



The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

ECONOMY, ENERGY AND TOURISM COMMITTEE

Wednesday 19 March 2014

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CONTENTS

	Col.
SCOTLAND'S ECONOMIC FUTURE POST-2014	4185
SUBORDINATE LEGISLATION	4215
Renewables Obligation (Scotland) Amendment Order 2014 [Draft]	4215
Land Registration etc (Scotland) Act 2012 (Commencement No 2 and Transitional Provisions) Order 2014 (SSI 2014/41)	4222

ECONOMY, ENERGY AND TOURISM COMMITTEE

8th Meeting 2014, Session 4

CONVENER

*Murdo Fraser (Mid Scotland and Fife) (Con)

DEPUTY CONVENER

*Dennis Robertson (Aberdeenshire West) (SNP)

COMMITTEE MEMBERS

*Christian Allard (North East Scotland) (SNP)

*Richard Baker (North East Scotland) (Lab)

*Marco Biagi (Edinburgh Central) (SNP)

*Chic Brodie (South Scotland) (SNP)

*Alison Johnstone (Lothian) (Green)

*Mike MacKenzie (Highlands and Islands) (SNP)

*Margaret McDougall (West Scotland) (Lab)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Michael Clancy (Law Society of Scotland)

Fergus Ewing (Minister for Energy, Enterprise and Tourism)

David Glen (PricewaterhouseCoopers LLP)

Fiona Hepplewhite (Scottish Government)

Moir Kelly (Chartered Institute of Taxation)

Elspeth Orcharton (Institute of Chartered Accountants of Scotland)

CLERK TO THE COMMITTEE

Stephen Imrie

LOCATION

Committee Room 4

Scottish Parliament

Economy, Energy and Tourism Committee

Wednesday 19 March 2014

[The Convener opened the meeting at 10:00]

Scotland's Economic Future Post-2014

The Convener (Murdo Fraser): Good morning, ladies and gentlemen. I welcome all members, our witnesses and those who have joined us in the public gallery to the Economy, Energy and Tourism Committee's eighth meeting in 2014. I remind everyone to turn off or at least turn to silent all mobile phones and other electronic devices.

Agenda item 1 is the continuation of our inquiry into Scotland's economic future post-2014. I am delighted that we are joined by an esteemed panel of experts in the tax world. We have Moira Kelly, who is the chairman of the Chartered Institute of Taxation's Scottish technical sub-committee; David Glen, who is a partner and head of tax Scotland at PricewaterhouseCoopers; Michael Clancy, who is the director of law reform at the Law Society of Scotland; and Elspeth Orcharton, who is the director of taxation at the Institute of Chartered Accountants of Scotland. I welcome you all.

We have a maximum of 90 minutes for the session. As it is budget day and you all have other things to do, I am particularly obliged to you for giving up your time to talk to the committee. We will want to cover a number of areas, such as the fiscal regime that might apply post-independence or if there is a no vote and that regime's consequences. We will also look at tax changes that are proposed in the white paper.

I remind members to keep their questions short and to the point, if they can. We have quite a large panel, so it might help if members direct their questions to a particular panel member. If a witness wants to respond to a question that another witness has been asked, they should catch my eye and I will bring them in as time allows. If the answers are fairly short and focused, that will help us to get through the issues in the available time.

My first question is to all the witnesses—we will start with Moira Kelly and work our way along. It is about the room for manoeuvre on fiscal changes in the event of a yes vote in the independence referendum.

Two weeks ago, Paul Johnson of the Institute for Fiscal Studies told the committee that it is likely that, in the event of independence, any Government would still have to pursue a policy of austerity because of the public financial position. Last week, we heard that Professor Jeremy Peat believes that an independent Scottish Government would have to apply fiscal rules that were at least as tight as—and probably tighter than—the rules that the current United Kingdom Government applies because, whatever currency arrangement was chosen for an independent Scotland, tight fiscal rules would need to apply for some years to establish credibility with the international markets.

What room for manoeuvre to make fiscal changes would exist in an independent Scotland? Is it credible to propose a corporation tax cut in the initial stages?

Moira Kelly (Chartered Institute of Taxation): I start by saying that I am not an economist; we are tax advisers, so my response must be considered with that in mind.

We think that this would be a great opportunity to derive tax legislation that is suitable for Scottish requirements. It would give us an open page for deriving and designing our own tax legislation. However, in practical terms, we would have to watch how we were perceived.

The white paper talks about a drop of perhaps 3 percentage points in corporate tax rates. One of our fears is that that might lead to a race to the bottom in which corporation tax in tax jurisdictions goes down and down. Squaring that with an approach of achieving various things with welfare benefits in Scotland might be an issue.

More practically, what would be the effect on companies that operate in both Scotland and the rest of the United Kingdom? How would we work out which profits were taxable in Scotland and which were taxable in the rest of the UK? That would lead to administrative issues. What about companies that operate in Scotland but that have their headquarters in the rest of the UK?

We have thought about aspects of the issue down at the individual level. Shall I talk about individuals or do you want me to stick to corporates?

The Convener: Please go ahead.

Moira Kelly: A corporation tax cut would have the same impact on individuals. I am a volunteer for the Chartered Institute of Taxation, but one of my colleagues is employed by CIOT. CIOT has a UK payroll and is based in England, but she is employed up here.

To take the issue a bit further, what about giving relief to someone who is an English taxpayer but who works in Scotland? If they contribute to a

pension, we would have to give them tax relief for the pension contributions in Scotland that would be equivalent to what we would give a Scottish taxpayer. What if the pension company was based in the rest of the UK?

We must take into account various practical aspects such as that. Rather than thinking, "Oh yes, we can do this," we are more interested in the practical implications for individuals, because a lot more individuals might have to file tax returns; the implications for companies and how profits are split; and the implications for how we give relief.

David Glen (PricewaterhouseCoopers LLP): Convener, your question was about the ability to afford a cut in corporation tax. I see that in terms of the classic fiscal equation of how much a Government will spend, how much tax it will raise and how much it will borrow. Some of those things are, at this stage, unknown.

The level of spending that we would want to cover and the level of borrowing that we would want to take on would be for whatever new Scottish Government to decide. Those things would also be determined by the level of debt that was taken on from the UK, and they would be significant factors in determining what the Government wanted to achieve from taxation.

When a Government has established what it thinks that it will need from a tax perspective, it can look at a range of taxes to see where it would be best to raise the tax from. In any economy, but particularly in the UK, the biggest tax take is from personal taxation. Your question about corporation tax must be seen in the context that corporation tax is not a major tax take for the economy, so it can be used as a lever to encourage other activity such as inward investment.

The ultimate question is whether we could lower the level of corporation tax in an independent Scotland. I am sure that we could, but the question is how we would square the rest of the equation. Should money come from raising taxes elsewhere? Would lowering corporation tax stimulate sufficient economic activity elsewhere to square the rest of that equation?

The scenario is different depending on the lens of the corporation that you are looking at. You also have to think about whether indigenous businesses are mobile, as some businesses are clearly not mobile. The Scotch whisky industry must be in Scotland for its product to be Scotch, so it will have a different lens from other, more people-based industries, which could think about moving their headquarters.

Perhaps more important is inward investment. I spent the week before last on the west coast of America, visiting various companies. I had a conversation with every one of them about

Scotland's potential independence and what the impact might be for them. They look at the situation through a completely different lens. They are large multinational corporations, and adding another country to the list of countries that they have to deal with would not be a big issue for them because they deal with so many. Adding another country to the list would be fine—they would cope with that as they cope with it elsewhere.

You asked about the level of corporation tax. The companies that I visited deal with various levels of corporation tax and other taxes, so they can handle that. Every company that I talked to either already has significant operations in Scotland as part of the UK or is thinking about moving more of its operations to Scotland or the UK. Why is that the case? It is because they see that current UK corporate legislation is becoming ever more benign and favourable to international relocation. Therefore, they might want to use the UK as a hub in which to headquarter their European operations. In one instance, it was a straight fight between two options: "Do I relocate to Singapore, where I will get a zero per cent rate, or do I relocate to Scotland, where, with current UK incentives, such as the patent box for innovations, I could get a rate of about 10 per cent?" The equation becomes powerful for the UK because we have a workforce that goes with that rate.

Those are the kind of equations that companies look at. The question for them is what Scotland will look like through that lens. They like the current UK lens. How much will Scotland differ as an independent nation? There are different lenses depending on which companies you look at.

The nub of your question was: can we lower the current rate of corporation tax? I am sure that we can. However, as you work through all the implications, many different things will get you to the answer to that question.

The Convener: Members want to ask supplementary questions, but we will hear from all the panellists first.

Michael Clancy (Law Society of Scotland): As I am the least numerate person on the panel, it is quite difficult for me to say what the impact of a 3 per cent cut in corporation tax would be. However, there are clearly issues about how the simplification of any complex tax system impacts on the three components to which David Glen referred: income, borrowing and expenditure.

Immediately after I-day, we would still have the existing tax regime to work through, and there will be a big debate about the nature of the tax regime that an independent Scotland would construct following a yes vote. That would depend on who

made up the Government in the independent Scotland starting in May 2016.

