



Scottish Government

**Consultation
Budget 2021-22: Supporting the
Covid-19 Recovery**

Submission from ICAS

8 October 2020

Introduction

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 22,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.
2. The ICAS Tax Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 board and committee members.
3. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.

General comments

4. ICAS welcomes the opportunity to respond to this consultation '[Budget 2021-22: Supporting the Covid -19 Recovery](#)', issued by the Scottish Government in September 2020. In the past we have commented on the constructive and helpful consultation exercise in November 2017 when the Scottish Government issued '[The role of Income tax In Scotland's Budget](#)' prior to the Scottish Budget. We also welcome this pre budget consultation to discuss the options, and the opportunities and constraints, relating to Scottish taxes and the fiscal framework.
5. It is not yet clear whether we have assumed too early - both as a component of the United Kingdom and also as a Scottish nation - whether any form of 'recovery' from Covid-19 is possible in 2020 or 2021, due to what appears to be a second wave of infections now taking place.
6. The role of Scotland's taxes is twofold: it is to collect revenues to support public expenditure programmes and to support the economy or, at the very least, not create economic disincentives or distort behaviour.
7. Scottish tax policy in the 2021/22 Budget will need to be set against the overall background of the need for funds to support the economy to rebuild and to provide public services. At the same time, sources of revenues are likely to be reduced and fragile. The Budget in 2021/22 will need to manage the tensions arising from a desire to spend, but less revenue with which to do so.
8. More broadly, the private sector economy needs to be as robust as possible to provide employment and wealth creation. Without this, there are limited sources of taxation revenues to provide government funds. Beyond Budget 2021-22, if increased tax revenues are required, the ideal would be to grow the tax base rather than to raise more tax from the existing base. Large increases in tax rates may not generate the expected revenues because of behavioural change and suppression of economic activity.
9. Scotland has an opportunity to promote itself as a place to live and work. Attracting business will be important but in an expected future of greater remote working and flexibility, attracting individuals may be just as important. The current Scottish Taxpayer rules means that 'home' is the relevant criterion when determining Scottish Income Tax. Much of what makes Scotland an attractive place to live is already in place, but non-tax measures can contribute to this – broadband infrastructure, education, health and social care, quality of housing stock and affordability. Making Scotland more attractive as a place to live and work will grow the tax base.
10. The Scottish Budget comprises the block grant, block grant adjustments, tax receipts and spending commitments. There are many moving parts, each of which may have Covid-19 risks attaching to it. There is concern about how the cumulative effect of these risks may impact on the Budget. There may also be a particular issue for the Scottish Government, if the Scottish economy grows less (or more) than the economy in the rest of the UK – this is a key risk (or reward) linked to Scottish tax raising powers affecting the Scottish Budget.

