Any increase in differential with Northern Ireland might exacerbate that problem.

Our members are looking forward and saying that if their taxes come down through reduced corporation tax—for those of them who pay it—they would be in a better position, and that if their taxes go up, that difference will be exacerbated so the situation could be even worse for them. Again, it is a question of what the politicians would do with business taxes under that environment.

If we did not have control of corporation tax, we would have to try to compete aggressively with the other tools that we have, such as our planning system and transportation. It would be challenging.

Derek Mackay: But do you accept the premise that to be responsive, we must have the power, and that it would be better to have it in advance of the difficulties than after them?

Garry Clark: If we have a lower rate of business taxes, we will be in a far better position to compete.

Martin Togneri: There is a slight danger of confusion between headquarters functions and high-value-added functions. Microsoft has been mentioned a few times. When it decided to locate in Ireland, it was never considering relocating its headquarters from Seattle to Dublin—

Derek Mackay: That would be ambitious, even for the Scottish Government.

Martin Togneri: Nonetheless, we should look at what Microsoft actually does in Ireland. It has a major global centre of software research and development and manufacturing that it would not have without the encouragement of the corporation tax regime.

If the corporation tax rate is lowered to allow the attraction of more inward investment, there is the potential over time for companies, following their tax strategies on a global basis, to add more high-value activities, as they must do under transfer-pricing regulations, in the locations in which they can benefit from low-tax regimes. Scotland would benefit from that.

The potential to get high-value-added jobs through inward investment is much greater than the potential to get strictly headquarters jobs. However—I am sorry if I am going slightly off the question—it is the potential for a low corporation tax regime to generate more headquarters of new and internationally successful domestically headquartered companies that is the real prize that could be had here for Scotland.

Alison Johnstone (Lothian) (Green): We have focused a lot this morning on cutting corporation tax but we must remember that we could do other things with it, too. For example, if it were devolved, we could reward socially and environmentally good behaviour.

Mr Thomson, your submission recognises Scotland's need to address some of our chronic social problems. You comment about the fact that the split in social protection programmes between Westminster and Holyrood can be unfocused and inefficient. First, do you see us being able to make savings or achieve more value for money in that area?

I liked your comments about the opportunities in compliance, and the idea that we might phone up a tax centre and have a human being on the phone, for example. That would be very welcome. Your paper also talks about empowering local authorities. Would you like responsibility for council tax decisions to go back to local authorities? Would you like them to be able to introduce, for example, a tourist bed tax?

Finally, Reform Scotland has said that it favours lower levels of taxation. Would increasing the Parliament's powers over taxation lead to lower taxes and, if so, what impact would that have on our ability to provide public services?

10:15

Ben Thomson: Gosh, your questions covered a range of topics—and I have 35 seconds in which to answer. I will be as brief as I can, convener.

There are two aspects to welfare, the first of which relates to those who have been employed and covers, for example, the state pension and so on. In that respect, we see the UK as a large pension company. If you add up all those benefits, which also include maternity benefit, the total comes to about £7 billion. The other £7 billion or so of the £15 billion-worth of welfare benefits provided by Westminster—another £4 billion is provided at local level—is made up of, for example, unemployment benefit.

We think that there is a natural argument that welfare should be provided at the level of responsibility and that, in that respect, there are some real opportunities to do what is right for Glasgow, right for Inverness or right for Scotland compared with England. It would be much better to ensure that welfare payments are made at the local level where responsibility for sorting out issues and problems lies. As a result, we propose that social welfare be devolved to Scotland because the problems that it addresses need to be sorted out here, not centrally at Westminster. There is no reason why housing, for instance, should be a local issue while housing rebates are Westminster's responsibility. As I say, that particular welfare budget amounts to about £7 billion.

As for opportunities with regard to compliance, I think that we both agree that it would be great to get someone real to answer our questions or to be able to pop into a tax office and sit down with someone. That would make the system more efficient and deliver more results. After all, the tax man takes 30 to 35 per cent of all our money; in that respect, it would be the biggest service we could buy if, in fact, there was some real customer service behind it and you could do this sort of thing how you wanted.

As you have suggested, Reform Scotland believes in empowering local authorities. In fact, we have already published a paper on that very issue and will produce another one before the end of the year. We think that local authorities should have more control over taxation, business rates and the council tax because it is our fundamental belief that people become more empowered if they have the authority to raise as well as spend money.

On the question of lower taxes, there are two arguments to make. The first is about the devolution of tax itself, which is all about making people more responsible and accountable. It is up to you as MSPs to set out your stall about what you would do with such a power. Would you raise taxes and improve services or would you lower them and make services more efficient? It is all about giving you the tools that you need to run the business of governing Scotland better.

Secondly, as we have set out in a number of papers on public sector reform, we believe that by doing things more effectively we can save money. It is not about the total amount of money that we receive; it is about the way we do things. Time is too short to go into all that, but I simply point out that although education expenditure has increased in real terms by more than 50 per cent in the past 10 years, standards have not improved in real terms by the same amount over the same period. We need to change the system to ensure that it delivers a better service more efficiently.

Alison Johnstone: You clearly believe that these things should be devolved and then made the responsibility of whatever level of government.

Ben Thomson: Yes, they should be devolved. However, we could also do things more efficiently. If, as your manifestos suggest, you want sustainable long-term economic growth, the fact is that having too high a tax take will impede that. I am very happy to send the committee one of our papers showing a definite correlation between lower tax take and economic growth.

Martin Togneri: You could of course lower corporation tax if you had the power to do so. Indeed, Ben Thomson has already mentioned the worldwide trend in that direction. It is unlikely to happen but if you had the power you could exercise it to raise taxes.

You could also tie corporation tax to specific behaviours by, for example, requiring companies to meet certain environmental standards in order to benefit from a particular tax rate. That, however, is a matter for you folks. I would be slightly disinclined towards going in that direction because, for a start, it lets less profitable companies off the hook. Why should a company that is very profitable have more stringent environmental requirements than a less profitable company? Although I would not be inclined to use corporation tax in that way, you could use the regime to encourage a range of behaviours in a variety of areas.

I share Ben Thomson’s view on the impact of lower taxes, especially with regard to corporation tax. As far as I have been able to understand it, the overwhelming evidence is that lowering the corporation tax rate has a very positive beneficial impact on growth rates and employment generation.

Garry Clark: Historically, our members have had concerns about politicians controlling taxation. When business rates were controlled at local government level, they increased at a higher rate than council tax bills—or, back in the day, domestic rates bills. In its early years, the current Administration made some positive moves on business rates but over the past couple of years there have been a few increases for medium-sized or larger businesses. The suspicion of our members is that taxes can go both ways and that corporation tax could be another example of that.

Taking a positive view as we move forward, however, I think that we should start to consider localised rates as a positive means of encouraging local authorities to invest in local economic development. After all, they would get benefit from a higher tax take and businesses would still get a good deal. The Scottish Government has taken positive action on business rates—indeed, the small business bonus scheme has been a terrific example of that—but there are examples in recent years where its approach has not been so great. Corporation tax could be an issue for business; however, it could also have major benefits, which is why we want to take the debate forward.

The Convener: Thank you very much, gentlemen. We really appreciate your excellent input.

I suspend the meeting to allow a changeover of witnesses.

10:23

Meeting suspended.

10:30

On resuming—

Air Passenger Duty and Aggregates Tax

The Convener: I am pleased to welcome Amanda McMillan, the managing director of Glasgow airport, and Mr Richard Bird, from the British Aggregates Association. Mr Bird has come along at short notice to replace his colleague at the table—thank you very much for that. I invite you both to make short statements: Ms McMillan, on air passenger duty; Mr Bird, on aggregates tax.

Amanda McMillan (BAA Airports): Good morning. Thank you for the invitation to speak this morning. We have submitted written evidence in advance and we are happy to supply any supplementary evidence that is requested today.

We are keen to get across the simple message that air passenger duty is a huge concern to us in the aviation sector. It is of particular significance in Scotland, because we find it incredibly difficult to deal with when we are pitching for routes and face global competition from other airlines. We see APD as another barrier to entry into routes. It is an increment on the ticket price and is of huge concern to airlines especially with regard to long-haul travel.

VisitBritain recently produced some statistics showing that APD is definitely having an impact from a UK perspective. Of the Chinese visitors coming into Europe, just under 700,000 went to France and only 100,000 came to the UK. That research cites the impact of APD, together with the cost of visas, as the principal driver for that trend. We hope that we will clearly articulate our concerns about the level of APD through our evidence today.

The Convener: Thank you.

Richard Bird (British Aggregates Association): Thank you very much for inviting me along. I am from the British Aggregates Association, which is a trade association for the smaller, independent quarry operators. For the past 10 years, we have fought the Westminster Government over the imposition of the aggregate levy. As the matter has come up in Scotland, this is, I hope, an opportunity for me to explain to you the situation concerning the levy.

The levy applies to certain aggregates that are used in construction, but it does not apply to them all. It is divided according to the geology of certain rocks. For example, granite rock is taxed whereas slate rock is not taxed even though they may both be used in motorway building. Our case is that the levy is an unfair or illegal subsidy on some quarry operators. It is a bit like the Government saying that it will tax whisky but not gin—it does not make a lot of sense. Aggregates are very important in so much as they are used in everyday life. We use them in the construction of roads, schools, hospitals, houses and so on. It is interesting to note that the public sector purchases about 60 to 70 per cent of all the aggregates that are produced. The tax on aggregates is, therefore, a tax on local authorities, the national health service and any other public authority.

I will explain the situation regarding the legal case. The tax was introduced in 2002 at about £1.60 a tonne. We went to the High Court in London and lost our initial case. We were referred to appeal and went to the Court of First Instance in Europe, where we had a very good hearing, but, unfortunately, we did not win that appeal. We finally took our case to the European Court of Justice in Brussels, on appeal, and we won it. The instruction from the European Court of Justice to the lower court was that it should reconsider its verdict. All that has taken something like 10 years. In June, we had the second hearing by what is now called the General Court in Europe. It listened to the case on the aggregate levy and we are currently waiting for its judgment, which we like to think will come in the next three, six or nine months at the latest.

In the meantime, a separate case was brought in relation to Northern Ireland, which paid only 20 per cent of the aggregate levy. Quarries that tried to export from Scotland to Belfast for railway projects had to pay £2 a tonne—which is the rate now—while local quarries in Northern Ireland paid only 40p.

We won that case, and the derogation for Northern Ireland was declared illegal because—as I understand it—the European Commission did not, when it first agreed to allow that so-called environmental tax, carry out a phase II investigation, but simply rubber-stamped the decision and let it go through. We argue that it is certainly not an environmental tax; there is nothing environmental about any of it. It is more of a stealth tax.

Initially, the Westminster Government said that 10 per cent of the money raised would go back into the aggregate levy sustainability fund, through which it could go to local communities that were apparently affected by quarries. However, local communities never had any problems with quarries—certainly not aggregate quarries—so the money was used for rather strange projects to do with old quarries.

Around £3 million came back to Scotland, but the previous Government immediately took £1.5 million and used it for investigations in the North Sea. The remaining £1.5 million was put into the communities fund, for which we sat on the committee. That lasted for about 18 months, and then the money was put into various carbon initiatives. None of it—or certainly not much—ever went back into communities in relation to quarries.

That is the gist of what I want to say; I will do my utmost to answer any questions. I have a draft submission here, and I will send the final version to you when it comes out.

The Convener: Thank you. Derek Mackay has the first question; I suggest that we stick to the subject that he raises and then move to the next one to make things simpler.

Derek Mackay: I am delighted to be the first speaker, in that case. I have looked at the evidence closely; I found the BAA Airports submission helpful, and I direct my question to Amanda McMillan specifically.

Page 1 of your submission states that the Scottish economy is “particularly reliant” on your services because of the geography of our country. Should Scotland take a particular approach on air passenger duty? Are there benefits in Scotland having control of that duty to give us a competitive edge on other places?

More generally, how is the industry recovering? Could lowering the duty be a helpful catalyst in the recovery of your industry, bearing in mind the airports for which you are responsible in Scotland?

Finally, your submission notes that APD has, under successive Governments, been a crude method of income generation but that, taking a more positive view, it could—depending on how it is used—be a useful tool for the industry.

Amanda McMillan: That was about six questions.

Derek Mackay: I have more.

Amanda McMillan: Okay. I will take the general point on the industry first, because it might help to set the context.

This year is playing out better than last year. Glasgow airport’s passenger numbers were around 6.5 million last year, and we hope to finish this year at around 6.8 million, so there could be growth of anywhere between 3 and 5 per cent—although I would describe it as regrowth, as Glasgow’s highest passenger numbers were back in 2006 when it carried 8.8 million people. The industry has experienced the worst downturn in its history over the past two or three years, and although we are recovering, it is a very modest recovery.

When we talk to airlines, we find that they are very risk averse and reluctant to open new routes. We find that we become—for want of a more elegant description—piggy in the middle. The business community and those who are driving the Scottish economy want us to create new routes, but the airlines tell us that that is incredibly difficult for them. Long-haul routes, for which APD on a ticket is in excess of £100, are very difficult to establish. It is difficult to get a long-haul route off the ground without any intervention or financial support. In Scottish terms, the best example was the Emirates route. Through the route development fund, the Scottish Government gave 50 per cent and BAA gave 50 per cent; in essence, that allowed the route to land for free for the first three years. It is now a huge success and when we talk to the airline about expanding it, the airline is extremely concerned by APD.

You asked whether lowering the duty could be a catalyst for recovery. Most passengers see APD as just another factor in the ticket price. Airlines tell us that it is more expensive to fly into and out of Scotland, because the distance is greater. We do not have a huge population, so it is riskier—airlines do not know that planes will be full and therefore the expected yields on those services can be more risky.

A recent example is the feedback from another airline, on a European route. The airline said that, given that there is an extra 20 minutes' flying time to Scotland, it had a choice: it had only one aircraft to place into Frankfurt and it could find another airport without the additional 20 minutes. In Scottish terms, the airline would not generate any more income from the ticket price and therefore the route would be more profitable operated from elsewhere. Therefore, we have been quite enthused by the current Administration's position on devolving APD and doing something creative.

In the example that I gave, the discussions to date have alluded to the fact that APD could have been used to start up that route. We are not looking for on-going support for routes, because they must be economically viable. In the first year or two, the route has to be heavily marketed and the flights do not hold the loads that the airline needs. The airline builds up its market and then the route becomes viable. What was mooted earlier by the current Administration was devolving APD and doing something creative like that.

The response to the second question is that lowering the duty could be a catalyst to that recovery. Regarding the point on reliance, this may be more of a necessity than a catalyst or about recovery. Everyone tells me that, from a Scottish perspective, they want to do business globally. We do not have all the dots on the map that we crave. Under the current regime, it is not possible to get all the routes that we want and, therefore, just to stand still we must hang on to some of the routes that we have. In that regard, APD could be a huge risk.

I cited the Chinese example earlier, which concerned APD from the UK perspective. Scotland is different, in that its airports are not full. The airports in the south-east are capacity constrained but, even though we do not have that issue in Scotland, we are not able to fill our airports because it is difficult to get airlines to fly to Scotland. Anything we can do to make Scotland better positioned in a hugely competitive industry is welcome. I might have answered all the questions but please challenge me if I have not.

Derek Mackay: That is all very helpful.

Joan McAlpine: When we spoke to the representative from the Scottish Chambers of Commerce, he confirmed many of your points. There are interesting aspects of their evidence that look to the future. They talked about how Scotland is now more dependent on air travel in order to do business. They also mentioned that when high-speed rail is opened up for England, the UK Government's plan is that it will stop at Manchester and Leeds. The Scottish Chambers of Commerce suggested that that makes it more important that we incentivise air travel to Scotland. Will high-speed rail cause problems that will have to be addressed through APD?

Amanda McMillan: I am not entirely sure that I understand the question. Are you referring to regional travel within the UK?

Joan McAlpine: Part of what those witnesses are saying is that high-speed rail, which will provide a high-speed link to the continent, will stop at Manchester and Leeds and will not come to Scotland. Therefore, Scotland will continue to be very dependent on air travel.

10:45

Amanda McMillan: Forgive me—I thought that you were talking about high-speed rail coming to Scotland, but you meant it not coming to Scotland.

We are not against high-speed rail. As a Scottish person, I am keen for Scotland to be connected in every regard. It is a huge concern that, if the south is better connected, Scotland will become more marginalised. Nothing presents itself to me as an alternative mode of transport for businesspeople and tourists to get into and out of

Scotland. Aviation is critical, and we do not see anything on the horizon that will change that.

As you rightly point out, the situation is getting more challenging. Our written submission is looking ahead. Independent work by York Aviation suggests that, in the next three years, the opportunity cost to Scotland will be the loss of 1.2 million passengers and 148,000 visitor trips to and from Scotland. That is a huge concern, so I agree with Garry Clark on that point.

Alison Johnstone: To clarify, are you entirely opposed to APD, or do you want it to be devolved so that we might have more control over what we use it for?

Amanda McMillan: I am sorry if I was not clear about that. We recognise that aviation must pay its way. Our opposition is about further increases in the quantum. We are hugely concerned about the current levels and the UK Government's appetite to grow them. We are against the current levels of taxation, but we are not against taxation of the industry as a principle. We are keen on the concept of devolution because the proposals to date have suggested creativity in the use of the tax in support of the industry. Is that clear?

Alison Johnstone: Yes. If, for example, we were to offer a reduction in APD if night-time flights were rescheduled to daytime to reduce condensation trail impacts and various emissions, would you consider that?

Amanda McMillan: We would be open to any suggestions. That one would have a marginal impact, because we do not do a lot of night-time flying in Scotland. Edinburgh airport is active during the night for cargo, but there are few passenger movements. The same is true of Glasgow airport. We have to look at operating models. People want to be global travellers so, by necessity, that means some unsocial flying times, such as leaving Scotland at 5 o'clock in the morning to get to another part of the world. That is the operating model that makes airlines viable. If taxation were to restrict airlines to a model that was hugely different and not viable compared with that which is available in other countries, I am not convinced that they would settle and come here. The measure that you suggest would not have a huge impact, because we do not do a lot of night-time flying.

Alison Johnstone: A few years ago, the University of Oxford produced a document that suggested the existence of a UK tourism deficit, because far more people were using airports to leave the country than were coming in. The study found that, at the time, for every £1 spent by an overseas resident visiting here, £2.32 was being spent by UK residents going overseas. According to the Press Association report on the issue, the deficit had hit £17 billion. Are you aware of whether that deficit is reducing? Are we successful in attracting people here or do more people still leave the country, which has an impact on attempts to build our domestic tourism business?

