



The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

FINANCE COMMITTEE

Wednesday 5 March 2014

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FINANCE COMMITTEE

7th Meeting 2014, Session 4

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*John Mason (Glasgow Shettleston) (SNP)

COMMITTEE MEMBERS

*Gavin Brown (Lothian) (Con)

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

*Jamie Hepburn (Cumbernauld and Kilsyth) (SNP)

*Michael McMahon (Uddingston and Bellshill) (Lab)

*Jean Urquhart (Highlands and Islands) (Ind)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Charlotte Barbour (Institute of Chartered Accountants of Scotland)

Paul Johnson (Institute for Fiscal Studies)

Elspeth Orcharton (Institute of Chartered Accountants of Scotland)

John Whiting (Chartered Institute of Taxation)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

Committee Room 6

Scottish Parliament

Finance Committee

Wednesday 5 March 2014

[The Convener *opened the meeting at 10:00*]

Revenue Scotland and Tax Powers Bill: Stage 1

The Convener (Kenneth Gibson): Good morning and welcome to the seventh meeting in 2014 of the Finance Committee of the Scottish Parliament. I remind everyone present to turn off mobile phones or other electronic devices.

Our first item of business is to continue our stage 1 consideration of the Revenue Scotland and Tax Powers Bill. Today, we will take evidence from the Institute of Chartered Accountants of Scotland and the Chartered Institute of Taxation.

I welcome to the committee Elspeth Orcharton and Charlotte Barbour of ICAS, and John Whiting of the Chartered Institute of Taxation. I understand that there will be no opening statements because we have your fairly extensive written submissions, which all members will have read and digested and on which they are prepared to fire questions at you. As usual, I will start off with a few initial questions.

I will go straight to one of the nubs of our deliberations, which is the general anti-avoidance rule. Your papers are so detailed that I could spend the full 90 minutes going through the matter but, obviously, my committee colleagues will want to have their say, so I will not abuse my position in the chair.

On the rule, ICAS states that

“the Bill lacks balanced safeguards”;

and CIOT says that

“the use of the phrase ‘one of the main purposes’”

will result in

“a very low threshold for”

determining that a tax avoidance arrangement exists.

Your organisations provide advice to people on how they can reduce their tax bills, but surely the point of the bill is to do the opposite and ensure that people pay their fair share. We want to pass legislation that ensures that the population accepts that there is general fairness. There is real resentment in society that someone who earns 10 times as much as a nurse, bus driver or postman might, through use of certain tax legislation, pay a

much smaller proportion of tax than people in those professions.

What would be the outcome of the changes that both organisations suggest to the bill, other than a reduced tax take for the state, which would mean fewer potholes getting fixed and less money in the national health service, for instance? How do your positions on the anti-avoidance rule create a balance whereby people pay what they should pay and, at the same time, pay a fair share?

John Whiting (Chartered Institute of Taxation): I will start on that one.

You are absolutely right, convener, to state that our members give advice in practice but, as a body, we are deliberately constituted as a charity and exist to improve the tax legislation for the benefit of all involved with it. That means taxpayers and the authorities, as well as practitioners.

The aim of our comments on the bill—and the key thing that we want to achieve with any amendment to the rules—is to improve certainty. It is obviously completely up to the Parliament and revenue Scotland to decide how they wish to frame the legislation on a general anti-avoidance rule. As you well know, the United Kingdom has gone down the route of the general anti-abuse rule. However you do it, one of the things that people—we mainly have in mind businesses—will ask when they look at it is whether they know that, if they take a particular course of action, they will or will not be within the ambit of the provisions. The worry is that if that is uncertain, people might decide not to do something, which can damage business confidence.

The simple aim is to try to improve confidence and certainty so that people know where they are. A simple illustration that I always use to test out provisions is: what would I say to someone who told me that they were thinking of starting in business and wanted to know whether they should act as a sole trader, a partnership or a company? There are many commercial issues around decisions of how someone should operate, and those decisions also have tax consequences. If I was going to say to you, convener, that you should operate as a company because of certain circumstances or as a sole trader because of other circumstances, I would want to be sure that there would be no risk of the authorities saying under the general anti-avoidance rule, “There was a tax benefit in you going one route rather than another.” Therefore, I might have to advise you that I did not know whether you would be affected by the GAAR.

It is as simple as that. I am aiming for certainty in knowing where I am and where you as my client are, so that you know what the results will be.

The Convener: I am keen to hear from ICAS on this important issue as well.

Surely the point of not having certainty—in tablets of stone, if you like—is that there is room for interpretation. The GAAR is not as wide as you have suggested. A couple of years ago, there was a famous case that every layperson would have said involved a deliberate attempt to avoid taxation. However, because the legislation was so specific, two thirds of the judges who looked at the case decided that the letter of the law had been followed, even though its spirit clearly had not been.

There is an issue about having tax law that is so clearly defined that it is easy to get around. Having less certainty to a degree allows interpretation based on what is intended, instead of just what is absolutely stated in the wording in a piece of legislation.

John Whiting: That is a fair point. We have great concerns about the way in which detailed anti-avoidance legislation is being piled on more and more. You are absolutely right that what you have suggested is sometimes the case. I do not know the exact case that you are thinking of, but disguised remuneration legislation is sometimes cited as a good example of something that exists to police things such as employee benefit trusts, which I know is a sensitive issue in Scotland. However, the problem with the legislation is that it has become so detailed that people start to look for loopholes in it and you end up with exactly the sort of problem that you allude to.

There is considerable merit in taking more of a look at the bill's principles, which should, after all, express what it aims to do, and they should be coupled with good guidance to make it clear what the bill really means. As we say in our paper, that might be termed “dynamic guidance”—in other words, guidance that is kept up to date in the light of experience and is not allowed just to lie down and grow whiskers.

That would help people know where they were; would give them certainty; and would help them know what the legislation was aiming at and what it was trying to prevent them from doing. They would know not only that it was trying to prevent them from avoiding tax in a certain way, but that they would not be tripped up if they went down what to them was a perfectly good commercial route for good commercial reasons.

I had better let ICAS speak.

Elsbeth Orcharton (Institute of Chartered Accountants of Scotland): Thank you. What with the press and media coverage in recent years, sometimes in relation to the case that the convener alluded to—which I thought was a slightly different case; it was not about EBTs—the

general expectation has become, in a phrase that I have heard used, “Everybody's at it.”

Like the vast majority of our members, I have spent the vast majority of my time in professional practice—I think that it is 25 years now; I have stopped counting—explaining to clients what the law is and what the answers are with regard to the specific transactions that they wish to make. We are not seeking to keep open any particular route to tax avoidance, but we are aiming to get to a position in which there is certainty in transactions.

That is why we want to look further at the current draft of the GAAR. ICAS has a committee of members from a significant commercial and business background who are examining the position with regard to Scottish taxes. Generally, their concerns are that, if more certainty is not given, businesses that are looking at property development or transactions or which are considering an investment might, in the absence of certainty, take their business south of the border rather than invest in Scotland. There is room to improve on the certainty aspect.

On safeguards, we are concerned about the extent to which revenue Scotland, which is as yet an unestablished and unstaffed body, appears to have almost a delegated right to decide whether a transaction—to use the wording of one of the tests—lacks “commercial substance.” As revenue Scotland would write the guidance that tribunals would have to take into account, it would to a certain extent have the right to say exactly what was and what was not commercial, despite the fact that the staff—with all due respect for their technical expertise—would not have a commercial background. We want balanced safeguards to ensure that, if there is a test for commercial substance, people with commercial experience will be involved in the decision-making process.

It might be helpful for the committee to know that earlier this week we met the Scottish Government bill team, and I would like to hope that the door is open for us to go back with some constructive suggestions about what might be possible with regard to adding further definitions to the GAAR or, alternatively, looking at a clearance process that might help to deal with the fear of a lack of certainty without necessarily giving rise to the kinds of misplaced concerns that Kenneth Gibson expressed that the measures are all about the tax avoidance industry.

The Convener: Revenue Scotland's role is to optimise rather than maximise tax revenue and to ensure fairness across the board.

At paragraph 23 of your submission you state that

“‘Reasonableness’ ... has been criticised as being too subjective”

and that

“the Bill lacks balanced safeguards”,

which I assume means for taxpayers, or a proportion of them.

Incidentally, on page 36, you mention “scheme promoters”. What is a scheme promoter?

Elsbeth Orcharton: I am sorry—I do not have the page numbers in front of me.

The Convener: I am sorry—I was talking about paragraph, not page, 36, which mentions

“disclosure obligations on taxpayers and scheme promoters”.

What is a scheme promoter?

Elsbeth Orcharton: Paragraph 36 addresses the question whether there would be an equivalent of the HM Revenue and Customs provisions for the disclosure of tax avoidance schemes. That separate regime requires what UK law defines as “scheme promoters”—those who suggest or recommend avoidance arrangements—to make formal disclosures of that activity to HMRC. I understand from recent discussions with the Scottish Government that Scotland is not going down that route.

The Convener: Okay. I have a question first for ICAS and then for CIOT.

On revenue Scotland's investigatory powers, ICAS suggests that the comment in the Government's policy memorandum to the bill that to extend protection beyond the legal profession would

“unduly hinder efforts to tackle tax avoidance in Scotland”

is

“unsubstantiated, misplaced and anti-competitive.”

How much avoidance is there, and how would extending the protection “unduly hinder” such efforts?

10:15

Elsbeth Orcharton: That was a deliberate quote from the Scottish Government's policy memorandum. Those claims are unsubstantiated, simply because we have not seen any evidence that, within the remit of giving tax advice, the non-legal profession on its own is the great promoter of tax avoidance in Scotland.

On your question about hindering efforts to tackle tax avoidance in Scotland, I should make it clear that, on a daily basis, most of our members help people to meet their tax obligations. Generally, people seek tax advice because they want to comply; because they do not understand the rules or necessarily come into contact with

those rules on a regular basis; and because they do not have the time to develop the expertise and are not comfortable about doing so. As a result, they go and ask someone who knows the answers to their questions.

In providing advice to those individuals, assisting them with their filing obligations and reminding them of their payment and legal obligations, tax advisers such as the members of ICAS and CIOT are governed by a professional code of conduct that covers legal and ethical issues. Most of what they do has nothing to do with tax avoidance; instead, they are mostly answering the question, “What tax liability am I going to pay?”

The Convener: That is a good point, and it is important for the committee to hear. I do not want to overegg the pudding with regard to GAAR, but in considering the legislation we are looking at the margins and where changes could and should be made. I think that everyone accepts that what you have described is the basis of what your membership does.

Mr Whiting, your organisation expresses concerns about client confidentiality, which is a real issue. In your submission you state that

“a tax advisor may have no formal qualification and not be subject to professional regulation but those who are members of one of the accountancy institutes or the CIOT are qualified and regulated.”

Do you think that extending protection beyond the legal profession is in the public interest? If so, can you explain why?

John Whiting: Our basic point is that, at present, there is not a level playing field. We are arguing that it is in the public interest—and in the interests of revenue Scotland and the Parliament—that people who want tax advice are free to go where they wish and to get the best advice that they can.

I associate myself wholly with Elsbeth Orcharton's comments about why people seek tax advice; they do so for all the reasons that she mentioned, including the fact that, frankly, they have better things to do. You and I could do plumbing, but I have no doubt that we choose not to do so because we would rather do other things. For those reasons it is in everybody's interest that, if somebody wants tax advice, they are in a position to go to the best—so there needs to be a level playing field—and to people who are well qualified to give that tax advice.

At present, the way in which privilege operates means that there is a certain amount of additional protection in certain circumstances, particularly for advice that is given by lawyers. Does that hinder people who are seeking the right advice? In some circumstances—as we mention in our

submission—it might push somebody to take advice from a lawyer because they know that the advice that they are getting can never be disclosed to revenue Scotland or to anybody else.

Does that get us to the right position? I am not sure that it does. Are we arguing that privilege ought to be extended to everyone? No, we are not. We are trying to highlight the fact that there is an unlevel playing field and that it is in everybody's interests that, in the same way as if they want an expert plumber, if people want tax advice they should get somebody who is properly qualified and regulated. We therefore think that, if there is an argument for some form of privilege, it should attach to certain circumstances and to anyone who is properly qualified and who gives advice in that area.

The Convener: Some of the tax advisers are not qualified, as you accept in your submission.

John Whiting: Yes, and in many ways that is quite a concern. The statistics show that approximately 30 per cent of those who act as advisers do not have a professional qualification or have a qualification that is not of as high standing, if I can put it that way, as ICAS or the Chartered Institute of Taxation. We subscribe to professional rules, practice guidelines, professional conduct in relation to tax and disciplinary boards, and, if we are in practice, we have to have professional indemnity insurance. That is all the paraphernalia that one could expect of a good professional.

