



The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

FINANCE COMMITTEE

Wednesday 10 December 2014

Session 4

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FINANCE COMMITTEE
32nd 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)
- *Mark McDonald (Aberdeen Donside) (SNP)
- *Michael McMahon (Uddingston and Bellshill) (Lab)
- *Jean Urquhart (Highlands and Islands) (Ind)

*attended

THE FOLLOWING ALSO PARTICIPATED:

- Isobel d'Inverno (Law Society of Scotland)
- Alexander Garden (Chartered Institute of Taxation)
- Elsbeth Orcharton (Institute of Chartered Accountants of Scotland)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament Finance Committee

Wednesday 10 December 2014

[The Convener opened the meeting at 10:00]

Interests

The Convener (Kenneth Gibson): Good morning, everyone, and welcome to the 32nd meeting in 2014 of the Finance Committee. I remind everyone present to please turn off any mobile phones and other electronic devices.

I welcome to the committee our new member, Mark “Back to the Future” McDonald, who returns to the committee, replacing Jamie Hepburn. I invite Mark to declare any interests that are relevant to the committee’s remit.

Mark McDonald (Aberdeen Donside) (SNP): I am not sure whether that makes you Doc Brown, convener. I have no interests to declare.

The Convener: Thank you for that, Mark. We will move swiftly on.

Decision on Taking Business in Private

10:00

The Convener: The next item is to decide whether to consider the last item on the agenda in private. Is that agreed?

Members *indicated agreement.*

Further Fiscal Devolution

10:00

The Convener: The next item is evidence on further fiscal devolution from Elspeth Orcharton from the Institute of Chartered Accountants of Scotland, Isobel d’Inverno from the Law Society of Scotland and Alexander Garden from the Chartered Institute of Taxation Scotland hub. Members have received papers from each of our witnesses, so we will go straight to questions. As always, I will begin, before opening it up for other colleagues round the table to ask questions.

I thank our contributors for their excellent and substantive submissions. There is plenty of meat in them for us to tear into, so to speak. Where shall we start? That is always the question. I may as well take the submissions in the order that they appear in our papers and start with the Chartered Institute of Taxation.

I am pleased that you numbered the paragraphs in your submission as members can see clearly what I am asking about. In paragraph 3.6, you state:

“we would not recommend assignment of revenues be considered until it is clear that it is possible to measure to an acceptable standard of accuracy the revenue attributable to Scotland. We do not believe it is currently possible to achieve this for VAT or corporation tax.”

You will know from the Smith commission that, although the devolution of corporation tax is not being recommended, assignment of VAT is. I have some concerns—I am sure that other members do, too—about your suggestion that it is not possible to measure those revenues

“to an acceptable standard of accuracy”.

What would that standard be and how could it be achieved?

Alexander Garden (Chartered Institute of Taxation): The Smith commission report states:

“These receipts should be calculated on a verified basis, to be agreed between the UK and Scottish Governments”.

That highlights an acceptance that there needs to be some kind of basis, which is yet to be agreed. The difficulty with VAT is that there are a number of ways of looking at it. There is the VAT amount itself, the net position when we go all the way through the chain, the question of whether place of supply is relevant, and various other ways that one could look at it.

I do not think that there is an easy answer to your question. What we try to do in our paper is to highlight that there are a number of ways that one could skin this cat. The Smith commission has

highlighted that there needs to be an agreed way of doing it. It is yet to be seen what that might be.

The Convener: Okay. Elspeth, do you have any comments to make on VAT?

Elspeth Orcharton (Institute of Chartered Accountants of Scotland): The only statistical split that I have found so far to try to address the issue is in a methodology note that Her Majesty’s Revenue and Customs produced in October—I do not know whether the committee has seen that—in which it starts to address the disaggregation of receipts. Its approach is to look at VAT from the consumption end.

The way that VAT works is that everyone who adds value in a supply chain has a net addition. Ultimately, it is borne by the consumer. Some is borne by partially exempt or exempt businesses, but broadly it is borne by the public.

I think that such an approach would give a measure of the consumption by Scottish taxpayers and in Scotland. However, if the allocation that, intellectually, you were trying to get to was more to do with the economy’s productive capacity, you would not get it from that approach, because it looks at the consumption end. Given the nature of the tax, it is difficult to know where the receipts are coming from or to which economy—Scotland or the rest of the UK—the tax generated is attributable. I am not aware of any other methodology that tries to determine that.

It is probably a question of deciding intellectually or conceptually what you want to do and then looking at what sources of data might be available, or what extrapolations or interpretations and analysis could be applied to that. It is probably a question of going back to the principles.

Isobel d’Inverno (Law Society of Scotland): May I add something to that?

The Convener: Yes. I was about to ask you something specifically about that, but carry on.

Isobel d’Inverno: My comments follow on from what Elspeth Orcharton said. There are completely different approaches. For example, we could say that traders had to indicate how many of their supplies were made in Scotland as compared with England. We could say to WH Smith, “Tell us what the supplies are from all your Scottish stores.” That would give us a split for that trader, but every trader would have to do that. That is looking at it from the supply side.

Because VAT has that supply element and because it can be reclaimed on imports, there is also the completely different, consumption-based approach that Elspeth Orcharton outlined. The issue with looking at it on that basis is how on earth you would verify that.

The Convener: Thank you. I was going to ask you about policy matters. Does the Law Society of Scotland have a view on whether the Scottish Parliament should have a say in the setting of VAT policy at UK level, if we are to receive assigned revenues?

Isobel d'Inverno: Dealing with shifts of revenue by assigning revenues is generally not accompanied by a say in policy. It is only where the setting of rates or indeed dealing with the tax itself is devolved that we would expect an accompanying say in policy.

The Law Society is probably reluctant to say whether things should or should not be devolved. Rather, it just points out the issues with devolution.

The Convener: I notice that the Law Society has hedged its bets a lot more than your colleagues on the panel. [*Laughter.*]

Returning to Alexander Garden, I note that paragraph 4.2 of the Chartered Institute of Taxation's submission states that some bodies receive

"funding from central government by way of refunds of tax outside the strict operation of the VAT system".

It adds:

"It may be worth considering the extent to which similar powers could be devolved rather than devolve powers over changing aspects of the tax system."

I am intrigued by that. Can you tell us more about your thinking on it?

Alexander Garden: I am going to have to hold my hand up here. I was thrown in at the last minute to stand in for the chair of our technical committee. I picked up on that point as well, but I was not involved in that section so I cannot give examples of what "similar powers" are being referred to. I tried to get an answer on that in time for the meeting but I failed. It is something on which I can feed back.

The Convener: Okay. It would be interesting if you could follow up on that, as it is an area of some interest.

I move on to Elspeth Orcharton and the ICAS submission. Early on, in the section entitled

"Economic growth and job creation",

you state:

"Power could be devolved to allow the setting of a minimum wage for Scotland".

That has not been recommended by the Smith commission. What is your thinking on that issue?

Elspeth Orcharton: It is quite difficult to identify the more generic powers that assist economic growth and job creation. If we look at job creation, it is difficult to identify things other than those that

affect the employment market itself. On the minimum wage, it seems to us that it should be relatively straightforward to identify who is employed in Scotland, barring the usual boundary issues, and to separate that out. That feeling came from some of our committees. In particular, those that feel strongly about the social justice argument consider that that could be separable. It is not a tax power, although it is currently administered by HMRC.

The Convener: Alexander, the four general principles that you set out at the start of the Chartered Institute of Taxation's paper are

- "Certainty of how the tax due is determined;
- The burden should be proportionate to the ability to pay;
- Convenience;
- Efficiency of collection."

You go on to talk about simplicity, stability, fairness and consultation. What is your view on the minimum wage? Do you believe, as an organisation, that it should be devolved?

Alexander Garden: It is not something that we have particularly considered as part of our review, so I do not have anything to add on that.

The Convener: Okay. Isobel, do you have anything to add?

Isobel d'Inverno: Again, it is not something that we have considered, but I think that in general, if we had considered it, we would have formed the same view as ICAS has—that it would make sense and it could be devolved. There is the whole issue of different prices and costs in Scotland and so on, so it makes sense for it to be devolved.

The Convener: In your submission, like Alexander Garden in his submission, you talk about the annual tax on enveloped dwellings, which of course is something that we talk about all the time here in the Finance Committee. [*Laughter.*]

Isobel d'Inverno: All the time.