Amanda McMillan: It is a complex argument. At Glasgow airport, the majority of traffic is outbound. I do not have the figures to hand, but that translates into the deficit that you mention. However, we must be careful, because there is huge employment at the airport and the business has huge economic value. To my mind, outbound travel is not necessarily a deficit to the country, because it involves our population travelling and doing business.

Outbound travel is not always bad news for the country. It is about balance. Airlines tell us that what they look for in a route is what they call perfect directionality—50 per cent outbound and 50 per cent inbound. We must be realistic about the high proportion of outbound travel; that is the nature of the industry.

Edinburgh airport has been hugely successful in its inbound business, which is where most of its growth has come from during the past few years. Our strategic ambition is to grow the inbound potential at Glasgow. There is a huge opportunity, which could be made more realisable by creativity on APD. We could help with the deficit, as you described it, and—on a practical note, from my point of view—we could help airlines with directionality.

Alison Johnstone: I appreciate that people need to fly—especially given our Scottish islands. We live in the modern world. However, a report by Sewill in 2005 took account of all the subsidies that airlines receive. Sewill found that every aviation job was subsidised to the tune of £45,000 per year. That was in 2005. Do you have a comment on that?

Amanda McMillan: I have not seen the report, but I would be happy to reflect on it and feed back to you. I am curious about the subsidies that you described, because I am struggling to think what subsidies per se airlines that operate from Glasgow are getting. However, I am more than happy to take a look at the report and respond in writing, if that is appropriate.

Alison Johnstone: Thank you.

Adam Ingram (Carrick, Cumnock and Doon Valley) (SNP): There is a circle to square in relation to the economic benefits and environmental impact of air travel. APD was established not as an environmental tax but for revenue-raising purposes. How can the aviation industry square the circle and ensure that it is appropriately taxed, given its benefits and disbenefits for the economy?

Amanda McMillan: I understand that APD was intended as an environmental tax. As you rightly pointed out, it has moved away from being that and now seems to be more of a blunt tax on the industry. Reports that I have seen suggest that some £2.2 billion goes into the Exchequer from APD, which, based on calculations, is in excess of the environmental impact of aviation. The industry is paying its way, albeit not through a mechanism that is based on environmental considerations.

I will give a more positive response to your question about how the industry should progress. The European emissions trading system, which airlines are due to come into in 2012, is a more appropriate mechanism whereby the industry can pay its way. Airlines will have to pay for the CO_2 emissions that they contribute. That is much more appropriate from an environmental perspective, and the approach will be more helpful in getting the message to passengers and enabling people to base decisions about travel on environmental considerations. APD is not linked to emissions in any way, so the ETS is the natural progression. I think that the industry is embracing the approach.

Adam Ingram: You argue that APD in the UK has been pushed so high that it puts you at a competitive disadvantage compared with other European countries. Is there a comparator country that you can point to? Is there a small northern European country that does better than Scotland in that regard?

Amanda McMillan: I direct you to the evidence that we submitted, rather than get into point scoring. The table on page 6 shows the variation across Europe. It is quite hard to show what happens, because there is not a universal language on the issue—it is not as if the tax is always called APD. There are different types of taxation.

Part of the reason why we commissioned York Aviation to do the independent report was that we wanted to understand the European angle, because that is what I come up against when I bid for a route. As much as people would like to convince themselves that my greatest competitors are Aberdeen airport, Edinburgh airport and other airports within the UK, when I bid for a route, I am up against other European countries. Ireland and France offer great examples of a more healthy outlook towards aviation taxation, which has encouraged airlines to go into those markets more than the Scottish one.

Richard Baker: Fundamentally, you are in favour of the devolution of air passenger duty as long as it is cut. Is that correct?

Amanda McMillan: Yes. It is always a bit nerve wracking to discuss devolution, because it does not give us any certainty about what will happen. The last panel of witnesses pointed that out as well. We are supportive of a more pro-aviation approach to APD, which is certainly how devolution of the tax has been described so far. A devolved APD would align itself to Scottish aviation more appropriately, which is why we are supportive of it.

Richard Baker: Aside from the pros and cons of devolving air passenger duty, are you confident that devolving it would be compliant with EU law?

Amanda McMillan: EU law is definitely a concern. The route development fund was suspended because of EU law and some of the creative ideas for using APD may be subject to similar rules.

If I take your question literally, the answer would have to be no, I am not confident. However, I believe in creativity and that, in running a business, there are always solutions to problems. If we do not have the opportunity to do something creative, that would be too easy an excuse for not doing anything. I would prefer to try and fail than not try at all with devolution.

Richard Baker: Obviously, when we pass legislation, it has to be EU compliant. We cannot pass a bill and hope that it is compliant.

Amanda McMillan: The message that I need to get across today is that, even if APD is devolved and we cannot be creative, the quantum is already excessive in comparison with other European countries. Therefore, our primary concern is not to have that quantum increased.

Devolution is potentially an and-and, but it could also mean that we just hold the tax steady or decrease it lightly. It does not have to be a creative, innovative solution. For me, devolution is about a clear understanding of the importance of aviation to Scotland. That is what I am looking for.

The Convener: Thank you very much, Ms McMillan. We move on to questions about the aggregates levy.

Mr Bird, does your organisation agree that the levy should be devolved to Scotland?

Richard Bird: The levy in its current form is probably dead in the water. When we heard that the Westminster Government was talking about devolving it to Scotland, our first reaction was that, by the time it was devolved, it might not exist. We felt that we should warn the Scottish Government that it may be being promised something that no longer existed. That is still valid. As I said, we have a court case in which we hope that a judgment will be given within 12 months.

The Convener: Let us say that the EU issues were resolved and that the aggregates levy was devolved to Scotland. What is your organisation's view of what Scotland should do with it? I think that I know the answer to that.

Richard Bird: You would have to make it fair. You cannot tax one guy and not the other; everyone must be taxed at the same level. We live in a democracy, and our complaint is not with the aggregates levy as such but with the fact that the Government taxes some companies and not others based on geological outcome, which is a complex system. As I said earlier, it is a bit like taxing whisky and not gin.

The Convener: I should warn you that a representative of the Scotch Whisky Association is sitting behind you.

Richard Bird: That is why I made that comment. Everyone then understands exactly what I am talking about. If the Scottish Government brings in an aggregates levy, that is fine—that is its job. All that we ask is that the levy is fair. If it will be a finance-raising measure, that is fine, but do not cover that up by suggesting that it is some sort of green tax and try to hide behind that. Let us be open about it.

11:00

The Convener: Let us assume—this is full of assumptions—that a fair tax was imposed. Do you think that the revenue from that should be hypothecated to, for example, green projects, which you mentioned? Would you like that money to be used for specific projects or put into the general pot?

Richard Bird: If we say that 60 per cent of it will go back to Government anyway, one has to scratch one's head. Roughly speaking, we do something in the order of 30 million tonnes of aggregate so, at £2 a tonne, that is £60 million. As 50 per cent of it is for public works, £30 million will go back into the coffers. You could argue that, if we did not have the levy in the first place, we would build motorways or railway lines. Over the past 10 years, Scotland must have paid £300 million to Whitehall, which would have built the Waverley line with some change left in your pocket.

I come back to your point. We have debated whether we put money back into the community. Our answer to that question is that local companies and industries put money back into the community. We are a rural industry, so it is to our benefit to ensure that the local rural community is well looked after. We do not want people to object to our industry.

If people say to us, "We need to put a new roof on the scout hut. Can you give us £10,000 towards it?" we will do that. We do that quite often. Individual companies assist a lot of community schemes. Okay, they get something out of it: they get good public relations and are able to go to the local paper and get it to say, "Bloggs company provided £10,000 to rebuild the scout hut". We put a lot of money back in, but we would be a bit suspicious if that was controlled by Government, because the Department for Environment, Food and Rural Affairs siphoned off its money from the aggregates levy for something else and in Scotland some of the money generated by the aggregates levy was siphoned off for North Sea whatever, so it did not go back into the community as it was supposed to in order to make it look like a nice environmental tax.

John Mason: I must admit that I am not a huge expert on all this. You can perhaps explain it a little bit. You said that granite gets taxed heavily but slate does not. What sort of percentage of value—obviously it is nil at one stage—does the tax go up to?

Richard Bird: I will answer your first question first. The aggregates levy does not apply to slate. The idea was that there were hundreds of millions of tonnes of waste slate lying around in north Wales that could be used as an aggregate, so slate was relieved and was not subject to the tax. The fact that, for every 7 tonnes of roof slate that are made, about 90 tonnes are dumped, seemed to make that a bit daft from an environmental point of view. China clay sand in Cornwall and parts of Devon is not taxed either. For every 2 or 3 million tonnes of China clay product, about 20 million tonnes of waste product are dumped down in Cornwall, but that is not taxed.

Shale, too, is not taxed, because someone in HM Customs and Excise thought that shale was stuff that you get at the end of coal bings, but the situation is a bit more complex than that. All the rock in Caithness is part of the Caithness shale beds. Therefore, the rock in Caithness is not subject to the aggregates levy, although people drill and blast it, manufacture concrete and asphalt from it, and do everything else that somebody with a whinstone quarry in Falkirk who pays the tax would do. It is open to people to dig and say, "Well, we've got slate on the ground here, so we'll produce the aggregates out of that, and we won't have to pay the £2 levy, so we'll be cheaper on the market." Does that help to answer your question?

John Mason: Is your summary argument that things are a real mess?

Richard Bird: Absolutely. The whole thing is a total, complete mess.

John Mason: And if the Scottish Government took things over, we could not do any worse.

Richard Bird: The whole thing is still a mess. I will have a meeting next week. People are now asking about the filler that is used in asphalt, which is exempt, because fillers that are used in paints and chemicals—limestone filler, for example—are exempt. Somebody decided that the filler in asphalt is not a filler but an aggregate, so we have to go down to Whitehall and say, "Well, no, guys, it's really something to do with the bitumen." There can be back charging for three years, which would put Amanda McMillan's runway costs up even more. The situation is a complex mess.

John Mason: You have convinced me that it is a mess.

Derek Mackay: I have learned more in the Scotland Bill Committee about aggregates than I ever thought I would. I was going to ask about hypothecation, but you have already covered that, so the next member may ask a question.

I do not have any financial interest in aggregates, but I did not declare an interest earlier, and would like to do so now, somewhat late in the day, for completeness. I still serve as a local authority member for Renfrewshire Council. The declaration has no relevance whatsoever to Mr Bird's submission.

Joan McAlpine: Why am I not surprised that the Calman commission suggested devolving a tax that may never be levied?

Earlier, several witnesses talked about business's difficulties with HMRC. It sounds as if Mr Bird very much agrees with what they said. We have talked a bit about simplifying the tax regime in Scotland. We talked about starting again from scratch and coming up with a simpler system. Mr Thomson from Reform Scotland spoke about that. Would that be attractive to your industry?

Richard Bird: Yes. To be serious, we could all get around the table and say, "Well, what do we need and where is it best to put this money in?" I am thinking of rural communities in particular. Our industry is a rural industry, so we would like to see money going back into villages and rural communities. I sit on the local community council and know the problems that local authorities have in providing money for extra car parking, play areas for kids and so on. We would like to get involved in that. I am talking about local issues rather than something that is lost in the corridors of power. If we are serious and people want to talk, we would look at the local and communities issues, and see whether we could come up with something, bearing in mind that 50 per cent or perhaps more—perhaps 60 per cent—of all aggregates go back into public works anyway. It seems a bit silly to take the money from rural communities only to put it back somewhere else.

Joan McAlpine: Sure.

My other question is about your Dickensian court case, on which I think you have the sympathy of every committee member—you have united the committee in sympathy. How much is the case costing you?

Richard Bird: At the moment, the legal fees have cost us £900,000. Members ought to be aware of an interesting thing. The lawyers have said—and I have seen this written in European Community official papers—that, with an illegal tax, the money has to be paid back. That is an extremely interesting point. If we go back even three years, we are talking about £1 billion. It will be most interesting to see what happens. Getting back our legal fees would be very nice.

The money has been put up by private individuals who think that the levy is totally unfair and have said, "Here is my 10,000 quid towards the legal fees." We should bear in mind that it is a levy and not a tax. As I understand it, that means that even if the quarry operator gives the stuff away to the local farmer, because it is a product that he cannot sell, saying, "Take it away and have it for nothing," he still has to pay the levy.

If the money comes back, there is an interesting question: does it have to go back to the customer? No one has come up with the answer. It is such a hot potato that no one wants to contemplate it. People would be knocking on our doors and saying, "Look, I spent 100,000 quid with you during the past five years and I want a portion of that back." That is another complexity of the levy.

The Convener: Does Willie Rennie want to grasp the hot potato?

Willie Rennie: Mr Bird, you have repeatedly said that the issue is fairness, but is the issue really the level of the tax? Is it the overall levy take that concerns you?

Richard Bird: It is fairness that concerns me, to be honest. Let us be clear. If the Government had come along 10 years ago and said that it was going to tax aggregates used in construction, that would have been okay—end of story. However, it did not do that; it said that it would tax granite but not slate. We said, "Well, wait a minute. We already use slate in roads. The road to Holyhead was all done with slate aggregate." The Government ignored that; it did not want to know. The poor guy who had a granite quarry had to pay £2 per tonne—or rather, £1.60 in those days—and the guy with the slate quarry next door paid nothing. The tax was unfair.

It is the Government's right to tax what it wants to tax. We live in a democracy. However, if the Government is going to do that, it should make it fair, for God's sake. Had the Government said that all aggregate that goes into construction would be taxed, there would never have been a court case.

What do we fight for? We cannot argue against tax. We can vote Governments out, but we cannot go to court and say that it is wrong to tax. What we did was to go to court and say that the Government did not follow the correct procedure, based on EC law. That is the basis of the court case. Fairness is the answer to your question.

Willie Rennie: If the levy is devolved and you come back to give evidence to the committee, I will remind you that you said that you did not want a reduction in the levy.

Richard Bird: I think that we would rather talk around the table. HMRC talked but, unfortunately, it did not listen; it laughed at us and said, “Oh, but you would say that, wouldn’t you?” We said, “Well, look, you are going to get yourselves into one big hole here, guys.” Customs said, “Rubbish. We know what we are doing.” Here we are, 10 years later.

The Convener: I thank both witnesses for coming along to give us the benefit of their knowledge. We have had an extremely interesting discussion.

11:13

Meeting suspended.

11:16

On resuming—

Excise Duties

The Convener: I reconvene the meeting and welcome everyone back.

I welcome the members of our next panel and thank them for coming along. Campbell Evans is from the Scotch Whisky Association, Patrick Browne is from the Scottish Beer and Pub Association, and Dr Evelyn Gillan is the chief executive of Alcohol Focus Scotland.

I invite brief opening remarks before we move to questions.

Campbell Evans (Scotch Whisky Association): Obviously, our industry is closely involved in excise duty, so we have widely consulted our members on its devolution. We noted with interest the view in the Scottish National Party’s manifesto, which it thought was in line with our view, that excise duty should be reformed, but there are many uncertainties about the devolution of excise duty and how that would work in practice. That is important to us, given that the UK is our fourth-largest market.

Excise duty goods, Scotch whisky and other alcoholic drinks move under a duty-suspended regime across the whole of the European Union. That is part of the way in which we facilitate trade and the exports that contribute to the Scottish economy. Under European law, there is a lack of clarity about whether more than one rate can operate within a national state. Indeed, from the barley that comes in at the front door to the bottles that leave the duty-suspended warehouse, our industry is the subject of customs controls.

We do not know what a devolved system would look like. As things stand, we see duplication and the dislocation of business without clarity. The Scottish Government was due to publish a paper on how it would deal with some of the issues, such as business disruption; increased bureaucracy; perhaps how duty-suspended goods would be dealt with in a country with an open border; the impact of cross-border shopping; whether HMRC would continue to operate under the duty devolution system or whether a separate body would be set up; and the legality issue. I find myself to some extent in tune with the article from Ms McAlpine this morning. Clarity would help us to answer some of the questions. In its absence, we do not support the devolution of duty.

Patrick Browne (Scottish Beer and Pub Association): Thank you for the opportunity to give evidence, convener.

Our particular issue is to do with the control of excise duty linked to the potential of minimum unit pricing and the taxing away of benefits from minimum unit pricing, and our particular concern relates to pubs. Our paper elaborates on that.

We share the SWA’s concerns about the devolution of duty, and think that complications would arise from that devolution that are perhaps not seen very well at the moment. Those implications would have an impact on the industry in Scotland.

Dr Evelyn Gillan (Alcohol Focus Scotland): I thank you for the opportunity to give evidence today, and I apologise for not submitting written evidence—unfortunately, the timescale between the request appearing and the closing date for submissions prevented me from doing so.

We support devolution of excise duty. If the purpose of the policy is, as we understand it to be, to reduce alcohol consumption and harm, all the available evidence suggests that it would be effective. The Scottish Medical Royal Colleges and Faculties recommended in 2007, in a report that I co-authored, that Scotland’s—and indeed the UK’s—best opportunity for reducing alcohol consumption and harm would be a combination of alcohol-by-volume-linked duty increases and minimum unit pricing. All credible scientific opinion now supports that position.

Such a move would give the Scottish Government the opportunity to use, as part of its preventative spend, some of the income that would be raised. Our harm levels are now at an historic high. In the UK we have gone from drinking 5.7 litres of pure alcohol per person in 1960 to 10.7 litres in 2009. The most recent data suggests that in Scotland we drink 11.8 litres of alcohol per person, while in 2005 we were drinking 11.9 litres.

We cannot experience such dramatic increases in consumption over a 20 or 30-year period without a consequent effect on harm. Scotland has gone from having one of the lowest liver cirrhosis mortality rates in western Europe to having one of the highest.

It is always useful to remind ourselves of history, as we were not always like this. I was reading a report from 1931 by the Royal Commission on Licensing (Scotland), which said:

"a younger generation is growing up to which, as a whole, any resort to alcoholic excess as a necessary or usual practice is almost totally unknown".

The report concluded:

"Drunkenness has gone out of fashion".

Patrick Browne's forebears responded in 1933 by putting in place a massive advertising campaign, which said that they must

"get the beer-drinking habit instilled into thousands, almost millions, of young men who do not at present know the taste of beer."

The campaign slogan was "Beer is Best For A Fitter Britain".

The 1931 commission concluded that increased taxation was one of the reasons why drunkenness had gone out of fashion, so it is clear that, historically, Governments have used that tool. We are talking about a harmful and addictive product that requires regulation. If we look at the history—which Campbell Evans and I were discussing this morning—we see a series of Government interventions at different times that had specific policy effects. That is why our consumption was at such low levels in the 1930s and 1950s as to give us the lowest rates of liver cirrhosis mortality.

