



The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

FINANCE COMMITTEE

Wednesday 5 February 2014

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FINANCE COMMITTEE

4th Meeting 2014, Session 4

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*John Mason (Glasgow Shettleston) (SNP)

COMMITTEE MEMBERS

*Gavin Brown (Lothian) (Con)

*Malcolm Chisholm (Edinburgh Northern and Leith) (Lab)

*Jamie Hepburn (Cumbernauld and Kilsyth) (SNP)

*Michael McMahon (Uddingston and Bellshill) (Lab)

*Jean Urquhart (Highlands and Islands) (Ind)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Professor Sir James Mirrlees

CLERK TO THE COMMITTEE

James Johnston

LOCATION

Committee Room 6

Scottish Parliament

Finance Committee

Wednesday 5 February 2014

[The Convener *opened the meeting at 09:30*]

Decision on Taking Business in Private

The Convener (Kenneth Gibson): Good morning and welcome to the Finance Committee's fourth meeting in 2014. I remind all those present to turn off mobile phones, tablets and other electronic devices.

Before I do anything else, I formally welcome Professor Gavin McEwen to the meeting. He has been with us for a couple of informal sessions, but this is his first public meeting. I am sure that he will be a tremendous asset to the committee's deliberations in the weeks and months ahead.

Under agenda item 1, do members agree to take item 3 in private?

Members *indicated agreement.*

Revenue Scotland and Tax Powers Bill: Stage 1

09:30

The Convener: Item 2 is an evidence-taking session with Professor Sir James Mirrlees as part of our stage 1 consideration of the Revenue Scotland and Tax Powers Bill. I welcome him to the meeting and invite him to make a short opening statement.

Professor Sir James Mirrlees: It is a pleasure and very interesting to be here. I wrote a short submission and, when I read it through again, I realised that I promised in it to refer to a fiscal commission working group report, but I did not do that. That is a good point at which to begin.

The FCWG used rather different terms from Adam Smith's four maxims. We said that good criteria for taxation are simplicity, stability, neutrality and flexibility. We did not mention progressive taxation, although, if anyone had asked, we would have said that we were certainly in favour of it.

There is an interesting contrast between those two approaches. Adam Smith was right to put a lot of emphasis on certainty, which was the first thing that I thought about. Setting up a tax system that will be in many ways like the UK's existing tax system will achieve a fair degree of certainty. It is probably a good thing that people should expect the tax system to continue to be administered in a way that is similar to what they have been used to. Changes can be made, but it is important to achieve the ideal of certainty that enables people to make decisions with a good sense of whether they will pay taxes on particular transactions. Certainty is achieved partly through people being used to practices.

As an academic economist, I have been intrigued by the way in which tax rates generally do not change much from one party to another. I think that the difference between a 40 per cent tax rate and a 50 per cent tax rate is not very large. It is as though an implicit agreement has been made not to change rates too rapidly. That is rather difficult to get into legislation; it must be a kind of understanding.

Members have probably gathered from the tone of my submission that, although I think that the bill does not achieve a lot of certainty about what taxes will be and how they will apply, that is right, because such certainty probably cannot be achieved directly by legislation. The difference between the framework that is set up in the bill, which will become an act, and the exact numbers that describe the tax rates and penalties, which

will be set in regulations, makes a lot of sense. That is the first point that I made in my submission.

There are other points but I assume that you do not want me to read out my evidence, since I know that it has been circulated.

The Convener: We all have copies of your evidence but if there is anything that you want to accentuate or add, we would be more than happy for you to do so.

Sir James Mirrlees: In talking about the convenience of taxing, I did not give sufficient credit to the plan for a great deal of information, for example in property transactions, to be entered digitally. That will be a tremendous advance in the simplicity of paying taxes, and most people I know greatly appreciate that. Digital entry is intended to be part of the whole system, but I did not mention that in paragraph 6 of my submission in which I talk about ways of increasing convenience.

I also mentioned the issue of how rapidly people can complete tax returns. That may be a bit harder to address if digital entry is being considered, partly because it is something that people often do several times. On reflection, that point may not be so relevant to the two devolved taxes that the committee is considering but I wanted to extend it slightly.

I also underline that the fiscal commission working group put a lot of emphasis on the criterion of neutrality. We put a lot of emphasis on that in the Mirrlees review of taxation, too. Neutrality is certainly a desirable feature, but exactly what it means seems to vary a lot from one tax rate to another. It seems to be something that, again, cannot be handled by very general legislation. It is something to consider when we talk about more specific taxes, such as the land and buildings transaction tax.