The Convener: Paragraph 17 of your submission states:

"We recommend that amendments should be made to the ATED legislation so that it does not apply to properties in Scotland."

Can you be more specific on that?

Isobel d'Inverno: I am glad that you have raised that point, because it is something that we feel strongly about, even though we do not come across ATED every day. We think it is an example of tax being devolved to Scotland but the consequences of that not being followed through at Westminster.

Stamp duty land tax is being devolved to Scotland from next year and it will be replaced by the land and buildings transaction tax. ATED is similar to SDLT—it is kind of an add-on to it. However, it is not the same tax, so it is not switched off by the Scotland Act 2012 and it continues to apply to properties in Scotland.

Why is that not appropriate? The Scottish Government has its own view on how to deal with LBTT avoidance—we will probably not have any such avoidance, because the Government has a fierce approach to it—and its own policy objectives. The way in which the Scottish Government has decided to consider the enveloping of properties—that is, the buying of properties through companies—is to have a possible charge on the transfer of shares in those companies, so there would be LBTT on the transfer of the shares. ATED is an annual charge that companies and other non-natural persons have to pay where they own residential property. It is like having a Westminster tax on something at the same time as a Scottish tax. ATED should have been switched off for Scottish properties.

The rates at which ATED applies used to be quite high. The threshold was £2 million, and there are not many £2 million properties in Scotland, as we know. However, the rates are now coming down, so it is more of an issue.

However, regardless of what the rates are, we should not be in a situation where a tax is devolved to Scotland and then a tax that is pretty much an add-on to it remains at Westminster. That is a conflict that we should not really have.

The Convener: Alexander, in your paper, you seem to take a different view. In paragraph 8.5, you state that

“it seems logical that ATED should also be devolved, with the Scottish Government able to choose whether or not to operate a similar tax or apply alternative (or existing) measures”,

but you also state that

“it would be possible to retain ATED as a UK-wide tax but require HMRC to pay the tax in respect of Scottish properties to the Scottish Government.”

Alexander Garden: That is just an example. There are several ways one can look at it. I endorse what Isobel d’Inverno said. The starting point is that, if a particular tax is devolved, it is important to consider other, similar taxes that may be covered elsewhere.

Isobel d’Inverno makes a good point about the specific provisions under LBTT to deal with corporate structures. We were trying to make the point that, if there is a policy decision to do something different, there are other ways within the overall structure to try to pass on some of the fiscal benefit through the allocation point.

As Isobel said, now that the rates for ATED are coming down and it is potentially more relevant in Scotland, and given that there is a provision under the Land and Buildings Transaction Tax (Scotland) Act 2013 that could be utilised, switching it off is perhaps the most obvious route to follow.

10:15

The Convener: Yes. Ultimately, ATED will affect houses that are worth more than £500,000. This is the first time that I have come across the issue and it is mentioned in two of the three submissions. Elspeth, can you tell me why it was not mentioned in the ICAS submission on the land and buildings transaction tax?

Elspeth Orcharton: It is such a new tax and it is not really considered to be widely applicable in Scotland. I was just flicking through the tax estimates paper. The estimate of the amount of ATED payable in Scotland for the year that has just finished is £1 million, and it is likely that about half of that is rounding, so it is not the biggest issue for taxpayers in Scotland at the moment.

Having heard the points made in today’s discussion, I think that our view would be that it should be kept together with LBTT. I am happy to agree with the Law Society of Scotland’s view on that.

The Convener: Gavin Brown has a supplementary question.

Gavin Brown (Lothian) (Con): You raise an interesting issue, convener. Have the Law Society and the Institute of Taxation raised it with the authorities, as it were? If so, what sort of response have you had?

Isobel d’Inverno: We have raised the issue with HMRC on a number of occasions and the response hitherto has been, “We have no plans to devolve any further taxes to Scotland” and so on. HMRC has also said that ATED probably does not apply to a huge number of properties in Scotland, but with the rates coming down, I think that there is an acceptance by HMRC that it is not appropriate. If ATED had been around when the initial discussions on devolving SDLT to Scotland were taking place, no one would have suggested devolving SDLT and not ATED. It is the fact that ATED came along afterwards that has caused the problem.

The important general point is that we need to ensure that the devolution of taxes is to some extent futureproofed so that we do not have, for example, a devolution of income tax rates—as is proposed under the Smith commission—but then have a different Westminster tax, such as a super-profits tax, that would not be caught by the devolved rates. I do not imagine for a moment that

that will happen, but it is an example of that sort of thing. It is very hard to predict what taxes will be introduced in the future, but there needs to be some sort of fair play clause.

The Convener: Mark McDonald has a supplementary question on ATED as well.

Mark McDonald: The point that has been raised goes wider than just the tax powers. A number of powers are proposed to be devolved. Some could be devolved earlier—maybe we will touch on that later—but the general trend is that there will be a lag while legislation goes through. Are you suggesting that there need to be some articles of good faith, if you will, that state that, during that process, new systems or policy decisions will not come in that would undermine the transfer or create a power that applies on a UK basis and would not transfer when the powers are devolved?

Isobel d’Inverno: Yes, or another possibility is that what was being devolved could be adjusted to take account of the changes in the interim.

The Convener: I was going to ask one more question and then open the discussion up to my colleagues, but no one has made a bid to ask a question, so I will continue until they do. Ah, suddenly they have all woken up and put their hand in the air. [*Laughter.*] I thought that that would get them going.

My final question is for Elspeth Orcharton. Paragraph 7.18 of the ICAS paper talks about demographics. It is an excellent section, which says:

“Other factors could influence assumptions made about Scotland’s demographics in the decades to come. Policies which successfully increased the proportion of the population who are expected to be economically active, or improve the predicted life-expectancy and healthy life-expectancy, could in time change the analysis.”

Are there any powers that are being recommended by the Smith commission that will allow Scotland to achieve that?

Elspeth Orcharton: I am not sure that the powers in the Smith commission report are necessarily intended to achieve that. On what would increase the proportion of the population that is economically active, the issue of pension age could be important. However, it is probably more to do with how many people wish to work or with getting 18 to 24-year-olds into employment at an earlier stage. A lot of that sits under economic development, which is already devolved. A lot of policies on improved life expectancy and healthy outcomes sit under health—particularly in relation to preventative measures—which is also devolved. I am therefore not sure that those were issues that Smith was aiming at. In our paper, we were making the observation that, over time, statistics

and forecasts change, depending on what is actually happening in the underlying population and how people might be responding to initiatives on smoking, drinking or whatever, all of which are already well in the Parliament’s sights.

The Convener: Immigration would obviously impact on demographics—that and the birth rate. However, immigration is not being devolved under Smith. Surely, without control over that, it is difficult to achieve—

Elspeth Orcharton: It was put to me yesterday that immigration is not as much of an issue in Scotland as emigration of talent is. I have no statistics on that, but I think that the two aspects are probably important. Population and migration statistics are beyond my area of expertise, but I think that the general attractiveness of the jobs market and the sorts of businesses that are attracted to being in Scotland will make talented younger and middle-aged people—or older people, for that matter—stay and work in Scotland.

The Convener: Ultimately, it is about economics. Each year in the past decade, Scotland has been losing 30,000 to 40,000 people in the 20-to-30 age group. That clearly has a major impact on demographics for the future.

Isobel d’Inverno: Presumably, the power to set income tax rates could be used to try to persuade people to remain in Scotland. Let me give an example. I do not know whether the Smith proposals would allow younger people and older people to pay different rates of tax—I do not know whether that is even possible. However, one would have thought that there would be quite a bit of flexibility in the rates and that one could have very low rates at lower levels. Even though the personal allowance is not to be devolved, setting a pretty low rate on the first chunk of income above the personal allowance would have pretty much the same effect. You would think that the income tax powers could be used imaginatively to try to reverse the brain drain.

The Convener: Does Alexander Garden want to comment on that?

Alexander Garden: No. I simply back up Isobel d’Inverno’s point. The power is there, and it can be looked at in a number of ways.

I do not have specific statistics, but Professor John Kay has published various figures about how much income tax is taken at the various levels, and I suggest that the ability to make imaginative use of flexible rates and bands, starting right at the bottom, could be used to encourage talent.