The Convener: I bet that Patrick Browne is glad that it was not him who produced that campaign.

Patrick Browne: Just for the record, the British Brewers Association, as it was in 1933, was separate from the Scottish organisation. I am happy to disown that one.

The Convener: Campbell Evans will not need to sit between the two of them after all.

Joan McAlpine: I thank you all for coming along, and for your submissions. I address my question to Dr Gillan. My understanding is that, if we consider excise in terms of the amount that it raises rather than looking at varying rates, alcohol tax raises a disproportionate amount of our revenue stream in Scotland. You alluded to that when you spoke about putting the money into preventative spend. What type of health programmes could we fund with that money? I understand that in Scotland we raise in excess of £250 million from excise. From a medical point of view, how would you use that money for preventative spending?

Dr Gillan: There is definitely evidence on that. A Scottish needs assessment was carried out two or three years ago to identify both the number of people who required access to alcohol support services and what was available to them. It found that we were falling significantly short in our provision. I cannot remember the exact figures—I can get them for you—but if, for example, 10 in however many people required access to alcohol support services, our current services were able to provide services to only three or four of them.

We know that we have a problem in Scotland with the level of consumption and harm and the provision of support services. Any new funding should be ring fenced to go into programmes that support people who experience problems and wish to reduce their consumption and—this is more important, in some ways—work that encourages children and young people not to engage in risky drinking. For example, we do work in schools with our "Rory" and "Oh Lila" resources, with which we try to raise teachers' awareness of the impact of harmful parental drinking on people other than the drinker. We have been contacted by a number of local charities and voluntary organisations that cannot afford to buy the "Rory" book, the other resources or training for the teachers. Preventative spend would be well used for those charities, which work with vulnerable families and children who experience, and live with on a daily basis, the negative effects and harm of excessive alcohol consumption.

Joan McAlpine: I was fascinated by the 1930s material that you quoted. Obviously, the main drink back in those days would have been Campbell Evans's product—whisky. The recent escalation in alcohol-related harm cannot really be attributed to Scotland's national drink.

Dr Gillan: Not at all—and I am sure that Campbell will confirm that. The big problem is cheap vodka. All the recent sales data has strongly identified cheap vodka, and evidence from accident and emergency admissions for acute alcoholic poisoning, particularly of young people, shows that we have a real problem with cheap vodka and high-strength ciders. We do not get anyone turning up in A and E who has had a few malt whiskies of an evening.

The Convener: Mr Evans, do you want to come in on that point—or will you haud yer wheesht just now?

Campbell Evans: I should possibly haud my wheesht, but I would rather say that we should address the problem of alcohol misuse, no matter what people are drinking. Everyone must be involved in tackling the issue by changing people's attitudes and the acceptability of drunkenness, which, as Evelyn Gillan said, was not acceptable many years ago. I do not think that anyone should take any credit; we should recognise that it is an issue that we need to address as a country.

The Convener: I will bring in Derek Mackay quickly on that point.

Derek Mackay: I want to ask specifically about whisky. Young folk getting tanked up on Glenmorangie is not the image that comes to mind in the central belt. Why is the Scotch Whisky Association in principle against the transfer of powers from Westminster to Scotland, especially when Westminster already levies a higher charge on the whisky industry?

Campbell Evans: The fundamental point is that we are unclear as to what the market would look like. As I said, the UK is our fourth-largest market, so our ability to trade within it is important to us. There are a number of companies, large and small, that have a single distribution system for the UK that sees products being put into duty suspension and then released into the market. I presume that that would have to change in some way for an England and Wales market and a Scottish market. None of that has been explained, and the legality of a single rate has still not been clarified. We are operating in the dark in terms of what the Scottish Government proposes, so we look forward to seeing its paper.

Derek Mackay: Okay. So you would describe it maybe—

The Convener: No, Derek, it was one question only on the back of the previous one. I will bring in Richard Baker.

11:30

Richard Baker: We have heard good points about the potential benefits of increasing alcohol duty and, indeed, of reforming the alcohol duty system. Of course, we are here to talk about a specific proposal on excise duty. My understanding of the Scottish Government's position is that it wants the ability to increase excise duty on alcohol to recover the profits raised from introducing minimum unit pricing. I would like the panel's views on that because it strikes me as quite a complicated proposal, given that excise duty is levied at the points of production and distribution and the alcohol goes across Europe and the world. I presume that the Government's proposal would mean levying the duty at the point of sale in Scotland. Would there be significant administrative burdens as a result of that? Do you envisage the proposal working in that way?

Campbell Evans: I am not entirely sure that even under European law that would necessarily be feasible, because it is all about the movement of the duty, which is paid when the product is released from bond into the market. It can then be sold in an establishment run by one of the members of Patrick Browne's association, for example, or in the off-trade or in a restaurant. We do not necessarily know where it will be sold when we release it from bond. It could go to a supermarket with a range of shops in England and Scotland, for example. The same problem applies when the product goes into a pub estate. Under European law, duty is paid when the product is released from bond, but it does not necessarily apply to the ultimate seller if it goes through, say, a cash-and-carry.

Richard Baker: How could the Scottish Government obtain its policy objective through the devolution of excise duty?

Campbell Evans: That is one of the questions that we would like to know the answer to.

Richard Baker: We are dealing with a complicated issue, but although we are now very far into proceedings on the Scotland Bill, and quite some way into this committee's proceedings, we have not received a detailed description of the proposal from the Scottish Government. Have you been involved in discussions with the Scottish Government that have given you the detail or any understanding of its proposal? Unfortunately, the committee is working in the dark.

Campbell Evans: I have not seen any paper that answers these questions.

John Mason: Some of what you say in paragraph 22 of the Scotch Whisky Association's written submission is quite dramatic. The submission states:

> "Different duty regimes north and south of the border, and possibly different regulators, would fragment and disrupt the industry."

That is quite strong language. It continues:

> "The industry, whether at production, distribution or retail level, would face massive dislocation across its business models."

Have you done any studies on that? Do you have any evidence on it from other countries around the world?

Campbell Evans: There is the well-known cross-Channel effect of alcohol going between

France and the UK. French duty rates are considerably lower than those in the UK. There is also cross-border shopping for some products between Spain and France and between Italy and France. Where there is a duty difference between different states, there is cross-border shopping and the supply chain is therefore disrupted. That is the sort of thing that we would expect to see here if, as Mr Baker said, one of the plans is to change the duty rate in Scotland so that it was higher than in England. With a porous border and no border controls, goods could move across the border quite easily.

John Mason: Presumably, if somebody was going to the pub for a pint, they would not go 20 or 30 miles.

Campbell Evans: Well, lorries drive up and down the M74 and the east coast and there is no reason why they could not be filled with alcohol that would be sold at the back door, which would mean that we had lost control of it. That is one of our concerns, and I am sure that it would be one of Patrick Browne's concerns.

John Mason: Have you got figures on how much alcohol crosses over between France and Spain, for example, or how much duty is lost from that?

Campbell Evans: I am sure that we can look at where those sorts of things happen and come back to you.

The Convener: If you would, that would be much appreciated, Mr Evans.

Adam Ingram: There are also opportunities if excise duties are devolved, including the SWA's own long-standing argument for equivalence for different alcoholic drinks or units of alcohol. Can we foresee a regime being established that addresses many of the threats that you have outlined and that perhaps takes advantage of opportunities? What kind of devolved system would you welcome?

Campbell Evans: There has certainly been a coming together of the SNP's stated policy and the long-held SWA policy. However, bearing in mind some of the issues that I have discussed and some of the legal issues that would need to be overcome, that does not seem to apply to the circumstance about which we are being asked—whether a state can have more than one duty rate—which relates to devolution within the UK.

We have to deal with the question that we are being asked. If there is a straightforward system of excise duty, and a straightforward HMRC regime that does not duplicate, and if the legal system is clear and the supply chain is clear, of course we and our members will consider the question. However, we have consulted our members widely, and we do not see the answers to those questions.

Adam Ingram: You highlighted particular types of alcohol that were causing problems—vodka and cheap cider. Could the minimum pricing mechanism and excise duty not offer an opportunity to target our difficulties? I believe that Dr Gillan would advocate that they do.

Dr Gillan: Yes. We ask people in A and E what their last drink was and what they had been drinking over the course of the evening and, as I have said, the evidence is that cheap vodka should be one of our biggest concerns. Industrial-strength cider is also a major concern. There is unfairness in the way in which cider is taxed at present.

Campbell Evans: European tax rules require all spirits drinks to be taxed at the same rate, so you could not pick one particular spirit and treat it differently from the others.

Adam Ingram: Would the minimum unit pricing approach not allow us to address that?

Campbell Evans: As you are aware, we have considerable doubts about its legality, and we have major concerns about the international impact. The situation is contrary to the one we considered in your previous question, where there might be a fine precedent of a reformed duty regime.

Consumption has been flattening over the past five years, and some of the key Government indicators of harm are starting to come down. For example, under-15-year-olds are drinking less. No one is denying that a problem exists, but there has perhaps been a slight turning. We should seize on that, if we can, so that the better figures can improve still further.

Adam Ingram: I do not recognise the better figures that you suggest are coming through.

Campbell Evans: Hospital admissions are down by 8 per cent, which is one of the Government's key indicators, and consumption has flattened over the past five years, so a message about responsible drinking may be getting through—especially when fewer under-15-year-olds are drinking alcohol. There is perhaps something to build on.

Dr Gillan: We welcome any evidence of changing trends, but I quoted figures earlier showing that our consumption of litres of pure alcohol in Scotland has gone from 11.9 in 2005 to 11.8 in 2010. We are starting to see plateauing. Differences exist between England and Scotland, and there is more evidence that consumption has started to come down in England.

As economists will tell you, the only real way to assess the situation is to consider time-trend data, so let us look at consumption and harm patterns over the past 100 years. We saw decreases in consumption in England and Wales by 3, 4 or 5 per cent in 1980, when we were in the midst of a recession, only for the figures to climb back up again.

Health economists would say—and we would concur—that any plateauing or indication that the trend might be changing is very much to be welcomed, but we must put that in the context of harm being at levels that are at an historic high. There has been a 450 per cent increase in liver cirrhosis mortality over the past 30 years. Although a levelling off may have started, our consumption levels are still very high in the context of the past 100 years, and they are certainly among the highest in western Europe.

One of the benefits of minimum unit pricing is that it would raise the price of very cheap products such as cheap own-label vodka and high-strength cider. The pricing mechanism that the Scotch Whisky Association recommended to the UK Government, which it has taken on, was to ban the sale of alcohol below a price of duty plus VAT. That would have no impact on consumption and harm and would, technically, allow some of the lowest-price products to be retailed at even lower prices than they are sold for at present.

Professor Tim Stockwell from Canada will be speaking in the Parliament at 5.30 today, and I strongly urge members of the committee who have any doubts about minimum unit pricing to come and listen to him, if they have time. He is to publish the first evaluation of MUP in Canada in *The Lancet*. It shows very clearly that MUP schemes in Canada have resulted in a drop in consumption. When there is a drop in consumption, we expect a drop in harm.

The Convener: Adam Ingram has started a debate.

Campbell Evans: I feel that Evelyn Gillan did not give the full story. In calling for a floor price, we also said that excise duty had to be reformed so that there was fairness across the piece. The committee should have the full story.

The Convener: I am aware that Mr Browne has sat patiently between Dr Gillan and Mr Evans. Would you like to add anything, before I move on to Mr Rennie?

Patrick Browne: It seems to me that there are two separate issues: control of excise duty, and minimum pricing. Our issue is the convergence of the two. Minimum pricing is about trying to prevent people from selling alcohol for under 45p per unit. If the Scottish Government proceeds with that and gets control of excise duty, our concern is that pubs, which already sell above the proposed minimum level, will have money taken back off them as the perceived benefits of minimum pricing are taxed away, which will mean that pubs will lose out because they will not get the benefits of MUP but will be hit with an extra 50p on the price of a pint. That is the specific issue that we are concerned about, which we are trying to get across.

When we see the detail of what the Scottish Government is proposing, I hope that that will show that it has considered that issue and come up with a way of addressing it. However, our understanding is that, under EU law, it is not permissible to have a duty system that differentiates between on-sales of alcohol and off-sales of alcohol, so we do not see how the Government can address that point. We are concerned that pubs will be hit hard again as a result of being caught in the crossfire between MUP and control of excise duty.

The Convener: I will let John Mason in, as he has a quick question on that point.

John Mason: I would have thought that pubs would benefit from the process that you have described. If the relative price of off-sales is increased, will that not encourage people to use pubs, which I would favour, instead of sitting in the park?

Patrick Browne: As an association, we do not support or oppose minimum unit pricing. We have a deliberately neutral stance because our members have different views on the issue.

It is difficult to know exactly what the impact of MUP will be until it is implemented and we assess where customers have gone. Our particular concern is about the 50p increase in the price of a pint of beer in a pub. I think that a large part of any benefit from MUP would be lost as a result of the extra 50p on the price of a pint.

John Mason: What if something was done on the excise side?

Patrick Browne: If a different mechanism was used to recover the benefits to retailers of MUP, we do not quite know how that would work. Again, it would be a case of waiting to see what the impact would be. What is certain is that if, as well as implementing MUP, the Scottish Government gained control of excise duty and tried to tax away the benefits of MUP, there would be a 50p increase in the price of a pint in the pub. In our view, it is pretty clear that that would happen.

11:45

Willie Rennie: Dr Gillan, I share your passion about minimum unit pricing and the problem of alcohol. All this may be academic because EU rules may forbid it, so we may be having a pointless discussion. Nevertheless, I am concerned about the complexity of introducing minimum unit pricing and having different systems in the UK for companies that operate across the UK. Have you looked at any evidence around the business impact of that, the compliance issues and managing its administration by the UK or Scottish Governments?

Dr Gillan: When the medical royal colleges published their first report in 2007, we commissioned two legal opinions. One looked at the licensing legislation and the other looked at potential compliance with EU competition law. The legal advice that we received was that minimum unit pricing would be possible with certain caveats—for example, it would need to be shown that minimum unit pricing was a proportionate response. We think that the Scottish Government could justify that MUP was a proportionate response on the basis of the very high levels of harm from alcohol. The EU confirmed in 2010, in two separate written answers to parliamentary questions, that EU rules do not prevent Governments from introducing minimum unit pricing. However, that remains to be seen.

Campbell Evans's association has indicated that it will mount a legal challenge. Certainly, the tobacco industry's response was consistently to mount legal challenges to increased regulatory measures that sought to reduce the consumption of tobacco. However, all the evidence that we have indicates that minimum unit pricing would be possible under EU law.

With regards to the UK, Northern Ireland is consulting on minimum unit pricing and our colleagues have indicated that it may well be on the table there, and the Welsh Government recently commented that it wanted to introduce minimum unit pricing. Abroad, Australia is investigating minimum unit pricing and Canada already does it. We might find that England becomes the only country in the UK that is not considering minimum unit pricing, which would then change the terms of the debate around business compliance, because three out of four countries in the UK would be looking to introduce minimum unit pricing.

Campbell Evans: Can I just correct something? I do not believe that we have ever said that we would make a legal challenge. There is a lot of supposition around that issue. The Scottish Government has said that it expects a legal challenge, but we have not said that we will make one.

The Convener: Thank you for that clarification.

Joan McAlpine: Mr Evans, can you tell us a bit about the membership of the Scotch Whisky Association?

Campbell Evans: We cover about 90 per cent of the Scotch whisky industry and are an organisation of distillers, bottlers, blenders and brand owners, so we are at the production end, not the retail end. We have some of the largest drinks companies in the world as members and we have one-man bands who may own a brand but do not own a distillery or perhaps own only one distillery—so we have large and small.

Joan McAlpine: The large drinks companies that now dominate Scotch whisky production will make a variety of other drinks as well.

Campbell Evans: Drinks of all sorts are made by different companies of different sizes that are in the Scotch whisky industry or which are members of the Scotch Whisky Association.

Joan McAlpine: They will make some of the drinks that will be affected by minimum unit pricing and raised levels of excise. I am thinking particularly of the cheap vodka that Dr Gillan mentioned earlier.

Campbell Evans: Many of them produce a range of products: many of those products would not be affected by minimum unit pricing, but some would be, depending on the level at which it was set. You should bear it in mind that the proposals in the previous parliamentary session could have hit about 30 per cent of Scotch whisky, so it is not just about looking at other drinks.

We should be quite proud of our vodka industry, given that about 80 per cent of the gin and vodka that is produced in the UK comes off Scotland's bottling lines. It is quite important to Scotland's economy that we do not harm the spirits industry per se.

Alison Johnstone: Mr Browne, I did not pick up from your written submission what the Scottish Beer and Pub Association intends to do if the proposed power does not come in. I assume that you are as concerned as the rest of society is about the increase in alcohol use and misuse. If excise duties are not devolved and we do not go down the minimum unit pricing route, what part would your organisation propose to play in tackling this very serious problem?

Patrick Browne: The industry is already involved in a range of activities to try to address alcohol misuse and abuse. It is for the Government to decide what measures to take in that regard. As I indicated, we neither support nor oppose the introduction of minimum unit pricing. The Parliament will make a judgment in due course on whether to proceed with that.

If the law changes, we will comply with it. Licensing reform over the past few years has significantly improved standards in pubs across Scotland. There is a series of new offences around what publicans can and cannot do, which licensing boards are rigorously enforcing. The environment in which licensed premises operate, particularly pubs, has changed markedly and that is already having an impact on people's drinking habits.

There is no comparison between the price of a pint sold in a pub and the price of a pint bought in a supermarket. Pubs must cover overheads, which means that prices are much higher. The correlation between price and misuse is well established. As a sector in the industry, we do not contribute as much as other elements of the industry do to that problem. However, if Parliament legislates on the problem, we will comply.

The Convener: I thank all of you for coming along, which is much appreciated. I suspend the meeting until 2.30.

11:51

Meeting suspended.

14:30

On resuming—

Corporation Tax

The Convener: I am happy to reconvene the meeting. We will continue our scrutiny of the Scotland Bill by taking evidence on corporation tax and the creation of a favourable environment for business. I welcome our witnesses, who are Jim McColl, Professor Hughes Hallett and Norman Springford. We had an extremely interesting session on corporation tax this morning, and it will be good to hear more from you.

I invite you to make short opening statements before we move to questions from the committee.

Jim McColl (Clyde Blowers): You would like a short opening statement?

The Convener: If you wish—you do not have to make one.

Jim McColl: I am quite happy to.

The angle that I come from on corporation tax is that our business population in Scotland is way below where it needs to be. It is the generator of wealth that provides the funds for the social progress that we need to make. We have to do something to increase the number and size of businesses in Scotland.