The political parties need to do a lot of thinking about what the best tax regime for an independent Scotland would be. We know what the Scottish Government thinks because the white paper sketches out a lot of its principles and some of its concrete ideas. Yesterday, we heard Johann Lamont's proposal for additional taxation in the event of a no vote. We are waiting to hear from the Conservative Party, and we have heard what the Liberal Democrats think in their home rule proposals.

The political parties need to think about the issue. They will have to work to certain principles of consultation and consideration in order to take into account the views of people who have an interest—not only experts such as those around me, but anoraks like me and the people who will be affected by this: the taxpayers.

As we say in our submission, if Scottish rates of tax were markedly lower than those in the rest of the UK, that would raise the question of whether Scotland would be able to raise sufficient revenue to maintain adequate public services. If we focused on having a markedly lower rate of corporation tax, Scotland might be a desirable place for some businesses to come to. We could become the Delaware of northern Europe and attract businesses in. However, there might be a cost to that because Scotland might not be desirable in other respects. A lowering of corporation tax might mean that the gap would have to be filled by an increase in tax in other areas.

You have asked a very complex question, and I do not think that anyone has a monopoly on wisdom about this—I know that I do not. We will have to start thinking in concrete terms, and people will have to start showing their hands about the proposals that will go into the manifestos for the 2016 election.

Elspeth Orcharton (Institute of Chartered Accountants of Scotland): A lot has been said and I disagree with none of it, so I will not repeat any of the points that have been made. It is important to think about the consequences of reducing corporation tax. You can read the various studies that say that if you have a 3 per cent differential seven years on, a number of jobs might be created. However, you also have to think about the wider consequences. How would you fund the dip in corporation tax, and how likely is it that a 3 per cent differential tax rate would be maintained?

The pattern of corporate tax rates across Europe is one of steady decline over at least 10, if not 20, years. There has been a shift in taxes at

that general level from corporation tax to labour and employment taxes and to property taxes.

I have had a quick look at the most recent "Government Expenditure and Revenue in Scotland"—GERS—figures. We could talk about percentages of gross domestic product, but the figures that jump out at me are the calculations for tax revenue per head of population in Scotland, which oil tax revenues have historically made higher than the figures for the rest of the UK.

It is also relevant to look at where the spending levels per head have been. There is an interesting change in the pattern of spending per head in Scotland relative to the UK, and where the tax revenues have been declining and the spending has been at quite a high level there is the deficit. We have a UK deficit and a Scottish deficit. That tells me that, if corporate taxes are to be cut, taxes somewhere else will have to be raised or there will be implications for spending. However, it is for the politicians to decide that.

Some other consequences of cutting corporation tax should be borne in mind. If it was being done to attract inward investment, you would have to consider that a bold cut in the rate would affect every company that is already in Scotland anyway, and some of those might not be mobile. The question is whether you would be making the best use of your tax powers by cutting across the board or whether you should do what a number of jurisdictions have done and make focused relief available across the board where you wanted the investment spend to be. David Glen has talked about the patent box regime, which is very much about attracting technological developments. That is, again, a decision for the politicians, but it should be understood that a more focused relief might be more effective in doing what you want to do.

In addition, tax rate cuts have behavioural impacts. The more that corporate taxes have been reduced in the UK, the greater have been two things: tax-motivated incorporations by self-employed businesses and partnerships and the invention of more of what some might call tax-avoidance structures to get to a corporate tax rate. There is always a behavioural part that you do not see.

There is also profit shifting to consider. Businesses that operate across the UK make submissions to the tax authorities that favour an under-the-rules move so that their overall profits are taxable at a lower rate. That has consequences not just for the tax yield but for the amount of spend that the tax administration must have to police such moves and for the administrative burden on businesses to prove to the tax authorities that they have followed the

rules. That applies for all companies across Scotland.

There are a number of complicated factors to consider.

The Convener: Before I bring in other members, I have one follow-up question. Do you agree with David Glen that the current UK fiscal regime is generally beneficial for and attractive to corporates in a European and global context?

Elsbeth Orcharton: That is certainly the feedback that we get from members.

Marco Biagi (Edinburgh Central) (SNP): I have a question for Moira Kelly, who mentioned cross-border issues, such as people working in one area and living in another. That happens already, although the scale would change. For example, last week, I met someone who lives in my constituency in Edinburgh but works in the Danish zone of the North Sea and is taxed under Danish law. Such arrangements exist and are dealt with using established procedures, so the issue would simply be one of scale.

Moira Kelly: Yes—it would be an issue of scale. The UK already has double tax agreements with other jurisdictions. We feel that more people would be brought into that, because folk would be more likely to live in England or Scotland and commute to the other country. It is probable that more tax returns would have to be filed, which would have an effect on revenue Scotland.

Chic Brodie (South Scotland) (SNP): I have a quick comment. I ran eight companies across Europe under one umbrella and I never had a problem with the mobility of staff, because we knew the country of residence and the country where they paid tax. That applied particularly in Belgium and Holland. To a large extent, it is a myth that those problems cannot be overcome.

Mr Glen says that the UK tax regime is helping investment. Figures that have just been handed to me show that Scotland had 8 per cent of the UK total of inward investment in 2009, while the figure was 19 per cent in 2010, 20 per cent in 2011 and 16 per cent in 2012, so we are already doing something right. Do you not think that, on the basis that we would reduce corporation tax, that percentage compared with the figure for the rest of the UK would increase?

David Glen: Who is to say? That depends on the extent of the changes in whatever the new Scottish legislation is. Let us not forget that the current plan is for UK legislation to roll over on independence to become Scottish legislation. To start with, we would be exactly the same. The issue is the extent to which the position would change.

Chic Brodie: We have the same legislation today, and look at what is happening.

David Glen: Overall, there is increased inward investment across the UK. If Scotland is picking up an increased share of that right now, that might be because of particular circumstances. Who is to say whether that will continue? The regime for the UK as a whole has changed fairly dramatically over the past five or six years as legislation has changed.

Elsbeth Orcharton: I will add something that might be relevant. What probably enabled Chic Brodie's businesses to operate on the basis that he described was knowledge of the rules and the international networks of tax agreements between authorities, which deal with things such as the tiebreaker when someone works in Denmark and the UK, who decides where they pay tax and how the offset rules apply. It will be important for the corporate regime in Scotland to ensure that a corresponding network of international tax agreements applies. The issue is not just about the domestic stuff but about the agreements that are reached with 100 or so international partners.

Dennis Robertson (Aberdeenshire West) (SNP): The convener introduced the panel as an "esteemed" group. That brought to my mind the fiscal commission working group, which is also made up of esteemed members. Three of them have a great deal of experience and knowledge of the taxation system—Professor Hughes Hallett, Professor Mirrlees and Professor Stiglitz. I sincerely hope that you agree that they have a great deal of knowledge.

In considering how to move forward in a modern Scotland, the fiscal commission working group suggested that the principles to follow for the taxation system should be simplicity, neutrality, stability and flexibility. Those are all principles that were included in Moira Kelly's submission. You suggested that you agree with those principles. Will you expand on them and on why you agree with them?

Moira Kelly: To have a good tax regime requires certainty so that, when individuals or businesses engage in an activity, the tax implications are easily understood. There should be certainty about how activities will be taxed. That makes the administration of the tax easier and it leads to an understanding of how the tax will operate. The entire tax regime is easier to operate, which means savings for taxpayers and the revenue-raising body.

David Glen: The point about stability is key. I deal with a fair number of inward investors among my clients. When discussing the implications of moving to Scotland and the UK, I have seen them trying to understand the system. They end up

hesitating to make a decision to invest when they see tinkering in tax legislation that affects them. A piece of legislation might come in that looks on the face of it to be favourable to them, but they ask how sustainable it is and whether it will last. When investors see tinkering, which happens quite a lot, they become disbelieving of how long lasting the benefit will be. They are making decisions to invest for an extended period, which is not just the next two or three years. They have a longer outlook, so they seek stability and certainty.

Moira Kelly: There is a contradiction between tinkering to achieve certain economic objectives and trying to have as simple a tax regime as possible. It is up to you guys to decide where you want to get to.

Dennis Robertson: I am grateful for that. I am sure that Mr Swinney would relish the challenge.

Does the current tax system, which is presided over at Westminster, follow the principles of simplicity, neutrality and flexibility that we have just discussed?

Moira Kelly: That is a difficult question.

Dennis Robertson: It is not really.

Moira Kelly: I am sure that the objective is to achieve a simple tax regime. However, on the practicality of encouraging certain behaviours and incentivising inward investment, I would comment that that is where people such as me get a job.

The Convener: So a simplified tax system does you all out of jobs.

Moira Kelly: Yes. When I started in taxation, our legislation was a big enough pile of paper, but it now runs to five or six volumes. That is a simple tax system.

10:30

Michael Clancy: I think that I might be slightly older than Moira Kelly. I remember when the law was written on stone. [*Laughter.*]

All law—not just tax law—has expanded over the past 30 or 40 years. We have a national propensity to create law to deal with problems that we perceive in our society, and tax law is not immune from that. One can talk about the idea of a simple tax system or a system that is, in the white paper's words, neutral, stable and flexible. They are great principles to guide one, which could be applied to almost any legislative endeavour, but they have a particular focus for tax, because tax law has acquired barnacles of complexity from the chase around avoidance and the need to deter evasion and meet objectives that might be socio-legal in order to incentivise types of activity or disincentivise types of behaviour.