11. A broader pressure on the tax system is a lack of public understanding and, hence, support: there needs to be a greater level of public debate, public understanding and engagement on public finances and tax, including increasing transparency about the link between raising tax revenues and paying for improved public services. Media reporting tends to concentrate on the need for taxes to be paid by large businesses and wealthy individuals, but the public debate should also cover how, and to what extent, everyone should contribute.
12. We welcome the work to improve communications about tax with the general public, which the Scottish Government has been carrying out. With greater awareness comes more understanding and this should help to generate taxpayer support for the tax policies adopted.
13. Success will depend on more collegiate politics across the UK, Scotland, regional partnerships and local authorities. Full recognition should also be given to regional variation and circumstances, with the roles of communities and volunteers harnessed for a more participative democracy. People should be fully engaged in the national effort to revive and restore the economy.
14. The coronavirus pandemic has highlighted points of tension in existing policies, systems and processes. This can be seen in the problems that are created for the Scottish Government when the UK budget is delayed beyond the autumn; or in more specific measures such as the increase in the threshold for paying SDLT (introduced in July 2020), followed by a rise in the LBTT threshold. It may have been helpful for the Scottish Government if this had been better coordinated across the two governments before the measures were announced.
15. We now know that a UK Budget will not be taking place; and following the UK 'Winter Economic Plan' announcements on 24 September we also know what the extended Covid-19 support mechanisms for individuals and businesses from Westminster will look like.
16. The delay in the UK Budget to spring 2021 combined with the Scottish elections in May 2021, which will require a Scottish Parliamentary dissolution, may reduce the available parliamentary time for debating and resolving Scottish budget matters. The 2020 Scottish Budget was published on 6 February 2020 and had to be based on a number of assumptions because the UK Budget took place later (on 11 March 2020) due to the delays arising from the general election of 2019. It was fortunate that no major changes in taxation were announced in that UK Budget. It will not be ideal, in 2021, if Holyrood has to manage the effects of major UK tax changes which might affect the block grant allocation or subsequent Barnett consequentials when there is an election for the Scottish Parliament taking place.
17. Scottish taxes do not sit in isolation – they are interwoven with the UK tax regime and there are connections and constraints which policy makers need to be mindful of. There also needs to be intergovernmental liaison to ensure that both the Scottish taxes, and the UK taxes, work effectively and efficiently for all taxpayers.
18. The pressures of the coronavirus pandemic highlight existing problems, and we believe there are a number of areas of the UK tax system that would benefit from reform. We address these in our paper ['Future of Taxation in the UK'](#), issued in June 2020.
19. The work previously undertaken when designing and redesigning devolution (Smith, Calman and Steel et al) should be reconsidered when reappraising the suitability of taxes for devolution. Certain things may have changed but many of the underlying principles that these commissions covered remain valid.
20. We have concentrated on the questions in the consultation relating to tax.

Specific questions

Question 1: How should the Scottish Government use its devolved and local tax powers to support the COVID-19 recovery as part of Budget 2021-22?

Your representation should contain policy proposals in relation to:

- devolved and local taxes as part of the Covid-19 recovery, with a focus on Budget 2021-22; and
- where applicable, any longer-term tax policy considerations for the Scottish Government.

Where possible, please consider the role of tax policy in the COVID-19 recovery, in particular balancing potential trade-offs between raising revenue to fund public services and COVID-19 support; stimulus for individuals and businesses most affected by the crisis; and supporting a greener, fairer and more equal society and economy

21. In the shorter term, the recovery from Covid-19 is subject to considerable uncertainties; it is likely to be lengthy and troublesome for business and the economy - and remains highly dependent on the duration of restrictions, recurrences of the virus and the effectiveness of the UK and Scottish Government responses. Taxation policy is difficult to manage in such circumstances, as the tax base is also subject to the same uncertainties; tax receipts cannot be easily predicted. We discuss below the individual taxes and the opportunities and constraints.
22. In the longer term, it would be helpful to have clear tax strategies developed for Scottish taxes and to seek to address some of the long-term challenges. Given that Scottish income tax interacts with the UK tax system, the tax strategies will need to be established in collaboration with the rest of the UK. Future tax strategies – with both Scottish and UK implications - may include:
 - the growth of the gig economy and the workplace of the future
 - removing incentives for tax driven incorporations
 - making devolved taxes work effectively, given that they interact with UK taxes
 - strategic direction for capital taxes and their interaction with taxes on income
 - VAT in a post-Brexit world.
23. This is a time of economic fragility so businesses value stability, certainty about the longer-term tax strategy and prompt communication to support their planning and encourage investment.

Income tax

24. There are risks that there will be less tax collected in 2021/22. In 2020/21 the budget estimates were that there were 2.6 million income taxpayers in Scotland and the average annual salary was estimated to be £25,200. Furthermore, in 2020/21 only 9% of Scottish adults (387,000 in absolute numbers) were expected to pay higher rate tax and 17,000 adults (0.4%) the top 46p rate. These are small numbers, and there is the risk that they may be smaller if the economy is restricted and unemployment grows.
25. At the same time there may be calls to collect more tax. Whilst many believe in a more progressive income tax system there are tensions and challenges arising from the size, shape and potential mobility of the Scottish income tax base, which need to be factored in when developing the Scottish Budget income tax rates for 2021/22. This may be more so, depending on what may be proposed in the UK Budget for 2021/22, if this leads to any greater divergence.
26. The very wealthy have always been mobile, with the ability to move between jurisdictions if they choose to do so (for tax or other reasons). However, one of the effects of Covid-19 has been a rapid shift towards home working – and a realisation that many jobs can be performed effectively without the workers being in the same place, or even in the same country. We already have reports from members of employees moving across borders whilst continuing to work for the same employer. This presents challenges for the tax system: the existing tax rules are likely to need updating to take account of this new way of working – but tax bases are more at risk if larger numbers of middle to high earners have the option to move to another jurisdiction. Both the Scottish and UK Governments may need to bear this in mind when setting income tax rates.
27. Key to the longer-term ability to generate higher Scottish income tax receipts is growing the economy and hence the taxpaying base – in both absolute numbers and higher incomes. It would also be desirable to attract more higher rate and additional rate jobs and job holders to Scotland.