At the moment, we are at a disadvantage. Naturally, a company would want to go to the south-east of England. It is necessary to give business some reason to locate in Scotland. I have just come back from Germany. It takes too long to get to different markets from Scotland. There is an additional cost in time and money. I sometimes find it difficult to get customers over here because they have to make that extra leap. We need the power to do something to attract more businesses to Scotland.

I was disappointed that the Calman commission's brief was such that it was not allowed to look at that. It still comes through from Westminster that you cannot do something that disadvantages another part of the UK. What we need is something that gives an advantage to Scotland so that businesses will look at moving here instead of locating in the south-east of England. That is my basic argument. We cannot grow the Scottish economy without growing the business base here. We need something radical—it is not a case of tinkering at the edges.

Calman's 10p tax proposal would be damaging and unworkable. It is just a variation of the power to vary the rate by 3p, which was not used because it would not make sense to use it. If the 10p rate was reduced, the block grant would be reduced, and if it was increased, that would damage the people we want to help. We want to reduce the bottom rate, but we must find a way of funding that, and we will not be able to do so without additional tax-raising powers.

The Convener: Thank you very much. Perhaps Mr Springford would like to go next.

Norman Springford (Apex Hotels): Thank you.

I have a more negative point of view in that I think that the corporation tax changes may be irrelevant. I have been a practising accountant for many years and an entrepreneur for even longer, and I have not yet met any emerging entrepreneur—which is the sector that we say the growth will come from—who puts taxation at the top of the list of drivers for their business. Someone who runs a small to medium-sized enterprise may well be concerned about their level of personal income tax, but I have not heard of anyone who will place corporation tax higher up than sixth or eighth in importance on a scale of one to 10.

Entrepreneurs are driven by access to funding, which is clearly highly relevant at the moment. Another concern is the level of bureaucracy that is endemic in their business. A current issue is the level of non-domestic rates and of utilities charges. Those are the sort of drivers that I consider to be relevant to Scottish growth. Corporation tax is of low relevance when it comes to where we think that our growth will come from.

The Convener: I invite Professor Hughes Hallett to speak for a few minutes on the evidence that he submitted.

Professor Andrew Hughes Hallett (University of St Andrews and George Mason University): Not to be outdone, Drew Scott and I have submitted two lots of evidence. They are both summary statements, designed to review the major issues and the evidence on those issues in the Scotland Bill process at large.

The evidence is in two parts. The first reviews the Scotland Bill's financial proposals as they now stand, and we have a number of serious concerns about their implementation that have, surprisingly, never been addressed elsewhere. Mr Danny Alexander might be addressing them in another place today but I do not know what he is saying. If he is, it is two years after the event, which is worth noting.

The second part of the evidence is a review of the case to be made for extending tax powers, principally corporation tax, which is presumably why I am sandwiched between two business types today. It also contains various ideas on how that can be implemented.

Both parts of the evidence are important. The former is important because it has never been done, as I emphasised, and the latter is important because, one way or another, the issue has become a live one and I presume that the committee wants to know what the experience has been elsewhere and what the research has shown. As I said, our evidence goes through some of that.

It is worth saying that those countries that have any form of tax devolution at all, without exception include corporation tax, among other things, so there is plenty of experience.

Because the issues I have mentioned are important in practice for the implementation of the bill's proposals, I ask the committee to read them carefully—that is a slightly barbed comment. The papers might be a bit dense but they are quite short. They are concerned with the likely economic impacts and justifications for what the committee is considering. It is not a case of marketing a particular agenda or anything. Our evidence just goes through what the economics would say.

There are various issues to pick out, such as due diligence not being done yet, risks, the need to broaden the tax base, other taxes, how borrowing would work and—perhaps not for this meeting but for when my co-author is around—the European consistency problem. There are also lists of recommendations, which I will say up front because I might not get there later on.

The income tax proposal in the Scotland Bill needs to be broadened to include the upper bands, savings income, thresholds and the tax base. None of those has been included and that is why most of the technical problems are coming up.

There is an issue about national insurance contributions. If the UK Government folds that into income tax, will it be part of the deal? I raise that because there is a general issue that when UK legislation changes, it impacts on Scottish revenues. How that will be dealt with is not at all clear. Then, of course, all the technical stuff about forecasting, the reconciliation process and so on is not yet clear. There is also the question of what to do about volatile revenue streams that would normally force borrowing and the financing of that.

Outside the Scotland Bill, excise taxes are one issue, and I underline their stability during recessions, which would make them suitable for funding any borrowing that might or might not have been done. The corporation tax is also a lever for growth.

Another issue in our evidence that has not been cited, and which might be important for the committee to think about, is positive spillovers from anything that Scotland does on other tax revenues, which, of course, will go straight to London. It will increase the degree to which Scotland is subsidising the UK Government, and that needs to be addressed.

Jim McColl: Could I make one more point?

The Convener: If it is a very quick one, Mr McColl.

Jim McColl: It is. I agree with Norman Springford when he says that corporation tax is not of the first importance for entrepreneurs. The level of entrepreneurial activity in Scotland is very low because the critical mass of businesses here is so low. A bigger critical mass creates entrepreneurial activity to interact with those businesses.

The Convener: Thank you for that. The evidence that we took this morning was primarily about corporation tax, but the three participants were obviously keen to be creating a good business environment in Scotland. Every one of them said that, although they were in favour of the devolution of corporation tax so that a Government would have the right to use that within its country, they also felt that that could be properly effective only as part of what they described as a basket of taxes, with all the tools in the box to give Scotland the best advantage. Do you agree with that?

Norman Springford: I will comment based on my accountancy background. The difficulty that I see is that, unless you balance your taxes, the risk of the anti-avoidance legislation and the arguments that will proliferate between HMRC and the rest of the legal and accountancy fraternities will be quite damaging. The cost of implementing any changes might well be self-defeating, in terms of revenue generated.

If one concentrates on corporation tax, the other direct and indirect taxes will have to be examined in the same way. Are we saying that we should change the level of VAT for a Scottish business? The situation becomes almost nonsensical when you start to consider the impact of taxation other than corporation tax.

Professor Hughes Hallett: I agree with that. I would be in favour of devolving a basket of taxes more widely, in the interests of broadening the base and so on. That follows on from my point about the spillovers of one tax on to another. That is probably true more in relation to corporation tax than the others, which means that it is more important in this context.

Because taxes do not have the same cycles, there are stability factors, which it would be useful to get your hands on, so that you can benefit from them. It would be useful to have those in the basket.

In passing, I point out that, for reasons of European integration—or, rather, European legislation, but also integration, I suppose—not all taxes can be devolved.

Jim McColl: I agree that it is more desirable to have a basket of taxes. With regard to the 10p variability, you need something to balance that. There would be difficulties, with people classing something as corporation tax instead of another tax, but I am sure that we could have some guidelines and rules to deal with that in the short term.

Richard Baker: What would be the optimum level of corporation tax in Scotland? What is an optimum level of corporation tax?

The Convener: Would anyone like to address that question? I assure you that it does not require a one-figure answer.

Richard Baker: No, simply a percentage; that is all.

Jim McColl: A good starting point is the Irish rate of corporation tax. Quite understandably, Ireland is fighting hard to hang on to that. If Ireland did not have the large number of businesses that have been attracted there because of the corporation tax, it would be impossible for it to fight its way out of this economic downturn. Only a few weeks ago, I read an article in a Sunday newspaper that said that Google has a £6 billion turnover in the UK and pays around £8 million in tax here. It diverts about £2 billion into Ireland and pays something like 10 or 12 times the absolute amount of tax there, because Ireland has a 12.5 per cent rate.

I believe that it has been estimated that the amount of money that we collect from corporation tax in Scotland is £2.6 billion. Halving that would take that down to £1.3 billion. In order to get that tax take up to £2.6 billion again, you would probably need to attract only three FTSE 100 or 250 companies. That is nothing. If you got 10 companies coming in, you would be way ahead. Of course, it is not an exact science.

Norman Springford: I do not agree with Jim McColl's point. My belief is that attracting companies to set up a head office structure in Scotland does not necessarily create growth in employment; it amounts to merely shifting money around. If you are asking what the level of taxation should be, my answer is that it should be set with regard to the unitary system of tax in the UK. Whatever tax rate the rest of the country is using should be the rate that Scotland uses too.

14:45

Professor Hughes Hallett: That is another point to do with forecasting: I will not give you a number, because I will certainly not make a forecast about the future.

If you put the tax rates up by a great amount, you will lose revenue. If you put them down, you may gain revenue, but after a time you will lose it again. There must be an optimal value somewhere in the middle; I am not sure whether that would be in the Irish range, or something not far from it. The important point is that if you put the tax rates down, what typically happens—because the elasticity is bigger than one—is that the revenues actually go up.

That is partly why corporate tax rates are falling worldwide, which would suggest—with deference to Norman Springford—that while the UK rate may be unitary it is not necessarily the right rate, and certainly not for Scotland.

Finding the right rate involves a complicated calculation that will depend on circumstances and exemptions, and on compliance. Our second submission contains some remarks on compliance: it goes up as the rates go down, so you get more out of it.

The interesting figure is—as Jim McColl said—the Irish case. To compare Ireland with Germany, Ireland has corporate tax rates of 12.5 per cent, from which it gets about 3 per cent of gross domestic product revenue, while Germany has corporate tax rates of around 30 per cent, from which it gets around 1 per cent of GDP. That suggests that 30 per cent is far from optimal. I do not know whether 12.5 per cent is optimal, but it is much closer to it than the German case. That has to do with all the things that I mentioned before such as elasticities, exemption and compliance, and incentives. It is perfectly possible to work out—although I will not do so this afternoon—the optimal rate within a range.

Richard Baker: That is an interesting response from Professor Hughes Hallett. The American Enterprise Institute for Public Policy Research has—as I am sure that you are aware—done some work on finding an optimal percentage for corporation tax by comparing OECD economies. It concluded that the optimal rate in the late 1980s was around 34 per cent, and that in the early 2000s, it was 26 per cent.

In *The Times* today, Peter Jones makes the fair point that the optimal rate might therefore be around 23 per cent by now, which is of course what the UK's corporation tax rate will be. After that, there is a diminishing return in terms of stimulating economic benefit, but one then has to deal with increased costs from funding cuts in corporation tax rates.

The AEI study was quite intensive and took account of economies throughout the world, so I am interested to hear your response to it.

Professor Hughes Hallett: You are right that after a time, as I said, there is a diminishing return: if you set the corporation tax low enough, you will get nothing. There is a question with regard to where the diminishing returns set in; they do not always set in at the same level in different places.

I suspect that Peter Jones and the others whom you quote are following the Springford rule: that whatever the UK does is absolutely right without question.

Richard Baker: I do not think that the American Enterprise Institute will, despite Mr Springford's qualities, necessarily be following the Springford rule on this occasion.

Professor Hughes Hallett: No, but I would possibly not spend a great deal of time talking to that institute about its econometric skills.

Richard Baker: Okay.

Professor Hughes Hallett: With great respect, your point is irrelevant, as we are discussing whether the Scottish Parliament should be able to set the rate. If it chose 23 per cent as an optimal rate, that would be fine, but at the moment it cannot do any different.

Say the UK Government decided on a rate of 20 per cent, which it might well do, and the Scottish Parliament decided that that was too low because it did not generate enough revenue for whatever programmes it had in mind. The Scottish Parliament has no right to resist that. If it were possible for the Parliament to choose the rate, it could do so. If it turned out that 23 per cent was correct, the Parliament could choose that rate. If it turns out—when I do my calculation tomorrow—that the optimal rate for Scotland is, let us say, 15 per cent, the Parliament would have the right to choose that rate.

Richard Baker: If I believe that devolving the tax rate will create tax competition, it is valid to ask what the process of devolution will lead to.

If I can cut to my third question, convener—

The Convener: I thought that that was it.

Richard Baker: No, this is it, I am afraid. Even the Scottish Government said in its paper that the perceived benefits that it argues will come from a corporation tax cut will not come for several years. In the meantime, by the Government's own estimates, a cut of 2 per cent will cost tens of millions of pounds—more than £100 million. The panellists heard the spending review announcements last week. Where in the Scottish budget should the money come from?

Professor Hughes Hallett: It is true that if corporation tax is cut it will take some time for the impact to be felt. That is probably true of many taxes. All the evidence suggests that a benefit of cutting corporation tax is increased investment, in particular foreign investment. That does not happen overnight, but just because a benefit takes a long time to emerge does not mean that it is a bad thing to have it—

Richard Baker: However, it is difficult, particularly in the context of the pressures on the budget that there currently are.

Professor Hughes Hallett: Of course things are difficult right now, but corporation tax is one of the few taxes that are likely to raise extra revenue, so if we want extra revenue to spend on various projects, that is a measure that we can use. We will not get that extra revenue from income tax, for example—all the evidence is that there is not the responsive power in that regard. That is a reason why some people around the table might argue against an income tax proposal. They would say that the approach should never be used, because there would be no benefit from it.

The tax competition issue will come up sooner or later. There is no evidence whatever of tax competition in the longer term. All the studies that have been done—the most comprehensive one, from which we have quoted, was by the OECD, which has a whole department that looks at such issues—find no evidence of tax competition whatever. Tax competition is a fear that everybody has—and one can understand why that is—but the evidence is that it is simply not there.

There are good reasons for that. A region or country will not get anything out of competition on cutting corporation tax, because it has to worry about what happens to spending on whatever Government services are offered, and it is obvious from the evidence from relevant countries, some of which are rich and some of which are less rich, that a region or country's ability to generate new activity depends on its services and infrastructure—Jim McColl said that it took him God knows how long to fly from Munich this morning, which is a case in point. If countries do not look after that side of the business, they will not attract any business at all, which is why there is no competition.

Stewart Maxwell: Richard Baker talked about the loss of income that would be experienced if corporation tax were cut and asked how, in the tight financial circumstances that we face, we would fill the black hole until the future date at which the money started to come back in—I am paraphrasing. Surely the obvious point is that the Government would not just cut the tax rate immediately; instead, it would announce that it was going to cut corporation tax not this year but in three years' time, which would give businesses the opportunity to plan for the cut. There would be no immediate, short-term loss of corporation tax, but the Government would have flagged up to the world that lower corporation tax would be coming in. Is that not how a Government would act, rather than cutting the rate immediately and suffering the consequences until business tax receipts recovered?

Jim McColl: I was going to make that point. The Government would signal a cut well ahead, which would increase the chances of attracting people who were considering inward investment, who might accelerate their activity or highlight Scotland as a potential area in which to invest. If the cut were signalled well enough ahead, there would be an increase in people looking to Scotland to base their businesses.

Joan McAlpine: I will return to what we are calling the Springford rule—the idea that it is always best to go for a unitary tax rate across the UK. We are in a recession at the moment, but a problem that people across the UK have constantly been faced with has been the economy of the south-east of England overheating. Under the Springford rule, the rate of corporation tax in the south-east of England is the same as it is in Stornoway. How can that be reconciled, given all the advantages that the south-east of England has?

Norman Springford: We have either to take a more parochial view and ask what is good for Scotland or to consider what is good for the UK as a whole. Some inequalities might arise because tax raising has different effects in different parts of the country, but the overall effect is still the same.

The cost of compliance and of the difference is an issue. When such a difference exists, other parts of the UK will say, "If they can get that rate, why can't we?" That creates a complete imbalance. A federal system might have some advantages for some things, but tax raising is not one of them.

Joan McAlpine: Are you saying that, if south-east England is booming, that is good for Stornoway?

Norman Springford: I am saying that that would be good for the UK—the whole country would benefit. I do not see the advantage of being able to manipulate our tax rates; it would not give us the growth that we look for—I do not see that growth.

I see as much danger in Scotland, Wales or another part of the UK changing its rates as there may be advantage. As Mr Baker said, a place might decide that it needs extra funding now and increase corporation tax to get that. That is the opposite of what we say that we are trying to achieve, which is greater growth from a reduced corporation tax rate.

That is where I am coming from. Compartmentalising a small area of the country would not necessarily benefit the whole country.

Joan McAlpine: If you are in favour of uniformity, are you in favour of the same corporation tax rate across the EU?

Norman Springford: No—I accept that different countries have different attitudes. If we are the United Kingdom, that is where our parochial nature applies. We are not members of the European Union in terms of taxation.

Joan McAlpine: You do not recognise the European Union as a country—not many people do. You recognise the UK as a country, but not Scotland.

Norman Springford: I recognise Scotland as a country, by all means, but it is part of a unified tax system. The UK should not be involved in the complexities of running separation of taxation.

Joan McAlpine: I will put my questions to Mr McColl, who—

The Convener: Ms McAlpine, if you paid attention, you would know that Mr McColl has been trying to speak for ages.

Joan McAlpine: Mr McColl might have anticipated my question.

You have experience of operating companies across the world and you are used to subnational systems with different corporation tax levels. What is your view on what Mr Springford says are the problems?

Jim McColl: I disagree with what Mr Springford said. Canada, the US and Spain provide examples of successful decentralised tax systems. We operate in all those countries and we have no problems with the different tax rates. In fact, the tax rate might be one consideration in picking where we go in the US.

The UK is one of the most fiscally centralised countries in the developed world. I know of no other country that is as centralised. Even in China, we receive different corporation tax treatment in different provinces. In China, we have had a five-year holiday from corporation tax, followed by two years at half rate and then the full rate. That is intended to help companies in the early stages of their business, when they need to reinvest in the business to grow it. There is absolutely no evidence to support what Mr Springford suggested. On the contrary, the evidence is that the UK's system is far too centralised.

London and the south-east is a city state. What we are discussing is a problem not just for Scotland but for the regions, too. However, we have a Scottish Parliament, which should look after the Scottish economy. To say to someone else, "How much will you give us?" and then work out how that will be spent is ridiculous.

15:00

Professor Hughes Hallett: Unitary rules? Well, as I am the academic, I can deal with that.

In passing, and given the remark about announcements, you will be amused to hear that my students in the US—I am in the US this semester—are answering a question at the moment about the effect of announcing a tax cut to come in the future. I shall see what they say—in fact, I shall grade them against what you say in your report.

On the unitary rule, the optimal currency area applies. That is to say that it is well known from all the economic analysis that different policy instruments, including corporation tax, need to be fitted to the place in which they operate. Jim McColl is right about the agglomeration effects. One reason why we find systematically not a tax competition but a level shift—with smaller places further away from "the centre" having slightly lower corporation taxes—is that they are rebalancing the competitive advantage that an agglomerated area has. The economies of scale mean that it is cheaper to operate in the agglomerated area so, by my definition, Stornoway should have a lower corporation tax to help it rebalance the giant sucking sound, to quote somebody else.