It is therefore difficult for us to say that we can immediately have what would be described as a one-A4-page tax code. That will not happen, because people with their advisers and corporations with their advisers will design mechanisms so that they legitimately pay the tax that they owe and do not pay tax that they do not owe.

We must remember that income tax is supposed to be a tax on income. If we go back to the origins of taxation, we see that taxes were meant not to be permanent features of life but to fund armies in 18th century Europe. However, as our society has grown more complex and as the demands on the body politic have increased, we have had to raise money to pay for that. As soon as we start doing that, complexity comes in.

We hope that any new tax arrangements will comply with the principles that I have described. In our paper, we quoted Adam Smith's maxims of certainty, convenience, efficiency and proportionality, which is the ability to pay. The world is different from what it was in Adam Smith's day. We live in a more complex society with a welfare state, and all the public endeavour needs to be paid for somehow.

I can say that our experience of dealing with the Scottish Government on the land and buildings transaction tax and the landfill tax has been positive. The engagement that we have had with Scottish Government officials has been helpful. Dealing with aspects of the cross-cutting nature of those taxes between Registers of Scotland and the Government provides an augur of hope for the future. We must bear it in mind that the Government's responsibilities might change through having more powers, whether there is independence or a no vote, so we need to maintain that hope.

Dennis Robertson: Margaret Hodge MP, the chair of the Public Accounts Committee, recently stated that tax law is hopelessly complex and outdated. Do the witnesses agree? If so, why?

David Glen: I do not know whether I would use the word "hopelessly" in that context.

Dennis Robertson: That was her word, not mine.

David Glen: Absolutely. Tax law is indeed complex and it is perhaps outdated. I contextualise it in that way because it links with the maxim of flexibility, which was just referred to. Tax law can be outdated, and it needs flexibility, because we have a changing world. We are now in the digital age of the internet but, by and large, tax legislation does not cope easily with that and only now are we starting to pick up on and deal with that.

There is much more to do. For example, a lot of work is being done at the level of the Organisation for Economic Co-operation and Development to look at how the world copes with the ever-greater internationalisation of business. Borders do not exist in the electronic world. How do we capture borders in this electronic age? To that extent, the legislation is outdated and needs to catch up.

I was not around when the army was being funded in the 18th century, but I assume that the legislation has been updated since then. As people tinker, they undoubtedly leave behind fairly archaic bits of legislation that do not sit well with other bits. However, rectifying that would be a substantial piece of work.

That brings me on to flexibility, which could be a plus point for a potential independent Scotland. The flexibility to respond quickly as an independent nation to what is going on in Scotland's economy and in the industries that are important to Scotland—oil and gas, financial services, whisky and so on—could be a positive thing.

Dennis Robertson: The fiscal commission suggests applying the four principles of simplicity, neutrality, stability and flexibility. I think that those were the principles on which Adam Smith founded modern-day economics.

Elspeth Orcharton: A couple of years ago, when the debate was kicking off, ICAS wrote a paper on the matter. You might or might not be interested to know that the current UK Government also has its principles, which include having taxes that are

"certain and predictable"

and

"simple to understand and easy to comply with"

and having a tax system that is fair and rewards work. Although principles are helpful, I am not sure that they completely determine the shape of a tax system.

The Convener: Does that demonstrate the key problem? It is easy to have a soundbite that we need a simpler tax system, but all the changes that are introduced are in response to some issue or lobby so, the minute that a Government says that it will take them away, that creates a backlash from whoever the beneficiaries are.

Elspeth Orcharton: Exactly. In his report, "Tax by Design", which is a lovely 800-page read for people like me who are into that sort of thing, Professor Mirrlees said:

"proposals for tax reform are, of course, constrained by politics—not least the unfortunate observation that those who lose from tax reforms tend to be vengeful while those who gain from them tend to be ungrateful."

That comes back to the fact that, although there might be a great wish to do something, it can be difficult in practice to make the decisions and negotiate the play-offs.

The situation is complex, which is why the legislation is complex. It is not that someone thought, "Great, let's have another bit of complexity"—although we sometimes think, perhaps unfairly, that HM Revenue and Customs thinks in that way. We are talking about tax administration, and Governments everywhere face the issue.

Dennis Robertson: The committee is considering the post-referendum situation. Although it would not start with a blank sheet of paper, an independent Scotland would have an opportunity to simplify the taxation system, would it not?

Elspeth Orcharton: The same opportunity exists whatever Parliament we are looking at. It is for those Parliaments to decide whether they want to commit to adopting a simpler system.

Michael Clancy: One must not forget that the tax law simplification project has been running at the UK level for more than 10 years. As Elspeth Orcharton said, no one sets out with the idea of making a system unduly complex. However, in responding to situations that arise through case law, other legislation or impacts on the economy, it is important that we have the capacity to change, and change might bring with it complexity.

A tax law system has to be flexible. However, I caution against having an easy flexibility—if that is not too much of a contradiction in terms—because the rule of law comes into play. We are dealing with a body of law, and flexibility in the law needs to involve the proper process of scrutiny and consultation.

We cannot just have a ministerial diktat that says, "This is how the tax law will be changed because we've got a principle of flexibility." We have to balance that. The white paper does not address the impact of the rule of law—and neither do the principles that the United Kingdom Government enunciates—in connection with adherence to the principles. However, we must bear it in mind that that is part of the bedrock of what we are dealing with.

Moir Kelly: We have found the collaborative approach to the development of our Scottish taxes legislation so far very refreshing, and that should continue. To put the matter in context, when the UK Government looked at the cash accounting system for small businesses, we made suggestions about a simplified regime. However, the tax authority went its own way, and we ended up with a far more complicated regime than we should have had. We should bear in mind the

collaborative approach. We are all working together for as good a tax regime as we can get. It is a matter of taking forward the feeling of collaboration.

The Convener: A couple of members want to ask questions. They should be brief, please, as we need to move on.

Mike MacKenzie (Highlands and Islands) (SNP): The witnesses have placed quite a lot of emphasis on consistency and certainty. I know that none of you is an oil economist. The oil and gas industry is very highly taxed, and there have been 16 major fiscal changes over the past decade, which culminated in George Osborne's quite infamous tax raid in 2011. What effect would that approach have on any industry?

David Glen: There is a recent change to the legislation that is currently being worked through that will affect the oil and gas sector. It came out in the autumn statement. In simple terms, it relates to the deductibility that businesses will be allowed for leasing costs when operating in the North Sea. We are beginning to find—I talk from experience with some of our clients—that that is having quite an impact on their thinking about their ability to continue in the North Sea.

We have seen that the larger players have moved out of the North Sea, as their cost base does not allow North Sea activities to be as profitable for them as they need to be. Therefore, the secondary drillers have moved in. As they have a lower cost base, the work is economical for them. However, with some of the tinkering with changes in tax legislation, even they are beginning to feel the squeeze in looking at whether it is profitable enough for them. Let us not forget that those businesses have choices. There are other places in the world that have oil and other places that afford them a greater return on their investment. Therefore, we must be very careful. We cannot just look on the oil and gas sector as a cash cow that we can raid every now and again when we are short of a bit of revenue. I guess that that applies to all the significant industries in Scotland, but I wonder whether the oil and gas sector in particular has been picked on in that respect. We need to be very careful about how we look after that industry.

Marco Biagi: Both Mr Clancy and Ms Kelly referred to their positive experience of the development of the Scotland Act 2012 taxes. Is that an intrinsic feature of proximity to where decisions are being taken, and is it helped by the scale? Whether we are looking ahead to independence or just the greater extension of tax powers, which I believe other parties are suggesting, is that a positive of bringing that decision making to the Scottish level?

Michael Clancy: It may have something to do with scale, because if one is trying to influence a finance bill in Westminster, one's voice is one of thousands, of course, whereas in Scotland, it might be one of hundreds. It is quite difficult to achieve change in the UK Parliament through amending a bill. I have managed to change one aspect of tax law, which was in the Scotland Act 1998 and related to the definition of a taxpayer.

10:45

If the civil servants who are dealing with such matters are less than 5 miles away from one's office, and if the group of people who want to contribute to the debate is smaller, those two factors allow for a more open discussion. In a participative Parliament such as this one, we find that bringing our views on legislation to the attention of committees and the chamber is a positive experience by which I would like to think that we have contributed to the law.

Overall, my answer to Marco Biagi's question is yes.

Moir Kelly: I come from Aberdeen, so I am not just 5 miles away. However, one factor may be mindset. We have this new baby here, and we are all trying to get the best tax regime by coming at the issues from different sides, while saying that we want to make the system as user friendly as possible for the revenue and for taxpayers. The process is very collaborative, which is refreshing.

Another aspect, which may be part of the Scottish psyche, is education, and specifically the proposal to bring financial education into schools. That will create individuals who see that they have to buy into their country and their Government, and that taxation is their duty. That is to be applauded, and if we can do anything to facilitate it, I ask the committee to get in touch with us.

The Convener: We are already halfway through our time, so we will need to move on. I will bring in Margaret McDougall.

Margaret McDougall (West Scotland) (Lab): Good morning. From what I have heard this morning, there are certainly more questions on taxation than answers. Perhaps David Glen can answer my question. If we were to assume that we would roll over the current UK tax system in the unlikely event of Scotland becoming independent, how long would it take to set up a new tax system, and how much would it cost?