I will not say any more at the moment, convener.

The Convener: That is fine. What usually happens at the Finance Committee is that I ask some opening questions just to kick us off and then I allow committee colleagues to come in with their own questions. Some members have already indicated that they want to come in.

I would first like to ask you about the general anti-avoidance rule. We have had some informal sessions with a number of organisations and, according to the papers that they have given us informally, that issue has been highlighted to them. You say that your

“sympathies are very much with this measure”

but that you see

“possible difficulties”

with it. You point out that, in section 58 of the bill, one of the criteria for identifying tax avoidance is that

“obtaining a tax advantage is the main purpose, or one of the main purposes, of the arrangement.”

Given that tax avoidance galls many members of the public, we obviously want to ensure that the legislation is fairly robust in that direction. Will you expand on your thoughts on that issue?

Sir James Mirrlees: I took that example because I think that, in the case of a property transaction tax, if we do not have proportional taxation of the value of the sale, there is clearly an incentive to split the sale into parts, each of which will attract the lowest possible proportional tax.

In my very limited experience of these transactions, I have never come across that being done. It cannot easily be done for a dwelling-house in Britain, for example, but the incentive to do it is very great when, as in the UK currently, the tax rate switches from 1 to 4 per cent of the value of the property when we go over the threshold.

An arrangement in which separate cheques are paid for different parts of the property simultaneously is something that we would want to rule as clear tax avoidance. I have no difficulty with that, but there could be good practical reasons why someone would gradually buy different parts of a property—it might be made up of a lot of different houses, for example. The difficulty there is how the plot should be defined.

My concern in relation to the anti-avoidance rule is the reference to just one of the purposes being to reduce taxation. That will frequently happen: if someone is thinking of alternative ways of doing something, without being too artificial about it, they will naturally try to keep the tax low. After all, you would not do artificial things that would increase your tax.

I think that there is a difficulty in drawing the line if the anti-avoidance rule refers to one of the purposes of an arrangement being to reduce tax. There might be entirely reasonable reasons for gradually buying different parts of a property, such as not being able to borrow enough money to buy the whole site straight away and having to wait several years to buy the rest of it. They would be perfectly legitimate, and we would probably not want to apply the rule in that case. The problem arises from the somewhat unreasonable structure of a tax that is not proportional.

In my submission, I mentioned one tax that is not explicitly under consideration, which is customs duty. I was thinking of the well-known case of people taking a van across to France, filling it with wine and bringing it back duty free. If it is meant to be a year's consumption for the family,

it will be regarded as being perfectly legitimate, but it would clearly breach the anti-avoidance rule if it applied. One of the main purposes of making a short trip to fill up the van is to reduce the tax paid.

I suppose that that is an extreme case, and too much might have been allowed. However, we are talking about areas in which there should be explicit legislation or regulation that sets out when tax should be paid rather than just a general rule that could catch everything. The rule, therefore, struck me as too strong.

The Convener: You say in your submission:

“It is reasonable to have progressive taxes on income, at least in the upper ranges; but not on property transactions”.

Why do you take that view? I take that as meaning that someone who is selling a house at £100,000 pays the same kind of transaction fee as someone who is selling a house for £1 million. A lot of people might think that that is not fair. What is your thinking on that?

Sir James Mirrlees: I certainly meant that the tax that is paid should be proportional to the value of the property.

The Convener: Okay. It is just that your submission says:

“It is reasonable to have progressive taxes on income, at least in the upper ranges; but not on property transactions”.

Perhaps I have not interpreted it properly.

Sir James Mirrlees: When I referred to “progressive taxes”, I was thinking of a system in which the rate of tax increases in the same way as it does for income tax.

The Convener: That is fine. That will happen under LBTT anyway. We already have that in the system and it will be as you suggest it should be.

Sir James Mirrlees: So LBTT is proportional.

The Convener: Yes. That is the intention. Apologies for that misinterpretation.

Sir James Mirrlees: That is fine. It is a step forward.

The Convener: The aim is to get rid of slabs of tax and stuff like that.

In your written submission—you also mentioned the issue in your introductory remarks—you refer to

“measures of convenience that could be imposed on the tax agency.”

Can you tell us a wee bit more about how that could work in relation to the bill?

09:45

Sir James Mirrlees: It ought to be relatively simple to report most of the items that come under the two taxes, so it is hard to imagine any convenience problems. I was really thinking more about what would happen if the same principles applied when more taxes were devolved. I did not know when there would be a chance in legislation to set out requirements concerning the nature of tax returns to ensure that there is a clear incentive for them to be convenient for the taxpayer—in other words, quick and easy to do.