On the question of responsibilities, if this committee has a responsibility at all, it is for the Scottish economy. If Scotland had corporation tax and was able to use it to grow the Scottish economy, it would have positive effects for the rest of the UK in performance and in trade—from the spillover effects of a stronger, growing Scotland—and there would be less pressure as a consequence on the UK budget. Those are not inconsiderable benefits. Scotland is not the biggest place in the UK but, nonetheless, it is not inconsiderable.

On the evidence, I can quote from academic studies and empirical studies of what has happened. On growth, look at Ireland. On investment, look at Ireland and other places. A paper in the *American Economic Journal*—not from the American Enterprise Institute for Public Policy Research—states that the number of entrepreneurs per 1,000 and the number of company registrations are both higher in places with corporation tax freedom. Those are all things in which, unfortunately, Scotland is not performing so well at the moment.

The Spanish example gives us clear evidence of a higher gross domestic product per head—that is not growth, but a level. To refer to an earlier argument, there is a difference between growth and a level. Nonetheless, it is desirable to have a higher GDP per head and higher productivity than we would otherwise. That is what tax freedom is good for.

The Convener: Would Richard Baker and Joan McAlpine please stop squabbling in the corner?

Richard Baker: We were doing it very quietly. [*Laughter*.]

Derek Mackay: Mr Springford, compared with what the other panellists have said, you seem to be saying that uniformity and a unitary system matter more than almost anything else and that, in a sense, lack of growth or missed opportunities for Scotland might be a price worth paying for hanging on to the unitary system. Would that not mean that we lose a competitive edge? That is especially the case given that we will not have a unitary system in the UK if the power is devolved to Northern Ireland. Would that not put Scotland at an immediate disadvantage if the powers were not devolved to this Parliament?

Norman Springford: I certainly do not accept the conclusion that the protection of the unitary system is worth any price. I am saying that the disadvantages that a difference in system would make to us, in cost of compliance and the complexities of how the figures would be manipulated and accounted for in the UK, mean that a level of complexity would be built in that would override the benefits that would derive from a reduced level of corporation tax. Furthermore, we are assuming that we are talking about a reduced level of corporation tax—subsequent politicians may say that they would like to raise it. I still say that I would like to see a unitary system and other methods of growth rather than corporation tax being used as a driver for growth.

Derek Mackay: My second question was what happens if there is no unitary tax. If Northern Ireland has the power and chooses to use it, would we not be at a disadvantage? Would that not be a risk to Scotland?

Norman Springford: Yes, it is a risk. That is the end of the argument on that one, as I agree with you.

Derek Mackay: If Northern Ireland gets the power, you would concede that Scotland should probably have that power too.

Norman Springford: Yes, I believe so.

Derek Mackay: Thank you.

Alison Johnstone: I thank the panel for coming. Mr McColl, I have read in the press that you do not pay full income tax in the UK but choose to do so in Monaco. Is that the case?

Jim McColl: That is the case. I am a resident there, but I pay income tax in the UK and I also pay tax in Monaco, which has a different tax system. The system there is indirect instead of direct, which is quite a good system. If you look at the wealth created here by me and my team, it puts into insignificance anything that I might pay if I was a full-time resident here.

Alison Johnstone: It is your view that we should, with a devolved corporation tax, look to lower the tax rate so that your companies would pay less tax.

Jim McColl: I am not fussed about my companies. I am looking at the Scottish economy and at increasing the population of businesses here. It is clear that we do not have a big enough business population. That is what generates the wealth; it is private enterprise that generates wealth. You should do everything that you can to stimulate the growth of private enterprise, because that is what will pay for the social progress that we need in Scotland.

We have kept companies here. For example, a company that I saved from closure in 2007, when 535 people were going to be paid off, is now, four years later, a headquarters with 891 people working there. We chose to keep the company here because of our commitment to Scotland, not because of corporation tax. I am looking to find a way to attract people from outside the UK who are looking to come in. I could easily have located that company elsewhere or increased the number of jobs elsewhere at a big advantage to our company, but we have chosen not to do that. It would be wrong to assume that everybody in business is just out to maximise their own wealth against anybody else’s. People have corporate social responsibility.

Alison Johnstone: Indeed. Thank you.

Do the panellists have any concerns about corporate tax avoidance as a result of lowering corporation tax in Scotland? The Institute of Chartered Accountants of Scotland has raised concerns about profit shifting. Ben Thomson, the chair of Reform Scotland, who was before us this morning, pointed out that companies can choose to take their tax in the lowest tax environment. ICAS also said:

> “The application of anti-avoidance provisions relating to profit shifting would have to be widened to deal with this”.

Do additional safeguards need to be put in place to prevent corporations from relocating to regions with lower tax? If so, what might those safeguards be?

Professor Hughes Hallett: One observation is that, obviously, tax avoidance is likely to be lower the lower the corporation tax rate is, so I would not have thought that that would be a great problem.

Many people are concerned about profit shifting—the brass-plaque syndrome. Other countries face the problem and are worried about it. A paragraph in my submission describes a way of dealing with the issue that is stolen from what the Americans do.

How much corporation tax a particular corporation pays is a function of how much profit it makes, but if the proportion that it pays in this jurisdiction vis-à-vis the one next door is in proportion to its employment in each, that gets round the problem of profit shifting altogether. There is no reason for firms to shift their profits if the only way they will get the lower rate is by employing people, so it is about activity levels. The US states face this issue all the time and they have all kinds of complicated rules, which for one reason or another they think are useful. The version that is outlined in my submission is a simple version of such a system; it gets round the complexity problem.

If you were to assess corporation tax in that way, the firms would not have to keep two sets of accounts or two sets of records and they would not have to supply any more information than they supply already through national insurance contributions. We can tell how many people are working here and how many people are working, for the sake of argument, in London, and we can divvy corporation tax up in proportion. The computer does it in a nanosecond.

The Convener: It is a wonderful theory that computers do these things in a nanosecond.

Professor Hughes Hallett: You have to remember to switch them on.

The Convener: I remind everyone that they do not have to press the button on their console to switch their microphone on—they come on automatically. Mr McColl, did you want to comment?

Jim McColl: Yes. I think the opposite is true. As Andrew Hughes Hallett said, anti-avoidance legislation is needed more if the corporation tax rate is higher, because companies will look for a way to reduce it, and they will find a way. However, if the rate is lower, doing that is not worth the effort, so companies will just pay it.

Norman Springford: The main plank of my argument is probably about the level of anti-avoidance. It is true to say that, in times of high taxation, the black economy is much bigger than it is in times of low taxation. The argument here is not necessarily about how low the corporation tax is; it is about the differential between the two levels of corporation tax. If the rate was as low as 10 per cent in Scotland but was 15 or 20 per cent in the rest of the UK, there would be serious anti-avoidance, because the differential is greater. To my mind, it is not a case of saying, "Let's try and put in a few rules." That is the game that HMRC and the rest of the professionals play day in, day out. Companies will look for a loophole; they will exploit it; HMRC will close that loophole; and on it goes. Anti-avoidance legislation creates a whole new industry; there will be even more opportunities for that if we have a differential rate.

John Mason: We have talked mainly about rates of corporation tax so far, but there is a suggestion that, if we had control of corporation tax, we could target small businesses, which I think we have fewer of than other places do—we need new ones—and we could target particular industries that are perhaps more important to us, such as the games industry. Does any of you see scope in that area, leaving aside the headline rate of corporation tax?

Jim McColl: Yes. I think that it is accepted now that, in the past, the UK economy has focused too much on banking and housing, or property, and that we really need to get manufacturing industry going again. I think that having control of corporation tax would perhaps give you the opportunity to give particular incentives to help to grow manufacturing and attract new manufacturing companies into Scotland.

Professor Hughes Hallett: Yes. [*Interruption*.] Sorry, it is a knee-jerk reaction to try to switch on the microphone. If you look at the experience in other countries, you see that they nearly always have different rates for small businesses and big businesses or different conditions attached to the rates. Spain has used corporation tax in its different provinces quite a lot, where there are different rates. In the Basque Country, for example, which is the one that I happen to know about for various reasons, the rates are lower for small businesses, which are defined at a certain level—you obviously need to worry about the definition of small businesses. The amount by which the corporation tax rate can differ from the Spanish average varies for small businesses, so small businesses have some advantages there.

You might well want to target a particular industry. There is a slight sore point there. You could argue that you have a set of policies that would help high-value-added and high-productivity businesses to be founded and grow up in Scotland, but then you realise that you have very little in the way of levers to help that to happen and you have to do something on the cost side to make it attractive, because such businesses can go to Latvia, too. Corporation tax is one lever for doing that; there are other things that you could think of. One in particular that you might be interested in, which I think is a bone of contention in other debates, is to favour companies that do a lot of R and D with R and D credits. You could control that to some extent. You could do a range of things, all of which I think would be helpful. By definition, if they were not helpful, you would not do them.

Norman Springford: We are now getting near the nitty-gritty of where it becomes useful to have this devolved power. I very much agree with the other two members of the panel. If you have a level of corporation tax that applies under the unitary system, the power of the devolved corporation tax rates could be applied to the smaller businesses. If we are looking for growth in SMEs, let us give them the incentives. As Jim McColl said, let us give businesses a five-year tax holiday until they reach a certain number of employees or a certain level of profitability. The power should be used to create growth among SMEs, because that is where growth will come from. By all means attract inward investment, but growth in Scotland will come from the smaller entrepreneur. Let us use the Scottish Government's power to produce a nil rate, a low rate or an escalating rate—whatever method is best. That is how we could create some genuine growth.

15:15

John Mason: Would you be happy for things to be slightly different in Scotland from the rest of the UK?

Norman Springford: Yes. It is almost falling within my original argument to say that we should try to retain a unitary rate but should use the powers that we have to incentivise locally—if we can refer to Scotland as a local community—and to try to create growth ourselves and get a competitive advantage. That has to be done through the smaller businesses.

The Convener: I am keen not to misunderstand. Are you saying that it would be good for Scotland to have the devolved power as long as it was used wisely? For you, using the power wisely would involve targeting SMEs.

Norman Springford: Yes. Clearly, politicians have different views and it is their views that count. However, if I were a politician, I would say that we should keep the main level of corporation tax for the larger companies—they generate the bulk of the revenue in any event—but give incentives to SMEs. That is not a particularly expensive option, because they are not paying all that much in corporation tax anyway, in relation to the big guys. However, doing that will create a level of growth.

Jim McColl: A total of 97 per cent of companies in Scotland are SMEs, and there are three key ways of stimulating growth in them. One is to halve the corporation tax rate. That would allow SMEs to accommodate the additional costs of being located in Scotland. For a small company, it is relatively very expensive to consider international markets, which is where the room for growth is. By definition, an SME has a small percentage of the available market. The economic climate does not matter. It does not matter if the economy halves; SMEs will still have fantastic opportunities to grow, because they start with such a small share of the market. They have to get out there and engage in markets outwith their home market, but they often cannot afford to. Secondly, therefore, we need to find a way of supporting them, and a third angle of approach is from the banking side. Debt finance is tough for SMEs, so some sort of industry bank would be helpful.

Corporation tax would give a lever to help small companies—along with some support from Scottish Enterprise on exploiting international markets.

The Convener: Before Mr Rennie asks a question, I ask everyone to wish him a happy birthday. [*Laughter*.]

John Mason: How old is he?

Willie Rennie: I have even brought some fudge.

The Convener: I am not that soft—we will have to wait for that until we finish the meeting.

Willie Rennie: Professor Hughes Hallett, you have kindly provided us with a formula that I have not seen since I was studying—which was a few years ago. You call it “simple”, although it is not very simple to me. Maybe I am just a simple politician. How many other academics or tax accountants would share your view that the process is simple and easy to calculate?

Professor Hughes Hallett: You have switched questions: you started on the formula and you are now on the process. They are two different things.

The formula is simple and you do not even have to worry about it. As I say, it is in the computer. If you think that it is complex, I wish you luck when you try to work out how the Treasury will produce its forecasts for the income tax component. Unfortunately, as things stand, you will not get to look at that and neither will I—nor will anybody in Scotland. We will be presented with a number and we can like it or not like it. One of the things that the Treasury needs to do is to bring it out into the open. At least this formula is out in the open.

On the process, I am not entirely sure what you are referring to, but I assume that you mean the one on corporation tax.

Willie Rennie: Yes, that is what we are talking about.

Professor Hughes Hallett: All it does is work out the proportion of profits that you allocate to the Scottish tax as opposed to the rest of the UK tax. It is no more complicated than proportions. There are two elements: employment in Scotland versus employment in the rest of the UK. I think that it is reasonably clear.

Willie Rennie: Is this widely shared?

Professor Hughes Hallett: What do you mean?

Willie Rennie: Do people agree with you that it should be the process?

Professor Hughes Hallett: Fifty US states agree with me, which is a good starting point. They actually have something more complicated, which the accountants—not the academics—dream up. From their point of view, the formula is simple because the alternatives are much more complicated.

Willie Rennie: The corporation tax rates have fluctuated quite substantially, even just in recent years. How do you estimate how the Scottish block, as derived from the Barnett formula, should change from year to year? How would you make the calculation?

Professor Hughes Hallett: If I had a free hand, I would not make it at all because I would not have the grant.

The question touches on other aspects of the problem when you refer to fluctuations—the volatility in the revenue coming from the different sources. The highest volatility comes from the grant, not income tax. Based on GERS calculations, the second highest is North Sea revenues, the third highest is income tax, and the fourth highest is corporation tax. I stopped after the fourth because I got bored with the calculations. Corporation tax is the most stable.

Going further down the track leads to smaller taxes that are more stable, such as excise taxes, which is interesting from a different perspective. If you want stability, you want excise taxes, whose revenue increased during the recession. If you want a secure income stream, for example to ensure that you have the adequate resources to pay on any borrowing, excise taxes—and particularly sin taxes—are the ones to go for. Correspondingly, my guess is that taxes on pollution would also be fairly stable, though probably not quite as stable. If you view these matters in terms of volatility versus stability, you get quite a different ordering of the taxes that you would want to be able to use. Corporation tax is relatively good, the reason being that it is not that large and if it fluctuates, in terms of pounds rather than in proportional terms, it will make a smaller hole in the budget.

Willie Rennie: We do not have fiscal autonomy on the table; we are discussing corporation tax in isolation. What would you say the reduction in the Scottish block should be in order to accommodate fluctuations?

Professor Hughes Hallett: If I had to do it that way, I would have to use some form of forecasting because I would have to know, ex ante, how much I was taking off the grant before I gave you the grant. There is no getting away from forecasting. I would find out the best forecasting formula, which I promise you is more complicated. From the one thing I have read on the UK Government's response, it seems that it has no idea on forecasting. I therefore do not know the UK Government's view on forecasting, but that is my view.

The reconciliation must be factored in. As all forecasts—like weather forecasts—are by definition somewhat in error all the time, it would pay to have frequent reconciliations rather than waiting three or four years, as is proposed in the case of income tax. Each time new numbers came in on actual revenue, you could reconcile it with the forecast and make adjustments accordingly, at much more frequent intervals. Other than using borrowing, I do not see any way of operating with a mixed scheme of devolved tax plus a grant.

If you use borrowing, the problem goes away. Every time you make a mistake or the forecast goes the wrong way, you can borrow; then, when things are more favourable, you can pay back a bit. However, that is not allowed under the current Scotland Bill.

Willie Rennie: So what is the number? You have given us a long explanation but, given the consequences, we could do with a number. We have heard criticism of the UK Government for what you have called its failure to provide forecasts or indicate what the impact might be. However, you are doing exactly the same now—you are not giving us the figures. If you are seriously putting forward the proposition, we need to know the figures.

Professor Hughes Hallett: If you have corporation tax, the conventional way of doing it is to take twice the standard error. In the written evidence, I have set out the standard error for corporation tax as £377 million. That means that you would need about £700 million.

Willie Rennie: So £700 million.

Professor Hughes Hallett: About £700 million.

Willie Rennie: The figures estimate the corporation tax take for Scotland at £2.6 billion. You are saying that there would be a £700 million reduction in the block.

Professor Hughes Hallett: That is the cushion that you would need. On the other hand, the standard error for an income tax would be around £4 billion, which means that you would need £8 billion. Which would you rather have?

Willie Rennie: For Scotland to get the corporation tax, surely the block will have to be reduced.

Professor Hughes Hallett: But you have switched again. You were talking about volatility a minute ago.

Willie Rennie: I have been consistent throughout. I want to know what the reduction in the block would be.

Professor Hughes Hallett: On average, it would be whatever the corporation tax is now.

Willie Rennie: Okay. Would you take into account any changes in the corporation tax in the UK, say, or companies shifting profits?

Professor Hughes Hallett: Why would I do that?

Willie Rennie: Because the UK gives a block grant to Scotland, so—

Professor Hughes Hallett: Compensating the UK for being disadvantaged is not part of the philosophy behind the Scotland Bill.

Willie Rennie: But obviously any profit shifting in the UK would impact on the UK's finances.

Professor Hughes Hallett: Indeed.

Willie Rennie: Should that not be taken into account?

Professor Hughes Hallett: It is for the UK to take that into account, not the Scottish Parliament.

Willie Rennie: So Scotland gets all the take but none of the give.

Professor Hughes Hallett: Which is exactly what happens with the current income tax arrangements.

Willie Rennie: But there are compensatory elements in the income tax arrangements.

Professor Hughes Hallett: There are.

Willie Rennie: That is the whole point. That is what I am trying to work out.

Professor Hughes Hallett: Well, that is precisely the problem. In the last UK budget, the lower income tax threshold was raised. Had the Scottish income tax been in operation, such a move would have lowered the revenues coming into Scotland. In England—I am sorry; I should say the rest of the UK, although I pretty much mean England—compensation comes through the raising of national insurance contributions and capital gains tax. In Scotland, those two taxes cannot be raised to compensate in that way. The London Parliament has not thought for a moment that it might have to compensate; of course, it has now been told to work out some way of doing that but when you ask the secretary of state he says, "I don't recognise that number" or "Calm down, dear. It'll be all right. We'll think of something". We do not have a clue.

Willie Rennie: That is rather insulting to the secretary of state. He is actually working—[*Interruption*.]

The Convener: Hold on. Mr Rennie, your job is not to put Professor Hughes Hallett on the spot over something that the UK Government is responsible for and about which it said it would provide a model and forecasting.

Willie Rennie: It was a rather silly criticism of the secretary of state—

Stewart Maxwell: No, it wasn't.

Willie Rennie: I am sorry to disagree about this but—

The Convener: I think that we will have to agree to differ but I will not have our witnesses harangued—even if it is your birthday. [*Laughter*.]