David Glen: I am not sure that I can answer the question on cost, as I do not have that kind of data to hand. I guess the issue comes down to how much a Scottish Parliament or Scottish Government would want to tinker with the legislation that is handed over.

The committee has heard from other witnesses on the panel about the consultation process for existing devolved taxes such as a Scottish income tax and the land and buildings transaction tax. Although that process has been very collaborative, it has taken longer than might have been expected. If the process were to be repeated as Scotland sought to amend further tax legislation, we could not keep to a similar timescale, as it would take too long. Something would have to be done. Perhaps, as the Scottish Parliament got used to dealing with that sort of thing, the processes would improve and the operation would become slicker.

It is also difficult for me to answer the question on the length of time that it would take, other than to reflect on the fact that what has happened to date has taken longer than we might have expected notwithstanding the fact that it was a collaborative and fair process. The timescale could therefore be an issue.

As well as dealing with the legislation, we would need to sort out the infrastructure. The initial plans are to outsource to existing HMRC resources, but the back-office functions of revenue Scotland would need to be set up to support that. We could not go for too long with a situation in which there is a devolved tax system but we are relying on what is in effect a third party to run it. That would have to be done at the same time if we were to make the system as efficient as possible.

Elsbeth Orcharton: ICAS has been asking questions about and looking at the outcomes of the previous process, and one of our concerns is that a lot depends on how much is moved. If we assume that there will be full independence and a complete transfer, it will—as David Glen said—take three years, if not four, from the passing of the Scotland Act 2012 to the implementation of those powers. The initial two taxes are probably the simplest to devolve. For example, the LBTT builds on existing operating structures in Registers of Scotland and the Scottish Environment Protection Agency, so there has been no need to build a huge organisation.

If we are talking about full independence, we must start by asking what we want to end up with. On a population share basis, there would be something like 6,000 HMRC staff in Scotland, although I believe that HMRC has a few thousand more than that here at the moment.

HMRC is not organised geographically, so all the oil tax experts and policy guys still sit in London. We would want to bring them up, but there might also be people in Scotland who deal with matters south of the border. The change would not be easy, and we would have to build from scratch a 6,000-person organisation that generates all the tax revenue. We would not want

to rush that process, but we would need a system in place quickly, so it would be quite complex.

My guesstimate—I have been asked the question before—is that the process would take nearer 10 years than four, or perhaps somewhere in the middle. I think that, even in the white paper, there is no aspiration to have everything done in the first session of the Parliament that is subsequently elected, although I stand to be corrected on what is in that document.

With regard to cost, there are two approaches. The white paper refers to “a small proportion” of annual revenue, which at 1 per cent would be £650 million and at 5 per cent would be £3 billion or so. I am not aware that a costing has been done, but I suspect that there might be more to it than that broad-brush approach.

However, it depends on how one looks at cost. When East and West Germany reunified, for example, people knew that there was going to be a cost. The Administrations costed it and introduced what was known as the solidarity charge. They were able to say, “This is what reunification will cost, and this is what it will cost you.” The solidarity charge was an additional percentage tax on income and companies, which was up front and paid for a fixed number of years. In effect, the Administrations were saying, “You want constitutional change, but it will cost you, and this is what you are paying for it,” and people went forward. Cost is one of those things that depend on what you choose to do and how you look for it. However, substantial administrative effort will be required, and that will not be cheap.

Margaret McDougall: So it would take about perhaps five to 10 years to bring in the system. There would be a tax of some sort to meet the cost of that, so we would all be paying for the change at the end of the day.

Elsbeth Orcharton: The question of who pays for what in the devolution negotiations is not for me to answer, but I do not see how we can build a system that is brand new. We could take the opportunity to change more and to build a better information technology system than HMRC has at present—frankly, I do not think that anyone in HMRC would want the current systems; they would probably say, “What a great opportunity to get something new and different”—but having new and different IT systems costs money. That is just a fact.

Another relevant point to consider is how the tax and welfare systems in the UK at present are linked and integrated, and what the proposals would be for dealing with that. ICAS has not considered that issue, but it would become quite complicated.

Margaret McDougall: I have a question on taxation, for Moira Kelly. We have heard from the witnesses that large multinational corporations are already dealing with a lot of different tax systems, but they can cope with that. We have heard from previous witnesses that small businesses are concerned about the different tax regimes, the bureaucracy and the administrative difficulties with which they would have to work and the cost implications that they would face if Scotland were independent. Small businesses are a large part of the economy in Scotland. Will you comment on that, please?

Moira Kelly: As David Glen said, large businesses, which are multinational by nature, just fit different tax regimes in. As Chic Brodie also said, companies bite the bullet and deal with the legislation and with operating in more than one jurisdiction. Our smaller businesses, which form the vast majority of enterprises in the country, will not have dipped their toes in that water. They, in the main, operate in the UK and I suspect that it would be quite frightening for them to consider how they would have to handle their employees under different tax regimes because they have never had to deal with such a situation before.

Chic Brodie is looking up and going, "It's okay, it's okay."

Chic Brodie: No, I just reflect, I had a—

The Convener: Hold on a second; this is not Chic Brodie question time.

Moira Kelly: Smaller businesses will find it frightening to think about how they will have to handle their employees and about having to operate in another jurisdiction—the rest of the UK.

There would certainly be another level of burden on smaller businesses because of having to deal with different jurisdictions, but the issue is how much of a burden it would be for them in practice. It might be that the burden is more psychological, because there are advisers who can easily advise them on the matter and there is a heck of a lot of software that will help them with it.

Margaret McDougall: It is the costs.

Moira Kelly: It is the administrative costs and, taking it down to the nitty-gritty, if we have to, how we would split the profits between those generated in Scotland and those generated in the rest of the UK.

David Glen: The issue for business is the additional compliance costs, which Moira Kelly touched on towards the end of her answer. Ultimately, there will be new sets of rules that businesses will have to pick up. They will get to know and understand them, but they generally come with additional compliance costs. That is the

issue, because businesses are always trying to keep their costs under control.

To help with the fear factor, an independent Scotland could have a light-touch approach in the early years to allow business to get used to the new rules. We could deal with that, but there will be another side to it, which is that, post-independence, some Scottish businesses would, in effect, become branch operations in the UK. The question is whether the UK would have an equally light-touch approach to allow those businesses to get up to speed.

We might be able to control it from a Scottish angle and be looking for our neighbours in the UK to take a similar stance, but the real issue for businesses is understanding what the extent of the additional compliance cost will be and how they will deal with it. Clearly, the impact of that on smaller businesses is proportionately bigger.

Margaret McDougall: Yes, and that is even without the currency. If there was a different currency, there would be additional complications.

Moira Kelly: Yes, indeed.

Marco Biagi: We were talking about administration costs. I have a table that shows the cost of collection. Averaged over three years, the UK currently has greater administration costs than Sweden, Switzerland, Iceland, Denmark, Austria, Turkey, Finland, New Zealand, Israel and Spain. That is an important point when we are thinking about whether we can make taxation more efficient. Could HMRC be made more efficient than it is at the moment? Are there inefficiencies that we could address? Anybody can answer, but I think that Elspeth Orcharton was the one who talked about administration costs, so the question would be best directed at her.

11:00

Elspeth Orcharton: Yes. HMRC administration costs have been higher than they could have been over this session of Parliament, which is when austerity has come in. Staff are the biggest element of HMRC's costs, and I think that its final aspiration is to cut staff numbers by 25 per cent. I am not sure how that translates in that table, though.

The administration depends on what is being administered. To a certain extent, it goes with the complexity of the tax system. I think that there is opportunity for the administration to be more efficient, but it depends on what you have as your tax system and how effective your IT and data sets are at delivering what you want to do. I deal with HMRC policy teams quite a lot and they tell me with considerable frustration that their IT systems do not necessarily give them the

information that they want, for example because they have been set up on a piecemeal, tax-by-tax basis.

There are probably legacy issues in there as well, and there is an opportunity to change that. However, that is where it was coming from. If you are going to build something new, you just have to accept that there might be an up-front investment.

Alison Johnstone (Lothian) (Green): I will continue with the issue of costs and opportunities. The written submission from the Chartered Institute of Taxation suggests that there are frustrations with the current UK Government approach to taxation. The example of the cash accounting scheme for small businesses is used as one that appears to have

“ignored many of the practical views of tax specialists and resulted in a far more complex scheme.”

It goes on to say that differences increasingly appear to drive avoidance behaviours and create further complexity in the tax system.

We know that avoidance and evasion loses us tens of billions of pounds in uncollected tax. We are hearing about the costs of setting up a new system, but do we not have an opportunity to design a fairer, more equitable, more efficient system? Revenue is lost to us every year, but we have an opportunity to change that. If we think of the number of HMRC staff who have lost posts—and perhaps have not added to that efficiency—do we not have an opportunity to make sure that people pay the tax that they owe and do not pay tax that they do not owe, as Michael Clancy said? That is not always the case at the moment. Regardless of colleagues’ concerns about the cost of setting a system up, is there not an opportunity here, in the long term, to design a far better, far more efficient system than the one we currently have?

Moir Kelly: Indeed. We have always said that this is a fantastic opportunity. We talked about the fundamental principles. It is about getting legislation that encompasses those principles, gives certainty and is easily understandable. I am thinking about fairness from both sides—there is the revenue side, but let us not forget the taxpayer side, too.