Land and Buildings Transaction Tax (LBTT)

28. There have already been two temporary changes to LBTT policy as a result of the Covid-19 pandemic. Firstly, to change the eligibility conditions for claiming a repayment of the Land and Buildings Transaction Tax Additional Dwelling Supplement, which was legislated for in the Coronavirus (Scotland) (No. 2) Act 2020; there is flexibility within this, so it is possible to further extend the two periods designated, if needed. Secondly, from 15 July, SSI 2020/215 will raise the threshold for paying LBTT until 31 March 2021. This may set expectations for 2021/22.

Question 2: Are there any further tax powers that should be devolved to the Scottish Parliament to facilitate our ability to support the economic recovery?

You may wish to consider the list of reserved tax powers (Figure 1, page 7) and how or whether these could be used more effectively in a Scottish context. You may also wish to consider which tax policy and powers you think are better suited at a UK wide level.

29. As discussed in the general comments above, we consider that a priority in Scotland is to encourage greater understanding of the tax powers that are in place.
30. A further priority is to try to encourage better understanding across the four nations of the UK about the devolved settlements. For instance, it may not be helpful if the UK government decides to increase NIC to fund social care, as some commentators have proposed; NIC is a reserved source of funds, but social care is a devolved responsibility.
31. There are also questions to be asked about the tax powers that are available but have not yet been exercised. In terms of VAT assignment, a satisfactory methodology for VAT assignment has yet to be identified. As things stand, the proposed VAT assignment model cannot be clearly linked to the Scottish Government's economic policy – and it is a moot point whether VAT assignment would bring any benefits to either government (UK or Scottish). We suggest that this be kept on hold at present. It would make more sense to revisit the fundamentals of this as part of the forthcoming fiscal framework discussions.
32. We note in the [Government's Programme for Scotland 2020-2021](#) that the government remains fully committed to introducing the Air Departure Tax (ADT) when a solution to the Highlands and Islands exemption issue has been found. We note too that any plans for a Scottish Aggregates Levy are to await the new Parliament.
33. Council tax and business rates are areas where the Scottish Government has much more autonomy and policy has been less fettered by interaction with other UK taxes. In the longer term, updating valuations more frequently and revisiting these taxes could allow policies to evolve that have stronger civic and business support and more effective accountability. More frequent domestic revaluations may need to be accompanied by consideration of measures to protect those whose income has not kept pace with the value of their residence, such as changes to Council Tax Reduction policy.

Question 3: Are there any new tax proposals you would like to see implemented by the Scottish Government?

You may wish to express views on new tax ideas or proposals as part of the COVID19 recovery. Please consider whether your proposals fall within the scope of current devolved powers, including suitability for devolution using the mechanism for new national devolved taxes under the Scotland Act [page 8].

New devolved taxes

34. There is scope to introduce new devolved taxes; so far, there is to be a Scottish wide framework to provide for a tourist levy and workplace parking, which each local authority can then choose to implement (or not). Other suggestions have been put forward including a vacant land tax.

35. Such suggestions need robust public consultation before proceeding to ensure the broadest possible public support for any new taxes. There are also other issues to consider before seeking to introduce a new tax, including:
- What authority is there to create a new tax?
 - What are the objectives of a new tax (to raise money or to encourage or discourage certain behaviours)?
 - Should responsibility sit at Holyrood or with local authorities?
 - Will local tax raising create funding inequalities between local authorities?
 - Would hypothecated taxes be more palatable to taxpayers?
 - What taxes might fit the bill?
 - How would this interact with existing taxes (both Scottish and the rest of the UK) and benefits?
36. Suggestions for new taxes so far are unlikely to raise significant sums and they lend themselves to being set and administered at a local level by the local councils. It is a complex matrix.
37. Against the backdrop of Covid-19 announcing a formal moratorium on the transient visitor levy would probably be well received by the tourist industry.