In some ways, the bill increases convenience by creating a more uniform set of rules about how long relevant information should be kept, which is, broadly speaking, five years throughout. That seems a bit simpler than what is in our current UK legislation. That is an example of where people would want convenience. I wonder whether that could be changed, as nowadays records can be kept on a computer and can, in a sense, last for ever—or at least until the hard disk dies.

The Convener: They will last a lot longer than us, that is for sure.

Sir James Mirrlees: The bill might increase convenience by saying that people should always keep their records.

The Convener: Okay. In paragraph 13 of your submission, you say:

“It is sensible to determine tax rates and penalties by regulation, rather than stating them in the Act.”

I have a lot of sympathy with that. I have never understood why pieces of legislation have specific financial penalties in them, given that inflation erodes them almost from the day on which the legislation is enacted. I take your point on board, as, I am sure, do my colleagues.

Are there any other parts of the bill that could be improved, or any that should be removed because they are superfluous to its good working?

Sir James Mirrlees: No. As I indicate towards the end of my submission—perhaps I could be more explicit—I was surprised that I had so few ideas about how the bill could be improved. The bill seems to have been arranged so that any numbers have been combed out of it and left to regulations, which seems entirely sensible. I do not know how regulations are handled in the Scottish Parliament, but I presume that they are laid before the house and can be discussed at a particular time. It is important that they should always be discussable in Parliament, but it would not sound quite right to say that they should be discussable before they become effective, as it would be natural for a budget to announce a number of tax increases that would come into

effect immediately or the next morning. As I understand it, that is allowed for in the bill.

The Convener: I will open up the session to colleagues. Jamie Hepburn will be followed by Michael McMahon.

Jamie Hepburn (Cumbernauld and Kilsyth) (SNP): Thank you, convener.

Professor Mirrlees, the convener raised the issue of avoidance. In paragraphs 10 and 11 of your paper, you raise the anti-avoidance rule, towards which you say that you are sympathetic. You then talk about possible unintended consequences and say that you are not necessarily a legal expert in these matters. Do you think that the current system does enough to tackle avoidance, bearing in mind the convener's fair point that the issue irks the public? Is there good practice in other jurisdictions outwith the United Kingdom, for instance? What more could we do on anti-avoidance?

Sir James Mirrlees: I am not terribly well informed on that area. Current practice in the UK is for schemes to be devised and discussed with Her Majesty's Revenue and Customs to see whether they are acceptable methods of tax reduction or whether they amount to tax avoidance. Many of those schemes are accepted, usually on the ground that they have some rationale besides simply trying to escape tax entirely. It seems almost as though we want to say that, if a tax lawyer comes along with a proposal for an avoidance measure, that means that it is an avoidance measure and we would like to stop it.

I know that HMRC constantly has a problem making such decisions. Any proposed scheme has to be pretty abusive of the system before it can be ruled out under the legislation, which is clearly too weak. In fact, we would expect the same thing to happen under Scottish tax arrangements. The question is, how can one find good reasons for ruling out such schemes?

Jamie Hepburn: Our adviser has suggested some form of general purpose clause that would say that no one should act in a way that is inconsistent with Parliament's intention. That might allow the tax authority to interpret Parliament's intention. Indeed, it would become a matter for the courts, which could look at what the relevant minister said in Parliament about the intention behind the bill. Is that worth exploring?

Sir James Mirrlees: When I was looking at that, I wondered whether it would not be natural to say that we want to rule out arrangements whose primary purpose was avoidance. A word that was slightly weaker than "main" could be used that meant that avoidance should not be the overriding purpose. In the spirit of exactly what you say, it

should then be a matter for judgment whether a scheme could be ruled out.

Jamie Hepburn: You also talk about revenue Scotland acquiring

"potentially larger and wider responsibilities"

in the context of either a yes vote or further devolution of taxes. Clearly, there is potential for revenue Scotland to become a tax body that deals with a more substantial array of taxes. Indeed, it could become the tax collection authority for Scotland. In that context, how could it improve on HMRC's approach? Can we build in some kind of advantage for Scotland?

Sir James Mirrlees: The improvement must come through its being more rigorous, perhaps along the lines that you suggest. The rest of the bill speaks of the overall intention, and what happens must be judged in that context. What you suggest makes sense, but it means that ultimately things will go to the courts—or a kind of court—and case law will be built up gradually.