We need legislation that gives us certainty about what it means, rather than legislation that ends up on the statute book not quite reflecting the effect that the debates indicated that we wanted it to have when it was going through the Parliament. If we can get well-drafted legislation, there is less wriggle room. Taxpayers and the tax authority will know that if they do something, another thing will be the effect. That is what we have been trying to assist with in the legislation so far.

Alison Johnstone: You obviously have concerns that current legislation allows too much wriggle room. You really need to ensure that you are working with the correct people to get the legislation just right.

Moir Kelly: Indeed. One of the advantages of what has happened so far is that the demographics of those assisting with the drafting of the legislation are wider. Obviously, we are not drafting the legislation, but we are feeding into it. We are perhaps getting an understanding from the people who are advising taxpayers, who are obviously taxpayers themselves, of what they have seen in practice, which will assist taxpayers.

David Glen: I am always a little wary when avoidance and evasion are so closely associated. To be absolutely clear, I point out that avoidance is legal and that evasion is not.

Alison Johnstone: I am aware of that.

David Glen: None of us would like to see evasion, but whether something is avoidance often depends on the lens through which it is viewed. Avoidance involves working with the legislation and doing what it allows. If you do not like what the legislation allows, the power is always there for you to change the legislation—let us be clear on that.

The Revenue Scotland and Tax Powers Bill has provisions on a Scottish general anti-avoidance rule. My firm and others commented on that during the consultation on the bill. That GAAR is to cover the currently devolved taxes, but it would be likely to apply post-independence as well. However, if we remain as part of the UK, the Scottish GAAR applying to the devolved taxes will be different from the general anti-abuse rule that works for the rest of the UK.

The Scottish GAAR is perhaps slightly wider than the UK GAAR and introduces the level of uncertainty that we referred to earlier in terms of what business is looking for. Business accepts that it must do things right within the legislation and not avoid paying tax. However, business also needs to know that it can operate with some certainty that the legislation as written is what will be applied to it and that there is no piece of legislation tucked away that, if the revenue or the Government do not like what is happening, it can apply to change the outcome that business thought would apply under the primary legislation.

The legislation must be drafted carefully, but it is perfectly possible to construct something that will give certainty. A great deal of work has been done by Graham Aaronson and his committee on the UK GAAR. We would support extending that into Scotland. Nevertheless, as I said, if you do not like what you perceive as avoidance, you have the powers to change the legislation.

Alison Johnstone: Yes, and I certainly hope that we do. Can I hear from Michael Clancy, please?

Michael Clancy: The Law Society is quite clear that unacceptable avoidance should be stamped out. In the evidence that we are giving on the Revenue Scotland and Tax Powers Bill, we are looking at its provisions on the Scottish general anti-avoidance rule. We have compared those provisions with the current general anti-abuse provisions in the Finance Act 2013 and we think that the Scottish GAAR provisions are much better. They are less complex and should prove to be more effective. The draftsmen will not like hearing that we do not think that the provisions are perfect, but we think that they are considerably better than the current general anti-abuse rule, which has been criticised by many people over the past few years.

To tighten up the GAAR provision in the Revenue Scotland and Tax Powers Bill, one would look to try to make things such as the enforceability arrangements and inquiry arrangements slightly clearer, to ensure that we do not get into a situation in which revenue Scotland is, in effect, taking on improper investigations. However, we are quite clear on our position and, as the bill approaches stage 2, we will be thinking about amendments that we would like the Government to consider.

Elsbeth Orcharton: We have likewise been giving evidence to the Finance Committee. I think that Scotland will end up with a broader general anti-avoidance provision. I hope that the Government team and revenue Scotland will take on board the concerns that we are raising about how to make it workable and provide some form of clearance process to give certainty without removing the teeth of the provisions.

Evasion is an interesting issue, as it is criminal behaviour and we do not get tax evasion without other forms of criminal behaviour. You have to look at tax along with your other powers and the whole approach that is taken to criminal matters. HMRC has made considerable investment in a data-mining software system called Connect, which looks for patterns of non-tax compliance, avoidance and, particularly, evasion. You might wish to get a copy of that should independence arrive. A raft of administration has proved necessary to support challenging illegal evasion. That is another thing for the to-do list, but it is well worth bearing in mind, because evasion leads to huge losses.

The Convener: Richard Baker has a supplementary question.

Richard Baker (North East Scotland) (Lab): It is on a separate matter.

The Convener: I will come back to you in a second, then, or you will interrupt the flow. We are a little bit behind the clock. If we can sharpen up our questions and responses, that will be helpful.

Chic Brodie: I apologise for shaking my head at Moira Kelly. I did so because I hosted a meeting of small businesses here two weeks ago and they all seem to be looking at the opportunity rather than the problems that people associate with the changes that independence will bring. After I ran companies in Europe, I came back to Scotland to do company turnarounds for small businesses. The single biggest problem for the small businesses that I was associated with was in dealing with HMRC and in trying to find their way round all the legislation and complications. What is your experience?

Moira Kelly: Tell me about it. Back in the good old days, you could speak to your local inspector—he knew about you and you knew about him and how the HMRC operated. Those days are no longer with us and there is a changing environment. Certain things are not so good and certain things are much better: you know that you will get a certain treatment throughout the UK, whereas in the good old days you might not have because it was down to the individual inspector. It all comes back to the need to make our tax legislation as simple and certain as possible so that businesses know what to do. I am banging the drum for that because that is what small businesses need.

Chic Brodie: Thank you. Ms Orcharton, in your peroration at the beginning you said that if we reduced corporation tax we would have to increase taxes elsewhere. However, the elephant in the room is growth in the economy. The childcare proposals that we have just announced are designed to increase the tax base, and our immigration policy will also do that.

The Institute for Fiscal Studies, which the convener mentioned at the beginning, said in its report on taxation:

“Scottish independence would provide an opportunity to make sensible changes to the tax system in Scotland that successive UK governments have failed to make. And it would enable Scotland to make choices about its tax system that more closely reflect Scottish voters’ preferences.”

The tax system should be designed to improve productivity and the economy. However, in 2011, you said:

“Devolving tax powers is contrary to the goal of simplifying tax legislation and stability at a UK level, and you could question whether such a move would make the UK as a whole less competitive on the international stage.”

Do you still hold that view?

11:15

Elsbeth Orcharton: You are talking about the 2011 paper. The context for that was to open up debate by putting questions on the table and really stimulating the debate about what was happening.

There are two things to think about. One is the longer term opportunity. What will be the environment and the landscape 10 years down the line, for example? There is an opportunity for the things that we have discussed—simplification, administrative ease and so on—to be in place. Lower administration costs would be one example. However, in the short term, will the transition and the complexity of it put people off as an economic upturn comes? Will that be the response, for right or wrong reasons? The answer depends on how the Governments implement any such change.

That paper was intended to stimulate debate by asking some questions and setting out the challenges. Yes, the opportunity is there, but it is perhaps not dead simple.

Chic Brodie: On that basis, do you not think that it would be helpful for the UK Government as is to negotiate or at least to communicate more and engage with the plans in the event of independence? Our view in the white paper is that nothing would change immediately—it would change over a period of time. I say to Margaret McDougall that the period of time in our view would be five years—

Margaret McDougall: So you say.

Chic Brodie: Would the UK Government doing that not actually help both sides—Scotland after independence and the rest of the UK—understand what the implications of changing the tax system would be?

Elsbeth Orcharton: I think that you are asking me a political question and I am here to answer on tax rather than politics.

The Convener: Thank you. Richard Baker is next.

Richard Baker: My question goes with the flow of current questioning. I will address it to Moira Kelly. We have had a great deal of discussion about simplifying the tax system and structure and how desirable that would be. However, surely, by definition, for individuals and businesses working across the United Kingdom, if a new state within that market was operating a whole new set of tax regulations and systems, that would automatically introduce more complexity. Also, given that it is a tax system that seeks, for example, to cut corporation tax, does that not increase the danger of avoidance?

Moira Kelly: Starting with individuals, yes, it may be that more individuals are drawn into

having to file a tax return than at present. There is the compliance cost that we have talked about. With corporation tax, if there are different rates, we have mentioned before that there might be some kind of profit shifting to take advantage of it. We would then need to have legislation in both jurisdictions. If we look at all the headlines about transfer pricing, it is very easy to say, “Oh yes, transfer pricing is terrible, it is about companies taking their profits out of the UK,” without reflecting that it is based on the tax legislation that we have in the country. It is up to the jurisdictions to get together and work out their tax law, as David Glen said, with the OECD handling it because it will come from the OECD.

David Glen: Assuming that we have independence, one of the key things that will have to be negotiated is a double tax treaty between Scotland and the rest of the UK, because that will determine a lot of what tax will ultimately be raised in Scotland and it will begin to give us an understanding of the level of complexity that individuals and businesses may have to face.

For individuals, it will be a matter of beginning to understand what defines them as a Scottish taxpayer or what could potentially make them a UK tax resident. Will they have dual residence? Will they have to start day counting? That principally applies to people who are constantly working cross-border. There are flights down from Glasgow, Edinburgh and Aberdeen to the south every day—maybe we will have day counters at the airport to make life easy for us all. I am being flippant, but that certainly raises an additionality that people will have to deal with.