The Convener: I am not convinced that there is as much flexibility as is being suggested. We might come back to some of these issues. I certainly have a few more questions that I would

like to ask, but colleagues might pick them up as we go along.

A plethora of members want to ask questions. Mark McDonald is first.

Mark McDonald: I thank the witnesses for coming along this morning and for the written evidence, which, as the convener said, was a meaty read. I want to pull out a number of issues.

Paragraph 5.5 of the Chartered Institute of Taxation's submission states:

"In respect of the block grant, it is important that the formula for reduction is transparent. Additionally, there must be co-ordination between the UK and Scottish Governments in relation to taxes."

Is there a lack of transparency at present about how the calculations operate within the Barnett formula?

Alexander Garden: There is certainly a lack of understanding. Our point is that, as we get more variables in there and as flexibility increases, transparency is very important.

Mark McDonald: Will there be implications if that lack of transparency is not dealt with, given the tax powers that will be devolved to Scotland?

Alexander Garden: It comes back to what the Government is trying to achieve and what the knock-on effects are. To make this work and to see what is happening with what is devolved at an early stage, it will be important to understand the impact on everything going forward.

Mark McDonald: I am happy to take a view from the other panel members on this, too, but, as you mentioned in your submission, stamp duty has been devolved and is to become the land and buildings transaction tax. The resulting impact on the block grant has still not been resolved. The Scottish Government still does not know whether it is structuring the tax in a way that will prove to be revenue neutral, because the Treasury has not given it those figures. We are fast approaching the setting of the budget. The process of stamp duty devolution could be repeated in the future—with income tax, for example—which might give rise to difficulties. Should that be a cause for concern?

Alexander Garden: It is important that the issue is resolved and that there is clarity in the future. I am assuming that that will happen as we come out of this process and that it will become easier when it comes to other taxes.

Elsbeth Orcharton: To answer Mr McDonald's first point, I have yet to meet anyone on the planet who could explain the Barnett formula to me, but maybe I should get out more. The formula is not well understood. People do not necessarily appreciate what it was intended to do, why it might work and why it might not work. The groundwork

and the homework need to be done on that before a lot of the debate happens.

It is really important that agreements are reached and that it is explained why the adjustments are the way they are and how the funding works. As we are not going to have the full accountability of independence, understanding the settlement has become much more important to people in Scotland, including our members and voters generally.

On the other hand, a whole load of administrative provisions sit around issues such as how the tax authorities will operate and how the Parliaments will work together. As we outlined in our submission, we certainly think that, with the need to reach agreement on the block grant—never mind the wider powers and the need to make things coherent between the Parliaments—we might need different processes and mechanisms. It is very important that a clear agreement is reached as soon as possible.

Isobel d'Inverno: The Law Society of Scotland thinks that there ought to be more of an agreed timetable for reaching agreement on the adjustment to the block grant, because it is not really fair for a devolved Administration to have to set tax rates before it knows what the block grant adjustment will be. That is back to front. How can it possibly figure out what measures will be revenue neutral if it does not know the basis of the adjustment?

Obviously, this is all new territory—it is not something that has been done before—but there seems to be an awful lot of brinkmanship. The draft rates for LBTT have now been announced but it is ridiculous to try to do that without knowing the basis of the adjustment to the block grant.

I wonder whether it is possible for the adjustment to have to be agreed between the Parliaments at a certain point before a new tax comes into effect and, in any event, before the rates are introduced—or something like that. Having said that, these things are never simple. The way that makes the most sense to adjust the block grant for LBTT might not make the most sense when it comes to income tax. However, the timetable is not really right at the moment. The committee has to consider the LBTT rates, but we do not know how the adjustment is going to be done.

10:30

Mark McDonald: Paragraph 5.3 in the annex to the Chartered Institute of Taxation submission talks about the complexities that would arise if corporation tax were to be devolved. However, the UK Government has indicated—since the submission was put together, I suspect—that

corporation tax is to be devolved to Northern Ireland. Is the scenario the same in that regard, or can the issues be overcome?

Alexander Garden: I believe that the scenario and implications that we have outlined are realistic. Obviously, Northern Ireland has particular circumstances. In relation to the position in Scotland and the rest of the UK, if we look elsewhere, we find that, as soon as businesses start operating in different jurisdictions, complexities are most definitely added. It is important to recognise the number of businesses that operate in Scotland and the rest of the UK. Very importantly, the majority of them are not multinationals that operate in multiple jurisdictions. A lot of them are small and medium-sized enterprises, which form an important sector in Scotland. The point that we were trying to make was about the importance of understanding the implications of devolving a tax such as corporation tax. There would be complexities of administration for the tax authorities and for businesses, which would have to operate with that extra layer.

Mark McDonald: Paragraph 5.44 in the ICAS submission sets out what is probably best summarised as the law of unintended consequences around the impact of tax changes on benefit recipients. I also sit on the Devolution (Further Powers) Committee, which last week discussed the impacts that topping up benefits or the creation of new benefits might have in a similar context. Your submission talks about “workable solutions”. What kind of workable solutions do you envisage to ensure that there is flexibility to make changes without them resulting in individuals being penalised under powers that exist elsewhere?

Elsbeth Orcharton: To echo a point that Isobel d’Inverno made, the solution that we are talking about is an understanding of where the consequences will pop out or where the interactions might arise, and planning for them accordingly. For example, if a welfare power is to be devolved, the impact on the recipient should be understood, and it should almost be ring fenced from the other Parliament’s system—and vice versa. Anything can be catered for, but you have to spend time going into the detail and looking into a lot of scenarios and circumstances—in this case, for claimants. You need to look at the interaction of the powers and scope out or in, as the case may be, the impact that you want on the individual from the other Parliament’s legislation. The approach is workable in the sense that it is about good implementation of policy, but it requires agreement between the Parliaments to ensure that the consequences that both sides seek are achieved.

Mark McDonald: Paragraph 9.3 of the ICAS submission talks about giving the Scottish Government borrowing powers to fund preventative spend. Does the framework of powers that is envisaged in the Smith commission report—in paragraph 95(5), I think—allow for that, or would further work need to be done to enable that to happen?

Elsbeth Orcharton: I am not an expert on the borrowing powers—tax is more my area—but they seem to be going in the right direction. It is difficult to say—some numbers need to be put on it. A lot of our members have said in discussions that further borrowing powers are required. I am not sure that I can add any more to that in terms of the specific shaping of the policy.

Mark McDonald: It would be quite interesting to see the thinking that lies behind that, but perhaps we can come back to it.

My final question is on the comment on air passenger duty in paragraph 14 of the submission from the Law Society of Scotland, which says:

“We do not anticipate that devolving APD would result in technical difficulties or significant administrative or economic inefficiencies.”

The three major airports in Scotland have called for APD to be transferred as soon as possible. At last week’s meeting of the Devolution (Further Powers) Committee, the Secretary of State for Scotland said that APD is a tax that could be devolved early. Does the panel have a view on the possibility of disaggregating not just APD but other powers in the Smith commission’s proposals and transferring them at an early stage, rather than transferring everything in one package?

Isobel d’Inverno: We feel that air passenger duty could be dealt with more quickly than income tax. There is already legislation in place to deal with the Scottish rate of income tax, which one would imagine the Smith proposals would build on. Air passenger duty is probably simpler and could be devolved more readily. There is also a great deal of enthusiasm for it to be devolved, as you have explained. I do not see why it would be necessary to do everything together.

Elsbeth Orcharton: There are two things to think about. One is the devolution of the power over a tax, and the second—this could be done separately—is deciding how a tax should be administered. For example, Revenue Scotland does not have a mechanism in place yet to operate APD, so transferring APD from HMRC to Revenue Scotland and giving it administrative power over APD might take longer than it would take if the Parliament set the rate while allowing HMRC to administer APD, with the tax being transferred over in due course. The administrative arrangements for a tax could be separated from

the power over the tax, which could be operated on a transitional basis—that is a possibility that you could think about.

You might wish to move all the taxes together. However, you should remember that it took three years to set up the operation of the land and buildings transaction tax, from the passing of the legislation to the expected start date in April next year.

If you did not want the same delay with APD—although the timescale might be a bit shorter than that for the LBTT process—you could consider the option of staged implementation. It is not for us to say, but staged implementation of individual powers, or implementation of individual powers that was as early as possible, would be an option, rather than waiting until the last one was ready and then switching on everything on the same date, which could be some way down the line.