That is a continuing issue. I do not have an obvious solution to it, but we have to flag it up. All we can do is make sure that our members are properly trained, kept up to date, subject to a proper code and disciplined if they do not conform to the proper way of operating.

The Convener: How often are people disciplined?

John Whiting: I do not think that I have one in my bag, but our monthly magazine *Tax Adviser* reports the results of the independent taxation disciplinary board, and I am not proud to say that cases are always being reported. I am also a member of the Institute of Chartered Accountants in England and Wales, and it has about four pages on the issue in most of its monthly magazines. I am not sure whether ICAS has people being disciplined; I am sure that it does. We are not proud of it, other than of the fact that it shows that we discipline those who fall short of standards.

The Convener: I am going to let in my colleagues in a wee minute, but Charlotte Barbour wants to say something.

Charlotte Barbour (Institute of Chartered Accountants of Scotland): I was just going to comment on ICAS's regulatory regimes because I

worked with them for a while. All our members who are in practice need practising certificates. Monitors go out, check the way that practices are conducted and report back regularly to the practising certificate committee. Like John Whiting, I do not want to say that lots of people are being disciplined, but there is a strong regulatory regime around all the activities of our members in practice. It is a well-regulated and well-functioning system.

The Convener: I have one final point on extending privilege. It would obviously benefit the accountancy profession as it does the legal profession, but how does it benefit the public? Is it just by widening choice? What are the benefits to the taxation system?

Elsbeth Orcharton: The answer to that probably sits in widening the choice. When I last appeared before the committee, I mentioned that that has not historically been a great issue for the accountancy profession or for ICAS members, but it has gained prominence recently in two situations.

I think that the committee has heard about the first one before. It was a Supreme Court case that involved Prudential, which was the name under which it was listed. The Supreme Court judges opined that the law did not require to be addressed in terms of the imbalance that means that only lawyers can have legal privilege on tax matters. However, in the UK, the bulk of tax advice is given by people who are not qualified lawyers, namely the accountancy profession or tax professionals as members of John Whiting's institute.

The second area in which the issue has come much more to the fore is the extent to which legal firms, particularly from London, are advertising in publicity and marketing material the fact of confidentiality of legal privilege as a reason why anyone seeking advice would want to go to them rather than elsewhere. I do not remember that being a feature a few years ago, but it is the kind of issue that we would not necessarily want games to be played with.

A straightforward method of addressing the issue might be to follow our suggestion—which is, of course, not the only solution—to go the way of the rest of the United Kingdom by having particular information powers at an early stage of an inquiry to keep the playing field level.

John Whiting: I completely agree with Elsbeth Orcharton. Some out-and-out avoidance schemes have been devised by lawyers under the cloak of privilege, and they have tried to resist disclosure of papers to the tax authorities by sheltering behind that privilege. That is a risk, but I simply want to point out how the system might not be operating in

the right way. We feel that the answer is to level the playing field, coupled with a certain amount of education about the value of going to a properly qualified adviser if people want proper advice.

The Convener: Thank you. I will now open out the session to colleagues.

Jamie Hepburn (Cumbernauld and Kilsyth) (SNP): I want to stick with this particular issue, because I think that it is important. Indeed, Mr Whiting's last response demonstrates why it is important for us to get all this right.

Elsbeth Orcharton has kind of answered this question already but I will ask it: on a practical level, how big is the issue? You have already said that, historically, it has not been a big issue for the profession, but the question is whether it actually harms accountancy firms. Are they struggling because of it? As has been pointed out, the vast bulk of tax advice is still given not by lawyers but by other professionals.

Elsbeth Orcharton: Someone might say that they have never seen a starving accountant, but that is not the point that we are making. At the moment, the provision of coherent tax advice, which sits primarily within the accountancy profession, can be interrupted, and if you are looking for people to make their fair contribution—and to understand what that actually is—you do not really want that conversation with an accountant to be interrupted by some lawyer jumping up and down, saying, "You should come to us to discuss this issue, because it's slightly different."

Although at the moment it is not a massive issue for most of our members, it is increasingly becoming one. This conversation and its timing have been occasioned by the introduction of this bill in the light of other case law that has come up. We believe that this is a matter for Parliament; indeed, the Supreme Court has said as much to the Scottish Parliament and Westminster, and that is why it is on the agenda.

Jamie Hepburn: I think—one of my colleagues will correct me if I am wrong—that, when we spoke to the bill team last week, it made it pretty clear that the privilege that lawyers have is not wide ranging but pretty tightly defined. It also suggested that it might go away and reflect on the evidence that we gather at stage 1 and that, if it felt that privilege needed an even tighter definition, it would put that in place. Do you welcome that?

Going back to Mr Whiting's comment that lawyers have used privilege as a guise to devise avoidance schemes, I have to say that my understanding is that that is not what this power of privilege—for want of a better term—is there for. Would you welcome a tighter definition of privilege?

John Whiting: Yes. Indeed, that is very much what we want. The Prudential case that we were involved in and which Elspeth Orcharton has already alluded to supports the argument in that respect. Our objective is for the issue to be looked at properly, and we believe that the Parliaments here, at Westminster or in both places need to examine the issue and tell us what they want privilege to apply to.

My own belief is that privilege stems from a time when only lawyers could speak on behalf of those accused of crimes and it was required to protect the accused's communications with their lawyer, who, in effect, was speaking their words. If that is where privilege came from, I am not entirely sure what it is doing regulating how tax advice is given. That is what makes me feel that the whole area needs to be looked at to determine what should be privileged.

10:30

I keep coming back to the idea that, in certain circumstances, privilege should apply no matter who is giving the advice because it is in everyone's interests that people get proper advice. I point to a situation in which somebody gets very behind, is seriously in arrears and has serious problems with their tax affairs. It is in everybody's interests that they make a complete clean breast of it to their adviser, who will then help them to get up to date and regularise their position. We might say that we want no worries about disclosure of what is said in those circumstances, and obviously the good professional will use the information that is given properly. It is in such situations that we might want privilege to apply because we want everybody to feel able to give proper advice and to get the person up to date.

Jamie Hepburn: Okay. We will probably look at that issue a bit further.

Mr Whiting, your organisation has set out concerns about some matters being left to secondary legislation, arguing that some rules should be part of the primary legislation. However, it is a more arduous process to amend primary legislation, and secondary legislation is still subject to parliamentary scrutiny, so I am not clear what your concern is.

John Whiting: It is one of those questions of balance. As a matter of principle, we always prefer rules about tax to be in primary legislation. At the same time, we freely accept that we can never put everything in primary legislation and that we are going to have secondary legislation, particularly about administrative matters, and guidance. However carefully legislation is written—the bill team has done a very good job in writing clear legislation—we will always want a certain amount

of guidance to help people to know what the law is. We might therefore say that there will be three levels.

Our concern is that the real rules should be in primary legislation and, in that respect, we home in on certain aspects of the penalty provisions. Penalties are a key part of legislation, and taxpayers should know when they are going to be penalised. I fully accept your point that secondary legislation is still subject to parliamentary scrutiny, but we think that something as key as the penalties that will apply should be in the primary legislation. Secondary legislation can cover how the penalties will be applied mechanically, but the circumstances of the penalties should be in primary legislation together with the welcome powers on how they can be mitigated and when they can be suspended. That area of the penalty regime is pretty fundamental to the fairness of the tax system, and we would have thought that the Parliament would want to be sure that it is being fair.

Jamie Hepburn: Why would taxpayers not know where they stand in relation to penalties just because they are in secondary legislation? I do not see why people would not know that. To be perfectly frank with you, I would imagine that most people out there do not know the difference between primary and secondary legislation.

John Whiting: That is a fair challenge. You might take it a stage further and ask whether they would mind if it was just in guidance. It is a matter of principle: I accept your practical point that, at the end of the day, the taxpayer does not know whether something is in primary legislation, in secondary legislation or in guidance, but I feel strongly that something as key as this should be in primary legislation.

I think that Charlotte Barbour wants to comment.

Charlotte Barbour: I and ICAS members feel strongly and have long said that principles should be in primary legislation. One of the difficulties with tax legislation is that a lot of it is very detailed. We tend to think, "Detail? Secondary legislation—pop it in the regulations", whereas an awful lot of what we are working with is the detail, and the detail constitutes powers.

I believe that principles should be in primary legislation, and the powers are the principles. What revenue Scotland will be able to do on levies, penalties and interest are powers and they should be up at the top. In particular, the penalties are for promoting and enforcing compliance in a self-assessment system, and so the penalties are the main tool. In any appeals system, people who are hit by penalties usually come back to the question whether or not they are fair.

That brings us back to your points about fairness, convener. I believe that, in order that those who have implemented the legislation can say, hand on heart, that the system is fair and that they have actively considered it and put it in place to encourage compliance in such a way that the onus is on the taxpayer to do things themselves, those provisions should sit up among the main principles in the primary legislation.

Jamie Hepburn: Whether they are in secondary or primary legislation, they will still have effect in law. I am hearing you all talking about the high principle, but I am not getting a sense of why it is such a high principle.

Charlotte Barbour: With regard to how you structure legislation, primary legislation—the first port of call—should say what powers are being awarded. Awarding a penalty to a taxpayer means giving revenue Scotland a power. The details of that are therefore really important: the amount, when and why. That should all be put in the proposed legislation, at the top. It is really important that Parliament considers that.

I ought to declare an interest, as I sit on the first-tier tax tribunal. We hear lots of cases about penalties, and nine times out of 10 the questions concern the fairness of the penalties. That is not for the tribunal, the taxpayer or revenue Scotland to decide; it sits with why the penalties have been legislated for. I accept that secondary legislation comes before Parliament, but I do not think that it is as actively discussed and deliberated on as part of the full package of how you are forcing your citizens to comply.

Jamie Hepburn: That depends on what committee the measures go before—it is up to the committee to consider them rigorously.

I have a question for the Chartered Institute of Taxation. In relation to the charter in the bill, you noted the contrast between what revenue Scotland should aspire to and what is expected of the taxpayer. That was raised with the bill team and, to be fair to them, they accepted that the provisions could be better framed. What was the institute's concern? There is an offer from the bill team to consider those provisions and perhaps word them better. How could they be worded better?

John Whiting: That is very welcome news—I am aware that the bill team is going to have a think about it.

We are great fans of charters. We have been involved in a project that has been taking place around the world to develop model charters. We view them as very good demonstrations to ordinary taxpayers of how the tax authority will work and what responsibilities there are. It is all part of building confidence in the tax system.

At the same time, the charter is a good means of communicating to taxpayers how the whole thing will operate. It is very much a two-way street, with rights and obligations on both sides. To have confidence in the charter and to make maximum use of it, it must be seen to say what the tax authority is expected to do. We were keen for the charter to outline the expectations on both sides.

The charter should regularly be reported on, with an obligation for revenue Scotland—probably signed off by the members of revenue Scotland—to lay a report before the Parliament on how the charter is going. There should be observations on how the tax authority is operating and how taxpayers are responding to it.

Jamie Hepburn: I take it from that therefore that there should be some sort of equivalence in terms of the standards for the tax authority on one hand and those for taxpayers on the other.

John Whiting: Yes. The system involves rights and obligations on both sides, and the charter is a good way to communicate that.

Returning to your previous questioning, I think that taxpayers will not look at legislation, be it primary or secondary, whereas ideally a charter can be communicated in a poster or in a pretty brief document. It can be part of a statement of how the tax authority is going to treat people and, at the same time, what it expects from people: taxpayers are supposed to do this, and in return the tax authority will do that. That is a pretty powerful means of building a good rapport between taxpayers and tax authorities and of ensuring that everybody has confidence in how the system will operate.

Jamie Hepburn: I take that point, which is well made.

Malcolm Chisholm (Edinburgh Northern and Leith) (Lab): I was going to ask about the charter, but that has been substantially covered by the previous series of questions and answers. To be fair to the bill team, it has indicated movement on consultation, which was a concern, and on the language of aspiration. I agree with everything that John Whiting said in his previous comment and I hope that those changes will be made, which would help to give the public confidence about revenue Scotland.

One of your concerns about the GAAR is that revenue Scotland's position is not quite right—perhaps it is being given too much discretion and too much will depend on what it decides is reasonable. I will ask mainly about that. Some of your evidence on that is a little persuasive. In the past few weeks, various people have mocked the double reasonableness test but, when I read your submissions, I came to think that the double reasonableness test is quite reasonable. The

essence of the test is an attempt to take an objective view of what is reasonable. The fear is that, otherwise, what is reasonable will be just what revenue Scotland decides.

Does the approach work in England? How does the advisory panel work in practice? That is the essence of achieving objectivity.

John Whiting: I make it clear that the advisory panel has not formally pronounced on the UK general anti-abuse rule—as far as I know, no cases have gone before it. However, in principle, the intention is to ensure that—as you put it well—reasonableness is judged reasonably, to keep peddling that word.