Companies might need to consider whether they need tax equalisation programmes for employees, depending where they are working. They will want to deploy staff from a base in Scotland to the south and vice versa. From a corporate perspective, if a Scottish company starts or continues to operate and sell in England, to what extent is it creating a permanent establishment—and thus creating a filing requirement—in the UK? How do I allocate my profits to that branch?

A further issue that is beginning to dawn on some people is that, within UK group environments, it is possible to surrender losses from a loss-making company to a profitable company. It has suddenly dawned on people to ask where the companies sit once there is a split along the border. Some of them might realise that their loss-making company is in Scotland and their profitable companies are in England. That has just increased their tax costs, because it is not possible to offset them. There are implications around Scotland not getting much of a tax take. Of course the opposite will exist, too. People have to

think about all those things, and a lot of it comes back to the double tax treaty.

Richard Baker: My final question is on corporation tax, which we were discussing earlier this morning. The Scottish Government has said that it aspires to cut corporation tax by 3 per cent. There is a cost attached to that. We heard that it would be around £300 million when evidence was given last year to the Scotland Bill Committee, of which I was a member. It seems from the evidence that we received at that committee to be a fairly big supposition to say that additional economic activity will result from that cut in corporation tax. Is £300 million under that policy not quite a big gamble, given that it involves 6,000 public sector jobs? It is a pretty hefty gamble to suppose that such a cut in corporation tax will lead, particularly in the short term, to increased revenues for the Scottish Government. Perhaps that question should be for David Glen.

David Glen: I reiterate that I do not think that any of us are economists and it is difficult to answer about what the precise impact would be.

There has been a lot of talk and concentration on the tax rate. What is ultimately of impact, however, is the tax base. The question is what else may be done in conjunction with the rate of tax. The headline rate might be falling to 20 per cent, but I can think of a number of companies that pay a fairly low effective rate of tax because, for example, of the arrangements in place for the deductibility of interest in the UK. In reality, companies often do not pay a lot of tax. Whereas the underlying rate of corporation tax gets the headlines, what companies really seek to understand is what their tax base is. It is also a matter of other things such as capital allowance.

Richard Baker: Based on that argument, the 3 per cent cut in corporation tax may have very little impact on economic growth at all, if it is competing with allowances elsewhere.

David Glen: It depends what else happens to the tax base.

Christian Allard (North East Scotland) (SNP): I have a question for Moira Kelly and one for Elspeth Orcharton.

The fiscal commission working group paper "Principles for a Modern and Efficient Tax System in an Independent Scotland" recommends on page 11 that

"Welfare and tax policy should ... be developed in tandem to ensure policy integration and alignment".

That is reflected on, I think, page 123 of the Scottish Government white paper. Do you agree that that would be a sensible way to proceed, Ms Kelly?

Moira Kelly: Yes. You have to consider that. The tax system interacts with various other systems, in particular the welfare benefits system. We must take that into account when we are developing our tax policy and devising our tax systems. Too often under the UK system, unfortunately, the various systems work against each other. We have to consider them in total.

For example, the European Commission has issued a consultation paper on the taxation of public bodies and exemptions from VAT legislation of activities that are in the public interest, such as medical care and education. It is hoped that the abolition of the exclusions and exemptions from VAT for such activities will not only increase tax revenues but reduce the complexity of the VAT regime. That all sounds laudable until we realise that that will lead to complexity in the benefits system. We have to look at it holistically.

Christian Allard: Do you think that successive Westminster Governments have done that so far? Like Chic Brodie, I ran a small to medium-sized company and I loved to have the same person come to my office all the time. When we did not have that, it became very complicated. I found it difficult to deal with HMRC not only as someone running a small company but as an individual.

Moira Kelly: I wonder whether Governments have done that. The high-income child benefit tax charge is laudable, but what does it do? It draws more people into having to file a personal tax return. We have to realise that, if we play around with the tax regime, because we are dealing with people, there will be an impact on the welfare system.

Christian Allard: My next question is for Elspeth Orcharton, who stated in her written submission:

"two key areas where attention might usefully be focussed are towards a business tax roadmap, and in focussing tax incentives to those who could provide funding to SMEs."

As I said to Moira Kelly, SMEs are close to my heart. You will be aware that the Scottish Government is committed to reducing the compliance burdens that small and medium-sized enterprises face. "Scotland's Future" sets out a business plan for Scotland. What scope do you see for reducing the compliance costs for small firms? How well is the UK Government achieving that?

Elspeth Orcharton: The position regarding compliance costs for small firms is changing all the time. We see scope to simplify the application of a lot of the detailed corporate tax rules—on corporation tax, for example—by working more collaboratively with the tax authorities. That may mean more disclosure to the tax authorities—for

example, once every three years giving them a big file saying exactly what firms are doing, how they are doing it and how their systems mean that they will be compliant with their tax obligations—but then having a lighter touch and taking a much simpler approach to the actual filing.

We sent a paper on that idea to HMRC last week, but it has not yet had the opportunity to reply so I cannot say that it has not done anything with it. I think that our proposal is consistent with HMRC's theme of trying to return to having the right relationships with taxpayers, which can remove some of the administrative burden. It has done that successfully with large businesses—its work in that area is generally accepted as having been successful—but it needs to roll that out.

There are opportunities to simplify the administration, but a lot of it is about the relationships that can be established with the tax authorities. Doing that may result in both a higher tax yield and a bit of tax cost for the tax authorities.

Christian Allard: You are talking about a collaborative approach. In your submission, you state that the tax system could be used

“to incentivise lending by private individuals to SMEs.”

What are the main obstacles to SMEs getting access to finance just now?

Elsbeth Orcharton: ICAS has a small business committee whose members are very much in the same league. They feel that the banking crisis and restrictions on the availability of bank funding have had a knock-on impact on how small businesses get hold of funding. They are also aware that there are large businesses and others—particularly high-net-worth individuals—that are still successful and that have moneys that they would previously have put into more regular bank deposits or savings.

The flow through the banking system is not working, so looking beyond that—not that we are necessarily into having another complicated relief—if we are to have flexibility in the system, is there something that the tax system can do to incentivise or focus in a structured way that surplus cash into those small businesses? We have seen the development of what I think is called crowd funding, which until recently has been unregulated. Is there a better way of doing that? Should the tax system play a role? There is a feeling that it supports equity investment in small businesses, but why should it not support different forms of funding?

11:30

The Convener: Margaret McDougall has a brief supplementary question.

Margaret McDougall: I will be very brief. My question is for Moira Kelly and is on VAT. Your submission states that, on page 315 of the white paper,

“A VAT reduction on repairs and maintenance work to help culture and heritage is suggested.”

However, what would qualify as “repairs and maintenance” and what is “culture and heritage”? The definition could leave potential loopholes. Would that not add complexity to the current system?

Moira Kelly: You have hit on one of the big nubs of tax deductibility: when does a repair cease to be a repair and become a capital improvement? You are right that that leads to complexity. In parts of the UK legislation, we have to use various sections to determine what is and is not a repair. I think that all of us sitting round the table would say that we know what a repair is. However, the difficulty is trying to get that into the legislation so that it captures what would qualify. That is when we bring in complexity.

The Convener: I am conscious that the minister is hanging around outside the door of the committee room waiting for our next evidence session to start and that Mike MacKenzie has still to come in. Over to you, Mike.

Mike MacKenzie: Thank you, convener. I have a couple of questions for Michael Clancy, whose submission suggests that

“Any decisions on what further devolution there will be needs to be taken on the basis of stability, practicality and principle.”

What test ought to be applied to partial devolution of tax? For example, is it sensible to devolve income tax but not the ability to expand the tax base?

Michael Clancy: When we talked previously about principles, we focused on not only the ones in the white paper of simplicity, neutrality, stability and flexibility but the ones that we referred to as certainty, convenience, efficiency and proportionality. There is already further devolution of income tax under the Scotland Act 2012. That does not impact on the tax base in terms, although it makes definitions of taxpayers.

One has to look carefully at the definition of taxpayers. As you know, during the Scotland Bill Committee's examination of the bill, there were discussions about some of the issues that we have raised this morning about those who live in Edinburgh but work in London and vice-versa. There were issues about the extent to which servicemen serving overseas form part of the body of taxable people in Scotland and perhaps even about oil workers—such as Mr Biagi's constituent who works in the Danish zone in the North Sea—

because they can have specific circumstances. Although there might be difficulties, it is not impossible to devolve tax and touch on the tax base in that way.

Mike MacKenzie: I was trying to get at the interconnectedness of the tax take in general and how each tax interacts with other taxes, rather than the technical difficulties. Christian Allard touched on the issue in the context of the integration of taxation and welfare.

Perhaps I can widen the question to other panel members. I am trying to get at how problematic the further partial devolution of tax powers that some parties propose would be. Would it be problematic?

Elspeth Orcharton: Matters are interconnected; that just adds a different dimension to the impact of partial devolution. For example, whether income tax rates go up or down under the Scotland Act 2012, any benefits that are paid according to a household's income net of tax will adjust accordingly and no impact will be felt. A decision would have to be made on whether an adjustment should be made in the benefits system to pass on any benefit or share a cost. That would mean considering a change in the welfare system.