We have perhaps already gone quite a long way in that direction in the UK, in that opportunities for tax avoidance are thought to be becoming fewer. The big thing—and it is hard to know how we can tackle this—is companies' ability to divert their profits to foreign jurisdictions. One example is Microsoft, which has all its patent royalties in Ireland, but there are lots of examples in company taxation. It is a big area. Of course, that is supposed to be handled by pricing—by insisting that the accounts should be worked out with appropriate prices for everything, which seems to have been very difficult to achieve properly. That might be one area in which you could expect to legislate in due course.

Jamie Hepburn: You said that revenue Scotland could act with greater rigour than HMRC does. Did I pick you up as saying that, in essence, the bill builds in greater rigour?

Sir James Mirrlees: Oh, yes—it is very rigorous. I was fearful that it had gone slightly too far in the direction of leaving things general when there should have been quite specific provision—or at least regulation—by Parliament, for example in the case of split purchase, which turns out not to matter under the current tax schedule for the property tax. In that case, my fear had been that things that were entirely reasonable would be covered, for example if there was a long delay between the purchasing of the various parts. Setting out the general intention of the legislation seems a very good thing.

Jamie Hepburn: You produced a report on UK taxation, which I confess that I have not read in great detail. Have your recommendations been taken account of in the context of the limited array

of taxes that fall within the scope of the bill? We must bear in mind that revenue Scotland might deal with a wider array of taxes. What key points in your report might we consider? As well as there being lessons for HMRC, are there lessons for us as we establish revenue Scotland?

10:00

Sir James Mirrlees: The items of tax change that generally attract attention—and which are reported as far away as Hong Kong, where I live these days—are things such as tax rates on top incomes. We did not really comment on such matters, because we were trying to find ways of making the tax system more efficient within a progressive overall structure.

If I were to pick out what we thought of as important general principles, one would be that—leaving aside what would usually be called income from pay and interest on investments—there should be a pretty much uniform rate of tax on lots of things. In other words, for example, VAT should apply to everything. It is difficult to make such an approach work because of things such as financial services and the enjoyment of property, which are difficult to measure properly for that purpose. However, if we leave aside the technical details, there seems to have been no change in that area and I believe that such change would be politically difficult.

The proposals on property taxes are the best example so far of a move towards what we recommended, which was effectively a proportional tax on value to replace the current council tax. The transaction tax that you are going to have is a considerable improvement. However, we also recommended that there should not be transaction taxes as such and that, ideally, the taxes should be based on the value of property. There has been no move that I am aware of towards that. I would struggle to think of changes that have been made in the British tax system that resulted from the report on UK taxation.

However, on the recent Australian tax reform, for example, it seems to me that the initial proposals—it is true that they passed through several stages of discussion—would have led to a quite wide-ranging tax on land, resources and so on. That is something that we recommended, and Australia had a tax commission of its own that made essentially the same recommendation. I find it hard to know the exact chronology of these things, but I think that we had some influence on that.

Michael McMahon (Uddingston and Bellshill) (Lab): Paragraph 3 of your submission states that

“The Bill is explicitly to create an agency ... to collect two taxes”.

You point out later on in the paragraph that there could be more devolved taxation or, if there is independence, all taxation could be brought to Scotland. Does the bill cover only the two taxes that we are discussing or is the framework that is being established by the bill sufficient to cope with additional taxes? Will there be a requirement for more primary legislation to take account of new taxation?

Sir James Mirrlees: The two devolved taxes are mentioned at several points, but in the main the bill is much more general than that. Almost everything—including the penalties and the period of time for which we have to keep information—is quite general. Things such as the structure of the membership of revenue Scotland, how many people would be involved and the appointment of a chief executive who is not a member of revenue Scotland itself, are all powerful general arrangements that are certainly not at all restricted to the two devolved taxes. I find it quite difficult to recollect anything in the bill that is specific to the two taxes.

Michael McMahon: Is there nothing that could require us to go back and revisit how revenue Scotland would operate, further down the line?

Sir James Mirrlees: That is hard to say; you have posed an interesting conundrum. I kept thinking, of course, about income tax, which could very quickly come to revenue Scotland. It seems to me that the bill covers almost everything. The only thing that I would pick out—it is really a very small thing—is that there has not been, naturally, a lot of attention paid to the exact way in which tax return forms would be done and how they would be handled through computers, for example. The intention is clear, however—in particular, in the policy memorandum to the bill—that those things should be carefully worked out. Of course, there is no reason to say much about that when we are looking at only two very simple taxes.