Isobel d’Inverno: We thought that APD legislation would be considerably simpler than that for LBTT. I cannot say that I am familiar with the existing APD legislation, but I do not think that it is very complicated. On that basis, it would not take nearly as long to produce a Scottish APD bill, or whatever it would be called, as the LBTT process took. However, as Elspeth Orcharton said, getting Revenue Scotland geared up to administer APD would need to be factored in.

Alexander Garden: Our view is that it would be relatively easy to devolve APD. However, that relates to the legislation rather than the administration of the tax. I do not know enough about tax administration to know how difficult it would be for Revenue Scotland to take that on. However, I agree whole-heartedly that you would need to allow sufficient time to ensure effective administration from day 1.

Mark McDonald: Okay.

John Mason (Glasgow Shettleston) (SNP): I should probably say that I am a member of ICAS, which will probably make me more aggressive in my questioning of the institute.

Elspeth Orcharton: Thanks. [*Laughter.*]

John Mason: I am fascinated by the VAT question that the convener asked, and I suspect that we will have to spend a lot more time on it, because it opened up a lot of thoughts in my mind.

I will use the example of biscuits, to which I think that VAT is applied. I have a biscuit plant in my constituency. If VAT is based on consumption and that plant makes loads of biscuits but they are sold mainly in England, we will not get any VAT from that whatsoever, because it will be applied where people buy the biscuits. That is despite the fact that we added value in Glasgow and the point of

VAT is that something is taxed every time that value is added.

If we look just at consumption, we will miss all the manufacturing. Would it be horrendously complicated to allocate VAT at every step? If value is added in Scotland, where the biscuits are made, should we just take all the VAT?

Elspeth Orcharton: Your first point, about consumption against production, is absolutely right. When I looked at the statistics that are being produced in the current HMRC analysis—which is a process that HMRC is going through to work out what should be done—I raised an eyebrow, because I was not convinced that that was necessarily what was expected, which was probably much more about the productivity of the economy.

What you suggest could start to get quite difficult. If your biscuit factory sells to a supermarket or individuals in England, you could look at its VAT return. The factory would have sales value on the output but it would be able to deduct all its input. To work out what was produced in Scotland you would have to adopt an economic value added-type measure, which does not necessarily come easily from VAT returns. To split by geography, you would need quite a few extra steps in a VAT return to identify where the inputs came from.

John Mason: Could Scotland not just take whatever the net VAT is, because the factory is in Scotland?

Elspeth Orcharton: I have not thought this one through, but it might get more complicated. Would you have to consider where the factory was getting its inputs from? There may be a methodology that would work.

If we assumed that we could work based on outputs, we would then be looking at needing VAT returns on a production unit rather than a corporate entity or group basis, which we have at the moment. A business operating across the UK might have four factories but currently make one VAT return, so the return would have to be split based on the productivity. I am not sure whether there are other economic indicators that would serve as useful proxies.

Isobel d’Inverno: You have to avoid double counting. If your biscuit factory also sold to a supermarket in Scotland, how would you ensure that you were not getting the same VAT receipts twice?

John Mason: This particular biscuit factory sends all its products to England, from where they are driven back to supermarkets in Scotland. Odd things go on.

Mr Garden, you raised this issue.

Alexander Garden: Yes.

John Mason: If we did not get VAT on production, it would not matter whether a factory was in Scotland or England, because we would look only at where the consumer got a product. It would be odd if we had all these factories in Scotland but got no VAT from them.

Alexander Garden: That depends on how we look at it, and we need to consider the border issue. The question is how easy it is to find a way to trace everything through. All we see in the Smith commission report is the phrase:

“The receipts raised in Scotland”.

We could probably spend a lot of time trying to work that out.

John Mason: We will probably return to that issue at some point.

One thing that the Law Society of Scotland has mentioned in its evidence, but which we have not yet touched on, is gift aid and potential complications with, for example, people in England being members of the National Trust for Scotland. Is the ultimate answer that we should separate gift aid from the actual rate of income tax? That has been done in the past. We could just say that gift aid is 20 per cent and forget about what the rate of income tax is.

10:45

Isobel d’Inverno: I suppose that that would be one approach. The gift aid issue arose before, in relation to the Scottish rate of income tax. There are bound to be difficulties.

John Mason: Am I right in saying that, at one point in the past, the income tax rate reduced but gift aid was not reduced at the same time? It was at least delayed.

Isobel d’Inverno: I think that is right, yes: that happened in order to protect charities from a reduction in income. There is also a confusion factor, with people making contributions to different charities and so on.

If we are going to have differing rates between Scotland and the rest of the UK, it might be possible to have a separate gift aid rate, which would simplify things.

John Mason: The ICAS submission contained a lot of things that I was interested in. Section 3 is headed “Fundamental principles”. You have raised the timescale a number of times, and you say in that section of your submission that there is

“a widespread expectation that devolution of further powers will be delivered quickly, but expectations need to be managed and time allowed to make sure that this is done in a sensible, planned manner”.

What are your thoughts on that? A lot of us might think that it is good to spend a lot of time thinking about things—we did that with SDLT, LBTT and that whole area—yet there is a time commitment here. Do you feel that the time commitment should perhaps be put aside and that we should take as long as we need to go through these things?

Elsbeth Orcharton: It seems to me that, if you do not take the appropriate amount of time, the chances of coming to a bad outcome are much greater. By “bad outcome” I mean something that is inconsistent or not sustainable in the longer term.

A common concern has been raised: if you think of the time that we have taken in both Parliaments over the years to try and get things right, and we have still not got there, this process seems far too rushed if we want to end up with something that actually makes sense. There is a saying about marrying in haste and repenting at leisure; this is almost a matter of divorcing in haste and repenting at leisure.

We believe that we should take the right amount of time and have the right resources for the process, and we wanted to express the concern that there should not be a sense of being rushed. If a process and timescale had been mapped out, that might have given more comfort.

We speak to civil servants, particularly those at the UK end, who have to do the transfer out, and they are still not clear about how the Smith commission—being the political parties, rather than the Governments—reaching a consensus to move forward will actually feed through. The process between the Parliaments, the timescale, the workings of joint committees and so on are still not widely understood. It would be helpful to have the likely timetables and processes mapped out so as to manage expectations of the delivery of the new powers.

John Mason: Clearly, things can be done either quickly or more slowly. We scrutinised LBTT over months. All of you here had input, which was much appreciated. At Westminster, ministers just said that they would change the whole SDLT system at midnight that night. Is one approach right and one wrong? Is one better and one worse?

Elsbeth Orcharton: I suppose that they do it because they can. It is not the first time that tax powers have been changed overnight. A number of people have raised eyebrows about that. Equally, however, if we give people three or six months’ notice that a tax is going to change, there are behavioural responses.

I know that there have been concerns about how far ahead to announce rates such as those

for the LBTT. There are difficulties in making such changes revenue neutral, but we have also to consider the impact of the behavioural response. The less said about political stunts, the better.

John Mason: Mr Garden, do you have views on that point and on whether such things should be done suddenly or gradually?

Alexander Garden: Ideally they should be done gradually. LBTT presented an opportunity to start with a clean sheet and create good new tax law for everyone across the board. That was achieved to a large extent, and we were grateful for the level of engagement and consultation in that process. However, there may have been a few areas that were in the box marked "Too difficult". LBTT is an example of a specific tax for which, even with the timeframe that we talked about, there was still not enough time to address all the issues.

Looking forward, the importance for further Scottish taxes is to take the opportunity to create good new tax laws that tie in with the Adam Smith principles—which we highlight at the beginning of our submission—that the laws do what they are meant to do, provide certainty for the taxpayer and result in efficient revenue collection for the authorities.

Mark McDonald: I have a question on the issue of behavioural response and the point that the LBTT rates were announced in advance. This may not be the area in which you have expertise or information, but have you noticed any indication of a behavioural response, given the advance warning, compared with the lack of warning in the stamp duty changes south of the border?

Elsbeth Orcharton: I have heard anecdotal evidence on the behavioural response that if people think that they will pay more tax by waiting they tend not to wait. I do not have any evidence of moves in the market, but you only have to read the newspapers to know what is being said.