That is not impossible; it is just a different dimension. The different touch points would have to be looked at in considering the overall impact on the total tax take and the total benefits cost, as well as the household impact. We are talking about a dimension rather than a complete blockage.

Mike MacKenzie: And—

The Convener: This is your last question.

Mike MacKenzie: This is of course my last question, convener—I would not dream of asking more.

I return to Michael Clancy. The Law Society's submission says that,

"whatever the outcome of the referendum,"

including in the event of independence,

"a tax system which is tailored to Scotland and Scots law is essential."

We heard about tax expertise being pretty much centralised in London. Given such considerations, how well does the current UK taxation system serve Scotland?

Michael Clancy: I take as my example issues with stamp duty land tax. When it was introduced, we found it difficult to deal with, because the forms were written according to English legal terminology. For example, they referred to freehold rather than what was in those days feudal

tenure in Scotland. That is about a sensitivity to a different legal framework and environment.

On aspects that are governed by what one might describe as UK law, such as company law, there are not many substantive differences between the law in Scotland and the law in England and Wales. Therefore, that sort of thing does not create as many difficulties as we have seen in areas that touch on parts of the law that are specifically Scottish.

As we move to the land and buildings transaction tax, some of the issues that related to stamp duty land tax have been addressed, because we have dealt with civil servants in the Scottish Government and others who are sensitive to the legal backdrop in Scotland.

Mike MacKenzie: You say that the way in which the Scottish Government has dealt with the land and buildings transaction tax gives you hope. Will you expand on that a wee bit?

Michael Clancy: When I referred to hope, I meant hope about the attitude for discussion. My broad point was on a general hope about politicians' attitude to making law. It is appropriate of you to focus on hope in dealing with legislation, but experience frequently triumphs over hope.

We must bear it in mind that dealing with legislation is an art and a science. There are many contending factors, such as the desires of political parties and politicians, which are balanced against the desires of those who will be affected by legislation. We must all participate fairly in that balancing act.

Moir Kelly: I will add something that is to do with not Scots law but commercial practicalities. I deal a lot with innovatory tax reliefs up in the north-east and it humbles me to see what some of our companies there are achieving with innovation. However, the new patent box legislation ignores the fact that a lot of companies generate income in the north-east and from the North Sea by renting assets to other companies. That is not included in patent box tax relief as qualifying income. There is a back-door way in, but the benefit is not as good. If we draft our own legislation, I hope that we will take account of practical considerations in Scotland.

The Convener: We have run a little over time, but the session has been useful. I thank you all very much for coming along and helping the committee.

We will have a short suspension to allow a changeover of witnesses.

11:41

Meeting suspended.

11:46

On resuming—

Subordinate Legislation

Renewables Obligation (Scotland) Amendment Order 2014 [Draft]

The Convener: We move to item 2. I welcome the Minister for Energy, Enterprise and Tourism, Fergus Ewing, who is joined by three Scottish Government officials. Olive Hogg is a solicitor in the directorate for legal services, Fiona Hepplewhite is policy manager for electricity market reform and Neal Rafferty is deputy head of the energy policy unit. Welcome to you all.

Minister, do you want to say something to introduce the draft order?

The Minister for Energy, Enterprise and Tourism (Fergus Ewing): Yes. Thank you, convener. I have come fresh from the launch of Bannockburn live, which is going to be a terrific success, as I know we all wish it to be. Thank you for the invitation to be here this morning.

The renewables obligation or RO drives investment in renewable electricity capacity across the country. Since its introduction in 2002, renewable electricity capacity across Scotland has almost quadrupled. Indeed, the final figures for 2012 show that renewable generation accounted for an equivalent 40 per cent of gross Scottish electricity demand, putting us well on our way to achieving our interim target of 50 per cent by 2015. We need to ensure that the upward trend continues. We want to see more generation coming from offshore wind, wave and tidal energy—sources in which Scotland has a huge competitive advantage and can create world-leading industries. Of course, the renewables obligation mechanism is due to be replaced by a new system of support based on a contract for difference. I will come on to talk about that later.

The amendments in the draft order are designed to ensure that the RO legislation remains fit for purpose and that we continue to attract investment in new technologies and developments across Scotland in a way that is both cost effective and sustainable. As is customary, we have proposed the same amendments, generally, as will apply across the rest of the United Kingdom. That approach is favoured by a majority and is fundamental to the successful and effective operation of the mechanism. However, as has been the case on previous occasions, there are some important exceptions to that approach.

The most prominent exception is our decision to introduce two new bands to provide additional support for innovative offshore wind generation

from, first, test and demonstration centres and, secondly, pilot projects that comprise non-fixed or floating turbines. Those new and higher bands are explicitly limited to apply to offshore wind turbines that are innovative and new to the marketplace. They are aimed at reducing the costs of generation from such sources, enabling them to make a greater contribution to meeting our binding European Union targets.

We have already seen a commitment from Statoil to develop its Hywind pilot project off the coast of Peterhead. The Crown Estate's leasing round for floating offshore wind will conclude in the coming weeks, and we hope that a number of other developers will secure exclusivity rights to pursue developments in Scottish waters and bring economic benefit to these shores.

The new offshore bands have been introduced and costed on the basis of the capacity that we expect to come forward between now and the order's closure in 2017. However, there are no limits or thresholds within the provisions.

The remaining changes that are set out in our amending order mirror the changes that are being made to the other UK obligation mechanisms. The first of them relates to tighter biomass sustainability criteria. The committee might remember from last year, when we introduced a 15MW cap on biomass, that we were considering the introduction of tighter sustainability standards under the RO. The amendment order introduces those changes, which are designed to ensure that biomass material is sourced responsibly and in a way that minimises or eliminates adverse impacts.

The order amends the information that is to be provided, on a per consignment basis, to the Office of Gas and Electricity Markets—Ofgem—by all stations over 50kW that use solid biomass and/or biogas. That includes the introduction of a timber standard, which is focused on sourcing wood from legal and sustainable sources, and a tighter greenhouse gas threshold for dedicated biomass stations that were accredited after 1 April 2013. It also creates a new requirement for generating stations of 1MW and above to provide an independent sustainability audit report for solid and gaseous biomass, which will report against greenhouse gases, land criteria and the timber standard.

Those reporting and audit requirements will enable generators to become familiar with the sustainability criteria before the introduction of the further amendments that will be made next year to make compliance with the sustainability criteria mandatory for generating stations of 1MW and above. The order also refers to the latest combined heat and power quality assurance standard, which has been tightened to reflect improvements in the efficiency of such schemes.

As the committee knows, the RO mechanism is due to be replaced by a new system of financial support that is based on contracts for difference. The process of reforming the UK electricity market seems to have been running for as long as most of us can remember, but there are still important decisions to be made. We have expressed concerns that the design and limits of the contract for difference mechanism will restrict the opportunities to develop the renewables industry in Scotland and that, as a result, we risk losing out on jobs and investment. We continue to press the UK Government to provide a clear and ring-fenced commitment to support the delivery of meaningful renewables capacity.

UK ministers have taken powers in the Energy Act 2013 to close the renewables obligation across the UK, meaning that the RO in Scotland will close from 2017. The next three years will be an important transition period, as developers and investors adjust from the tried and tested RO to the entirely new and innovative CFD. The order will partly implement those important transition arrangements. They are largely technical changes, which allow developers to make a one-off choice between the RO and the new CFD scheme in certain circumstances. The changes will also prevent duplication of support for the same electricity by ensuring that generation that is supported under electricity market reform is not eligible for renewables obligation certificates.

In conclusion, the changes will improve the efficiency and sustainability of the obligation and will ensure that the legislation remains fit for purpose. In the remaining time available for the RO, we want to continue to attract investment in the right kind of projects and continue the progress that we are making towards meeting our important targets while keeping cost increases for consumers to a minimum.

Before I formally move the motion recommending that the order be approved, I am of course happy to respond to any questions that members might have.

The Convener: Thank you for that detailed explanation. I will take questions from members.

Marco Biagi: I have questions about biomass, which is an issue that I have followed in the past. In your comments and in the policy note, you referred to the latest combined heat and power quality assurance standard, which you say has been tightened to reflect improvements in the efficiency of such schemes. Will you give more detail on how it has been tightened?

Fergus Ewing: It has been tightened with a new requirement for a minimum heat efficiency of 10 per cent. The combined heat and power quality assurance standard, which, to those in the know,

is known as the CHPQA, includes a minimum primary energy saving of 10 per cent and an overall efficiency of at least 35 per cent for schemes of more than 25MW electricity capacity.

Marco Biagi: Following the consultation that was held, have there been further discussions with the wood panel industry about concerns over supply? Does the Government intend to continue to monitor that on an on-going basis?

Fergus Ewing: I have had extensive discussions with the timber products sector, including the wood panel industry. We think of Norbord in my constituency and in Plean in central Scotland, I think, Egger in Ayrshire and the wider sawmill sector. In addition, the timber growers have a plain interest, of course, as does the forestry sector.

The topic is extremely important. Obviously, we want to ensure that the interests of all those who require to source Scotland's timber for various purposes can be accommodated. In particular, the analysis of the supply side suggests that, over the next 10 years, additional availability could average between 700,000 and 1 million green tonnes per annum compared with current production. That suggests that wood fuel supplies should not pose a barrier to further development of the heat sector in Scotland, especially as we have, unlike south of the border, the 15MW cap for CHP electricity-only schemes. That is a further safeguard. The CHP schemes that have been approved in Grangemouth and Rosyth also have the requirement that there must be a strategy that the Scottish ministers have approved, of course. I think that the intention there is to import timber rather than use home-grown timber and risk displacing the legitimate interests of the timber and panel products sector. We will, of course, keep that closely under review.