Michael McMahon: In paragraph 4 of your submission, you point out that it is just not viable to set tax rates 10 years in advance. However, during our consideration of the Land and Buildings Transaction Tax (Scotland) Bill, there was a bit of debate about how far in advance commercial entities require to know what tax rates are going to be, because they have commercial and investment decisions to make. If 10 years is too far ahead, what would be a reasonable timescale over which to give even indicative figures for the two taxes that are covered by the proposal?

Sir James Mirrlees: One Government cannot commit the subsequent Government to do something. Even in Scotland, it is possible that a different party might be in power.

These things have been discussed by tax people. Professor Marty Feldstein has argued that people should legislate on taxation and savings, for example, long in advance. In a related area, one of the arguments—with which I do not agree—against having a state pension system is that it is difficult for governments to make really effective commitments. There are situations in which people are not going to get the pensions that they had expected. It is clearly desirable that governments should be able to make something in the nature of a sensible promise. The United States has sometimes legislated quite far in advance on taxes—in the order of 10 years.

I will leave aside the tax rate for a moment and consider pensions. It can be argued that governments should commit as much as possible to saying that the basic pension rate will be a given proportion of the then-average wage in the country. That would get around the problem that commitments might not make a lot of sense when circumstances change and the economy does not do as well as it should. We have had a lot of experience of that. It might be better to think in terms of fixing proportions, in a sort of automatic way.

With major taxes such as income tax and VAT, it really does not make sense to fix the rate, except for the next year. We have to rely on a kind of social contract that no one will abolish the tax suddenly or, say, in the following year. Small changes could be made. The difficulty is that, on the one hand, you do not want to rule out possible small changes, while on the other, you do not want things to change so rapidly that people are unable to make sensible plans.

John Mason (Glasgow Shettleston) (SNP): It is good to have you here, professor.

In paragraph 8 of your submission, you say:

“When Adam Smith suggested that taxes should be proportionate to ability to pay, I doubt that he thought that meant proportional.”

Some of us have greater and some have lesser understanding of the English language, so can you clarify the difference between “proportionate” and “proportional”?

Sir James Mirrlees: I have always understood the term “proportionate”, which is rather old-fashioned now, to be vaguer and to mean “related to”. That is my interpretation, but I do not claim to be a great lexicographer.

John Mason: So, the word “proportional” is more definite.

Sir James Mirrlees: Yes—“proportional” refers to definite proportions.

John Mason: So, for example, VAT being 20 per cent of everything is proportional.

Sir James Mirrlees: Yes.

John Mason: You could say that income tax is proportionate because it is related to individual incomes.

Sir James Mirrlees: Yes.

John Mason: That is the key difference.

Sir James Mirrlees: That is what I had in mind.

John Mason: That was helpful.

The issue of the pace of change and, indeed, whether change itself is possible has come up once or twice in our discussion, particularly in your response to Mr McMahon. You have said that we could make little changes, but your review suggests some changes that are actually radical and major. You also said that Australia has not implemented some of the changes, but New Zealand has. Do we simply have to take a very long-term approach? Will it take, say, 50 years to change the whole tax system?

Sir James Mirrlees: I am certainly not against making big changes from time to time, but they should be well heralded. Fifty years is certainly far too long. I think that one might aspire to create such a programme within 10 years.

I can easily think of examples of tax legislation that has introduced completely new arrangements. For example, when the student loans system, which is sort of part of the tax and benefits system, was introduced, quite a large change was made straight away. That was a perfectly reasonable move; quite often it does not make sense to introduce a tax gradually and then build it up. That said, when people suddenly discovered that student grants were no longer available in the UK—of course, I am not referring to Scotland—their expectations about the savings that they would put away for their children were confounded. I have no objection as such to that kind of big change, but it seriously confounds people.

10:15

In areas such as taxation of land and property, big changes can have a very big effect; land and property could lose a lot of value because of the introduction of a new tax or a new way of taxing. Something that puzzled us in our tax review was the question of what one should recommend about the present very unreasonable system of local taxation based on property, which has tranches and a remarkably low top. It is clear that change is wanted, but the change is bound to involve enormous changes in the values of more valuable properties.

John Mason: Would it be necessary to have cross-party agreement for such radical changes in the tax system, or could they be imposed by one Government that would just be there for four or five years?

Sir James Mirrlees: With the example of local taxation based on property, one could change the legislation straight away and say that tax would be proportional to the value of property. Of course, if it were just going to be changed back again, there would not be much point in doing it.

It is an interesting suggestion and I am trying to think of examples. Has it ever happened?

John Mason: You made the point at the beginning that changes between parties often are not very radical—1 or 2 per cent, or 5 per cent; that kind of thing.