Isobel d'Inverno: Surveying firms are definitely saying that there is an increase in market activity in the bands where LBTT will be more than SDLT. One does not know how much of that is simply sales chat, but there appear to be more transactions going through.

Mark McDonald: Okay.

John Mason: I want to pursue the point about timescale. Under the Scotland Act 2012, there is a plan to have some control over the Scottish rate of income tax with a variation of 10p. We are now talking about control over both bands and rates. How do we do that? ICAS was suggesting that we take it step by step and that if there were to be further powers they should be addressed further down the line. However, would it be better to bring it all in as a oner? Should we bundle the rates and

bands and the powers under the Scotland Act 2012 together and bring in everything in 2016, if that is possible?

Elsbeth Orcharton: We have to take each of the recommendations on each of the taxes separately in order to work out the right path to reach a sensible solution quickly. My understanding from HMRC and the team considering how they will deliver what is in the Scotland Act 2012 is that it is relatively straightforward to move from the lockstep proposals to rates and bands, so those could be implemented from 2016. That would layer over the administrative proposals the fact that the system will deal with rates and bands rather than rates in a lockstep.

If HMRC is geared up for the powers under the 2012 act and feels that it is ready to deliver and go through the extra process, there is no reason to prevent it from going ahead. I do not think that the timetable can be brought forward, but I wonder why Parliament would want to delay it further. HMRC might as well do the one exercise for what is now intended to be the outcome, rather than moving to implement the 2012 plans with a lockstep and then moving forward.

There are two aspects to the process: first, making sure that the administrative arrangements are in place to deliver the wishes of Parliament; and, secondly, the Parliament deciding what it will do with the powers of adjusting. Our feeling is that it will be enough of an exercise that it will probably take one or two years anyway before HMRC has the right Scottish taxpayers coming through the system properly. There will be a transition and a familiarity issue for taxpayers.

Sometimes the fewer big changes you inflict on a taxpayer population at one time, the better, although there is no right answer to the question. However, if HMRC was ready to deliver, why would you not have it deliver?

John Mason: As I understand it, HMRC is going to play around with the codes in the meantime, rather than having a separate system with different rates or bands. If we did something dramatic, such as have income tax rates of 10, 20, 30, 40, 50 and 60 per cent, that would be very different from what is happening down south. Could HMRC cope with that?

Elsbeth Orcharton: My understanding is that it feels that it can. There is the code identifier and the self-assessment system. Because the proposals do not adjust anything before taxable income, and the arithmetic is applied in rates and bands, HMRC feels that payroll systems and its own system can cope with doing the right calculation. The Scottish taxpayer identifier sends the taxable income number into the Scottish

calculations; if the number does not have that identifier, it goes into the rest-of-UK calculations.

My understanding is that HMRC thinks that that arithmetic box—that part of the IT system—can cope with the rates and bands as well.

Isobel d’Inverno: That is our understanding as well. It is not actually terribly difficult to have different rates and bands.

What is different is that, whereas the Scottish rate of income tax was probably not going to be a great change for many taxpayers, having different rates and bands might be. Therefore, the taxpayer education process becomes more of an issue. Whether somebody is a Scottish taxpayer, when they become one or stop being one, and all those sorts of administrative things become more of an issue too, depending on what rates are set. We need to be sure that HMRC is putting enough resources into those issues.

Even though it is not a devolved tax, there may be a role for Revenue Scotland in assisting with disseminating information about it. People are going to start thinking that, when they have a problem with their income tax, they should phone Revenue Scotland—that might seem to be the natural step to take. Because we are talking about rates and bands and not just the 10 per cent variation rule, there is more of a change for taxpayers—and for employers, for that matter. It may be that more needs to be put into making it work. However, the payroll system itself does not seem to be too much of a challenge.

Alexander Garden: The educational side is important. Even today, there are a great number of people who have no idea that there is a provision in the 2012 act for a Scottish rate of income tax.

The other point, which will have to be addressed anyway as it is required by the 2012 act, is the identification of Scottish taxpayers. Elspeth Orcharton has mentioned the readiness of HMRC. The latest thing I saw was its risk register in October, on which, I think, the point on identifying Scottish taxpayers had been changed from amber to red. I do not know whether that was just because the timescale was becoming shorter or because HMRC was finding that it was not as easy as it might have thought to identify who a Scottish taxpayer is in all cases. That issue will have to be grappled with anyway, as the Scottish rate of income tax is coming in 2016.

John Mason: My final point is about the section of the ICAS submission on constitutional issues and scrutiny. In paragraph 4.4, ICAS talks about the fact that there is a majority party in the Scottish Parliament and the need to ensure that there is a satisfactory quality of legislation. Does ICAS feel that there has not been a sufficient quality of legislation since 2011? For this committee, SDLT

and landfill tax are examples of the legislation that we have dealt with.

11:00

Elspeth Orcharton: We were not so much expressing concern about what has happened, although I have at times been a little surprised at what has happened in Parliament—for example, legislation going through without scrutiny and without a lot of questions being asked. There were not many questions in the chamber on any of the tax powers. There is also a concern that there have been issues with LBTT, and that the details in the “More difficult” and “Too difficult” piles have still not been finalised.

That stuff is difficult to get right, and the point that we make is not intended as a criticism of the committee or of anyone else. However, if the Parliament is to have much more to consider of much greater significance, that raises the question of whether there is sufficient time to do that properly. That consideration will involve accountability and scrutiny, and members have raised concerns that a huge workload will land on them all of a sudden.

It is not as if any MSP has been sitting doing nothing for the past few years since the Parliament was established, but there will be a lot more work. How will it be done, and how will it be done properly?

That links in with our concerns about pace, and the need for Parliament to have time to consider issues properly without being in a rush. We are concerned about getting the best possible outcome and about members having the time and the opportunity to deal with the issues as they would best wish.

John Mason: I have noticed that there is less time to sit around here than there is at Westminster.

Do the other two witnesses have any comments on the points that have been raised?

Alexander Garden: I have nothing to add.

Isobel d’Inverno: We recognise that there are—or will be—a lot of things to think about. Even though the income tax will be dealt with through legislation at Westminster, this committee will probably need to keep an eye on quite a lot of issues, not least the cost of implementing the rates, bands and so on.

The Convener: I wonder whether the deputy convener is one of the 1,260 ICAS members who participated in the survey.

John Mason: No, I did not, because I take the view that I am here to listen to surveys and not to take part in them.

The Convener: Incidentally, on the survey, I noticed that 61 per cent of people who responded said that

“Speed of delivery of devolved powers to meet voters’ expectations”

was either “Very important” or “Fairly important.”

Jean Urquhart can go next.

Jean Urquhart (Highlands and Islands) (Ind):

A couple of my points have already been dealt with. One thing that comes through is the anxiety about, or emphasis on, co-operation, and the need not to have dramatic differences in tax levels for any tax, and certainly not in relation to the tax powers that are being proposed.

When we took evidence on the landfill tax, the potential issue of waste tourism and landfill crossing borders was raised. How far is that a real consideration?

There have been references to the different VAT levels in the south of England and in France, and what that does to the market. There is also the situation in Northern Ireland and southern Ireland. How seriously can you take that, given that there are very dramatic differences between some European countries in VAT levels for different services and so on?

Elsbeth Orcharton: Is that question for me?

Jean Urquhart: It is for anyone, really.

Elsbeth Orcharton: There is evidence in a number of research papers that goes back to the question of behavioural response. For example, people may say, “If I can get my booze cheaper by getting a ferry to France, I will do it”—not that I have ever done that, but that is the premise.

The Convener: Aye.

Elsbeth Orcharton: I have not—honest. I fly to places; I do not drive.

On the question of whether people do that, there would not be a call to cut corporation tax if a behavioural response was not expected as a result. On the question of the extent of such behaviour and how great the tax difference would have to be to provoke it, there is probably less direct evidence.

If, for example, income tax rates move from 20 to 21 per cent, would we see a lot of movement across the border, and would companies change their location? I suspect not. The difference would have to be more meaningful and sustained in order to achieve that. I believe that there is evidence out there, but not so much on the degree.

Alexander Garden: Jean Urquhart is right that, on tax rates, it depends on the variable. Various

tipping points—please excuse my using that phrase after the landfill tax example—can be reached. People and businesses will take many things into account and one that they will put into the mix is tax. There will always be differentials and different ways of doing things, so it is not a given that, as soon as there is any differential, it will lead to a massive flood of people going one way or another. However, there will come a point at which there is greater evidence of people taking that into account.