Marco Biagi: I was particularly interested in the sustainability audit report requirement for the biomass stations. Will that be a broad requirement for them to report? I know that there have been criticisms of some of the off-the-shelf sustainability accreditation methods from non-governmental organisations in particular.

Fergus Ewing: Yes. I believe that the new audit requirement that the RO is introducing will be applicable to certain schemes. With the convener's permission, Fiona Hepplewhite, who is one of my officials, will be able to give a little bit more detail to Mr Biagi, if that is in order.

Fiona Hepplewhite (Scottish Government): The independent audit requirement for biomass will follow a programme that is similar to that for the bioliquids audit report that is currently in place. Basically, land criteria, greenhouse gases and all the things that are reported on will need to be

reported on on a monthly basis, and the report will be independently verified by an auditor. There will be a robust audit of the monthly information that is provided, and in a year's time that will be mandatorily linked to the ROC issue.

Margaret McDougall: Good morning, minister.

Under the heading "Biomass sustainability", paper 3 mentions

"Amendments to land criteria so that energy crops grown under the Energy Crops Regulations 2000 or an equivalent scheme are automatically treated as meeting the land criteria for solid and gaseous biomass".

Will you expand on what would be involved in that particular automation? Does that mean that no checks are carried out on that happening and that it would just happen?

Fergus Ewing: No checks carried out on what?

Margaret McDougall: Exactly. What would the checks—

Fergus Ewing: No. What is your question?

Margaret McDougall: That is my question. If that is automatic, no checks will be carried out to see whether the energy crops comply with the 2000 regulations.

Fergus Ewing: I am not absolutely sure that I understand the question. With the convener's permission, I will perhaps bring in Fiona Hepplewhite in a moment.

The provisions that are being introduced are consistent with those that are being introduced across the UK after extensive consultation with all stakeholders involved and a great deal of thought. They involve a cautious approach that is designed to ensure that appropriate sustainability standards that apply more generally across the sector, I think, are applicable here, and that new sustainable forest management criteria for the use of wood fuel are prescribed and introduced by the regulations, as set out in the timber standard. I think that those in the industry are already familiar with that process.

Fiona Hepplewhite might be able to provide some more information, if that would be helpful.

12:00

Fiona Hepplewhite: The energy crops regulations are English regulations. The other scheme was designed to include any scheme such as the single farming payment that might take into account crops that are grown in Scotland. Any information that would need to be provided would have to go through an audit report, and through the land criteria that Ofgem collects. It is not an automatic guarantee that the crop would come under the scheme, but if it is supported by

other Government schemes, it would meet the land criteria.

Margaret McDougall: Okay. Thank you.

Chic Brodie: I have been asked to look at a company in my patch that has created submersible offshore turbines. Could you or one of your officials expand on what the order means for innovation? I know that you alluded to that, but I wondered whether you could expand on it.

Fergus Ewing: As I explained, the order offers two new bands for innovative offshore wind that will apply to Scotland only. The 2.5 ROCs band aims at supporting generation from offshore test and demonstration sites that are deploying innovative and new-to-market turbines. The band that is set at 3.5 ROCs is for pilot projects consisting of turbines that are not fixed to the sea bed, such as floating turbines or those that deploy tension deployment systems.

Let us take each of those two measures in turn. In order to develop and reduce the costs of offshore wind, there needs to be test and deployment. That is part of the process of engineering, testing and getting the cost down. We are fortunate in having Andrew Jamieson of the Offshore Renewable Energy Catapult, whose efforts are solely devoted to reducing the costs of offshore wind. The majority of people in the industry believe that it should be perfectly possible to reduce those costs, but there are challenges.

An essential ingredient of meeting those challenges is to test the product. It is impossible to try out new turbine designs unless there are testing and demonstration sites. It is difficult, if not impossible, to do that entirely in a commercial setting so there needs to be a particular stimulus for test and demonstration sites. That is a fairly widely accepted analysis.

Why are we doing this for floating offshore sites? First, in Scotland, we have deeper waters so, if we think about it, deploying fixed turbines is inherently more expensive because we need to use more steel and concrete in more difficult conditions. The costs might be greater than they would be in some of the alternative fields in England, to take our neighbours as an example.

Shortly after I became minister in 2011, I enjoyed a breakfast with Fred Olsen in Orkney after a visit to the European Marine Energy Centre, and he put it to me that we might want to consider promoting Scotland as an area for floating offshore generation by implementing a scheme that would allow us to be the test centre for floating offshore wind turbines.

I mentioned Statoil in my introduction. It has pursued its Hywind project since, I think, 2009. That is a demonstration of a floating offshore

turbine that has succeeded in the sense of showing high reliability rates of generating electricity. The company now wants to use a site called the Buchan deep, which is off Peterhead, to move to the next phase of that demonstration of its floating offshore turbine by trying it out in the more testing waters at that site. Statoil wants to do that in Scotland, and we hope that it will also be encouraged and persuaded to use a number of Scottish businesses and a Scottish port—Kishorn—to carry out a substantial part of the work that will be involved.

There is a second rationale, which is this. At the moment, as is known, most of the major offshore wind applications are on the east coast, substantially for reasons of proximity to ports but also because of the nature and conditions of the sea. The conditions on the west coast are even more challenging. However, if the innovative offshore floating technology can be further developed—it is already a success; it is not a prototype but is already generating electricity—that will open up the possibility, subject of course to respecting the legitimate rights of fishermen, who, I emphasise, have been there for centuries, of considering options for deploying turbines on the west coast of Scotland as well as the east coast.

In those two respects, we have a strategic interest and objective in taking the measure forward. It is particularly appropriate to Scotland for the reasons that I have mentioned, and we would like Scotland to be at the centre of what could be an exciting new method of harnessing the power of the wind offshore.

Chic Brodie: Thank you—that is encouraging. It certainly paints a brighter picture for the company concerned.

The Convener: I have a couple of follow-up questions on the enhanced ROC payments for experimental offshore wind. I think that everyone supports the principle of developing offshore wind with a view to reducing the costs, which are at present quite substantial, as you are aware. I am aware of three test sites that are either proposed or in construction—one at Methil, one at Hunterston and one just north of Aberdeen. Would they benefit from the proposal?

Fergus Ewing: If developers wish to deploy or continue to deploy turbines that meet the provisions in the RO, we would expect the answer to be yes. The developments at Hunterston and Methil have been broadly welcomed by all political parties as part of a necessary process, as I have described, so we would expect the answer to be yes.

I am not sure to what extent I am permitted to comment on the Aberdeen case, given that it is

still sub judice, so I had better not comment on that, if you do not mind. That is the approach that I have adopted before and I think that it was remarked upon favourably by m'learned friends.

As a matter of general practice, offshore test berths are required because testing is required, so we need to find places to do it. We have found places to do it, and now we want to move on to the next stage and actually see it done.

The Convener: On the issue of public resources supporting these projects, various pots of money have gone into the work from Scottish Enterprise and, perhaps, European funding. Can you tell us how much public money has been spent so far on the projects?

Fergus Ewing: I can go away and come back with a note for the committee. If we are talking about Hunterston, Methil and Aberdeen and dealings with companies, I do not have that information to hand because it is perhaps not immediately germane to the RO. However, this is a matter of some public interest, and I can say that the cost of the total RO in the UK—every single ROC and every single megawatt of electricity generated from renewables in the UK—is £27 per household, which is set to rise to £63 by 2020. The measure that we are discussing today, were it to be adopted to its absolute maximum, would add 60p or 70p to that.

The Convener: Thank you. As there are no further questions, we move to agenda item 3. I remind the minister's officials that they may no longer participate on the record. I invite the minister to move—and, if he wishes, speak to—the motion.

Motion moved,

That the Economy, Energy and Tourism Committee recommends that the Renewables Obligation (Scotland) Amendment Order 2014 [draft] be approved.—[*Fergus Ewing.*]

Motion agreed to.

The Convener: Are members content for the convener and the clerks to prepare a short factual report and arrange to have it published?

Members indicated agreement.

The Convener: I thank the minister and his officials. We will continue, but you are free to leave.

Fergus Ewing: I will depart. Thank you.

Land Registration etc (Scotland) Act 2012 (Commencement No 2 and Transitional Provisions) Order 2014 (SSI 2014/41)

The Convener: I remind members that we are still in public session. We are now on item 4.

Do members wish to raise any issues on Scottish statutory instrument SSI 2014/41? If not, is the committee content for the order to come into force?

Members *indicated agreement.*

The Convener: Just before we move into private session, I put on the record our thanks to the clerk to the committee, Stephen Imrie, who is moving on to pastures new after long service to the committee. I am not sure whether that entitles him to a medal for long service, but I express our thanks to him for all his years of service to the committee and his support to all of us—me as convener and the other members. We wish him every success in his new position.

Members: Hear, hear.

Chic Brodie: He will have to get a new shirt.
[*Laughter.*]

The Convener: With that, we move into private session.

12:11

Meeting continued in private until 12:13.

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