The view should be not just that of HM Revenue and Customs or revenue Scotland but that of a group of reasonable people. The aim of having the advisory panel is to bring in commercial common sense. That does not override the rights of revenue Scotland or HM Revenue and Customs to run the tax system properly and police the avoidance that the convener referred to; the aim is just to ensure that the view fits in with commercial reality.

Elsbeth Orcharton: As John Whiting said, the advisory panel has not judged a case, but it has had a role in reviewing the guidance that was issued on the operation of the UK general anti-abuse rule. That guidance was universally welcomed by practitioners, because it described succinctly what the rule is intended to do—it is game changing, to use that expression. The guidance also went into detailed worked examples to show why the law would be considered to apply in particular circumstances. That law applies to a range of taxes and not just to the two currently devolved taxes, as in Scotland.

The advisory panel objectively reviewed that guidance. We would support having such guidance in Scotland. It does not say just what does and does not work; it explains in the context of the legislation and the legislative principles why something is or is not acceptable. That is an additional role for the panel.

Malcolm Chisholm: I was going to ask about the guidance. The bill says that the courts must take into account non-statutory guidance, which revenue Scotland could issue. You have suggested one way of dealing with concern about that—having oversight of the guidance—but is there another way of doing that? Is it accepted that such guidance is required? Should some of it be in legislation of one form or another? Is there another way of ensuring a check on the guidance?

10:45

Elspeth Orcharton: The question to be answered with respect to the provision as it is drafted is: what will make the guidance both workable for practitioners and succinct and clear in terms of revenue Scotland fulfilling its obligations? I alluded earlier to the test on whether a transaction lacked commercial substance or otherwise, or whether it was artificial or otherwise. The model seems to be—so far—working for the rest of the UK, partly because it is deterring people from the kind of behaviours that the tax authorities want people to steer clear of. The model seems to be a good one on which to proceed, and it should be seriously considered.

John Whiting: It all comes back almost to where the convener started. The guidance, in common with the GAAR, should send clear signals that abusive tax avoidance will just not be tolerated and will not work.

The point of an advisory panel, or something else, looking at the guidance is to ensure that the message goes out in a proper, balanced way. What could operate as well as an advisory panel? As much as anything, that probably comes down to our favourite topic of consultation. Even if an advisory panel is not formally constituted, the guidance should go through bodies such as ours so that we have an opportunity to comment and say, “We can see what you’re getting at but it won’t be read quite like that in practice. To get over the message that you want to communicate, it would be better if it were worded in this way.”

Malcolm Chisholm: One of your concerns that I am not quite so sure about is whether the bill should refer to

“one of the main purposes”

or just to “the main purpose”. I do not see the problem, as

“one of the main purposes”

is still a main purpose. I am not sure why the fact that there may be other main purposes should make much difference.

John Whiting: Our point is that we would prefer the phraseology “sole or main purpose” to be used in reference to tax avoidance. That is our objective. We can accept the way in which the provision has been framed but, at the risk of sounding like the proverbial stuck record, we want to be sure that people going into normal commercial transactions are clear about whether they are caught by the provision.

Earlier, I used the example of incorporation. If I advise someone on incorporation, one of the purposes of the advice is to enable them to take into account tax considerations. I would not be doing my job if I did not explain that aspect to

them. Giving someone advice on incorporation is, therefore, immediately within the ambit of the provision, whereas nobody would say that the sole or main purpose of advice on incorporation is tax avoidance.

It is a matter of terminology. We accept that “one of the main purposes”

is where we are; we are just trying to ensure that there is proper balance to achieve the certainty that we think is important.

Malcolm Chisholm: I have one final question about another area. Different views seem to have been expressed, over the past week or two, about the extent to which the bill will be fit for purpose in the context of a greatly expanded range of tax powers, whether they come through enhanced devolution or independence. Is the bill geared simply to the limited tax powers that are in the pipeline, or will it be fit for purpose in the context of that wider range of tax powers?

Elspeth Orcharton: My view is that the bill does what it set out to do, which is to provide everything that is needed for the currently devolved taxes to be brought into play, but that it does not cover every circumstance that will be possible in the future. It covers the landfill tax and the land and buildings transaction tax, which are essentially one-off transaction taxes. However, income tax powers work on an annualised system of annual income, offsets and different things. A number of powers would probably need to be introduced simply to deal with annualised taxes as opposed to transaction taxes.

However, that is not a failing. Our concern, back at the start of the process, was that a bill could be devised to deal with absolutely everything and to detract attention. We feel that there is quite enough to focus on in the bill as it stands and that it is far better to focus on a really good-quality bill with one eye to the future than to try to cover everything at the same time, particularly when those further tax powers have not been designed or determined.

John Whiting: I am possibly a little more optimistic than Elspeth Orcharton. The bill does a very good job of putting in place a framework for revenue Scotland—let us not forget that it establishes that body—for powers that will apply in most circumstances and for the tribunals. The bill has a terrific amount in it and, as I have said, the bill team deserves great credit for what it has covered in the bill.

I do not think that the bill takes into account or caters for absolutely everything that could happen on devolution in any shape or independence and I do not think that anybody could ever imagine it. There are reports in the papers today about a

possible sugar tax. If the Parliament decided to introduce a sugar tax, would the bill cover it? The framework is there, but you would almost want to be sure that it did. As Elspeth Orcharton said, if Scotland takes full powers over income tax, we would want to test whether the bill would cover everything that you would want.

As a framework that gets you most of the way, the bill does a good job.

The Convener: The next rumour will be that we will introduce a tax on the air that we breathe.

John Mason (Glasgow Shettleston) (SNP): I should probably declare an interest in that I am a member of ICAS, which means that I have to cross-examine the ICAS witnesses with more rigour.

John Whiting: Be careful of the disciplinary process, Mr Mason.

John Mason: Yes, well I might touch on that later, but we will see how we get on. We have covered a wide range of areas. I will go back over a few and question a few points that have been raised.

I start with privilege for the legal profession as against the other professions. I totally agree with the idea that there should be a level playing field. If we are in the position in which lawyers have a bit more privilege and accountants and tax advisers have a bit less, the question is whether we bring everybody else up and give them more privilege or bring the lawyers down and give them less and, perhaps, define it. I would prefer the latter approach. Do the witnesses have particular views? Should there be more privilege for everybody?

Elsbeth Orcharton: We are looking at the powers in relation to certain information notices only. We are talking about accountants and tax advisers coming up in a fairly contained area. The area simply supports open discussions when clients come in and, particularly, something has gone wrong so that there are enough safeguards on what the advisers have to do on that.

I suspect that lawyers apply legal privilege to things other than tax advice that do not cause a particular concern, but we are considering tax, so it is a lifting up but in a fairly defined and narrow area.

John Whiting: To use your analogy, Mr Mason, we would envisage the lawyers coming down and qualified tax advisers going up. I do not know whether they would meet halfway, but it would be a movement on both sides. Of course, some of the CIOT's members are lawyers and they end up in slightly strange positions.

John Mason: When they are giving different advice.

I think that the bill team said that it was considering the matter.

If someone comes along with their affairs in a bit of a mess—perhaps they have just not done their tax return in a while—and they are going to be open with their adviser about that, there seems to be an assumption that they should not be open with revenue Scotland about it. I am a bit concerned about that. We have had a very confrontational approach in the past between HMRC and taxpayers. Would it be possible to have more of a partnership approach in which the adviser or the taxpayer goes to revenue Scotland, admits that they have made a mess, provides all the information and asks whether they can come to a reasonable agreement?

John Whiting: Yes. I think that that is what we would all promote.

Charlotte Barbour: That is an excellent road for going forward. We would hope that that would always be our starting point. I would be very supportive of the mediation facilities that are proposed in the bill. Anything that helps to fix things must be good. I do not think that privilege is necessarily used to cover up anything; I think that it is used to help get the best compliance. We know ourselves that if we have blotted our copybook, we might not be sure how to proceed. We might want to have a private discussion about it, then be assisted in addressing the matter properly. As was suggested, our accountants are mainly fairly conservative professionals who are there to help and make the system work.

John Mason: Right—although we have one or two accountants who have not been quite so conservative.

Elsbeth Orcharton: The power that we are looking at in the bill relates only to investigations. The vast majority of cases, as was described, involve someone who has not filled in their tax return and has gone to their accountants. The expectation is that the full work would be done, full disclosure would be made to HMRC and all taxes would be paid and settled. However, I think that the power is about cases in which a different view might be taken by the tax authority, and that happens in a very small percentage of cases. There are occasions when HMRC takes a particularly aggressive approach and wants copies of absolutely everything but not necessarily at the right time for disclosure to be made. In addition, HMRC might make allegations or go beyond what is necessary for full disclosure and settlement, and for regularisation of tax affairs to take place.

I would therefore not want everyone to think that it is a day-to-day occurrence for accountants to put

their head in their hands and say, "Oh, I don't have privilege." In a big percentage of cases, privilege does not apply. However, where it applies, it is pretty relevant.

John Mason: Presumably, that is where the charter might come in. The attitude of revenue Scotland could be covered in there, as well as the need for it to be as rigorous with big taxpayers as with small taxpayers; sometimes that has not been the case in the past.

John Whiting: That is a very good point.

John Mason: The word "reasonable" has been mentioned. You got some sympathy on that from Malcolm Chisholm, so I will give you a different view. I still maintain that using the word "reasonable" twice in the same sentence is bad English. We could just keep adding the word "reasonable"; I came up with a sentence that used the word three times. A wording has been suggested along the lines of, "The arrangement cannot reasonably be regarded as a reasonable course of action", but that still does not say who will have the regard. I would add to that wording, "a reasonable person cannot reasonably regard as a reasonable course of action." That would give us the word "reasonable" three times, which presumably would be even better.

Someone—I cannot remember who—referred to bringing in commercial common sense. However, that approach would worry me. Would it mean that we were swinging the balance towards commercial interests or the taxpayer and away from the beneficiary of the tax—that is, the citizen? Do the witnesses have any thoughts on that?

John Whiting: The concern with the use of the word "reasonable" is around who is being reasonable and whose judgment it is. If you want a fourth use of the word "reasonable" for your example, you could add the phrase "at a reasonable time of day." I am being facetious, but the serious point is that we would all come to a slightly different view of what is reasonable at different times and in different circumstances.

In all honesty, I do not think that one can get away from the use of "reasonable". It is a well-used term in cases. One of its prime uses is with penalties and whether a taxpayer has a reasonable excuse, so it comes up a great deal. The concern is that it is a rather flexible term, whose meaning can change according to circumstances.

We probably need to establish some guidance or track record on how the term will be used. If we can constrain, rather than expand, the number of occasions on which it is used, that will contribute to certainty for the individual taxpayer or business taxpayer. It will also translate to a little more certainty about how much tax will be raised by the

revenue authority through the power, so the recipient will know a little more surely when they are going to see the money.

11:00

John Mason: Do you accept that, as the convener pointed out, the more we pin such things down, the more we move away from principles and back to the detailed rules and regulations that we are trying to escape from?

John Whiting: I quite accept the danger of going down the path of endless details, but it is a question of striking a balance between those endless details, which none of us wants, and the legendary one-section act that some people say the UK tax code could be reduced to, which is basically that the taxpayer shall be left with such proportion of his, her or its income as HM Revenue and Customs in its infinite discretion shall reasonably decide. *[Laughter.]* I should say that I am a non-executive director of HM Revenue and Customs and that I do not support such a proposition.

John Mason: To be fair, most of us probably do not.

On what the word "reasonable" means, if I understand it correctly, the double reasonable condition in England has not yet been tested in court, so any words that we use—including the word "reasonable", although it has been used in court in other areas—will move us on to new ground anyway. Presumably, therefore, if revenue Scotland were to abuse its position and be unreasonable, that would soon be challenged in court.

John Whiting: Potentially, yes. I am sure that revenue Scotland does not plan to set out to be unreasonable. Without trying to do Charlotte Barbour out of a job, we do not want endless cases coming to the tribunal, so it is about giving some reasonable guidance.

Elsbeth Orcharton: I completely understand the slight frustration about the use of the word "reasonable". I have failed to come up with a different word, so I cannot criticise from that perspective, but context is the way in which one applies what is reasonable, and context is what we are looking for. It could be given in guidance, by a separate panel or by moves towards objectivity rather than subjectivity and uncertainty.

John Mason: You said that you reckoned that most taxpayers want to comply, and ICAS's submission refers to the expectation of revenue Scotland

"Treating the taxpayer as honest (unless there is a good reason not to)."

I suppose that I start with a slightly more sceptical approach, because there are a lot of people out there who want to pay as little tax as they possibly can, especially if they are writing a cheque for it, and self-employed people have more freedom than employed people, I guess. Do you stand by your claim that everybody is honest to start with?