Jean Urquhart: My next question is kind of on the same theme. ICAS’s submission to the Smith commission says, under the heading “Economic growth and job creation”:

“Power could be devolved to allow the setting of a minimum wage for Scotland”.

As it happens, that is not part of the political parties’ recommendations, but I think that I am right in saying that, in the vast majority of the 18,000-odd submissions—including the ICAS one—it was recognised as something that could happen.

What about behavioural change in that instance? Why would ICAS recommend that power for devolution and why has it not ended up being recommended in the report?

Elsbeth Orcharton: Unless Scotland were to cut the minimum wage dramatically and almost become a slave economy, I doubt whether the power would have much impact on behaviour. I really doubt whether that would be in anyone’s sensible proposals.

Ultimately, it comes down to the costs for business. As Isobel d’Inverno said, wage costs and costs of living in the south-east of England are very different from those in the more rural parts of Scotland. It might be that some flexibility was sought.

On why it was not recommended, if I interpret the intent of the Smith commission properly, there was a wish to maintain a single UK labour market. That is why powers over national insurance, employment law and the minimum wage did not change.

With competition across borders, there is always a concern about a race to the bottom. However, the power to set the minimum wage was regarded as an identifiable part of something on which a distinct economic case could be made in relation to the costs of living in rural Scotland and the south of England. It was not the single biggest thing that our members said, but it was an observation that a number of them made.

Jean Urquhart: Thank you.

Malcolm Chisholm (Edinburgh Northern and Leith) (Lab): The Chartered Institute of Taxation, like others before it, goes back to the principles of Adam Smith at the start of its submission. Are there any discernible underpinning principles in the contemporary Smith report?

Alexander Garden: We strongly feel that the Adam Smith principles still apply. In theory, each of the individual taxes could be devolved, subject to some of the European Union laws, but we need to come back to the principles and decide what we are trying to achieve, what the cost benefit analysis is, what impact it has on the taxpayer and what the efficiency of collection that is needed to get the result is. I assume that the Smith commission tried to factor in some of those elements when it decided what it is right to do at this point, bearing in mind those principles.

Malcolm Chisholm: I ask the other witnesses whether there are any principles that they would like to see in the Smith report that are not there.

Elsbeth Orcharton: That is a difficult question to expand on because so much can be interpreted into the Adam Smith principles—for example, what is convenient and what is efficient to collect.

The principle that we might put in would be about ensuring a coherence for as long as we have two Parliaments with the powers to set taxation in different ways. We would like to see a coherence in the experience of the taxpayer or the business. The two tax regimes should not overlap or be too contradictory and should have as few interactions as possible, as that would bring complexity.

Isobel d'Inverno: For our part, it would be the fair play principle that was mentioned earlier. We do not want a repetition of the ATED situation. To some extent, that issue is mentioned in the Smith commission report, but I think that it needs to be strengthened.

Malcolm Chisholm: That is helpful. Thank you.

One of the most interesting issues that has come up today is VAT. I am sure that a lot of us will do some more work on that. Under the current circumstances, would the consumption approach or the production approach be more beneficial for Scotland?

Isobel d'Inverno: I imagine that the supply basis would be more beneficial—or we would all have to start eating a lot more biscuits.

Elsbeth Orcharton: I do not know the answer. I suppose that, if consumption depends on the income position and there is a different income profile among the very small number at the very high end in the south of England, all the London bankers would have to eat lots of biscuits to get the same answer.

Isobel d'Inverno: Are the biscuits zero rated?

Elsbeth Orcharton: I do not know. It is a good question. Perhaps some of the economists would have a better answer.

Jean Urquhart: I have a supplementary question. Maybe my logic is wrong, but VAT is cumulative on every service—it is value added, literally, on everything. I presume that the top rate of tax is on the final sale and it diminishes underneath that. Would that not make it—

Elsbeth Orcharton: No, because you get an output with an input. Sorry—everyone who makes an output takes off their input. It is on the cumulative value added, if that is what you mean.

Jean Urquhart: But if everybody who is VAT registered is paying more, they are really claiming back more VAT than they are charging. I presume that, because it is value added, it is cumulative in that sense.

Elsbeth Orcharton: Yes.

Isobel d'Inverno: Although some supplies are zero rated. It is not a simple area.

Malcolm Chisholm: Some previous witnesses have said that assigning VAT does not really increase accountability. Do you have a view on that, or do you see certain advantages in assigning VAT, notwithstanding the difficulties that you have described?

Elsbeth Orcharton: I must admit that it is easier to see accountability when there is a particular voter's experience of something, and I am not sure that they will feel the same experience with an allocation of consumption-based or production-based VAT. That would be purely a perception problem. It is not something that we have studied in detail.

Isobel d'Inverno: An allocation of VAT revenues without any control over the policy or anything like that is rather remote, is it not? If there was VAT only on alcohol and you could somehow influence how much VAT there was, you could see the increased accountability. However, when it is the whole of VAT, it is just far too remote.

Malcolm Chisholm: I suppose that I quite like it in the sense that it could be related to the state of the economy, but there are different ways of looking at that, as you have highlighted this morning, in terms of production and consumption.

A more general question is about the actions of the UK Parliament. I support optimum devolution, whatever that is, but I worry that some actions of the UK Parliament—the tax changes that it makes—could have negative consequences. For example, if we do not have any assignment of VAT, what if the UK Parliament suddenly decides to change the balance between income tax and

VAT? That has happened, to some extent, under Conservative Governments.

11:15

Another scenario is what would happen if the UK Government, whether or not it changed VAT, reduced the rate of income tax. Jim and Margaret Cuthbert have written a paper about this; I will not attempt to summarise it, but they argue that such a move would have negative consequences for Scotland. Are there any tax policy changes that the UK Parliament could make that could have a negative effect on our Parliament under the Smith proposals?

Elsbeth Orcharton: The main one under the current proposals would be if there was a vast, widespread change to what is defined as taxable income. Is that likely with regard to the income tax proposals? I would be very surprised if, say, everyone got another £10,000 of personal allowance, but I think that that is where you would be exposed. If the UK doubled the personal allowance to £20,000 a year—we should not in any sense expect it to do so—such variability would have to feed through, unless you had powers over rates and bands such that you could introduce a lower rate or a band that cut into the personal allowance. I am not sure that whether you could do that has been defined.

At the moment, powers over the personal allowance will stay with the UK, with the assumption that powers over rates and bands will come to Scotland, but you would have to look at whether you could eat into the personal allowance or have a zero rate.

Malcolm Chisholm: The other area of great importance and, indeed, some uncertainty is the block grant adjustment. Theoretically, would it not deal with the scenario that you outlined? If the income tax base were to be changed in England, would that not result in a better block grant adjustment for us, as it were, or would there be other problems to deal with?

That was, in fact, going to be my next question. We have a block grant adjustment methodology for SRIT—the Holtham methodology—but would that translate simply and effectively into the enhanced income tax powers that we are getting or does having power over rates, bands and the whole of income tax introduce a lot of complexities?

Elsbeth Orcharton: I could be entirely wrong, but my understanding is that the block grant adjustment for SRIT has not been finally worked out. Nevertheless, what this debate demonstrates is that there are many adjustments that could be made in one Parliament that would have many possible consequences for the financial position of

the other. We need to take time to think through all the permutations and ensure that the framework for the block grant adjustment to take account of all the powers being devolved under Smith is clear and robust and understood by and supported on both sides. Otherwise, working out what the adjustment should be will become an arithmetical playing field, which would not be a healthy or constructive way forward for either Parliament. I realise that there are a number of questions that we have not answered, but we must ensure that there is a mechanism for answering them.

Malcolm Chisholm: It would be good if all the people who understand taxation could think of all the worst-case scenarios so that we could try to avoid them in any legislation that comes through.

Isobel d'Inverno: Another such area is national insurance, which is just income tax by another name. The UK Government might dramatically reduce UK income tax rates but increase national insurance to ensure that it got the same take, but how would that play out for us? I suppose that that brings us back to the block grant adjustment, the fair play principle and all the rest of it. It is all a bit chicken and egg.

Malcolm Chisholm: Your suggestion of having a fair play principle is very important, although, unfortunately, highly subjective.