Willie Rennie: I am not haranguing anyone. Still, I will make one more attempt. Even though there could be profit shifting in the UK and even though the UK Government is considering similar measures for the other taxes that it is looking to devolve, you still do not think that there should be any compensatory arrangements.

Professor Hughes Hallett: That is correct. Indeed, the same holds true for all of these taxes. It is up to the responsible Parliament to put in place the responsible compensation arrangements. It is perfectly open to the UK Parliament to find another tax to substitute, to change the arrangements of a particular tax or, indeed, to do anything else. It could even ignore it. It is a free choice—and vice versa. Given that the spirit of the Scotland Bill is such that these arrangements are not built in for income tax, why build them into corporation tax once the initial calculation has been done?

Willie Rennie: Okay. I am finished.

The Convener: Did you wish to come in, Mr McColl?

15:30

Jim McColl: What we are trying to do with the measure is to compensate Scotland for its disadvantages. If you compensated the UK Government for the people that moved business to Scotland, all that you would be doing is re-establishing the disadvantage. What we want is for the people who locate in London or the south-east to move here. They go naturally to those areas because things are much easier: there is more of a critical mass, the cost of doing business is less, and it is easy to get to every country in the world. If I want to go anywhere from Scotland, I have to add in extra days, it takes longer, and it is more expensive. I need compensation for that. I cannot see how a reduction in corporation tax would provide that compensation if the UK Government simply said that we have to give money back to compensate it.

The Convener: I think that we have to conclude this discussion because we are running out of time and Mr Ingram still has to ask his question. The no-detriment issue has been discussed at great length and can be raised later with the Treasury minister and again with the secretary of state when he returns.

Adam Ingram: I have a brief question for each of our panellists.

Mr Springford, do you approve of the tax powers in the Scotland Bill, bearing in mind the potential for different income tax across the UK?

Mr McColl, you described your experience of different corporation tax rates both throughout Europe and in relation to your worldwide business interests. I presume that you also have experience of various tax authorities in the world. How would you rate HMRC and would Scotland benefit from a fresh start, as it were, with a basket of taxes governed by a new authority?

Professor Hughes Hallett, as a former professor at the University of Strathclyde, you will have noticed that the Scottish Government used the Strathclyde model to describe how a reduction in corporation tax might impact on economic growth. The model suggests that there is an inverse relationship—in other words, if you reduce the tax rate, you will increase economic growth. Is that analysis robust?

The Convener: Was your first question for Mr Springford?

Adam Ingram: Yes.

Norman Springford: If it was, I have probably forgotten it by now.

I think that you asked whether I approved of the powers in the bill to change tax, whether it be income tax, corporation tax or whatever. My answer is still no—I prefer the UK's unitary system of taxation. However, if those powers are to be devolved, I would like corporation tax and income tax rates to be maintained at broadly the same level as the rest of the UK, although I would also like the kind of flexibility that was being discussed just a moment ago to give incentives for growth to smaller SMEs. I say smaller SMEs, given Jim McColl's comment that most businesses in Scotland are SMEs. We need to use the power wisely to create growth.

Jim McColl: HMRC has one of the most complicated tax systems. Given the volumes of things that you have to go through, it is a nightmare. Giving Scotland all its own tax-raising powers would create a fabulous opportunity to do everything in a more cost-effective way; after all, you should see the number of people who are employed by HMRC to collect the money.

I can give you an example of how bureaucratic and difficult the system is. One of our companies applied for an R and D tax credit, which we were assured we would get. Here, you have to claim such credits from the tax people, who are not known for giving out money and who, in the end, said that we did not qualify for them. Out of principle, I employed PWC to fight our case. We won it, but the money I got for the tax credit was less than the amount that I had to pay PWC to fight the cause. There were all these complicated tax rules that I could not go through myself and which I had to get in some outside body to help me with. The system itself is too complicated.

Professor Hughes Hallett: Are the Strathclyde results robust? Of course they are. Where else would you go?

From the evidence, it appears that, in all instances where corporation tax has been lowered, there has been some effect on growth. Perhaps, though, I should be more careful with my words. In the long term, what it really does is raise GDP per head; it does not necessarily result in a permanent increase in the rate of growth. That said, if you get richer, you must also have grown along the way.

The analysis is robust in the sense that all the other evidence suggests the same thing. The *American Economic Journal* paper that I cited, which looked at what I consider to be the right comparator group—the 22 OECD countries—shows as much. It also shows that investment increases and, of course, increased investment enables growth to happen a bit later on. Many other studies show the same.

In the submission, I have included a quick calculation that shows that the studies come to roughly the same number. The period under consideration might vary—I believe that the Strathclyde study was over 20 years—but it is clear that, if you cut down to get the proportional effects over a shorter time period, you seem to come to the same figure, which is around an extra 1 per cent growth in GDP per head after five to 10 years. It might not be the biggest number in the world but you would certainly feel it if you did not have it. Indeed, it is amazing how it adds up when you project it forward over a number of years.

I have not seen the details, but as far as I know the Strathclyde calculations were for corporation tax, which is only one tax in the basket. Of course that brings us back to our very first discussion about whether it would be better to have a basket of taxes. The answer is yes, but corporation tax is probably the most responsive and useful tax in that basket for generating the necessary results. As I have said, the results are pretty robust.

The Convener: I thank our three witnesses for their evidence and members for their questions. We have had a robust but, I think, respectful evidence session.

I suspend briefly for a changeover of panels.

15:36

Meeting suspended.

15:42

On resuming—

United Kingdom Minister

The Convener: I am happy to chair this session taking evidence from a UK minister. I welcome David Gauke MP, Exchequer Secretary to the Treasury. With him is Paul Doyle, who is deputy director of the devolved countries unit. Thank you for coming—we are very pleased to have you here.

Would you like to make some opening remarks?

Mr David Gauke MP (Exchequer Secretary to the Treasury): Thank you for the opportunity to contribute today to the debate on devolution in Scotland and the Scotland Bill in particular. I have worked closely with my colleagues in the Scotland Office on developing the financial proposals in the Scotland Bill, which I believe substantially increase the powers and accountability of the Scottish Parliament.

The proposals represent many years of detailed work and analysis from the Calman commission, the work of the current Government in introducing the bill and the publication of the detailed command paper, "Strengthening Scotland's Future". The proposals continue to be considered by two Parliaments. They have been scrutinised here by this committee and its predecessor, and in Westminster by the Scottish Affairs Committee and during debates in the House of Commons and House of Lords.

Industry has also had a say on the operation of the proposals through the high-level implementation group, chaired jointly by the Secretary of State for Scotland and me, as well as through a number of detailed HMRC-led working groups.

The committee will be aware that the joint exchequer committee met for the first time earlier today to discuss a wide range of issues, including the implementation of the proposals. I am pleased to report that the first meeting was successful and productive.

I am aware that the Scottish Government has further proposals for devolution and has presented some papers. We are in the process of asking follow-up questions on those. However, I am sure that we are all of the view that such significant changes need to be considered in detail, over an adequate period of time, and with the engagement of a wide range of stakeholders, as has been the case for the policies that are contained in the Scotland Bill.

If I cannot answer any question today, I am happy to follow up by whatever suitable means to provide the committee with the information, but I will of course try to answer as many questions as possible now.

15:45

The Convener: Thank you very much. I will open the question session. I noted that you said that the committee would be aware that you were meeting the Scottish Government today, but we became aware of that only because we saw it in a press release. It happens, but it would have been—

Mr Gauke: I am surprised that that information was not shared with the committee. The point is duly noted. I am sure that it has been duly noted by the Scottish Government as well.

The Convener: To those who are muttering from the sidelines, I say that I make the same criticism of the Scottish Government.

In that particular press release—and I raised this point with the Secretary of State for Scotland when he was here a few weeks ago—I noticed the phrase

"previously endorsed by the Scottish Parliament"

being used about the recommendations of the Calman commission. However, that endorsement was heavily caveated with the need for a second legislative consent motion to be fully discussed and brought back to Parliament for consideration of amendments. Again, I ask you to bear it in mind that the Parliament did not endorse what was in the Calman report.

Mr Gauke: I take your comments on board. It would be fair to say that the Scotland Bill Committee in the previous session of Parliament was supportive of the direction that the Scotland Bill was taking and thought that it was a substantial step in the right direction. We have certainly listened carefully to the comments that were made by that committee and have taken up a number of its recommendations. However, we are keen to make progress in a consensual way, and I look forward to this committee's questions.

The Convener: Good. I am glad to hear it.

How did the meeting go?

Mr Gauke: I am sure that the Scottish Government will release its points. The discussion was confidential, but I can say that the key output of the meeting was that we made progress on the high-level principles for the adjustment to the block grant. I am pleased that we made progress on that. The co-operation between the UK Government and the Scottish Government on that specific point is important to ensuring that we get the block grant right as income tax powers are devolved.

The Convener: On a point of information, do both Governments intend to share some of the findings of that meeting? If so, when will that be?

Mr Gauke: It would be discourteous for us not to be as open as possible with both Parliaments. I am sure that the Scottish Government will take the same approach. The intention is not to produce a formal communiqué from this morning's meeting, but that will be the intention for future meetings of the joint exchequer committee. It was a useful forum for us to discuss the key issues, and I hope that it will be useful in future as we discuss the implementation matters that need to be addressed.

James Kelly: Good afternoon and welcome to the committee. What is the Treasury's understanding of how the income tax proposals in the bill would impact on future Scottish budgets?

Mr Gauke: Our policy intention is that the income tax powers and the adjustments to the block grant will essentially be revenue neutral, and that has been agreed by the UK and Scottish Governments. The intention is not for there to be a systematic flow in one direction or the other. Clearly, there are matters that we need to address. We agreed the high-level block grant principles, but it is a process of the Office for Budget Responsibility making predictions, gaining an understanding of what effect devolution of income tax as proposed would have on the Scottish exchequer, and then ensuring that adjustments are made to prevent unnecessary flows. There is uncertainty and a degree of unpredictability, but we want to eliminate that as much as possible so that there is no impact on the Scottish Government.

James Kelly: You say that the system will be revenue neutral. How will the no-detriment principle work to achieve revenue neutrality?

Mr Gauke: Revenue neutrality is the objective. We have set out our assessment that, if we had applied the system historically, in some years there would have been a net benefit to Scotland and in other years a net cost. I know that the issue has been debated many times in this committee and outside it. Working with HMRC and the OBR, we will try to find the mechanism that gets us close to revenue neutrality as consistently as possible. That is part of the work that needs to be done in the months and years ahead.

James Kelly: In the early years of the process, in years in which there is no benefit, you would take steps to ensure that any shortfall is made up to achieve revenue neutrality.

Mr Gauke: We want to ensure that the system is not in any way systematically biased for or against one Government. We will have the transitional years, during which the methodology can be refined and improved so that we can be as accurate as possible. That is not a guarantee that, in any one year, there will not be a cost or a benefit, or that the next year will necessarily act to counterbalance that. The attempt is to find a system that, over time, will be neutral.

Stewart Maxwell: I took great interest in the statement in your opening comments that you and your officials spent an enormous amount of time and effort working through the financial proposals in the bill. What evidence did you consider for choosing the 10p tax rate?

Mr Gauke: The 10p tax rate was based on the Calman commission recommendations. We see that as a substantial increase in accountability for the Scottish Government. We have to choose a level somewhere. The 10p level is clear and simple and, as I say, was recommended by the Calman commission.

Stewart Maxwell: It is very trusting of you to accept the Calman commission recommendation on that point, although you did not on many others. I return to the original question: why 10p and why not 12p or 8p or any other figure? What work did the UK Government do that brought you to the conclusion that 10p is the correct rate?

Mr Gauke: As I say, the parties that were involved in the establishment of the Calman commission enabled it to produce recommendations. There is no particular reason or strong argument for moving from the Calman commission proposal. The 10p rate is simple and straightforward and one that people can understand. It would be more difficult to say why we should move from 10p to 8p, 12p or 13p. The Calman commission recommended 10p, which seems to strike the right balance. It is half the standard rate of income tax. For standard rate income taxpayers, something that is half of their marginal rate is significant and straightforward to understand.

Stewart Maxwell: I am sorry to stay on this point, but I am still trying to discover what work the Treasury did to convince itself that 10p was the correct rate to choose.

I have the *Official Report* of Sir Kenneth Calman's evidence. I asked him the same question, as I am sure you are aware, and he confirmed that the commission had no deep or solid evidential reason for choosing 10p; it just chose that rate because it seemed like a reasonable amount. That does not seem like a good reason for changing the Scottish Parliament's funding arrangements, so I assumed that the Treasury would do detailed work to decide whether to agree with the Calman commission that 10p was the correct rate. I still do not hear an answer to that question.

Mr Gauke: I am not persuaded by the argument that the fact that something is a reasonable amount should be discounted. It is a perfectly sensible point and I am not sure what body of work would result in the conclusion that there is something magical about another number—that it should be 8p or 12p. As I said, 10p is half the standard rate of income tax. It is a clear, straightforward number and I am not sure what economic argument you think exists that would take us to another number.

Stewart Maxwell: Let us be straight: I do not propose that the 10p rate is a good idea. It came not from us but from the Calman commission, and Sir Kenneth Calman said that there was no evidence for choosing that rate. I would have thought that the Treasury might look into it to determine whether it was the right rate, but you seem to confirm that neither the Treasury nor the Calman commission had any particular reason for choosing 10p over any other figure.

Mr Gauke: We considered the implications of the 10p rate for budgeting, for example. There was no particular reason why it should not be 10p. A huge amount of work has been done on a range of issues, but 10p is a clear point. Remember that the context for this is trying to increase the level of accountability for the Scottish Government, so a straightforward number clearly has advantages over a complicated one. Can you come up with something that is more straightforward than 10p?

Stewart Maxwell: What do you mean by a complicated number? Is 9p any more complicated than 10p?

Mr Gauke: The 10p rate is more understandable for the Scottish public because half of their basic rate will go to the Scottish Government and half will go to the UK Government.

Stewart Maxwell: If, as you said, it is about giving responsibility to the Scottish Government and the Scottish Parliament, why not 20p rather than 10p? We would be twice as responsible if it was 20p.

Mr Gauke: It is a question of striking the right balance. The 10p rate is a significant step in providing greater accountability to the Scottish Government and devolving tax powers. It is a major constitutional and fiscal change. I am not surprised that some people want all of it and will come back for more, but it is a substantial change and I hope that the committee welcomes it.

Derek Mackay: On income tax, I am still none the wiser on the compensatory measure that you described other than that you are saying, “Trust us, we will work it out.” We need a bit more reassurance than that, if I can be so bold.

Many of the witnesses from whom we heard earlier today said that it was better to have whole tax powers rather than part of a tax. The idea that the 10p rate has been plucked out of the air is of some concern.

I will ask about the revenue compensation that Mr Kelly identified. The volatile nature of income tax means that it can stagnate over time. However, the OBR suggests that corporation tax might grow by as much as 40 per cent, so why devolve income tax but not corporation tax?

Will you further explain the stratification—

The Convener: Derek, can you ask one question at a time, please?

16:00

Mr Gauke: Let me deal with the point about volatility. It really is the other way round. Corporation tax, which I am sure we will talk about in greater depth later, is undeniably a volatile tax. Much of the difficulty that we see in public finances in the UK is because of the volatility of corporation tax in addition to the high level of borrowing before the recession. There is no denying that corporation tax is much more volatile than income tax. Of course, income tax drops in bad years but nowhere near as much as corporation tax. Therefore, one argument for devolving income tax rather than corporation tax is its lack of volatility.

Derek Mackay: I want to ask specifically about the revenue compensation, picking up your point about the patterns of income tax. Overall, the share of public spend from income tax has changed, and we would be at an immediate and annual disadvantage if the Parliament relied only on income tax as opposed to having a basket of taxes and a range of economic tools that we could use. We would be too heavily reliant on income tax, which, as a share of public sector spend, has been going down.

Mr Gauke: If more taxes are devolved and a greater share of the Scottish Government’s revenue comes from taxation as opposed to the block grant, the volatility risks will increase. Having a spread of taxes does not compensate for the fact that the more reliant the Scottish Government is on tax as opposed to block grant, the greater the volatility will be. The decision for the Scottish Government and the Scottish Parliament is whether that is welcome. I stress the point that income tax is not particularly volatile and is less volatile than other taxes.

We are working closely with the Scottish Government on the adjustment to the block grant. This morning, we had a constructive meeting of the joint exchequer committee, which addressed that point. We have reached agreement on the high-level principles, although there is more work to be done on the details, and I hope that we can continue to work constructively with the Scottish Government on that issue. There is an acceptance on all sides that nobody is trying to put one over on the other. We want to reach a position where the adjustment to the block grant accurately reflects the income tax position.

Derek Mackay: Can I ask about the stratification within the 10p rate?

The Convener: Yes, but make it your final question, please.

Derek Mackay: Okay. It is quite important. Bearing in mind that the 10p figure is just something that somebody liked, can you explain the rationale for a figure that is 50 per cent of the basic rate, 25 per cent of the higher rate and 20 per cent of the top rate? Where has that logic come from?

Mr Gauke: It is 10p across the piece. As I say, it has the advantage of simplicity—it is clear and easily understood—so it will contribute to increasing the accountability of the Scottish Government for the decisions that it makes as far as tax and spend are concerned. I hope that that is welcomed.

Derek Mackay: That does not explain the variation in rates.

Mr Gauke: Well, it is 10p in the pound. That is a fairly simple way of doing it. The fact that it is a flat rate across the income distribution does not take anything away from the fact that it is a simple, straightforward measure that will, I hope, be readily understood.

Adam Ingram: Can I pick up on that point?

The Convener: Very quickly, please, because I think that Mr Rennie wants to come in.

Adam Ingram: The argument is that, as the economy grows—as we hope it will do over coming years—the UK will benefit. You say that the 10p rate amounts to half the standard rate, but economic growth will mean that more people are pushed on to the upper rates, and the Westminster Treasury's share of the revenue from those upper rates will be substantially more than the Scottish Government's. Where is the rationale there? If, as you said, we are sharing the tax rate between us, why should the UK Treasury benefit more than the Scottish Government?

Mr Gauke: We anticipate that the higher rate threshold will continue to rise, as it has done. There are provisions under the Rooker-Wise amendment whereby it does so automatically—it rises in line with the consumer prices index. It is the case that, in Scotland, a higher percentage of taxpayers pay the standard rate as opposed to the higher rates than is the case elsewhere in the UK but, for everyone, the proposed rate will be half their standard rate. The intention behind what we are doing is to ensure that Scotland does not lose out.