Elsbeth Orcharton: Two different things apply. My experience is that most people whom I have come across want to comply, and that means that they want to act within the law and in a lawful fashion. That can sit alongside not wanting to pay the maximum amount of tax possible. Those people want to pay the minimum amount of tax possible within the law.

There are statistics on the scale of the black economy—those who operate outwith the law and do not comply with their obligations. I am not sure that anyone has ever measured it accurately, but it is still expected to involve a minority rather than a majority of the UK population. The interesting question is about the extent to which fairness is a spectrum. If you ask a room full of people how many of them would like to pay less tax, most people will put their hand up. If you give people two legal alternatives and ask who would like to take the alternative in which they paid less tax rather than more tax, most people would say that they want to pay less tax rather than more, but within a framework of complying and doing it legally.

I do not think that we will ever get away from that, or that we should necessarily try to get away from it. However, we try to ensure that the boundaries on what is legal and what is not legal are as clear and certain as possible, so that we can go back to people and say that they were definitely on the wrong side or on the right side.

The wording in our submission was intended to stimulate debate. Quite a few of the suggestions come from other charters that are around. John Whiting alluded to some international charters. We wanted to get a flavour of the Parliament's thoughts on what should be in the charter. Are those reasonable—sorry, there is that word again. Are they appropriate comments or expectations? If Parliament can set the tone and the direction, it is a lot easier for professional bodies and our members to understand what you are aiming at. Also, it is about the direction that you give revenue Scotland.

John Whiting: The vast majority of people in this country want to pay their taxes and move on—they have better things to do—and therefore they want to comply. To put the issue into context, the UK generally is a pretty compliant country. About 93 or 93.5 per cent of our taxes just come in, and HMRC gathers a little more on top of that. That means that our tax gap is famously about 7 per

cent, compared to about 13 per cent in the US and 8 or 9 per cent in Germany. We are a pretty compliant nation. Although I am not in any sense saying that we have not got a problem, let us keep it in proportion.

John Mason: That is fair comment, although I sometimes wonder how such figures are measured.

I turn to the final area that I want to touch on. Ms Orcharton suggested that, if there was more certainty in England and less in Scotland, businesses would move there. However, I suppose that that depends a bit on the type of business. Businesses such as Tesco or Starbucks want to be everywhere and extract money from the population wherever they are. From their point of view, if the tax situation was slightly less favourable in Scotland or Holland—or anywhere else, for that matter—that would not prevent them from going there, and it would not mean that they would concentrate only in England. I presume that they would just have to deal with it. However, I presume that, if a business such as Barclays is thinking of staying in England or moving to Scotland, the comparison becomes more relevant. Is that the case?

Elsbeth Orcharton: The discussion that took place in our office was in the context of the land and buildings transaction tax, which is the imminent one that we face, and locational decisions by those who might invest in a portfolio. The issue is not the absolute cost of the tax; it is the uncertainty as to whether the tax applies. If a business knows that something will definitely cost X, it will price that into its commercial decisions on deals and might pay less for a piece of land because it has more tax to pay. The issue relates to the impact of the uncertainty over whether businesses will have to pay tax. While that period of uncertainty exists, they might think that they cannot be bothered and will just concentrate elsewhere. That was the context in which our discussion took place—it was more about dealing with uncertainty rather than the absolute cost.

John Whiting: From my experience as a long-time tax practitioner, when businesses or wealthy individuals are making decisions as to where to locate, tax is one of the issues, but it is only one of the issues, and there are plenty of others. Tax can tip the balance, but it is rarely the deciding factor, except when people are, frankly, trying to out and out evade tax. Obviously, on evasion, we are into a completely different area.

John Mason: Obviously, tax is a factor. Some people go to the Isle of Man or the Channel Islands because the tax position is certain—they will pay less tax—but not everybody does that.

John Whiting: Indeed. For a period, I was involved with location studies and helping businesses to decide where to invest. As I said, tax is one factor, but so are things such as communications infrastructure, transport infrastructure, language, time zone and availability of grants—you can tick them off as well as I can. All those are put into the mix and weighed up.

Tax is a factor, and very often—particularly in relation to headline rates of tax—it can get on to the shortlist for the individual or company to consider. More detail is then considered and we will see the likely result at the end of the day. If the result is that people do not know how much tax they will pay in a country or if they think that they will be subject to the vagaries of a rapidly changing tax system, that will tend to put investors off the country. However, there is a range of factors.

The Convener: I do not know how rapidly changing many tax systems are, but there is a real issue to do with organisations—Starbucks has been mentioned—paying tax in the country where they make money as opposed to looking at countries such as Ireland or Luxembourg, where they choose to pay the lowest tax for their entire European or worldwide operations. That issue is separate from the one that John Mason raised.

John Whiting: It is. I am sure that you are aware that the Organisation for Economic Co-operation and Development is seriously worried about that.

On how frequently tax systems change, I am aware that Brazil is legendary for being the country in which it takes longest for people to do their tax. Basically, that is because its tax system changes every day. The Parliament is very productive, but I suggest that that is not an example that you should emulate.

The Convener: That would keep some of your Brazilian colleagues in work, though.

John Whiting: Indeed.

Jean Urquhart (Highlands and Islands) (Ind): A couple of my questions have been answered, one of which was about the bill being fit for purpose, given the constitutional change in the country.

I want to follow up on the heartening information that most people pay their tax, although people want to know that they are being fairly taxed and are paying their due. Does that not reflect the earlier concern about primary legislation dealing with the tax that is to be paid and the default position of secondary legislation dealing with tax evasion and avoidance penalties? The penalties are not spelled out. It seems to me that, if this is a positive piece of legislation and we agree that

most people want to be fair and to be treated fairly, that should be reflected in primary legislation.

Elsbeth Orcharton: The view that we took and which our members express to us is that the bill is fairly historic. This is the first time that the proposals have come to the Scottish Parliament, and our members have many aspirations and expectations that the bill should be as comprehensive as possible, set out a coherent picture, and tell people what is expected of them and what will happen to them if they do not comply. That is where the point about having penalties at the same level of detail as applies to obligations comes in.

As has been said, the bill has to do all those things. It should raise revenue, give certainty, say very clearly what will happen to those who do not comply and fall foul of it, and be fit for purpose. I think that everything sits together in the same place.

John Whiting: Yes. Some 93 per cent or whatever pay partly because of sheer confidence in the system. It is well run by HMRC and Parliament and is not subject to whim or the Brazilian style of constant change. That creates confidence in the system, and that is an important message that the Parliament needs to send.

Jean Urquhart: I have another question about reporting to Parliament. I think that you have concerns about that, although I cannot find the page in question. How do you envisage the system working? Who should do the reporting?

Charlotte Barbour: We were slightly unsure about exactly what the reporting structures were from the bill. I know that it says that a report will be laid, but there is no provision for accounts or actively reporting to Parliament. We have had subsequent discussions with the bill team in which it explained the finer nuances of how the chief executive will report to the board and how the board will be the office-holder.

We just wondered whether the bill or the supporting material need to be slightly clearer so that people know exactly how the board is to conduct its business.

11:15

Gavin Brown (Lothian) (Con): Paragraph 8(2) of schedule 1 to the bill says:

“The person employed as chief executive may not be a member of Revenue Scotland.”

Are there advantages to that approach?

John Whiting: I will, if I may, reiterate something that I mentioned in passing earlier. I am a non-executive director of HM Revenue and

Customs in my spare time, as it were, so I have some experience of this.

The CIOT thinks that it is much better to have the chief executive and, potentially, the chief operating officer—the senior members of the executive, if you like—of revenue Scotland as part of the governing body. In the terminology of schedule 1, they should be members.

We say that because we want to build the right sort of team for non-executives, if I can use that term, and executives, so that there is good regular interaction. It seems a little strange to set up a structure that has members—all of whom are non-executives—who govern but who, when they meet, do not routinely have the chief executive there. They can call her or him in to see them, and they would probably do that as a matter of routine, but it builds a better, more regular operating atmosphere if the top team consists of the members, the non-executives and the senior executives.

From my experience of being a board member at HMRC, that structure works. We are trying to take a regular team approach, with people who know, trust, and deal with one another regularly. That does not stop us challenging.

Gavin Brown: Does ICAS have a view on that one?

Charlotte Barbour: ICAS feels quite strongly that it would be much better to have a mixed team of executives and non-executives for the reasons that John Whiting has just discussed. It is slightly disjointed to have a completely non-executive board.

Revenue Scotland is going to be primarily operational and, if it is to have a proper handle on how operations are running, the chief executive needs to be on the board of revenue Scotland as a member of revenue Scotland. It would all pull together much better if the board had that mixture of executive and non-executive members. That is what most businesses do. A complete board of non-executives is often at one remove, which does not seem to make sense.

I also should mention that when we were asked about the issue in the consultation before the bill was drafted, the majority said that it should be a mixed board. What is in the bill is quite unusual, and, from subsequent conversations, it is my understanding that it has been decided to do it in this way because of the reporting provisions. However, the approach is perhaps slightly artificial.

Gavin Brown: Okay. We will move on to the issue of penalties, which has already been touched on.

Penalties are covered in sections 148 to 185. I do not propose to go through each section, but some stakeholders have made the point that the sections on penalties are a little bit light and overreliant on regulations.

As I read them, the sections on failure to submit a return, on failure to pay tax on time, on making an error and on underassessment by revenue Scotland have almost nothing by way of specifics. However, section 167 is explicit: it says that not complying with an investigation carries a penalty of £300, and submitting a document that has errors carries a penalty of £3,000. Some sections contain nothing, whereas others give exact sums. What is your view on what needs to change in the bill to comply with the principles that you think are important?

John Whiting: That is a very good analysis. We think that section 150 needs to set out what a failure is and what the penalty is. Given that there is provision elsewhere in the bill for penalty amounts to be increased in secondary legislation so as to keep up with inflation or whatever, it will not hamstring the system if such provisions are laid down in the bill—if the bill spells out the circumstances and the amounts. To me, it is as simple as that.

Charlotte Barbour: I completely agree with that. Sections 150 and 151 probably need the most expansion. The circumstances in which a penalty is payable should be on the face of the bill, and the amounts should be on the face of the bill, too. To me, the only things that should be in regulations are the procedure and the administrative side. Everything else should be in the bill. That is particularly the case for penalties for the most humdrum things: the failure to make a return and the failure to pay tax, which we come across most frequently.

John Whiting: Those are the regular ones.

Charlotte Barbour: Yes. Those are the regular ones—they are the penalties that really upset people when they get them. Usually, people do not appreciate that they should have done something, and they think that it is singularly unfair when they get a penalty.

Gavin Brown: I have a question about another aspect of penalties. Some of the issues are similar, and I will not press those points.

Section 163 is on “Under-assessment by Revenue Scotland”. From a brief reading of that section, it seems to me that, if revenue Scotland makes an error and underassesses, and if the taxpayer—or person P, as they are described in the bill—through carelessness does not notice that, they must pay a penalty because revenue Scotland has made a mistake. Further, it is up to revenue Scotland to decide whether that person

has been careless. That struck me as giving revenue Scotland a fair bit of power. Effectively, it could rectify its own mistakes in that way. Do the witnesses have views on section 163?

John Whiting: Let us start with the fact that mistakes happen. In a sense, the starting point should be that, if an honest mistake has been made on either side, people should not suffer. What section 163 is trying to get at—you have picked up on this very well—is the situation in which it is blindingly obvious that the tax authority has made a mistake. If someone's income is £1 million and the authority has put the decimal point in the wrong place and has instead assessed an income of £1,000, that is screamingly obviously wrong, as the person knows perfectly well, and frankly they should own up and say so. In such situations, we would accept that there is the possibility of a penalty if the person does not own up. However, even in such cases, there are issues around whether it is really that obvious to an ordinary taxpayer that things have gone wrong. You put it well. Section 163 seems to leave quite a lot of discretion to revenue Scotland.

Elsbeth Orcharton: My handwritten note says that that provision is very harsh, for two reasons.

In what will be quite unusual in a self-assessment system, revenue Scotland will issue an assessment in which it has made a mistake. That activity will involve a tiny fraction of revenue Scotland's business. A really harsh penalty applies, yet—to return to your first point, Mr Brown—the bill is silent on all the other processes and procedures that might take place on a day-to-day basis. Who is doing what that might give rise to a penalty, which could then give rise to something equally harsh? Could it be harsher? Could it be less harsh? We do not know. On the question whether the penalty provisions in the bill should be really harsh, is that the tone that the Parliament wants to set? Do you want something much fairer? "Fairer" is another word that we used earlier. Do you want something that is quite lenient in certain circumstances, with something very penal put in place for persistent offences?

That is what we are trying to get at in relation to the shape and consistency of the bill and the penalty system. What is it that you are actually trying to penalise, by how much and with what caveats? In the view of ICAS, it is for Parliament to determine that, and that is why we wanted to have a discussion about what is in the primary legislation.