Isobel d'Inverno: Indeed.

The Convener: Thank you, Malcolm.

The VAT issue is important. After all, when Denis Healey was Chancellor of the Exchequer in the 1970s, he set two VAT rates: a basic 8 per cent rate and a 25 per cent rate for luxury goods. As I recall, the move was deeply unpopular because luxury goods included fridges, cookers, washing machines and so on. When Mrs Thatcher came in, the rate was changed to 15 per cent across the board, but there is a history of differential VAT rates in the UK.

I think that Mark McDonald wants to ask a small question about VAT.

Mark McDonald: The assignment of VAT relates to the first 10p or 10 per cent. At the moment, VAT is at 20 per cent so, in effect, half of the VAT that is raised in Scotland will be assigned. The question arises whether there would be potential for VAT to be lowered substantially in a particular sector. A number of sectors have, in the past, called for VAT to be reduced to 5 per cent in certain areas to stimulate economic activity. That would obviously have a consequential impact on the assigned revenues without the Scottish Government necessarily having an input into the policy decisions that lie behind it.

We are at risk of creating the Isobel d'Inverno fair play clause but, if we are talking about fair play

and more intergovernmental working, and if we take into account Malcolm Chisholm's point about worst-case scenarios, does that need to be ironed out for those potential future decisions and the impact that they could have?

Elsbeth Orcharton: Reducing VAT below 15 per cent is subject to a number of pretty strict EU conditions, so we are not likely to see a lot of it. The question is whether those calls for reductions would be in areas in which Scotland was disadvantaged. For example, tourism beds or hotel beds in Ireland are at 9 per cent. Would Scotland be disadvantaged by that or would it have the same or corresponding economic outcomes as the rest of the UK?

The second question is whether that would be your choice of power. That goes back to how the agreements are struck between the Governments to decide how to implement the provisions.

Those are all good questions and they need to go into working out what the principles of the intergovernmental agreements will be and what the fora will be for deciding whether things are fair or not. It might be that the UK Government will do something like that and you will be perfectly happy with it, saying that you wish that it had done it years ago. The examples do not necessarily have to be negative. You can separate out whether it is the financial effects that you want to deal with or whether it is the process of agreeing what might be mutually useful. All those questions probably have different solutions.

The Convener: Of course, the issue is that it is hardly a debate between equals. The Treasury and the UK Government have the whip hand. We have already seen that in the block grant adjustment for LBTT. That is a real concern.

Gavin Brown: I find the VAT stuff fascinating, and I think that we are all very grateful for what the witnesses have given us today.

In its submission, the Chartered Institute of Taxation makes the point that we should look at

"other jurisdictions (such as Germany) where assignments of revenue are part of the settlement between national and local governments"

and take account of the issues. Is that something that we should consider? Has Germany or some other country already wrestled with many of the issues that have been raised today and created some models that we could have a good look at to get a handle on things quickly?

Alexander Garden: The example was meant to be illustrative. I am not an expert in how assignment of revenue works in Germany, but I know that the Germans deal with it in a particular way through how they make allocations in their federal system. It was meant to be an illustration,

but it is worth considering as far as potential impacts are concerned.

Elsbeth Orcharton: What we have identified this morning is that there are different ways to make a VAT allocation. I do not think that we have the answer but there are probably more out there who could contribute different methodologies that could be developed.

Gavin Brown: Moving on to a couple of points raised in the Law Society submission, I note that the convener—or it might have been the deputy convener—asked about gift aid. Are the gift aid issues that arise under the Scottish rate of income tax different from those that would arise under the Smith commission proposals? Is it just the same issue, magnified slightly?

Isobel d'Inverno: It is probably the same issue magnified slightly, given that all the rates and bands are going to be devolved. It is not a different issue; the complexity is still there.

Gavin Brown: I was interested in your comments on ATED, which is something that I have not yet thought about too deeply; indeed, I am not sure whether the rest of the committee has done so. Am I right in saying that, in strict legal terms, it is a separate tax, but in conceptual terms, SDLT and ATED are one and the same?

Isobel d'Inverno: In conceptual terms ATED is considered to be part of SDLT. If you go to the HMRC web page on stamp tax, the heading refers to SDLT and ATED and the same policy team deals with both. ATED was part of the three-pronged attack on enveloped dwellings and all the rest of it. It is a different tax with different tax returns and so on, but it is not that different and it should be dealt with in the same way. The issue is one of timing. I am sure that, had we had ATED when the devolution of SDLT was being discussed, it, too, would have been devolved.

Sometimes, though, you have to be careful what you wish for. If ATED were to be devolved to the Scottish Parliament, we would want to avoid being forced to introduce a Scottish ATED. The Scottish Government has already decided—or, at least, appears to have decided—that it does not want an ATED-type tax. That was a bit of an issue with LBTT. Because of the way in which it was devolved in the Scotland Act 2012, it had to be a transaction tax, which meant that there was not a great deal of flexibility in how it was done.

Looking at some of the wording in the Smith report, I believe that what it is trying to say is that the Government should be free to decide how to introduce any replacement taxes, which I think is a flag to say that there should not be the kind of straitjacket that there was for LBTT. Asking for the devolution of ATED is perhaps not what we want; we just want it to be switched off for Scotland.

Gavin Brown: So are you recommending that in April 2015, on the same day that stamp duty land tax is switched off in Scotland, ATED, too, should be switched off?

Isobel d’Inverno: Yes. It should not apply to residential property in Scotland.

Gavin Brown: I think that it was Elspeth Orcharton who put some numbers on the revenue resulting from ATED—it was a low figure of about £1 million. Is that because the threshold is set at £2 million? Will the tax become more relevant as the rate comes down to £500,000?

Elsbeth Orcharton: I was just quoting from the HMRC estimate for the tax in 2013-14. It is coming down in steps; when, in 2017, it comes down to £500,000, it will become more relevant. As Isobel d’Inverno has suggested, the history of the tax is quite interesting. It was introduced as a separate tax to deal with stamp duty land tax avoidance, which is why it is both joined to and separate from SDLT.

One of the statistics in the autumn statement was that ATED has already generated five times more revenue for the chancellor than he thought it would. That is a very nice return for a tax that you just decided to introduce. It is likely that, as it grows and we become more used to it, its role in the tax system will change, and I agree with Isobel d’Inverno that the time to raise the issue might be now, while it is not too embedded. It would clarify matters and clear the landscape.

Isobel d’Inverno: ATED was introduced to try to prevent people from putting properties into corporate envelopes, but it has not done that. People are continuing to put properties into such envelopes, which is why the take from ATED has been so much higher than the Government expected. The UK Government is also raising the rates from ATED next year, so it is obviously seen as a good revenue generator. We just do not think that it should apply to Scotland.

11:30

Gavin Brown: The last issue that I want to ask about is income tax. The panel members have put forward some pretty strong views about why the Smith commission agreement on income tax should be implemented alongside the Scottish rate of income tax, and then some strong reasons why we might want to delay implementation slightly from the current date of 2016. Do your organisations have a view on when the Smith income tax proposals should be implemented? You have outlined both sides of the argument cogently, but ultimately do your organisations have a view on the correct year for the devolution of income tax bands and rates?

Alexander Garden: We do not have a clear view on an exact year, but, because of some of the points that we made earlier about the power just being over a certain amount, we tend to fall on the side of letting the Scottish rate bed in. Moreover, that approach will help the system get used to some of the difficulties that we have talked about—identifying Scottish taxpayers and the impact on businesses’ payroll systems, for example, and individual taxpayers having to self-assess a different rate of tax—before the further powers are brought in.

Elsbeth Orcharton: On the grounds of practicality, we would agree. We suggest that the process that is in train, with HMRC aiming for 2016, should be allowed to continue to ensure that the administrative framework is set up. When the powers on rates and bands come in, you might decide not to move them for the first year, just until you make sure that the whole system is working. With any new system, it is useful to give it time to bed down and see whether there are more significant consequences and whether the administrative aspect works. There will be no trialling, and no pilot system will be set up; the new system will be switched on from the tax year when it starts. You will have the opportunity to take more time about exercising the powers—if you decide to do so—to ensure that some of the consequences, the block grant adjustments and all that stuff are understood. Exercising the powers could come later.