Wealth taxes

38. In the longer term, some commentators have been suggesting that additional tax revenues need to be raised and that these could come from a tax on wealth. It is not clear what the definition of wealth might be and, depending on this, whether such a tax would be a reserved matter or have devolved implications.
39. In our view the focus should be on reforming and improving existing taxes – particularly capital gains tax and inheritance tax - rather than introducing new taxes, which inevitably mean more complexity and new administrative mechanisms (and costs). IHT and CGT are both UK-wide taxes.
40. However, there may be questions about whether a tax is reserved or not if the definition of wealth is based on land ownership; consideration would also need to be given to how a wealth tax based on land would interact with existing taxes on land (NDR, CT LBTT and SLFT).
41. There are also other problems associated with wealth taxes; valuation issues, ability to pay (illiquid assets), disincentivising effect and behavioural reactions (mobile tax base).

Environmental taxes

42. Due to societal changes, technological developments and environmental issues there may be strong arguments for introducing new environmental taxes in Scotland or across the UK. These should not be primarily intended to raise revenues; the intention should be to change behaviour and deliver benefits for the environment.
43. The primary objective of an environmental tax should be to encourage positive behaviour change. Therefore, it would be counterproductive for government to hope to raise significant revenues from environmental taxes. The key measure of success for an environmental tax should be the reduction or elimination of environmentally damaging behaviour. A tax which continued to raise significant amounts of revenue over a long period of time would therefore have failed. Initially there could be high yields as those affected adapt to the new regime but if the environmental tax is well-designed receipts should subsequently decline, along with the targeted environmentally damaging behaviour. If everyone is willing to continue to pay high levels of tax, i.e. the tax does not effectively change behaviour, there will be little benefit to the environment.
44. It will be important to maintain public engagement with environmental issues and to generate public support for new environmental taxes. The rationale behind environmental tax decisions therefore needs to be explained clearly and there should be meaningful public consultation on the rates and design of any proposed new environmental taxes.

Question 4: What particular fiscal challenges have been highlighted as a result of the Covid-19 emergency?

Your response should contain any observations and evidence on how the devolved fiscal powers have or have not been sufficient to deal with this exceptional situation and what this reveals about the need for change.

45. We understand the fiscal framework - 'The agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's fiscal framework' - to be an agreement to:
 - Coordinate sustainable fiscal policy within the UK, and
 - Enable the practical operation of the legislative provisions in the Scotland Acts.
46. Given that the fiscal framework is based on an agreement between the Scottish and UK governments, there should be some scope to revisit and revise it if this would help the effective operation of the devolved powers.
47. In order to build trust in government, and to meet stewardship duties and demonstrate accountability for decisions, there needs to be clarity and an understanding of governance structures in the wider population. This is difficult in relation to the fiscal framework, which few people understand.

Question 5: What changes, if any, should be made to the scope of devolved fiscal powers under the Fiscal Framework?

Your response should contain proposals for any changes to fiscal powers (e.g. borrowing, use of the Scotland Reserve). Where possible, explain the rationale for extending or limiting powers, including whether and what borrowing and Reserve limits should be changed or abolished?

48. We have no comments on possible temporary adjustments to the fiscal framework for the 2021/22 Budget; however, there may be lessons to be learned from the Covid-19 crisis that can be taken into the fiscal framework discussion next year.
49. If there is a desire to re-examine VAT assignment and to consider devolution of VAT powers, a full analysis of the potential consequences is needed to inform decision making.

Question 6: What fiscal rules should the Scottish Government follow?

Fiscal rules set out how a government uses its fiscal powers (e.g. self-imposed limits on borrowing). Your response should set out whether there are any rules that are of particular importance now, or in conjunction with a future extension in the scope of fiscal powers.

50. We have no comments in relation to this question.