Gavin Brown: To paraphrase John Whiting, if an error is made in relation to someone with an income of £1 million and the mistake is blindingly obvious, you would have a lot less sympathy for somebody who did nothing than you would have for someone who was penalised if the error of

margin was small and there was a perfectly feasible reason why the error was not picked up. You would find that a bit harsh.

John Whiting: It is not just a function of size. We are in a complex area, so you have to ask whether it is reasonable—to use a well-known word—to expect the average taxpayer to pick up the error.

Let us face it: most people who get a letter from HMRC tend to accept that HMRC has got it right, because tax is complex and people do not always understand it. You can project from there that if something comes from revenue Scotland that says, "We have assessed this. We've worked it out and the figure is so much," the taxpayer will say, "Oh well, I suppose that must be about right."

I come back to the point that if it is blindingly obvious that something is completely wrong, you can say that the taxpayer is at fault. However, whatever penalty there is should not penalise those who make a tiny error or errors that the taxpayer could not be expected to pick up. He or she is not the expert.

The Convener: That concludes the committee's questions. Would you like to make any points to the committee that have not come out from the questioning?

John Whiting: No. We have been given a good opportunity, so thank you very much for listening to us.

I echo what we said earlier: the bill team has done a good job. The CIOT put out a note earlier this week in which we awarded the bill eight out of 10. That will very quickly get to nine out of 10 with the discussions that we have suggested, although I do not suppose that we would ever give a bill 10 out of 10.

The Convener: I am sure that the bill team will take eight out of 10 at this stage. There are still stage 2 amendments to come and the committee has yet to produce its report.

Thank you very much for your comprehensive answers, which the committee appreciates.

11:27

Meeting suspended.

11:35

On resuming—

United Kingdom Budget

The Convener: Right, folks—let us get back in business. The second item is the UK budget, which is expected to be announced on 19 March. I once again give a warm welcome to Paul Johnson, who is director of the Institute for Fiscal Studies, and invite him to make a short opening statement before we move to questions.

Paul Johnson (Institute for Fiscal Studies): What shall I say by way of introduction? As ever, the key messages with respect to the budget are about the state of the public finances. We finally got some relatively good news in the autumn statement. The Office for Budget Responsibility increased its view of growth last year and this year, so borrowing this year is likely to come in at knocking on for £10 billion less than it was last year, although at more than £110 billion it is still a very large number.

The Chancellor of the Exchequer announced in the autumn statement that he will—assuming that he is still chancellor in 2019—add an additional year to the years of spending restraint, which he will do with the aim of getting a budget balance, or even a very small surplus, by then. That is obviously subject to immense amounts of uncertainty, depending on what happens to tax revenues, growth and so on.

The one bit of good news that the OBR did not come up with was that it has not taken the view that the economy's potential has increased relative to what it thought it would be a year ago; in its view the scale of the required fiscal adjustment has not changed, despite the additional growth last year. Its view is that that growth was essentially cyclical—it came a bit earlier than it might, but was not additional growth.

However, there is a lot of uncertainty about that. One of the things that we bring out in "The IFS Green Budget: February 2014" is that some macroeconomic forecasters believe that there is a significant output gap and that the potential for the economy to grow is much larger than the OBR believes. If they are right, the suggested scale of consolidation will prove to be more than will be necessary. However, others are less optimistic than the OBR. It is a terribly difficult judgment to make.

I do not expect there to be anything significant in the budget in a couple of weeks that will change the Government's expected fiscal path, so I do not think that there will be a significant change to expected spending or tax, in toto. If there are changes, and I am sure that there will be, they will

be offsetting changes, so there may be some additional spending reductions this year and next—the kind of thing that has been announced in previous budgets—to make space for some tax cuts, or some tax cuts may be paid for by tax increases elsewhere. I would be very surprised if there is a net giveaway or a net takeaway in the budget; indeed, neither has happened since 2010. Each budget and autumn statement since then, for the period of this Parliament at least, has essentially been neutral, but that has not prevented quite a lot of activity within that, with quite a lot of work being put into, for example, funding of substantial increases in the personal allowance, cuts in the rate of corporation tax and so on, which have required changes elsewhere.

We have looked in "The IFS Green Budget" at what is happening to household incomes—I am happy to talk further about that—and we have looked at some specific areas of tax and spending, which I am also happy to talk about in more detail, if members would be interested.

The Convener: Thank you for that introduction. Your "IFS Green Budget", which was published on 5 February, covers UK issues, but certain aspects including housing, childcare and education are specific to England, so we will concentrate on the UK and Scottish aspects.

Chapter 1 is entitled, "Public finances: the long road ahead". It has been a long road already, and will remain so. You say that

"Borrowing this year is forecast ... to be £111 billion, which is still £51 billion higher than it forecast back in 2010."

You also mention the budget forecast for 2018-19, and say that

"Public sector net debt in 2018-19 is projected to still stand at nearly £1.6 trillion, or 76% of"

anticipated

"national income",

and you go on to mention

"substantial annual debt interest payments."

Interest payments can change, of course, but what is the UK's current level of interest payments on that debt?

Paul Johnson: We are on a path on which interest payments will move from £20 billion to £40 billion or so over the period. I do not have the number in my head, but it is in the document somewhere.

One of the reasons why spending on certain elements of public services is being squeezed so much is that debt interest payments will rise over the period. If we look at the period between 2010 and 2018, we see that total public spending is not falling by much at all, while debt interest spending

is increasing by more than 50 per cent. As one would expect, some other elements of spending are rising, and in order to keep the total level flat, public service spending is being cut substantially.

I am sorry that I do not have the numbers immediately to hand; I can spend a couple of minutes finding them in the document if you like. The role of debt interest is important in constraining other elements of spending.

The Convener: As you said, that situation is likely to continue for a number of years, and to get worse. In the chapter, “Public finances: risks on tax, bigger risks on spending?”, you mention the remaining

“significant risks to both receipts and spending.”

Can you expand on that a wee bit?

Paul Johnson: The fiscal numbers depend overwhelmingly on what happens to growth, so if growth does not turn out as expected, tax revenues in particular will turn out very differently. The reason why we have such a big deficit now, in comparison with what the Government was hoping for back in 2010, is that growth has not arrived, and therefore tax revenues are very much lower. There is obviously a growth issue.

If we get the expected growth, the expectations for tax receipts look reasonable to us, but with three concerns. One is that the forecast for tax revenues includes default indexation of things such as petrol duties, council tax, business rates and other such things. The current and previous Governments have not managed to increase petrol duties in line with inflation for a very long time. Council tax has been frozen in England for three years and in Scotland for quite a lot longer, and there are quite a lot of changes going on in business rates and so on. There are policy risks. If it continues to be the case that we cannot increase petrol duties for whatever reason, revenues will need to be made up from elsewhere or there will be a bigger gap.

A second potential risk is the increasing dependence on capital taxes such as stamp duty, capital gains tax and inheritance tax, which are forecast to make up 5 per cent of all revenues by 2018. That will be the highest proportion that they have ever reached. In capital gains tax in particular there is a great deal of uncertainty on how things will move forward.

The third area of risk on the tax side to which we draw attention—I should say that there are upsides as well as downsides to these things—is the extent to which we have become increasingly dependent over quite a long period on a very small number of taxpayers for a very large proportion of total revenue.

For example, the top 1 per cent of income tax payers pay somewhere between 25 and 30 per cent of all income tax, which is itself about 8 per cent of all tax. That is just the income tax that they pay. The top 0.1 per cent are paying more than 10 per cent of all income tax, so 30,000 individuals are paying more than 10 per cent of the entire income tax revenue. That is, of course, because those guys have such an enormous amount of money, but being so dependent on such a small number of individuals means that changes in their behaviour can potentially make tax revenues somewhat volatile. Our view is that the Government estimates are probably the best—and a sensible—central case, but there are some risks around them. Of the three risks that I have mentioned, the policy risk may be the biggest, because it has proved to be difficult to achieve some of the policies that are assumed. That is on the tax side.

11:45

On the spending side, the risk is associated with the scale of the cuts that are anticipated. We have already had some fairly significant cuts in public service spending in police, transport, defence, local government and so on. Those cuts have, in some senses, proved to be easier to deliver than was expected three or four years ago. They have been delivered—in fact, they have been overdelivered, because departments have spent less of their budgets up to now.

However, we are only a third of the way through the cuts in public service spending that are now planned up to 2019. That will mean that, if things continue to move in that direction, and health and other such areas continue to be protected, there will be cuts of more than a third in those budgets between 2010 and 2018. That is a very large cut to achieve, and it will take public service spending to its lowest level since the late 1940s—for which we have comparable data—as a proportion of national income. Whether that is deliverable remains to be seen. As I have said, the cuts have so far proved to be more deliverable than was expected, and that may continue to be the case. On the other hand, however, I presume that the easier cuts have already been made and the harder cuts are still to come.

Finally, there are two particular things that may make the situation even more difficult than it appears. One is that the current Government has already promised significant additional spending increases for the next session of Parliament; those are, in a sense, unfunded. There is £7 billion-worth of promises for additional spending, which will mean £7 billion of cuts from the rest of spending.

Secondly, the population is growing and ageing quite rapidly over the period in question, so

spending per head is falling more quickly than total spending. We are going through a period of remarkably rapid demographic change in the current decade, which will make some of those things harder to achieve.

The Convener: Your comments provide a great deal of food for thought for members of the committee. I will take on a couple of the issues, and then open up the discussion to members, who are all lining up with their questions ready.

You said that freezing fuel duty up to 2018-19 would cost £4.2 billion, but the Government would suggest that one reason why we are not increasing fuel duty is because it is relatively high relative to that of other countries, which undermines competitiveness. In addition, there is an issue with the impact on household budgets. Although £4.2 billion of revenue might be lost on the face of it, there is a counterargument that, if businesses cannot compete because of high fuel duties relative to competition elsewhere, they are not in a position to pay some of the taxes. Surely the £4.2 billion is a two-dimensional figure that does not take into account the impact in the round.

Paul Johnson: Sure. The actual net costs might be a little bit less than that because of some of the behavioural effects that you are describing.

The point that we were really making is that the official forecasts for revenues assume that fuel duties will rise and that we will get that additional £4 billion of revenue. We are asking whether that will happen. I do not know, but history suggests that it might not. The first-round effect of that will be that revenues will be £4 billion less. That might have a behavioural effect on other economic activity that would increase other revenues, but there is no prospect of it increasing revenues by anything like £4 billion. The real amount to be lost might be £3.5 billion rather than £4 billion, but the point stands: it will require a change of political direction to secure those revenues. It would be perfectly sensible to choose not to increase those revenues and to decide to raise revenues elsewhere, but that is a choice that would have to be made in order to keep to the same total level of revenue.

The Convener: Your submission says:

"If 'protection' for schools, the NHS and aid spending were continued through to 2018-19, other 'unprotected' departments would be facing average cuts of 31.2%."

You go on to say that even if NHS spending—I take it that you mean in England—was

"protected" and frozen in real terms between 2010-11 and 2018-19, real age-adjusted per capita spending on the NHS would be 9.1% lower in 2018-19 than in 2010-11."

The obvious question is this: what would be the impact on Scotland's budget?

Paul Johnson: We have not pushed those numbers through the Barnett spreadsheet. The effect would be whatever the Barnett consequential would be, so I guess that they would be proportionately similar to the cut in the overall UK budget, but we have not calculated that number.

The Convener: Okay—but can you give us some kind of ballpark figure? Your submission says:

"Even with the Chancellor's mooted £12 billion of further cuts to social security benefits, the implied cuts to public services from 2010-11 to 2018-19 would mean departments facing budget cuts of 17.1% on average."

Paul Johnson: I have no reason to believe that the numbers would be significantly different in Scotland.

The Convener: Thank you for that.

Before I open the meeting up to colleagues, I have a final question about spare capacity and productivity. You will recall that we have had quite extensive previous discussions about productivity, and there was some uncertainty, not just from IFS but from the committee's previous economic adviser. Why has relative productivity not really increased? When one considers what has happened during the past few years, according to what happens in normal recessions, one would expect the economy to shrink, but the number of people in the workforce would shrink further so that there would be productivity gains and so on. That has not really happened in this recession.

Can you talk us through the situation with respect to productivity and, as you mentioned in your paper, the issue of spare capacity in the economy?

Paul Johnson: I will try, but I am afraid that I am not going to provide any definitive answers.

During the past five years, productivity has dropped remarkably fast against a normal trend, when it would rise. A big gap has therefore opened up in terms of productivity relative to what one might have expected. Why is that? Part of that is the flip-side of what I think is the extremely good news story about what has happened during the past several years: employment levels are higher than they were before the recession. Arithmetically speaking, employment levels are higher, but output is lower and productivity has gone down, so what is causing that drop in productivity?