Sir James Mirrlees: Yes, but from time to time there are cases in which the Government wants to introduce a tax that the Opposition says it will repeal as soon as it gets back in. You can see that in relation to healthcare in the United States.

John Mason: In “The Mirrlees Review” there is a fascinating table. The left hand side shows “a good tax system”, and the right hand side shows the “current UK tax system”. The top item says that a good tax system has

“A progressive income tax with a transparent and coherent rate structure”

and that the current UK tax system is

“An opaque jumble of different effective rates as a result of tapered allowances and a separate National Insurance system”,

which I think is quite scathing.

One of the things that I would really like to make, and I believe that John Swinney would like to make, is a simple tax system: to make whatever taxes we have simpler. Is that possible?

Sir James Mirrlees: Countries, for example Estonia, have from time to time tried to do that. They seem to have had a lot of difficulty in hanging on to it. The main difficulty is in the relationship between the tax system and what we call the national insurance system. Ideally, we would like a fixed basic subsidy for everybody, which would be equivalent to having the tax-free allowance as part of the income tax schedule, and various other allowances such as housing allowance. When you look at the total effect of British tax and insurance legislation, you get a rather complicated graph to show what it is like, which is what John Mason referred to. It could be made into a nice straight-line system, or something a bit like that, which would be simple.

It would not necessarily be so simple to administer that because, for example, the various

national insurance things would be paid on a weekly basis whereas, of course, income tax is determined on an annual basis. There is “pay as you earn” being collected at whatever the pay frequency is from people’s employment, but it is the same week after week, whereas welfare benefits such as housing or disability benefits have to be checked more frequently. In some ways, we cannot quite get away from that.

To be honest, I think that the review group slightly overstated the point in the table to which John Mason referred because, when we were doing it, we kind of ignored disability benefits, which in practice is an important area and it cannot be administered simply. It turns out that there are lots of such areas. It is not simple to get a lot of information about people, and sometimes it is not even simple to find out what a person’s income is.

Although it is a reasonable ambition to have a nice simple overall tax schedule, including benefits in general, you would have to start making exceptions. Another issue is the business of assessing the size of the tax base, as it is called, of income, for example, because income is not as easily defined or measured as one might think.

John Mason: You mentioned national insurance. Is there any logic at all for PAYE, or income tax, and national insurance being separate, or should they be combined?

Sir James Mirrlees: The logic is that, as I mentioned, one is in essence determined on a weekly basis, while the other is determined—

John Mason: I am talking about payment. We all pay both, so would it not be simpler for us all to pay a bit more tax and to forget about national insurance?

Sir James Mirrlees: Yes—I am very much in favour of that. From time to time, there have been initiatives on that in the Government. Barbara Castle tried to achieve something like that years ago, and it came up again in Conservative plans to try it, I think. So far, such plans have always collapsed. One wonders why.

John Mason: I suspect that people would not like the idea of paying 10 per cent more income tax, even if they were paying no national insurance.

Sir James Mirrlees: It is even more complicated than you suggest, because the tax credit system has been put on top of another system.

John Mason: Is the present system a disincentive to work at some stages because, as you say, there is not a smooth line? Are people discouraged from working just because of how the system works?

Sir James Mirrlees: The members of the group that wrote the tax review had remarkably differing views on that. I happen to think that it is not all that well established that the effect applies to people in the lower income range, which is where there is in theory a big effect, because there are income ranges over which, in effect, the marginal tax rate is about 100 per cent. I have come across cases in which, because of the particular rules on unemployment or disability benefit, people would lose out by going to work. It is hard to believe that that does not have some effects but, anecdotally, I have found that, partly because people like to do a certain amount of work, they are not necessarily discouraged all that much.

It comes down to one of the fundamental empirical issues that are very hard to settle: to what extent are people not working because there are no jobs that they can get, and to what extent are they not working because they really do not want to, and are avoiding it? That is very hard to establish.

The reason why I do not believe that the incentive effects are all that strong is that, in countries such as Spain and Greece, there have recently been such big changes in the level of employment over relatively few months. That is even the case in parts of Britain.

John Mason: You have mentioned other countries and you said that Estonia tried to make its system simpler. In comparison with the UK, do some countries have a simpler system or do most countries have a more complex system? How does the UK fit in on the world stage?

Sir James Mirrlees: Hong Kong has a much simpler system, although it achieves its simplicity by having some very odd features. The income tax system is not a strictly proportional tax system, and the income tax is only a salary tax. In other words, only the parts of income that can be easily reported are taxed. Furthermore, there is a 15 per cent maximum rate for higher incomes. The rates are all quite low.