Adam Ingram: Some might say that it might contribute to the deflationary bias that is inherent—

The Convener: I think that the agreement was that you would get to ask one little question.

Adam Ingram: Okay. Perhaps someone could pick up on that.

The Convener: I will exercise the convener's privilege. When Sir Kenneth Calman gave evidence in the session that Mr Maxwell referred to, he said—I am paraphrasing, as I do not have his words in front of me—that he regarded the work of his commission as a starting point. When he was asked about the 10p rate, he said that he envisaged that such things would be looked at much more closely before it came to legislation. It seems to me that your Government attaches great weight to the Calman commission report—you admitted that to Mr Maxwell—but given that the lead author of that report said that the members of the commission viewed its proposal as a starting point for discussion rather than something to be included in legislation, would you take that on board, even at this stage?

Mr Gauke: I am not sure that we have seen persuasive arguments to move away from the Calman commission recommendations. I do not want to repeat myself, but I think that what is proposed in the Scotland Bill represents a highly significant change. It represents a big increase in responsibility for the Scottish Government, which will increase the Scottish Government's accountability to the Scottish people. The simplicity and straightforwardness of the commission's proposals are commendable, given that taxes can be far more complicated than people would like.

The Convener: We had some very interesting discussions this morning about the potential for simplifying the tax system.

Joan McAlpine: You made the observation that the block grant is based on a spread of taxes.

Mr Gauke: The block grant is calculated based on spending, but clearly the Exchequer—

Joan McAlpine: Is not it the case that the revenue comes from all UK taxes?

Mr Gauke: Yes.

Joan McAlpine: You mentioned that the spread of taxes is more volatile.

Mr Gauke: My point was that the greater the share of the Scottish Government's income that comes from taxation as opposed to the block grant, the more volatile its income will be.

Joan McAlpine: As I understand it, the proposal will involve you taking away some of the block grant, which is based on a basket of taxes, and replacing it with revenue from one tax—income tax. All the calculations show that the revenue from income tax grows more slowly than the revenue from other taxes. For example, the International Monetary Fund showed that since 1965 in the UK, the revenue from income tax has grown at 0.9 per cent, whereas the revenue from all taxes has grown at 6.5 per cent. The reason is that some volatile taxes are volatile up the way. For example, oil revenues are very volatile up the way and have risen by eight times since 1965, which makes up 43 per cent. You are taking away those very buoyant taxes from our share of the block grant and replacing them with income tax, which grows very slowly. I am not sure why that is fair or why it gives the Scottish Parliament more power or responsibility over the money that is raised.

Mr Gauke: With respect, I must come back to the point about the block grant. It is calculated for Scotland on the basis of the Barnett formula, which is a spending formula and not—

Joan McAlpine: It is based on tax, including Scotland's taxes from oil, whisky and so on.

Mr Gauke: I do not think that it is based on tax. It is based on spending.

Joan McAlpine: It is based on UK revenue. We get a share of UK revenue through the block grant.

Mr Gauke: Yes—and you will do in the future. I wish it were the case that there was a strong link in the UK public finances between revenue and expenditure, but in recent years that has not really been the case—that is the problem that we face. The block grant is based on a spending formula.

Joan McAlpine: There is, however, a mechanism for the block grant. You said that there is a lot of uncertainty about your proposal. Given that—

Mr Gauke: I am sorry. Can I just make one point? Three years ago, we saw tax receipts fall very dramatically. That did not automatically feed through to a reduction in the Scottish block grant.

Joan McAlpine: The Scottish block grant has been cut by £1.3 billion this year.

Mr Gauke: Yes, but it did not automatically feed through.

Joan McAlpine: If you ask anyone in Scotland about it, they will tell you that the money has been cut this year. Anyway, if I can just move it along—

Mr Gauke: That is a slightly different thing.

The Convener: Can we move on?

Joan McAlpine: The Scottish Government calculated, using 1999 as the starting point, that if we had used the proposed mechanism for the block grant we would have lost £8 billion because income tax grows more slowly than other income that makes up the block grant. That is the deflationary effect of the proposed scheme. I know that the UK Government disputes that.

In your letter for today's meeting you talk about your methodology, which came up with a different conclusion from that of the Scottish Government. However, you did not take one year as a starting point. The Scottish Government used 1999 as a starting point and looked at how the 10 years after it would have been affected if the Scotland Bill had been in place. The UK Government has taken what you call a "hypothetical scenario". Can you explain that? You say that you did not use a real year but an average of the years, and concluded that we would have been no worse off.

The Convener: I clarify for the record that the letter was from the Secretary of State for Scotland.

Joan McAlpine: I apologise.

The Convener: I presume that you got a copy of the letter, Mr Gauke.

Mr Gauke: Yes—I have a copy in front of me. We work very closely together, so that is fine.

Joan McAlpine: You will be able easily to explain the methodology, then.

Mr Gauke: The difficulty with the Scottish Government's methodology is exactly as you describe: it takes one year. You can take individual years and they will point in one direction or the other.

Joan McAlpine: The period was 10 years.

Mr Gauke: Yes—but that is another hypothetical example.

Joan McAlpine: It is not hypothetical because the Scottish Government starts with 1999.

The Convener: We are going to have to stop this because it is becoming—

Joan McAlpine: It is really important, convener. I am sorry, I will behave myself and be more polite, but if I could—

Mr Gauke: We do not accept the Scottish Government's methodology. The UK Government has set out our methodology. What is very clear is that the answer to the question whether Scotland wins or loses depends on which years you take. I can quote you a set of years where, for example, over the spending review period, Scotland would do very well under the proposed system. You can cite other years when that would not be the case. It partly depends on the relationship between tax receipts and the increase or decrease in those, and what public spending is doing. However, overall, I am afraid that the evidence does not support the view that the proposed system would cost billions and that it has a deflationary bias. We do not think that the Scottish Government's work in this area is very impressive.

16:15

Joan McAlpine: Can you explain your methodology, please? The Scottish Government's work was based on the 10 years after 1999, which was the year when the Parliament was set up. That seems to be quite reasonable, because those years include a period of boom and a period of recession, which seems to be a fairly good stretch of time to examine. However, you dispute that by citing a hypothetical situation, and say that your methodology is more accurate. I do not understand that, which is why I am asking for an explanation.

Mr Gauke: We have published a technical note—

Joan McAlpine: Can you explain it to me, please?

Mr Gauke: I am not sure how long we have got. The technical note clearly sets out that in different years, there are different effects. One can cherry pick a group of years, which is the point about the Scottish Government's work and some of the other assessments in that area that you have quoted. In a period in which there is a severe recession, there is one impact, while in a period in which there is fiscal consolidation—which we are doing at present—and tax receipts increase more quickly than spending, there is a substantial gain for the Scottish Government.

We are seeking, by working closely with the Scottish Government, to come up with a methodology and a block grant adjustment that is fair to the UK and to Scotland.

The Convener: There is one more—very quick—question from Joan McAlpine.

Joan McAlpine: With regard to that methodology, the Secretary of State for Scotland claims in his letter—exactly as you do—that the "hypothetical" system will result in a gain for us. However, he goes on to say:

> "This is an illustrative model and does not reflect what will happen once the Scottish rate of income tax is introduced."

That contradicts what you have just said, and suggests that there is a considerable amount of uncertainty about the Parliament's future income.

Mr Gauke: I am just re-reading the letter, and I am struck by its similarity with what I said. We have done the work, and the model illustrates what would have happened if the rate had applied in the past. However, it is the case—as I said a moment ago—that, as Michael Moore's letter states:

> "The UK Government is working with the Scottish Government to develop methodology for adjusting the block grant in future and will put in place a transitional period from April 2016 to ensure that the mechanism operates on a basis that is fair to both Governments before the Scottish Government bears any of the risk."

I am feeling rather pleased with myself that I have managed to stick to the line quite so closely.

The Convener: John Mason will come in next. Is your question on income tax, Mr Mason? I know that Richard Baker is keen to get on to borrowing powers, and there are other things to discuss.

John Mason: Yes, but I would like to discuss borrowing powers too.

The Convener: Perhaps you can discuss those issues together.

The minister is obviously a very popular chap, because we want to keep him here for much longer. Minister, is it possible for you to stay beyond the allotted hour?

Mr Gauke: Yes. We said 5 o'clock, but we can go a bit beyond that.

The Convener: That is even better than I imagined—how wonderful.

Mr Gauke: I do not want to bring this to an end.

The Convener: We will see where we get to. John Mason can round up on income tax.

John Mason: I will not touch on borrowing powers until later.

Minister, I will press you on the 10p tax rate. You said that you want a system that is as clear and accountable as possible, which is good. Would not it be clearer for the ordinary member of the public if we just said that all income tax is the Scottish Parliament's responsibility? If it goes up, they can blame the Parliament, and if it goes down, they can praise it, or whatever they want to do. As soon as we split it, complexity and lack of understanding come in.

Mr Gauke: It would be a very important change to bring in the 10p rate, which is the Scottish amount. We must remember that income tax is the biggest tax—the biggest revenue raiser—in the UK, and the most important. If we had gone down the route of saying that we should devolve income tax altogether, that would be a significant shift. We must remember that a lot of expenditure is still done on a UK basis.

Mr Mason is a Scottish nationalist—I would expect him to support that shift, and to campaign for it. However, we feel that we are striking the right balance: we are giving greater responsibility to the Scottish Government, but still within the United Kingdom.

John Mason: Is there a risk that the public will not understand, and that each side will blame the other?

Mr Gauke: I am sure that political arguments will be presented in that way. However, the Scottish people are more than capable of understanding how the 10p system will work, and of holding both the UK Government and the Scottish Government to account.

John Mason: We have discussed HMRC with witnesses, and have heard about various experiences. We have heard that the country's tax rules are complex, and that there are lots of books on that. We have also heard that HMRC is "a guddle". I do not know whether you are familiar with that word.

Mr Gauke: I fear that you may have to help me.

John Mason: I think "mess" could be used instead. The committee has wondered how much we can depend on HMRC.

Most of what I know about the Office for Budget Responsibility is good, but I believe that it has only 17 members of staff, which is not a lot. How much work has been done to prepare both HMRC and the OBR for the new system?

Mr Gauke: As I mentioned earlier, we established a high-level implementation group, and HMRC has been engaged in the process. I meet senior members of HMRC regularly, and they are conscious of the challenges that devolution will bring and of the need to adjust the system. I am confident that they will deliver, so I am not overly concerned.

The Office for Budget Responsibility is, indeed, a small organisation, but we must remember its role—it is there to provide analysis. It is staffed with very high-quality people. The organisation does not require huge numbers of people to process data; it requires the right quality of economists to make the necessary assessments. Also, the OBR and HMRC will be working with the Scottish Government in this process.

John Mason: In that relationship, will Scottish ministers be able to question the OBR and HMRC directly, or will they have to go through the UK Government?

Mr Gauke: For HMRC, an accounting officer will have specific responsibility for Scottish matters. We have also made it clear that senior officials at HMRC are available to give evidence to the Scottish Parliament and its committees; they will be held accountable by entities such as this one, and by other organisations.

John Mason: So, the Scottish Parliament can hold HMRC to account.

Mr Gauke: There will be the mechanism whereby HMRC can give evidence. I envisage the Scottish Parliament's being able to question HMRC and to issue reports on its performance in the matter, in a way that is similar to what is done at present by the Treasury Select Committee—or, more precisely, by a sub-committee of the Treasury Select Committee.

John Mason: Forecasting would mainly be done by the Office for Budget Responsibility. Will forecasting separately for Scotland and the UK involve a lot of extra work?

Mr Gauke: A lot of the data is held by HMRC, which has a well-respected unit—the knowledge, analysis and intelligence unit—that will gather data and provide it to the OBR, which will then be able to assess the situation and make forecasts. That is how things will work at a practical level.

The Convener: Before we move on to Richard Baker, who wants to introduce a new subject, I mention that we have had informal round-table discussions with many practitioners. There is real concern that HMRC will not be able to come up with the necessary implementation methods within the timescale that is proposed in the bill. There is real concern that an awful lot of work has still to be done. How do you respond to that?

Mr Gauke: HMRC tells me that it is on track, but you are right to say that a lot of work has to be done on the implementation side. Our focus has been on income tax, but one can also discuss other taxes. A lot of implementation work needs to be done on stamp duty land tax and landfill tax. We hope that the Scottish Government, which will have responsibility for those taxes, will also do a lot of the necessary work.

I take on board fully the point that implementation is important. The focus of the UK Government and HMRC is on implementation. We hope that the focus of the Scottish Government will be on implementation with regard to the taxes for which it is responsible, although we note that we have not heard very much from the Scottish Government on stamp duty land tax and landfill tax. I am sure that the committee, in holding the Scottish Government to account, will also want to raise those questions with it.

The Convener: That was rather neat, minister.

Richard Baker: I will ask a couple of questions on some of the other issues in the bill.

There is a strong consensus in Parliament that the borrowing limits that are set out in the Scotland Bill are not high enough and that the power should be introduced earlier than is currently proposed. I am aware that the UK Government has said that the limits that are set out, particularly on capital borrowing, are a floor rather than a ceiling, but can you reassure us that there will continue to be negotiations, prior to the conclusion of consideration of the bill at Westminster, between the Treasury and the Scottish Government on the limits that have been set out and what they might be in the future?

Mr Gauke: You are absolutely right that the cap is a floor rather than a ceiling and that it may subsequently be increased.

We must also bear in mind the fiscal situation. I know that the Secretary of State for Scotland also made this point in his evidence to the committee: we have judged that the cap is set at a level that fits in with our overall fiscal plans. It is clearly important that our fiscal plans have credibility and that we do not depart from those plans. We have seen the consequences in other countries that do not have credible fiscal plans.

The figures have been chosen as part of an overall assessment of the public finances. We cannot easily change the figures immediately, but we will continue to listen to the arguments; we are not saying the cap is how it will be for ever more. We will examine the situation in the light of the state of the public finances and the arguments that are put to us.

Richard Baker: We would hope that the discussions on the cap can continue, because it sounds like there may be some disagreement about what the cap should be in order to allow a credible fiscal policy here in terms of stimulating economic growth.

I will move on quickly to one other question on two areas. First, the Scottish Government has produced a paper on corporation tax. Do you expect further evidence from the Scottish Government to back up its case on corporation tax? I am sure that the committee hopes that there will be further arguments from ministers to make their proposal stack up.

On the same theme—if not the same issue—we are clearly also waiting for details from the Scottish Government of its proposals on excise duty. Have you had those detailed proposals yet? If not, when do you expect to get them? What would be a reasonable timescale within which to receive the proposals to allow proper scrutiny of them before the bill is passed?

Mr Gauke: I agree with your point. We await details on excise duties. We have not, as yet, received anything and we look forward to doing so.

16:30

As we have heard, there have been a couple of papers on corporation tax but, frankly, they are inadequate as an assessment of the impact of the devolution of corporation tax to Scotland. They do not address some of the fundamental questions. Obviously, I have asked a number of questions about the cost assessment. There is nothing on tax-motivated incorporation and there is no assessment of profit shifting. There is no recognition that if Scotland were to have power over corporation tax and it were to be cut, that would involve a reduction in the block grant.

We currently have papers for advocacy purposes rather than as an open, straightforward and honest assessment of the pros and cons of devolving corporation tax to Scotland. That is a great pity and it is disappointing that the Scottish Government’s focus has been on issues such as corporation tax rather than on the bread-and-butter issues of, for example, implementing devolution of SDLT and landfill tax. It is a great pity that, although the focus has been on corporation tax, we are still not getting substantial and thorough pieces of work that set out the arguments fully. I am sure that the committee, in holding the Scottish Government to account, will press it for more details and better analyses than have so far been provided.

The Convener: Mr Maxwell wants to ask about corporation tax, but before that can I go back a wee bit and ask for some good analysis of the 10p rate of income tax from the UK Government?

Mr Gauke: We have done a great deal of analysis of what the impact of the 10p rate would be. We continue to work very closely on that.

The Convener: I meant the thinking behind 10p being reached as an optimum figure.

Mr Gauke: I do not think that one would sit down with a lot of data, come up with a magical number and say that the optimum level would be 9.123 or something. The important thing is to identify a straightforward number that the Scottish people will understand and 10p does that.

The Convener: If we were not in a decimal system, would the figure be 12p?

Stewart Maxwell: Since the convener has raised the issue, I will follow it up. Mr Gauke said that a whole lot of analysis had been done on the income tax rate—not on the 10p level, but in general.

Mr Gauke: A whole lot of analysis has been done on the impacts and there is continued analysis to work out what the block grant changes would be and so on. That is what I am talking about.

Stewart Maxwell: That is what I thought you said. Perhaps I have missed that analysis: where is it?

Mr Gauke: It is continuing analysis, which is continuing to be worked through, on what the block grant would be. We talked earlier about the methodology that the UK Government produced on the impact of income tax devolution.

Stewart Maxwell: Have you submitted that to the committee?

Mr Gauke: We produced a technical note, which you have seen.

Stewart Maxwell: But the analysis that you are talking about—

Mr Gauke: The technical note is an analysis of the impact of this devolution of income tax on the Scottish budget. The committee has that technical note.

The Convener: The clerk has informed me that the technical note was provided to the previous committee.

Joan McAlpine: Can I come in? I have the technical note.

The Convener: No. Perhaps you can come in after John Mason has asked a question on the same point, and then it will be back to Stewart Maxwell on corporation tax.

John Mason: My question is about how much work has still to be done on both income tax and corporation tax. The Institute of Chartered Accountants of Scotland told us that it reckons that there is a huge amount of work to do on the question of residency and whether people are resident in Scotland, England or wherever. I assume that the UK Treasury would lead on that.

Am I right in thinking that there is still a lot of work to be done on that, as there would be if we did the same thing with corporation tax?

Mr Gauke: We have refined the definition of residency in the Scotland Bill, so there has been improvement there.

As for HMRC's readiness, a lot of work has already been done on the Scottish variable rate and much of the work that is to be done on the Scottish income tax can build on that. A definition of residency was used for the Scottish variable rate, and it has been amended and improved in the Scotland Bill.

Let me take away the views of the Institute of Chartered Accountants of Scotland—an organisation of which I am fond—and raise them with HMRC. I understand that HMRC feels that it is making good progress and should be ready for this.

The Convener: I now have a copy of the technical note, for which I thank Ms McAlpine. It says:

> "Given this lack of data, the exact mechanism for making the initial adjustment to the block grant has not yet been determined."

It would seem that quite a bit of work remains to be done.

Mr Gauke: Yes, it does—I want to be clear about that. Work has to be done with the Scottish Government, and I think that we have made progress today on the exact mechanism required.

Analysis of the possible impact resulted in the technical note. I apologise that the note was provided only to the previous committee, but I assume that it is available to you.