There appears to be an increasing amount of evidence that that the drop is associated partly with the type of recession that we have had. It was a financial crisis, so the funds that were available to business have been less and the banks have not been lending—especially not to new businesses. It seems that old businesses have

been able to continue to access funds, but new business and projects are not being funded. Business investment has been at very low levels, so the capital that workers have to work with has been lower. That has clearly played a role in the issue.

There is also the point about the number of people who are in work. It is hard to know which is driving which. Is low productivity driving high demand for low-skilled labour, or is it the other way around? There appears to have been a change in how the labour market works, which has allowed—or has, perhaps, pushed—more people into work, relative to the 1980s, for example, when a lot of people lost touch with the labour market very quickly. That is partly to do with the type of recession that we have had, and it is probably partly to do with the current structure of the welfare state, which has increased the labour supply of some people.

No doubt we will be arguing for a long time about the causes of what has happened so far. The big uncertainty going forward is about the point at which the productivity story will start to take a turn upwards. It is at that point that we will get to the link between what has been happening to productivity and the question about the scale of the output gap. If a lot of the productivity that we have lost so far is regained—if there is scope for that—that will be equivalent to saying that there is a large output gap remaining. If that productivity is not regained, that is equivalent to saying that there is not much of an output gap remaining.

It is very hard to judge where the output gap lies. Why might we think that there is a very small output gap? We might think that partly because we have very high levels of employment. If we consider that the equilibrium rate of unemployment is somewhere in the 5 per cent or 6 per cent range, we are not very far off that, which means that there is not an awful lot of space left in the labour market. There is also the fact that while business investment may pick up, there is no particular reason to think that it will pick up everything that has been lost over the past five years. That would be a story that says that we have a rather small output gap.

A story that tells us that we have a rather large output gap would be one that says that although a lot of people are in work, many are working part-time and want to work longer hours, and that business investment may well make up a lot of the gap that has been lost over the past few years. The problem is that we will not really know the answer to the question until several years down the road, by which time choices will have been made about the scale of fiscal consolidation, which will be partly irreversible.

The Convener: Have reduced labour costs had something to do with it? We are also talking about a 6 per cent reduction in real mean household incomes, so it has perhaps been less expensive to retain labour than in previous recessions.

Paul Johnson: Yes, and again the question is why. It certainly has been less expensive to retain labour. Real wages have fallen by 7 or 8 per cent over the period, which is historically unprecedented. I do not think that we have seen a period like it. There were some times in the 1970s when inflation was very high and wages were not quite keeping up, but during a period of relatively low inflation we have never seen anything like this.

The question is why wages have remained low. It is very difficult to get at the causation. It may be that productivity has been low, which has resulted in low wages. It may be that companies now have more power in the labour market and can pay low wages, therefore the large amount of labour has reduced levels of productivity. Which way round that is working—there is probably a bit of pressure in each direction—is uncertain. However, that very unusual labour market behaviour has been at the root of what has been happening to output, employment and household incomes.

Michael McMahon (Uddingston and Bellshill) (Lab): Thank you for that outline, Mr Johnson.

If I understand your UK economic outlook correctly, you are predicting growth at a higher rate than the rate that the OBR predicted. When the OBR predicted its growth rates, a number of commentators said that, given that the trade in the economy is cyclical, the levels at which the OBR was predicting growth could have been predicted anyway. Nothing that the Government is doing is stimulating that increase in growth; it would have happened as a matter of course.

Your predictions are slightly higher than that. Is the Government doing something that you think will increase growth beyond what the OBR predicts? How do you feel about the comment that the growth level that we are told to expect is no more than we could expect in relation to other economic indicators at this point in the economic cycle?

12:00

Paul Johnson: I should be clear that we are not making growth forecasts—Oxford Economics made the growth forecasts in the document. The point relates to a previous question. The view of Oxford Economics on growth over the next several years is not very different from that of the OBR, but it differs from the OBR in thinking that the output gap will be significantly bigger. Oxford Economics has not forecast the figures, but it thinks that growth will continue at more than 2 per

cent for quite a long time after 2018-19, which the OBR does not believe. What differentiates Oxford Economics, rather than the IFS, from the OBR is its view on the output gap rather than on growth in the next three or four years.

I slightly take the view that, over short periods such as the next two or three years, Government policy can make relatively little difference to the position unless it has a big fiscal expansion, which would have trade-offs or costs down the line. What the Government does in the long run can have a big effect on growth and productivity through the education system's structure, the amount of infrastructure that we have, the design of the tax system and so on. However, changing those things now would impact on growth and productivity over the next decades rather than the next two or three years.

Michael McMahon: You touched on productivity. As you are well aware, there are different arguments about the value of increasing taxation allowance thresholds in order to reduce in-work benefit levels. You appear to argue that raising the threshold to £12,500 will not be as effective as maintaining or increasing tax credits for people who are in work. That goes against the perception that it is better for people who are working not to be on benefits.

Paul Johnson: As ever, there is a trade-off and there are pros and cons. Raising the personal allowance is extraordinarily expensive and the Government has already spent more than £10 billion a year on increasing the allowance, which is quite a large investment in the current fiscal circumstances.

Raising the personal allowance further will be less well targeted on the lowest paid, partly because quite a lot of low-paid part-timers have been taken out of income tax already and partly because the allowance is now close to the allowance for pensioners, so they will start to benefit, too. That might be what is wanted but, if the Government wants to help low-paid people, the increase will not be targeted on them. Nevertheless, increasing the personal allowance is the most progressive way of changing the income tax system.

If the aim is to change the direct tax system in a way that helps low-paid individuals, it is clearly better to increase the national insurance contribution floor—the point at which people start to pay NI contributions. National insurance captures more people because it is set at a lower level and focuses only on people who are in work. If the intention is to help low-paid workers through the tax system, it is entirely clear that the Government should raise the point at which people start to pay NI contributions rather than the point at which they start to pay income tax.

The question then arises of what to do about in-work benefits. That involves a genuine trade-off. If a limited amount of money is available, an awful lot more can be done with in-work benefits because they are targeted on people with low household incomes. The downside is that, once people are on in-work benefits, they can face a high withdrawal rate of 70 to 80 per cent, so their incentive to work more is much reduced. The take-up level might also be less than 100 per cent and, for other reasons, the Government might not want people who are in work to be on benefits.

So there is a trade-off. We have not said that one should be done rather than the other, but we have said that, within the direct tax system, NI should be considered rather than income tax and that careful thought needs to be given to the trade-offs between changes to the tax system and changes to the benefits system, depending on exactly who is to be targeted and, in particular, how much worry there is about some of the work incentive effects.

Michael McMahon: You mentioned the increases in employment levels but, within those statistics, there is increasing underemployment. For individuals who are ostensibly employed but who are on zero-hours contracts or in part-time work, the productivity that they are achieving might be much less than we would expect were they employed on a full-time contract and paid at a level that incentivised them to work more and produce more. We then get into the argument about whether incentivising people to work by increasing their salary would have an impact on the economy, and that brings us to the living wage. We had scare stories about how adversely impacted the economy would be as a result of the introduction of the national minimum wage, and we now hear the same concerns about the introduction of a living wage. Would the living wage increase productivity, and what would be the adverse effect and the complexities of its introduction?

Paul Johnson: That is another tough question. Inevitably, there is a point at which a higher living wage or minimum wage would have a negative effect. We could not introduce it at the absurd level of £20 an hour. The question is at what point between where it is at the moment and £20 an hour it would start to have a negative effect. Once the minimum wage got up to the living wage level, it would affect a much larger chunk of the population than it does at the moment. At that level, we would be hitting about 20 per cent of the people who are in work, whereas the minimum wage currently affects about 5 per cent. We would get to a much thicker bit of the earnings distribution.

That might have the positive effects that you describe, in the sense that it would force higher productivity, or it might have negative effects because it would impact a lot more people and employers might respond by having fewer jobs. Over the past decade and a half for which the Low Pay Commission has been in place, it has tried to make judgments about the point up to which we can keep moving the minimum wage so that we can be confident that it will not have a significant negative effect on employment and the labour market.

The commission has made that judgment. Initially, it increased the minimum wage significantly, but it has reduced it again. It will probably start to increase a little over the next few years. The level is based on the commission's best judgment, and I think that the commission's judgment is that increasing the minimum wage to the level of the living wage would have negative effects on employment. It certainly would if it was done straight away in one big chunk, although moving gradually in that direction might have a less deleterious effect. However, the judgment about where we think that the wage would start to have that impact is a terribly fine one. One thing that we know is that the minimum wage would start to impact on an awful lot more jobs if we increased it significantly above where it is at the moment.

Jamie Hepburn: I want to focus on some of the areas that Michael McMahon has touched on. I had wanted to talk about the income tax personal allowance, but that has been usefully explored. In the summary, your green budget states:

"A substantial minority (30%) of those who are low paid have partners who are not low paid. Hence, policies that help all low-paid individuals would also help some relatively high-income families."

The first question that that begets is: how do you define "not low paid"? The emphasis is interesting because you talk about a substantial minority, but the flip-side is that the overwhelming majority—70 per cent—of those who are low paid do not have partners who are "not low paid", however you define that.

Paul Johnson: Indeed. We defined low pay relative to the living wage, so—

Jamie Hepburn: Can I just clarify that? Are you saying that anyone who earns the living wage is not low paid?

Paul Johnson: That is the definition that we used in that chapter. We can put the line wherever we decide to put it, but you are right to say that most of the effect would be on the group that you mention.

I will make two points about the personal allowance. First, if we are to make changes to the

income tax system, increasing the personal allowance is the most progressive thing that we can do. Secondly, when we target something on individuals who are low paid—be it wages, income tax or national insurance—we should remember that some of those individuals will have partners who are better off and that an awful lot of people who are on the minimum wage are relatively young people who live at home with their parents and are therefore in households that may not be terribly badly off. It depends on what we are concerned about—the income of the individual, the income of the individual and their partner or the income of the household in which they live—and that is a political rather than an economic judgment.

The natural effect of an increase in the personal allowance is that everyone who is an income tax payer with an income below £100,000 will gain. On a couple of occasions, the Government has ensured that higher rate income tax payers do not gain, and on other occasions it has at least ensured that they do not gain more than basic rate income tax payers, but inevitably people who are not on low incomes do gain as a result of such increases. In a sense, that is a good thing, as people become better off, but it is one reason why such increases are so expensive. An increase in the personal allowance from £7,500 to £10,000 costs £10 billion because it involves giving a bit of money to a lot of people.

Jamie Hepburn: Do you accept that, although those who earn the living wage may be defined as not low paid, they are not exactly wealthy?

Paul Johnson: Of course.

Jamie Hepburn: You will be aware that the Scottish Government is committed to paying all its employees the living wage. You talked about the stage at which increasing the minimum wage would have a negative effect and about the vast difference between the minimum wage, which affects 5 per cent of the population, and the living wage, which would affect up to about 20 per cent of the population. On the narrative about a negative effect on the economy, am I right to recall that the same set of arguments were laid out when the minimum wage was introduced?

Paul Johnson: Yes. The judgment of the Low Pay Commission has been that it will set the minimum wage at a level at which it is not going to cause that kind of damage. At some point it would cause damage, but I do not know where that point is—it may be below the level of the living wage or above it. The Low Pay Commission's view is that the minimum wage should be roughly where it is at present.

It is difficult to know beforehand what the impact of a change would be. The most compelling thing

that we need to take account of is that we would expect a move from something that affects 5, 6 or 7 per cent of the population to something that would affect 20 per cent of the population to have a different effect.

Jamie Hepburn: Surely, it could have a positive effect. These individuals are not wealthy, and instead of saving for a rainy day they are spending the money that they earn. Increasing that could have a positive economic impact, could it not?

Paul Johnson: Of course, but that would depend on the response. If the only effect of the introduction of the living wage was an increase in the incomes of people who were in work, that would be positive, but the money would have to come from somewhere. It would either come from—

Jamie Hepburn: Could it come from increased economic growth as a consequence of the change?

Paul Johnson: Perhaps it could in the very long run, but the change would certainly not have that effect in the short run. It could come from cash piles that some businesses are sitting on, but a lot of people who are affected by low wages work for small employers, who tend to pay an awful lot less than big employers. It is probably not going to come from cash piles in those cases.

It might come from lowering the wages of those who earn a bit more at the moment, it might come from higher prices or it might come from lower profits. If it came from one of those places, it would have some other effect on the economy. It might come from having fewer people in work. I do not know where the effect would be, but there is no cash machine that would create the money that people would get—it would have to come from somewhere else.

12:15

Jamie Hepburn: Following that line of inquiry, in chapter 6, which is on the squeeze on incomes, the summary points out:

“the average price level faced by households in the bottom quintile rose by 7.1 percentage points more than that faced by households in the top quintile between 2007-08 and 2013-14.”