Hong Kong also has a uniform profit tax and some simple property taxes. That is all made possible because the Government owns the land and enormous reserves have been stored up. It is easier to be simple if that is the case. On the other hand, large amounts of income simply do not get taxed. If the Government needed the revenue, it would have to do something about that. However, other countries do not have that situation.

Jean Urquhart (Highlands and Islands) (Ind): I will highlight a couple of statements in your review. You state that to

“improve the quality of debate on tax and help people think coherently ... will lead to some improvement in policy”.

How does that manifest itself? Whose debate is that? I, too, am interested in the idea in the review about clarity on tax and about laypeople—for want of a better term—such as us understanding the tax system. Perhaps there will never be a day when people are happy to pay their taxes, but at least they might understand better the system that has been devised and the outcomes from that system.

The other quote that I want to ask you about is:

“we need to get better at the very tough job of quantifying the welfare gains to be had from reform.”

The two statements seem to be related.

Sir James Mirrlees: Yes. On the first point, one question might be whether people can understand the arguments for an alternative to having zero VAT on certain foods. Almost everybody agrees that we want to do some redistribution, and the obvious thing to do is to base that on how well off people are.

We would think that, once the issue was discussed, people would begin to see that there is no reason for treating food differently from, let us say, expensive wine—although, at first, they might think, “No, that doesn’t make sense. Obviously we should be taxing luxuries at a higher rate.” There are some paradoxical things such as that, where the argument can be widely understood, although it will no doubt take a little while. That proposal would probably work.

10:30

Even our students have a lot of trouble with quantifying welfare gains, so people at large would be a bit puzzled. We can produce numbers, as we did in the review, but we are relying on people believing that we have done a good job rather than understanding exactly what the argument is. It is a different thing to say, “We claim that, if you make that change, the efficiency gained would be worth so many millions of pounds.” We are just hoping that the—perhaps slightly spurious—precision of the number will at least tell people what is at stake, but that is not the same as persuading them of the validity of the argument.

There are two different things, both of which are important to do. We should not expect people to accept a tax change happily if they have not been given some estimate of the gain and some indication of who is gaining and who is losing.

Malcolm Chisholm (Edinburgh Northern and Leith) (Lab): It is not a tradition in the Scottish Parliament, unlike at Westminster, to put general principles in bills. In your submission, you suggest that

“A proportionality principle could have been inserted in the Bill”

and that

"There could also have been a principle of continuity".

Were those partly recommendations or were you talking theoretically, as it were?

Sir James Mirrlees: I was not sure whether that would work, taking into account the views of people with a much better judgment of what is influential in legislation. Bringing in such principles is a bit like what happens when one establishes a constitution, and that has not always been the British way of doing things. Members might not accept that the principles are good and sensible to include and you might not quite see the point of creating a constraint on future legislation.

However, the issue struck me in the context of the bill because of the striking difference between what is in the bill and what will be set out in regulations. It seems to make more sense to have some constraint on the type of tax rates and schedules that could be proposed.

There is no indication—in fact, the position is rather the contrary—that the tax rates would not conform to such principles. I could probably dream up other general principles of the same character. I was not sure whether those principles would sound attractive to most of the people who are responsible for legislation, and I was absolutely right.

Malcolm Chisholm: As I said, we have not had a lot of precedent for including principles. Would including such principles rule out some taxes per se? There is also the question of ambiguity. We have dealt with the issue of proportionate and proportional taxes, so to what extent would your suggestion be viable?

Sir James Mirrlees: There are UK taxes—the transaction taxes are leading examples—for which we do not have continuity. That is what made me think that, if one could rule out some unfortunate things, that would be fine. It might not be as easy to think of other clearer examples. Of course, one of the principles—continuity—is much weaker and therefore much more acceptable than the other.

Malcolm Chisholm: We know from your submission that you do not like taxing property transactions. You say:

"Taxing property transactions is also a source of inefficiency. There is little the Scottish Government or Parliament can do about it, since they have been given so few tax powers."

You suggest in your review that we could

"replace business rates"

and LBTT on business property

"with a land value tax".

Would that be a viable approach in Scotland? Would we have the powers to make such a change? Could that change be revenue neutral?

Sir James Mirrlees: There is a lot to be said for it, but I do not know what powers are available. Such a change could be revenue neutral, but it would not need to be.

Malcolm Chisholm: In your review, you seem quite keen on a land value tax—is that right?