Derek Mackay: May I make a brief point?

The Convener: If it is brief and on this issue, because time is running out.

Derek Mackay: The point is pertinent. It is not just the Scottish Government that has to be convinced, but every member of the Parliament. We have to be armed with the facts on how Scotland will be affected. Has consideration been given, for example, to a joint commencement order? Time is marching on with the Scotland Bill.

The Convener: We can come back to that, but Mr Maxwell has been very patient.

Stewart Maxwell: In your response to Richard Baker, I think that I heard you say that the Scottish Government had failed to accept that the block grant would be adjusted if corporation tax were devolved. Is that right?

Mr Gauke: It had failed to accept that there would be an adjustment to take into account tax-motivated incorporation and profit shifting.

Stewart Maxwell: The Scottish Government paper on this issue talks about an immediate adjustment to the Scottish block grant by the equivalent amount.

Mr Gauke: But it clearly does not take into account tax-motivated incorporation and profit shifting.

As I understand the Scottish Government's position on the block grant—I have debated this with Stewart Hosie in the House of Commons—the argument is that corporation tax would be devolved and the appropriate amount of revenue subtracted from the block grant, and then the Scottish Government would take that back again. The Scottish Government would be left in the position that it was in, and could do what it wanted with the rate. He argues that it is as simple as that. It is not as simple as that, and I think that the Scottish Government paper suggests that it is not as simple as that. Tax-motivated incorporation and profit shifting have to be taken into account. As far as I can see, the Scottish Government has not explicitly acknowledged that point, which suggests to me that it has to do a little more thinking about the policy. It should be straight with the Scottish people.

Stewart Maxwell: The committee that considered devolving the power to Northern Ireland made exactly the same proposal as is in the Scottish Government paper.

Mr Gauke: The calculation that would have to be made is that the change in the block grant would need to take into account the cost to the UK Exchequer of tax-motivated incorporation and profit shifting. I think that the point is accepted in principle by the main political parties in Northern Ireland, but it does not appear to be acknowledged, let alone accepted, by the Scottish Government. There is a need for much greater clarity from the Scottish Government about how those issues would work, because if corporation tax were to be devolved and Scotland were to cut corporation tax, the issues would be relevant to what the adjustment to the block grant would be, which is clearly of relevance to the Scottish people in deciding whether they support the policy.

Stewart Maxwell: I refer you to the paper that HMRC produced in July, "Explanatory Note on estimating the cost of a reduction in the Corporation Tax rate in Scotland", which assumed a cut to 12.5 per cent—the Scottish Government had not suggested such a cut but you produced the paper anyway. Where in table 1, on page 2, or anywhere else in the paper, are estimates provided of changes in other revenue, such as a rise in the amount of income tax as a result of increased economic activity, a reduction in unemployment and benefits being claimed and so on?

Mr Gauke: The paper did not do that. Its purpose was to assess the costs of the policy. We produced it as an illustrative example. You said that the Scottish Government did not ask for such an assessment, but given that the Scottish Government had not addressed cost, we thought that it would be helpful to produce the paper, to inform the debate. The paper considered the costs.

Stewart Maxwell: When most people—if not all people—estimate the cost of a policy or anything else, they take away the expense, add the gains and regard the difference between the two as the cost. What you did was to say, "It is all negative" and ignore the positives. How can your assessment be the cost?

Mr Gauke: It is clear what the paper does; it sets out the costs. The Scottish Government's paper sets out the advantages. The methodology that was used in the paper is exactly the same as the methodology that the Treasury and HMRC use to cost policy measures on a regular basis, including for every budget. The methodology is not unusual. The paper very much filled a vacuum that the Scottish Government left when it failed to address the whole point of costs.

Stewart Maxwell: I see no vacuum, because as far as I am aware the Scottish Government has not suggested that it would cut corporation tax to 12.5 per cent. Even if we accept your figures, we must surely not accept your assessment of the cost, because you have ignored all the positives.

Can you confirm that table 1 shows a cost to the UK as a whole and not just to Scotland?

Mr Gauke: The point is that under the Azores judgment, which means that there cannot be state aid—there cannot be a subsidy from the UK as a whole, as the member state, to part of the member state—the cost to the UK would have to be picked up by Scotland in the adjustment to the block grant. That is how it would work. I take one example in relation to the cost to the UK Exchequer of tax-motivated incorporation, which would result in an increase in corporation tax receipts but an even greater decrease in income tax receipts and NICs receipts. The difference would have to be picked up by Scotland in the calculation for the block grant. That is the point that I am not sure that the Scottish Government has brought to the fore. It was important that we made the point.

16:45

Stewart Maxwell: Table 1 does not show a cost to Scotland, though, does it? It is a cost to the UK.

Mr Gauke: It is a cost to Scotland, because to comply with the Azores judgment we understand that the cost, which is a cost to the UK Exchequer, would have to be picked up by Scotland. If it was not picked up by Scotland, in essence there would be an element of state aid or subsidy for the corporation tax cut, which would not be compliant with the Azores judgment.

Stewart Maxwell: As I said, the Scottish Government has not suggested a tax cut to 12.5 per cent, so it seems odd that you produced your paper on that basis. You also failed to provide any figures for revenue growth from income tax, corporation tax or anything else.

Strangely enough, you seem to think that cuts in corporation tax for the UK produce beneficial effects for the UK Treasury. You have said that you have been pleased by those effects—I can quote you, if you like. The OBR's analysis is that, during the next four or five years, corporation tax receipts will rise by 40 per cent in the UK, as a result of your cuts in corporation tax. However, you think that a corporation tax cut in Scotland would result in a massive loss. Why do you think that such a cut increases income in and is good for the UK, but would cut income in and be bad for Scotland?

Mr Gauke: On your point about the Scottish Government never saying that it would reduce corporation tax to 12.5 per cent, the Scottish Government and certainly members of the SNP in Westminster, in making the case for devolution of corporation tax, have been making the case for Scotland being in the position of the Republic of Ireland, for example. At that point the Scottish Government had not set out a specific number on how it would like to reduce corporation tax, but it had certainly been making the case that it was looking to the Republic of Ireland as an example of where it could go. Therefore it was perfectly reasonable to inform the debate and bring the numbers out into the open by using 12.5 per cent as an illustration. If you want us to produce the numbers for corporation tax at 15 or 20 per cent, I am sure that we can do that.

On the point about a cut in corporation tax being good for the UK but not for Scotland, I can see the arguments for reducing corporation tax, and indeed the UK Government is doing that. There are strong economic arguments for reducing corporation tax. The case that the Scottish Government is seeking to make is that, above and beyond that, corporation tax should be devolved to Scotland, and if that were to happen there would be specific costs, which would need to be taken up.

There are good economic arguments for reducing corporation tax, but when we did that in the June 2010 budget and then went further in the March 2011 budget, there was a cost to the Exchequer in each case, which the OBR assessed and put within the scorecard. The rough ready reckoner—it depends which year you are looking at—is that for every penny by which corporation tax is reduced, revenue is reduced by roughly £800 million from what it would otherwise have been. There is a cost; the question that the UK Government has to ask is whether the price is worth paying. The same principles would apply to the Scottish Government if corporation tax were to be devolved.

What is not tenable or credible is the argument that somehow the cut would pay for itself because there would be an immediate response in additional growth. Nor is it credible to argue that tax-motivated incorporation and profit shifting can be ignored in the calculations, because those effects cannot be ignored. The HMRC paper made that very clear.

Willie Rennie: You make a valid point about Ireland. It is often cited by the Scottish Government, which then distances itself from the impact of the reduction in the tax take. Perhaps the minister can explain the additional cost to business of compliance and the additional cost to the Scottish and UK Governments of devolving corporation tax to Scotland. Has any analysis of that been undertaken?

Mr Gauke: That is an important point. We would need to take steps to counter profit shifting as much as we could. The complexity would be increased for cross-border businesses, which would need to be able to attribute profits either to Scotland or to elsewhere in the UK. There would also have to be a methodology to ensure that profit was not attributed falsely one way or the other—that there was not an issue with people putting up a brass plaque in one place but not conducting operations there. All of that anti-avoidance activity would impose a cost on both HMRC and businesses, which we would need to quantify.

Scotland is heavily integrated with the wider UK economy, and one could foresee great difficulties for a small business in the Borders to deal with. One should not ignore that complexity, which the Institute of Chartered Accountants of Scotland has concerns about. One would have to get to grips with that and look at it closely. I am not sure what work the Scottish Government has done in that area—for example, what work it has done with tax professionals to reach an understanding of how the policy would work. Perhaps the committee will want to pursue that in due course.

The Convener: I am aware that time is getting on. I will pick up on a couple of points, the first of which was raised by Richard Baker in his questions on borrowing. It relates to the general theme of shortfalls in income and how people would manage; it also relates back to much of the evidence that we have heard suggesting that a basket of taxes is required if the Scottish Government is to be properly able to boost the economy.

You said to Richard Baker that some things were still being considered regarding borrowing caps. The previous Scotland Bill Committee—unanimously across the parties—called for certain things to help to avoid forecasting errors, for example. It called for specific borrowing limits, as it thought that the amount that had been discussed before was arbitrary; it wanted short-term borrowing limits considered; and it did not want excessive Treasury control over the ability to introduce new taxes. It also looked at the Scottish cash reserve and said that the Scottish Parliament should be free to put money into that and take money out of it.

None of those suggestions was taken on board and incorporated into the Scotland Bill as it is now drafted. How can the committee be confident that anything that we put forward for discussion will be properly considered for inclusion in the Scotland Bill, when the views of the previous committee—including those of members of your party, minister—were just ignored?

Mr Gauke: There has been some movement on, for example, the policy that the Scottish Government would have to deal with the first 0.5 per cent of any forecasting errors. As far as revenue borrowing is concerned, we have made the case that that is sufficient given the size of forecasting errors in recent years. We will continue to engage in that area.

However, overall, in capital borrowing, we are constrained by the fiscal situation that we are in and the paramount need to retain our fiscal credibility and have a plan that we can stick to. That has implications for a range of areas, including this one. There is limited flexibility in these difficult times, but there may be greater flexibility in the years ahead.

The Convener: It has been quite a while since the previous committee's report was published. We subsequently received a white paper from the previous UK Government and we were then told about the respect agenda, but this committee is again considering the matter. It seems that little movement has been made by the Government on the recommendations that the previous Scotland Bill Committee came up with, considering that they had cross-party agreement and that a lot of them were agreed by everyone in the Parliament.

Mr Gauke: On borrowing, we have gone further than the Calman commission recommended—a point that Sir Kenneth Calman has welcomed.

The Convener: Excuse my interruption, but I do not believe that you have gone further than the previous Scotland Bill Committee recommended.

Mr Gauke: That may be the case, but, as I say, we are constrained on the issue by the current public finances and the need to stick to our overall proposals. We look constructively at the arguments that are made by parliamentary committees and, where possible, we take those comments into account.

The Convener: My second point returns to what I mentioned at the outset of this discussion. The most recent legislative consent motion to go through the Parliament was heavily caveated because of real concerns and it has to come back again. Today, we have heard concerns—across the piece in the committee, some of which have been relayed to you—about implementation and the effects on the block grant, discussions on which are still on-going. We are told that the respect agenda is still in place. Do you agree with the Prime Minister that the respect agenda is still in place, and will there be joint commencement of the bill?

Mr Gauke: I always agree with the Prime Minister, as you would expect.

On commencement, I am not divulging any secrets in saying that the matter has been raised with us—including this morning—by the Scottish finance minister. We are determined to work closely with the Scottish Government and to engage with the Scottish Parliament. We want there to be consensus as we move forward in this area. Were there to be joint commencement—a point that has been debated on the floor of the House of Commons—the question is whether that would create unnecessary uncertainty. It is important that we all move according to the timetable that has been set out and that all parties play their part in that, and uncertainty would be unwelcome. Nevertheless, we hear the points that the Scottish Government and Scottish Parliament are making on the issue, which we will consider.

The arrangement whereby we work with the Scottish Parliament with good will through the joint exchequer committee is something that has not been done before. I hope that the current working arrangements are more constructive and positive than they have been in the past and that all parties comply with the respect agenda. I hope that we can reach a consensus between the UK Government and the Scottish Government on the commencement of the income tax powers.

The Convener: There is a precedent in the Welsh Assembly having joint commencement of its bill. Can we expect Scotland to be accorded the same respect? You have not answered my question.

Mr Gauke: I am quite happy to look at that precedent. I want us to reach a consensus on the point and hope that the issue will not cause a divide among us. We believe that we have in place a mechanism that is appropriate and reasonable, but we hear the points that you are making.

The Convener: We have time for two quick points, although I am aware of the time.

17:00

Stewart Maxwell: I do not understand how any instability or uncertainty would be created. This is exactly what happens in Wales, and there are a number of examples of the same sort of thing. The UK Parliament and the National Assembly for Wales must agree on matters before they make progress.

I must push Mr Gauke on this point. If you were confident that the tax proposals were at least neutral, if not of benefit, for Scotland, why would you be at all hesitant about, or resistant to, accepting a vote of the Scottish Parliament on the implementation of the proposals?

Mr Gauke: I am sure that we can reach consensus.

You mention uncertainty and instability. Long before my involvement, powers were made available in respect of the Scottish variable rate. Those powers were never used, but HMRC did a lot of preparatory administrative and implementation work. The UK Government wants to press on with the Calman agenda, and we are confident that we can be fair to both the UK and Scotland.

You wonder why we do not simply proceed with a joint commencement, but I have said what I want to say on that point. We hear arguments that do not appear to be based on a thorough analysis of the cost of devolving income tax. We will want to address that in order to reach consensus. We seem to be struggling to reach consensus on what the costs will be, even though we have produced a thorough analysis.

Stewart Maxwell: May I—

The Convener: Very quickly.

Stewart Maxwell: It is very important.

The Convener: It is all important.

Stewart Maxwell: Are you saying, Mr Gauke, that if the Scottish Parliament—after listening to the arguments and analysis of the UK Government and the Scotland Bill Committee, and after listening to all the evidence from outside stakeholders and other interested parties—decided on a vote of its democratically elected members that it did not wish to implement the income tax powers because it believed them to be damaging to Scotland's interests, the UK Government would then go ahead and force those powers on us?

Mr Gauke: That is a very hypothetical question.

Stewart Maxwell: It is not the least bit hypothetical.

Mr Gauke: It is a very hypothetical question. The UK Government does not intend to find itself in that position. We will work hard to develop proposals, and we will work closely with the Scottish Government.

Stewart Maxwell: Will you accept a vote of the Scottish Parliament?

Mr Gauke: I have nothing more to add to my answer. The question was very hypothetical. We will work hard to ensure that we are not in the position that you suggest.

The Convener: Thank you, Mr Maxwell. I hope that Mr Mackay's question will not be hypothetical.

Derek Mackay: It is not hypothetical. Mr Gauke, your colleague from the coalition brought along some fudge today, but you have produced some of your own on the issue of commencement powers. The matter is straightforward: if we reach consensus, there is not an issue; if we do not reach consensus, and if you still want us to support the Scotland Bill, we will need clarity on the financial implications for the country, the Parliament and the Government. Will you be a little more constructive on commencement powers? You have been vague on the principle.

Mr Gauke: We believe that what we have set out is perfectly reasonable. We want to proceed with the Calman agenda, because we believe that it is right for Scotland. We will act in good faith in ensuring that the block grant adjustment mechanism is fair to all sides, and we expect to proceed in 2016. I do not think that we will need additional legislative hurdles, but we hear the points that are being made by this committee and the Scottish Government and we will reflect on them. However, as I say, I think that what we have set out is perfectly reasonable.

The Convener: I will allow another five minutes, if that is all right with you, minister.

Mr Gauke: That will probably be it—then, I will have to go.

Joan McAlpine: On commencement, I understand that the go-ahead for the tax powers rests solely with the Treasury in London. We are asking why it cannot be based on an agreement between London and Edinburgh.

Mr Gauke: It is a question of the UK Government devolving powers that are currently its sole responsibility. We hear the arguments that are being made and want to work in a consensual way. You and a number of your colleagues have made the point that you want the commencement power. We hear that, but it is devolution of a power that is currently held by the UK. We want to work as constructively as possible with the Scottish Government and the Scottish Parliament.

Joan McAlpine: You said—

The Convener: No more than a few seconds, please, because it is not fair.

Joan McAlpine: No, it is okay. I have made my point already.

The Convener: Stewart Maxwell will ask the final question. I must insist on quickness—we cannot have the minister miss his flight.

Stewart Maxwell: Of course not. Minister, let me sum up the evidence that we have heard today. You have no evidence for the 10p tax rate, no explanation for the revenue compensation process, no rationale for having a flat-rate tax only and no mechanism for making the adjustment to the block grant, and you refuse to accept a democratic vote of the Scottish Parliament as being a part of the process of implementing the income tax proposal. Why would we accept any of that?

Mr Gauke: Thank you for your characterisation of the afternoon. I have rather enjoyed it.

This is a big step forward for Scotland. It is an opportunity for the Scottish Government to take much greater responsibility and for the Scottish people to hold the Scottish Government to account in a much clearer and more straightforward way. Yes, it involves greater responsibility and, yes, we will do everything that we can to ensure that we have an adjustment mechanism for Scotland that is fair to Scotland and fair to the UK as a whole. Yes, there will be a degree of volatility, but that is what comes from taking greater responsibility. I assume that the Scottish Government and Scottish Parliament are willing and able to do that.

On implementation, there is still a long way to go and I have highlighted some of my concerns about the slow pace of the progress that is being made by the Scottish Government in some areas. I hope that I have also made clear some of the complexities that are involved in the additional areas that the Scottish Government is seeking to pursue. I am sure that the committee will question the Scottish Government on those points as well.

I am grateful to the committee for the rigour and enthusiasm that it has demonstrated today. Although I appreciate the fact that not all my answers were to your liking, Mr Maxwell, I assure you that the UK Government will continue to engage with both the Scottish Parliament and the Scottish Government to ensure that we get through this and take what I hope is a big step forward for Scotland.

The Convener: Thank you, minister. In closing, I make a final point on commencement. I do not think that anyone on the committee—or, indeed, in the Parliament—would like to be in the position of signing a blank cheque by approving the bill without knowing all the implications. We will be talking about joint commencement quite a lot.

You will be disappointed, minister, to discover that we had loads of questions on the Crown Estate that we have not had time to ask you. Can we put those to you in writing and have a response to them by letter?

Mr Gauke: Please do.

The Convener: Thank you for your time, minister. Thank you, Mr Doyle, for your forbearance and patience.

17:09

Meeting continued in private until 17:34.

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