In terms of the evidence base, that is intuitively going to have a negative effect on those individuals and households.

Yesterday, the Welfare Reform Committee heard evidence from the Trussell Trust, which told us that 300 per cent more people are using the food banks that it operates in Scotland this year than last year. Presumably, that could have a negative economic impact. Those households are not putting money aside. They are going out and

spending it productively, and if their income is being squeezed they can do that less than they could previously, whereas those in the top quintile are more likely to be putting money away and saving for retirement, or having two or three holidays a year. Do you have any assessment of the negative economic impact?

Paul Johnson: The big impact is the negative social impact. Making people on very low incomes worse off has an immediate impact.

Jamie Hepburn: We accept that, and that is obviously readily understood.

Paul Johnson: What is happening has been driven by an increase in energy and food prices, and that is why inflation has been higher. For better-off people with mortgages, big falls in interest rates have made them relatively better off. That is what is driving it. You are right that, if people with low income are seeing their incomes fall, and they are a group who spend all their income, that will have an effect on the economy, perhaps more immediately and directly than would be the case if money is taken away from people who would otherwise have saved it. Taking money out of the economy and out of people's pockets has a negative effect on growth in the short run.

Jamie Hepburn: I have a final question that relates to a policy divergence between what is happening in Scotland and what is happening south of the border. Chapter 5 of your paper, on housing market trends, refers to the right to buy. It was interesting to read what you say about

“the excess demand for public housing in some localities”.

I would be interested to know the localities that do not face such a demand. There are certainly no localities in the areas that I represent that do not have an excess demand for public housing.

You also say that it is unclear whether the UK Government's policy of further entrenching the right to buy by increasing the amount of discounts

“will achieve the desired balance between increasing homeownership and minimising reductions in social housing.”

I would have thought that there was plenty of evidence, given the pattern of housing tenure during the period of right to buy's existence. The UK Government has implemented that policy on the one hand, but on the other hand it has implemented a bedroom tax. It says that there are not enough houses to go round, so we have got to get the right people into the right houses, but at the same time it is selling off the housing stock. Surely the evidence base is there already.

Paul Johnson: We are trying to say that it depends on how one weights those objectives. If increasing home ownership is weighted extremely highly, that might be the kind of policy to pursue,

but it would have to weight very highly relative to the demand for social housing. If any significant weight is put on the demand for social housing as a policy objective, then—

Jamie Hepburn: The UK Government says it does so, and that that is why it has introduced the bedroom tax.

Paul Johnson: Again, as with most such things, there is a trade-off. Increasing the right to buy clearly implies a trade-off where a large part of the objective is to increase owner-occupation relative to being clear that there is enough social housing.

Jamie Hepburn: Do you consider that to be an effective use of the public housing stock?

Paul Johnson: That is a policy trade-off for politicians to decide on, rather than something that I would want to pronounce on.

Jamie Hepburn: Fair enough.

Malcolm Chisholm: Mr Johnson, you said that you see no reason to think that the 17.1 per cent average reduction at UK level would not be replicated in Scotland. However, because of the protection of health and schools, that surely works relatively favourably for Scotland, given that those areas take up about half of the Scottish budget.

Paul Johnson: Yes, that would be right, for that part, clearly. As I say, we have not run those figures, so I would not like to say what the number would be.

Malcolm Chisholm: I just wanted to make that point, in case anyone ran out of the room and said that there is going to be a 17.1 per cent reduction in public expenditure in Scotland.

You dealt with policy risks such as dependence on capital taxes and on the small number of taxpayers at the top, but you did not mention two of the things that you addressed in chapter 4, where you say:

“The risks around our forecast are more balanced now than they have been since the financial crisis. Domestically, the main uncertainties surround the housing market and the high level of consumer indebtedness.”

Are you saying that those issues could make the situation a lot worse, or is that not likely to be the case?

Paul Johnson: Our view is that no great risk is posed to the housing market at the moment. Outside of particular bits of central London, prices are still well below where they were in 2007, and the most likely path is for there to be a continued improvement in the housing market. In 99 per cent of the country, we are nowhere near bubble territory. The prospects are probably relatively positive.

On consumer spending and indebtedness, one of the problems is that the numbers from the Office for National Statistics are changing all the time. Even since we went to the printers with the green budget about six weeks ago, the ONS has changed its view about how much of last year's growth was down to consumer spending as opposed to business investment, and has moved its estimate in a positive direction. Again, however, the evidence is that we are not yet at a point where one would worry too much about where we are with that. However, if growth this year were to be fuelled by a further increase in consumer spending and indebtedness, and there were to be little in the way of business investment, we would start to worry about that.

Malcolm Chisholm: So it is all pretty gloomy. You say,

“If the most optimistic assessment of the amount of spare capacity in the economy is right, all spending cuts ... could be reversed”,

but you are obviously not totally persuaded of that scenario.

You have touched on this issue to an extent, but are you basically saying that Governments cannot do much about the output gap? You seem to be saying that, but surely the last two things that you mentioned as being relevant—business investment and consumer spending power—can be influenced by Government policy to an extent, as can public investment. Is that not the case?

Paul Johnson: Yes. Clearly, policies such as patent boxes, rural economic development tax credits, corporation tax and a series of other policies and subsidies impact on business investment. Probably the most important thing that impacts on business investment is the availability of finance, and there are certainly some policies that impact on that. However, it is easier to affect those areas in the long run than it is to make something dramatic happen tomorrow. When you are able to make things happen quickly, you often have to pay a price for that later on—for example, because you have involved yourself in a higher level of borrowing in the short run. That might be a price worth paying, as it gives you a high multiplier on your spending now, relative to what you might get in the future.

That said, I am slightly sceptical about the extent to which the Government can manipulate those issues.

Malcolm Chisholm: You have already been asked about policies to help the low paid, and what you said was interesting. However, I was slightly puzzled by one bit. One problem with tax credits and so on has been the rate of withdrawal. It seems that raising the amount that people can

earn would be a positive work incentive, but you say in the document that

“it would make 200,000 more families eligible for universal credit ... leading to weaker incentives for some people to earn more”.

Surely the higher disregard level is a work incentive rather than a disincentive.

Paul Johnson: Yes, but, as with all such benefits, there is a trade-off. There will be a benefit for those at the bottom of the system, as they will be able to earn more before having anything withdrawn, but that pushes further up the distribution the point at which people are affected by universal credit, thereby reducing their work incentive. We cannot get away from those trade-offs—

Malcolm Chisholm: It would push the point up, but one could presumably get round that to some extent just by withdrawing universal credit more gradually.

Paul Johnson: You could, but the more gradually it is withdrawn, the more people are brought in, so there would be a trade-off. You can pay a citizens’ income to everybody, and everybody would face a tax of 60 per cent or whatever to take it back, or you can just pay income support with a 100 per cent withdrawal rate, which affects a much smaller number of people but has a very negative effect on their work incentives. We just cannot get away from those trade-offs.

Malcolm Chisholm: The section on childcare in your document is interesting. You are coming across as a bit of a childcare sceptic. I think that we would all agree that childcare is good for child development, and it is right to distinguish between the effects on child development and on employment. However, I was a bit surprised that you imply—I cannot find the exact wording—that there is not much evidence on the effects of childcare on employment. Is that internationally, or just from the way in which childcare operates in England at present?

Paul Johnson: We were a little surprised at the paucity of evidence on the issue. We were trying to say not that spending on childcare is a bad thing but that there is a degree of conflation in the debate about what childcare is for. One gets the sense that some people think that spending on universal childcare is a good thing for helping children from very deprived backgrounds. It might help a little, but it is not really what is going to help—we need much more targeted and high-cost interventions that involve significant childcare.

Secondly, one likes to hope that childcare will improve labour supply. There is a bit of international evidence to suggest that childcare can be effective in that regard, but there is very

little UK evidence. That is not to say that it is not effective, but there really is remarkably little evidence that it is effective in the way that it is delivered.

Thirdly, we wanted to point out that the way in which we spend the £7 billion or so that we spend on childcare policies in the UK is fragmented and complex. Some of it involves direct delivery and some involves subsidy. The way in which the subsidies work is in itself complex, as the amount that people get depends on the exact number of hours that they work and their exact income. Those things will obviously change over the year, so that is likely to be a difficult way of making it all work.

We are certainly sceptical about the current structure of spending on childcare. If we were clear about the objectives, the evidence on where things work and how we are going to deliver childcare, we could almost certainly spend the money more effectively.

Malcolm Chisholm: It could potentially influence the output gap.

Paul Johnson: Yes—if one does things that increase labour supply in the short run, or that increase the productive capacity of young people in the long run, one could influence that.

Malcolm Chisholm: Some European countries have much more extensive support for childcare. I suppose that part of the difficulty of research involves disentangling the effects of that support from the effects of all the other things that are happening in an economy, because intuitively it would seem to have an effect. That is why I was surprised by your statement. I have read quite a lot of information that is presented as evidence that, if one expands childcare provision, not just in nursery education but to cover working hours, that certainly increases, most obviously, female employment rates.

12:30

Paul Johnson: There are two points to make. First, in the OECD statistics on spending on the early years and childcare, the UK is near the top of the league. The question is not whether we spend too little on those things but whether we are spending effectively. One reason why we rank so highly in the OECD statistics is that the OECD includes the reception class, which we have not included in our figure of £7 billion. Children in most countries do not start school until a year after children in the UK, so the OECD includes reception provision in its numbers. If that is included, we find that we spend considerably more than the average on the early years, so it is not right to start from the presumption that we spend a lot less than most countries.

Some countries, however, have a rather higher provision. The short-run effect might be smaller than the long-run effect, in terms of labour supply, but you are right that it is difficult to disentangle what is going on in, say, the Swedish economy, because all sorts of things are different from what is going on in the British economy. How much of that is to do with the way in which childcare is provided is hard to disentangle. We lack evidence that comes from looking at changes in policy within countries rather than from trying to distinguish the effect of something in one country relative to its effect in another.

Jean Urquhart: Mr Johnson, I have to say that I find your document quite gloomy reading. Because of where we are, I see the differences between the Scottish Government and the Westminster Government. I understand that, currently, we are the fourth most unequal society in the world. Do you think that, given the forecast for the years ahead, we might rapidly become the third or second most unequal society in the world?

Paul Johnson: I do not know. How high up the inequality scale the UK is depends on what you measure. There is a relatively high degree of inequality in income. It is worth noting, however, that the Scandinavian countries have a much higher degree of inequality of wealth than we do. Even Scandinavia is not super-equal; it is much more equal in terms of income, but it is very unequal in terms of wealth, so the answer to your question depends on what one looks at. That said, we have very unequal wealth as well.

The fact that we have a relatively high degree of inequality is significantly driven by the fact that there are high levels of income at the top of the scale—the top 0.1 per cent that we were talking about earlier. To think about the future, let us think about what has happened over the past 30 years. Inequality in the UK rose dramatically in the 1980s, not because incomes at the bottom of the scale fell but because incomes at the bottom were steady while incomes from the middle to the top continued to rise. There was a big increase in inequality in the 1980s, although that was from a historically low level of inequality in the 1970s.

In the 1990s and 2000s, not much happened across most of the income distribution. Through the 2000s, there was even a bit of a reduction in inequality across most of the distribution but a continued pulling away by the top 1 or 2 per cent. Therefore, depending on how we weight that top 1 or 2 per cent, inequality rose over the 2000s. Since 2007, it looks as though inequality has fallen a bit. Why is that? It is largely because wages have fallen, and wages are earned by people in the higher half of the total income distribution—people at the bottom do not earn.

At least until last year, benefit cuts were not beginning to take effect, but they have now started to take effect and will have an effect over the next couple of years. Our view, therefore, is that the degree of inequality will rise over the next two or three years as wages start to rise, helping the people in the top half of the income distribution, and benefit cuts start to hit people who are towards the bottom. By 2015, the level of inequality will probably not be very different from where it was in 2007. What will happen thereafter? If the top 1 or 2 per cent continue to pull away, the level of inequality will rise further.

If the Government implements the £12 billion of welfare cuts that it suggests it is looking for, that will clearly have a negative effect on the incomes of people who are towards the bottom of the income distribution. We have not done an analysis of that, but my guess is that the thrust of your point is probably right: inequality will probably continue to rise over the next small number of years.

Jean Urquhart: Does the Institute for Fiscal Studies do any calculations on these projections after potential constitutional change in Scotland, so that you are considering a very different set of figures?

Paul Johnson: In terms of inequality?

Jean Urquhart: No, I mean generally.

Paul Johnson: Sorry, could you—

Jean Urquhart: Generally, on the budget. It will obviously be a very different budget if Scotland's system is removed from it. Is that not something that you are concerned with?

Paul Johnson: You mean what it would look like from the UK point of view if Scotland was removed from the picture.