Sir James Mirrlees: I have concerns about a land value tax, which is more subtle than it seems at first. It is an old idea. On general economic principles, it sounds as though it would be grand because, in some sense, it has no adverse incentive effects. People will not throw away land or fail to create land because of such a tax. However, we then start to realise that Government regulations and permissions—local as well as central—can greatly change the value of land. Development value is a well-known concept. To get down to pure, simple land value is not straightforward.

The real concern—although I thought in the end that one should not be too concerned about it—is that, if we introduce a land value tax, it will have widely different effects on different people. It will tax people who happen to have a lot of their wealth in land but it will do nothing to people who happen to have their wealth in other things—in stocks and shares or in the bank.

If all those people are pretty rich anyway, we might say, "Well, we are still doing some good—we are taxing the rich and that is what we wanted to do. We are just missing out some of the rich." However, a land value tax has a rather inequitable aspect in that it has a very different effect on different people who, in other respects, the system would want to tax to the same extent. The feeling is therefore still that a more general wealth tax would be better.

Malcolm Chisholm: Paragraph 6 of your submission says:

"The American requirement that the Internal Revenue Service state how much time they estimate it will take to complete the tax return, on average, seems an example that could with advantage be copied."

Are you suggesting a general reference to that principle in the bill or do you just think that that would be quite a good idea administratively?

Sir James Mirrlees: It is a small point, but it would be a good idea to require revenue Scotland to estimate how much time would be involved in taxpayers conforming to the legislation's requirements.

Malcolm Chisholm: I will go back to something that you touched on at the beginning—the general

anti-avoidance principle and your concern that section 58 says that

“obtaining a tax advantage is the main purpose, or one of the main purposes, of the arrangement.”

How does that compare with the general anti-avoidance measure in UK legislation? I presume that there is no similar reference. Is it just omitted or does the UK legislation say something better?

Sir James Mirrlees: I do not have the wording here, but I think that the UK legislation refers only to a main purpose and that the arrangements have to be abusive. I have forgotten the exact wording, which is quite a lot weaker.

Malcolm Chisholm: So you are mainly concerned about the words

“one of the main purposes”.

Sir James Mirrlees: Yes—it is only that.

Malcolm Chisholm: This is rather a general question. To what extent does the bill reflect UK arrangements and to what extent is it significantly different?

Sir James Mirrlees: On the anti-avoidance measure, the bill is significantly different and is distinctly stronger.

Malcolm Chisholm: What about in other respects, more generally?

Sir James Mirrlees: The bill seems very like the UK arrangements. In many ways, it is presented somewhat more smoothly. That is the advantage of coming later.

Gavin Brown (Lothian) (Con): I have a couple of brief questions. Do you have a view on the board structure that a tax authority should have? Are there any general principles on, for example, having a mixture of executives and non-executives or having all non-execs and having the chief exec report separately to the board? Are there any general principles that you would recommend?

Sir James Mirrlees: I have thought about that, but I really do not know. The way in which the arrangements are set out seems perfectly sensible, but other arrangements would have seemed sensible, too. I am sorry—I do not have enough expertise on the subject to make sensible recommendations.

Gavin Brown: Okay. The concept of advance clearance—the idea that the tax authority could speak to parties before a transaction took place and, in effect, clear it by saying that it would not be subject to tax, for example—has been raised with the committee in various discussions. I guess that there are three broad approaches. One is not to have a system of advance clearance at all. Another is to have a system in which there are informal discussions between the tax authority and

the parties and a non-binding steer is given. A third example that we have been shown involves a formal discussion between the tax authority and the parties and a binding agreement on clearance being given in advance of the transaction. Do you have views on any of those three approaches or any principles about advance clearance?

Sir James Mirrlees: Often, the particular instance needs to be thought about. We can have tax avoidance schemes or a question whether a set of transactions is held to be an example of tax avoidance that would change the tax calculation. Many cases would be like that, which implies that the tax authority could give a steer in initial discussions without any commitment to approve what is finally done because, as with many legal cases, the exact circumstances might turn out to be important.

The second of your three approaches makes sense to me. It violates certainty a bit, so I can see why there is a case for the third approach but, on balance, that is what I would call for.

The Convener: That concludes questions from the committee. Would you like to make any other points?

Sir James Mirrlees: That was an interesting set of questions. Thank you very much for treating me so well.

The Convener: We have quite a gentle bunch. Thank you very much for coming along. It is very much appreciated and will help us in our deliberations on the bill.

That is the end of the public session. I will allow a brief pause to enable the public and the official report to leave before we go into private session.

10:46

Meeting continued in private until 11:09.

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