Isobel d’Inverno: I am not sure that we entirely agree. We have always thought that the Scottish rate of income tax was a rather odd power to have and that it could result in a lot of costs for the Scottish Government with precious little gain, particularly if it was set at a quite similar rate to the UK one. So although time is relatively short, we would favour moving straight to the Smith-type rates and bands, given that it seems that the computer systems could cope with that. The Scottish rate of income tax is a very inflexible and strange proposal with, as I have said, a lot of costs attached for not much benefit.

Gavin Brown: I am grateful for your answers.

Michael McMahon (Uddingston and Bellshill) (Lab): It has been really interesting to listen to some of the analysis. It has sometimes felt like being in a game of “Bullseye”, because we have been having a look at what we could have won. Interestingly, the ICAS survey asked a question about powers that we already have but which are not being used, and there was a strong feeling that there are areas in which the Scottish Parliament and Scottish Government have not used the powers that they already have, never mind ones that we might get. You mentioned the council tax, but I find that a strange example of a power not

being used, given that it is one tax that has featured prominently in Government policy and that a large amount has been spent on freezing it.

Elsbeth Orcharton: My point was not so much about what is happening between Parliament and local authority level, but about the changes that I as a resident who pays council tax or any of my neighbours have seen—and the answer is not a lot. It does not appear to anyone that there have been any recent changes in method and approach, valuations or which properties are taxed in what way. I believe that the tax is under the control of the local authorities, although that is dependent on agreement from the Scottish Government, and it raises around £2 billion a year in Scotland, or almost 80 per cent of what is thought to be raised through corporation tax. The fact is that you have something quite significant under your control that has not been altered or adjusted in a way that anyone has experienced; that was the analysis and the lens through which I was making this particular point.

Moving on from council tax, I note that there have been separate discussions about the optimum level of business rates, which represent a direct cost to business in the same way that some consider corporation tax or employers' national insurance to be. I know that there is a proposal to look at some of those things, which is probably the response that our members would want. So far, however, the Parliament does not seem to have taken the opportunity to examine and exploit those areas where tax is being taken out of the economy.

Michael McMahon: Mr Garden, I was interested in the reference to local taxation in your submission. You remind us that, following its manifesto commitment to replace the council tax, the Government undertook a consultation, but it never came to fruition. However, you raise the point in the context of the implications for the transfer of funds for council tax benefit, or what is now called the council tax reduction. A commission to look at these taxes is being set up, but can you expand on the implications that you mention in your submission with regard to the transfer of funds and the need to take that issue into consideration? What sorts of things will the commission have to look at and bear in mind when it decides what should replace the council tax?

Alexander Garden: Our general point was that, after looking at tax generally, we should take things to the next level and look at local taxes and that because specific areas might have specific requirements, the ability to extend responsibility and accountability should be considered. We were just making the point that, in the overall review of taxes, we should not stop at a certain level. It is

important to go down to the next level and look at the flow of funds and local taxes.

Michael McMahon: That is fine. Your valid points help to clarify the comments that you made in your submission.

The Convener: That concludes questions from the committee, but I still have a couple to ask.

Going back to ATED, I note in the Law Society submission that it was

“part of a three pronged attack on the perceived avoidance of Stamp Duty Land Tax ('SDLT') through 'enveloping'”.

Surely we would want to devolve that instead of switching it off completely, as it would bring in revenue for the Scottish Government and eliminate some avoidance.

Isobel d'Inverno: The problem with devolving it instead of switching it off is that the Scottish Government would almost be forced to set up a similar data system. Most people think that ATED does not prevent them from putting properties into companies; its objective was to stop such behaviour, but it has not had that effect. Indeed, the behaviour continues because people often put properties into companies to avoid inheritance tax; because the rates of inheritance tax are higher, they are quite happy to pay ATED. As a result, it does not achieve its objective. If it can be made to work, the Scottish Government's approach in LBTT of levying a charge on transferring shares in companies that own residential property might have more success in preventing the enveloping of properties.

ATED is terribly complicated. It involves an awful lot of administrative paraphernalia, because it captures every type of company with residential property in it, so there have to be lots of exemptions for people who let residential property, developers such as house builders, property funds and houses that are used for trading purposes, such as hotels that are actually houses. Given that a whole lot of administrative nausea comes with ATED, most people would think that it would not be desirable for Scotland to be forced to have such a tax.

I guess that all of this would depend to an extent on how the tax was devolved and whether it was devolved with sufficient flexibility to allow the Scottish Government to do its own thing, but we did not think it advisable to ask for it to be devolved, because having to do a Scottish ATED would be a waste of everyone's time and money, given the amounts that it would bring in. There are probably better ways of achieving the objective.

The Convener: Which are?

Isobel d’Inverno: One of them is the charge on transferring shares in companies with residential property.

The Convener: What impact will the general anti-avoidance rule have on tax avoidance in relation to devolved taxes, especially the land and buildings transaction tax, and what role should Revenue Scotland compliance officers play in that regard?

Isobel d’Inverno: The Scottish general anti-avoidance rule is much fiercer than the UK general anti-abuse rule, because there is not an independent panel for Revenue Scotland to refer matters to first, and because it is aimed at avoidance rather than abuse. I think that that will have an effect in stopping LBTT avoidance.

Revenue Scotland can play a significant role if it carries out inquiries assiduously and follows things through. In the early days of SDLT, there were very few revenue inquiries and people who designed tax avoidance schemes could tell their clients, “There’s never been a revenue inquiry into these, so it’ll be fine.” We do not want that situation to arise when LBTT starts next year.

The landscape in Scotland is different, because there is a stronger anti-avoidance power. One hopes that Revenue Scotland will also carry out a lot more inquiries into returns than HMRC did with SDLT. That could also play a role with regard to the enveloping of properties. It is one thing to have tax charges that apply to properties in corporate envelopes, but it is another thing to make sure that everyone pays them. It is necessary to have the administrative inquiries side of things working properly.

Alexander Garden: I would like to make a general point. It has consistently been said that the Scottish general anti-avoidance rule sets out the stall with regard to the level of tolerance; in that sense, it is distinct from any targeted anti-avoidance rules that apply to specific taxes. The role of such an anti-avoidance rule is as much about its being there as it is about its being relevant in numerous cases such that it has to be actioned.

A key message has been sent that the Scottish GAAR sets the bar. When we look at some of the specific taxes, we must consider what targeted anti-avoidance there might be and whether, in the corporate envelope scenario, when shares are transferred, there might be a mechanism to prevent people from doing other things.

11:45

Elsbeth Orcharton: It is right to say that the GAAR was put there as a deterrent, and I think that it will be.

As for Revenue Scotland’s role, it will need information on and analysis and understanding of what is happening in the marketplace to be able to perform that role, to set challenges that should have been applied through the GAAR but which someone thought should not be or to catch a transaction that it had been involved with, but which, for some reason, it did not catch.

It remains to be seen how Revenue Scotland will monitor market activity and the transactions that take place to weed out those that it thinks can be challenged. I am not aware that the organisation has settled on what that process will be, but we know that it has decided not to have a disclosure of tax avoidance scheme-type provision in place. Other than people asking, when the returns go in, “Am I falling foul of the GAAR?” and putting a tick against that—no one is going to do that, because they will think that they are not falling foul of the GAAR—I am not quite sure whether, for that slice of transactions, Revenue Scotland has yet determined its investigative and enforcement mechanisms. That remains to be seen.

Isobel d’Inverno: One advantage that Revenue Scotland has is that it will be working closely with Registers of Scotland. One of the easiest ways of policing SDLT, which HMRC could have adopted, would have been to look at the transactions that were registered in the Land Registry and to follow them through and check that SDLT had been paid. There will be a much closer link between Registers of Scotland and Revenue Scotland than there has ever been between the Land Registry in England and HMRC, and registration is more important in Scotland than it is in England. If people know that everything is registered on the land register and that that will make it possible for Revenue Scotland to pick things at random and follow them through to the LBTT returns, that will provide a more rigorous regime.

The Convener: Thank you very much for that. You have given us many issues to ponder.

As our witnesses have no further comments before we terminate the session, I want to thank them very much. We have covered a lot of ground, and I really appreciate your involvement in answering our questions this morning.

As the committee agreed at the start to take the next item in private, I close the public part of the meeting.

11:46

Meeting continued in private until 12:00.

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