Scotland is less than 10 per cent of the total UK picture, so the extent to which the overall picture changes will be constrained by that. It will also be constrained by the fact that the fiscal situation in Scotland is not ever so different from the fiscal situation in the UK as a whole. There were a number of years when the fiscal situation in Scotland was a bit better because of North Sea oil. It looks like it is probably a little bit worse at the moment. However, in terms of the scale of the UK budget, we are talking about £2 billion or £3 billion out of a deficit of £110 billion. I would not say that £2 billion or £3 billion is neither here nor there, but it is not a very big number. Over five years, if there were an equilibrium situation and Scotland was outside it, the UK budget would not look terribly different.

Jean Urquhart: Earlier, you spoke about the 0.1 per cent of people, the very, very wealthy, who contribute enormously, paying 10 per cent of all income tax received. This might have been in last

night's presentation, rather than today's, but you also said that those people mostly live in London. You highlighted the considerable difference that that makes to the tax income. At a stroke, that would make Scotland more equal.

Paul Johnson: Yes. Scotland is more equal than England.

Jean Urquhart: Given the differential in incomes.

Paul Johnson: Yes.

Jean Urquhart: Will there be a point at which you will calculate a budget or look at figures without the Scottish economy?

Paul Johnson: That would fall out relatively straightforwardly from the things that we have done. We could do that, but it would make only a small difference to the UK budget.

Jean Urquhart: Do you accept that a number of the issues raised in "The IFS Green Budget" relate to quite different policies—on housing, for example—which will make a difference to the Scottish budget? In your green budget, they might not be relevant.

Paul Johnson: Yes. How Scotland spends its budget is very different from how the rest of the UK spends its budget. There is very much higher spending on housing, agriculture, enterprise, transport and so on in Scotland compared with the rest of the UK. The Scottish budget looks very different from that of the rest of the UK.

On the point about small differences, if you net out the additional revenue that you get from North Sea oil and the additional spending, the difference is not very large at the macro level.

Jamie Hepburn: I will return to your point about Scotland's current fiscal position not being as good as the UK's. You will be aware of the "Government Expenditure and Revenue in Scotland" reports that are produced regularly. My understanding is that the last GERS report that was published demonstrated that Scotland was actually in a stronger fiscal position than the UK, by some £12.6 billion over four years, according to some.

Paul Johnson: I think that the most recent publication is for 2011-12; we expect the 2012-13 numbers to be out quite soon.

You are absolutely right. For most years in recent history, the Scottish fiscal position, once we take account of North Sea oil revenues, has been noticeably stronger than that of the UK as a whole, but that reverses a little bit if we take into account the Office for Budget Responsibility's views on oil revenues in 2012-13 and going forward. In that case the Scottish position looks a little bit less

good than that of the UK as a whole. That is what I was saying.

Jamie Hepburn: The OBR's oil and gas projections have been pretty conservative compared with other measures. Do you accept that other bodies have suggested that production will be higher?

Paul Johnson: Some of that is now history, in the sense that we know the numbers for 2012-13, which really were quite small. Our expectation is that that will make a significant difference to the Scottish position relative to the UK position in 2012-13.

I do not know what will happen to oil revenues, but the key point is that they are uncertain and volatile. It may turn out that the OBR has been much too pessimistic, but if we are thinking about an appropriate fiscal policy for an independent Scotland, it will be important to make that policy robust to the uncertainty and volatility of oil revenues. In one sense, there is a limited amount to be gained from saying, "Well, I think the number's £4 billion," while someone else thinks that the number is £8 billion. The fact is that we do not know the number and the budget needs to be robust to that uncertainty.

Jamie Hepburn: The oil and gas sector invested £14.4 billion of capital in 2013. It did that for a reason, did it not?

Paul Johnson: Absolutely, and that is one of the reasons why revenue has been lower: that investment can be offset against tax payments.

I do not know, but the key point is that nobody knows. It seems to me that assuming that revenues will be at the optimistic end would be incautious. If they turn out to be at the optimistic end, that will be great, but if we assume that they will be at the optimistic end and they do not turn out as we thought, we will have a bit of a problem. The question is how the volatility is dealt with. That probably means treating oil revenues differently from revenues from elsewhere.

John Mason: We have covered quite a lot of ground already. I will pick up one or two points from elsewhere.

I was interested in your comments on the help-to-buy scheme, the concept of helping people to buy properties and whether in the longer term that pushes up property prices artificially and squeezes people back out again. There is quite a lot of uncertainty in that area. Is that the reality?

Paul Johnson: Yes. There are two elements of the Government's policy, one of which is directly aimed at new properties. The bigger element is aimed at buyers of any properties.

There are a number of reasons why it might be appropriate to have such a policy at the moment. The best economic reason for thinking that help to buy, for example, might make sense is that it is clear that the availability of 90 or 95 per cent mortgages has dropped a lot since the financial crisis began. If one thinks that a well-functioning system would provide those, one might want to intervene in the market to ensure that it does so. That might have three effects. First, it might have an effect on prices in pushing them up a bit. Secondly, it might affect supply by pushing that up a bit, although that would probably be somewhat indirect. The third effect might be on who is able to afford to buy.

Another rationale for such a policy is that, if we are in a world in which we can purchase property only if we have a deposit of 20 or 25 per cent, we might think that there are social equity reasons for helping those who do not have such a deposit, because those who do are likely to be from better-off backgrounds and can go to the bank of mum and dad for help. There is certainly some evidence of that.

The economics of the housing market are quite complex. We need to be very clear about what we are trying to achieve. The Government could be trying to achieve several different things through that policy: it could be trying to achieve some degree of social equity as I have just described; it could be trying to fix what it thinks is a short-term problem with how the finance market is working; it could be trying to increase the amount of supply. You need to be very clear about which of those things you are trying to impact when considering the precise way in which to design such a policy.

12:45

John Mason: There was some feeling that, in the UK, we have put too much emphasis on property values and prices and owning houses, whereas in other parts of Europe there is less emphasis on owning and people seem to be more comfortable with renting. It seems to me that one of the lessons from before the crisis was that people borrowed too much. I would be wary of saying that it is a good thing that people borrow 90 or 95 per cent of the value of a property.

Paul Johnson: The question is what a well-functioning market would allow people to do. It may be that we are moving towards a world in which, instead of having to put down only a 5 per cent deposit, people have to put down a 20 per cent deposit. That would be a painful transition because prices will adjust only gradually. We will get a generation—as we have had a generation—of people who are buying much later in their life than they might otherwise have expected.

There has clearly been a gradual reduction in the level of home ownership over the past several years. For the first time in a very long time, there has been quite a sharp reduction in people of particular ages who are home owners. I cannot remember the numbers, but the probability of being a home owner at 30 is now much lower than it was 15 years ago. You may think that that is good or you may think that that is bad, but it is a significant social change—in particular a generational change. The intergenerational effects are potentially substantial.

There has been a significant increase in private renting, but the structure of the tax system continues to favour owner occupation over renting.

John Mason: Another area that I am interested in is what is driving energy price rises—despite the fact that there has been so much discussion about that issue, perhaps we have not got to the bottom of it. In the chapter on energy prices in your green budget, you specifically say:

“Are prices higher than they should be because markets are not effectively competitive? Are prices being driven up too far, or at too fast a pace, because of the push for secure low-carbon energy?”

Have we really not got to the bottom of that issue?

Another issue that comes to mind is international demand. Is it just that China, for example—or somewhere else—is using loads more oil and gas, which is pushing up the price internationally? Is it because the pound is so weak that it has fallen against the euro? Is that disadvantaging UK prices?

Paul Johnson: Clearly, the biggest underlying cause of the rise in energy prices—including electricity prices—over the past four or five years has been the increase in the cost of gas and other fuels. The rise has largely been driven by that increase.

The question then is whether there are other things that may be causing problems. Clearly, green policies are increasing the price of energy relative to a world in which we did not have any of those policies. On the other hand, taxes on household energy use are very much below the taxes on energy use by businesses and lower than they are in most European countries. Neither are they very close to what the Government thinks the social cost of carbon is. If you think that a consistent carbon price is an important part of a response to climate change, we are not very close to that. In that sense, taxes are lower than they “ought” to be, but the costs of having higher energy prices are very obvious: we discussed earlier the impact on people on low incomes. As with all these things, there is a trade-off on that side of policy. That is one bit of policy. The other—

John Mason: So energy prices are too low in one sense?

Paul Johnson: In one sense. I am not going to sit here and say that they are too low, but if we had a consistent carbon price they would be higher than they are now. However, they will rise over the next several years as the energy market reform effects come in because the price of electricity will be increased in order to create wind power and so on. That is part of the policy that the Government is pursuing and there is a trade-off between the impact on prices and the efficiency with which we reduce carbon emissions.

John Mason: Can I press you on that? If that was not there, would prices be falling, or would they still have risen over the past few years?

Paul Johnson: They would still have risen over the past few years, although not quite as much as they have done. Those policies, however, are responsible for a relatively small part of the total rise.

The second part of the question, which the chapter on energy prices was more focused on—we have written quite a lot more about green taxes in the past—but does not come to a very clear conclusion on, is whether, given all that, the energy market is working well. That turns out to be a very difficult question.

We have not had a comprehensive market review by the Office of Fair Trading or the Competition and Markets Authority. There may be a case for such a review, because we remain remarkably ignorant about the extent to which the market genuinely works effectively.

The picture regarding the outcomes—what prices we pay relative to those paid in other countries in Europe—does not look too terrible. The prices that we pay in the UK are not higher than they are in other parts of Europe, but that is not to say by any means that everything is working as well as it could be.

John Mason: That is extremely interesting.

You seem to suggest that perhaps the tax system and the fact that there is no NIC on pension contributions is distorting the market a bit, and—to go back to points that were raised earlier—may be distorting it in favour of those who can afford to save. On the other hand, we do not want to discourage people from saving, because my gut feeling is that people are not saving enough.

Paul Johnson: There have been significant reductions in the generosity of the income tax treatment of pensions, particularly for very well-off people, over the past few years. We wanted to look at whether the tax treatment of pensions was appropriate and our view is that the income tax

treatment of pensions is not too bad, although it is probably more generous than it ought to be, due to the availability of a tax-free lump sum of more than £300,000, which it seems hard to justify. The income tax treatment otherwise looks pretty sensible. You do not pay tax on pensions when you put money in; you pay tax when you take it out. That is a rather good way of taxing savings.

However, the national insurance treatment looks remarkably generous. If my employer pays me money, they pay national insurance on it and I pay national insurance on it. If the employer puts money into a pension, no NI is paid and, of course, no NI is paid on the way out. It is by far the biggest bit of remuneration that escapes national insurance contributions altogether. If you were to look at significant changes to the way that pension saving is taxed, it would be in the way that employer pension contributions are treated regarding national insurance contributions.

There would be downsides and negative consequences to any tax rise, but it is hard to think of a very good reason why no national insurance contributions should be paid at any point on employer pension contributions. If you are not lucky enough to have an employer putting the money in, you have to pay national insurance contributions.

John Mason: Is it your gut feeling that the current system favours people at the top end of the scale?

Paul Johnson: Not necessarily—it favours people whose employers put money into their pensions. Outside of the public sector that probably is people towards the top end of the scale. In the public sector it is much more even across the piece.

Gavin Brown: Malcolm Chisholm asked about the link between high-quality childcare and parents' employment. Were you saying that you could not find any work that had been done on that, from a UK point of view, or were you saying that work was being done but that the results are inconclusive?

Paul Johnson: Not very much work has been done, and that which has been done is inconclusive.

Gavin Brown: Jamie Hepburn asked about oil revenues. Were you saying that the 2012-13 figures, which will be formally published in GERS next week, are below those of 2011-12?

Paul Johnson: If my recollection is correct, I think that that is true. I have a chart in my head on which the line comes down sharply between 2011-12 and 2012-13. The numbers are in the public domain.

Gavin Brown: We will see GERS next week. Your organisation said yesterday—I do not know whether it was a press release; I think it was described as an observation—that

“with the vast majority of payments already having been made for 2013-14,”

the Scottish Government

“forecasts for this year also look to be too optimistic.”

Where did you get the figures for 2013-14? Are they publicly available?

Paul Johnson: They are publicly available. The figures are published monthly by the ONS and the OBR. They show month by month the revenue that comes in from different revenue streams and you see how much comes in from the North Sea. It may turn out that we have a couple of very good months towards the end of the year, but thus far this year the figures have not been very good.

The Convener: That concludes the committee's questions. Do you have any other points that you want to make to the committee?

Paul Johnson: I do not think so. We have gone through everything fairly comprehensively. Thank you very much.

The Convener: Thank you very much. We appreciate you coming up and comprehensively answering so many of our questions.

That is the end of today's meeting and I thank members for their contributions. Before you go, I would like to say that the draft budget will be published before the October recess. The committee pressed for that and it is a very positive development.

Meeting closed at 12:56.

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