Scottish Government

Tax Policy and the Budget

Response from ICAS

26 October 2021

About ICAS

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants. We represent over 22,000 members working across the UK and internationally. Our members work in the public and not for profit sectors, business and private practice. Approximately 10,000 of our members are based in Scotland and 10,000 in England.

2. The following submission has been prepared by the ICAS Tax Board. The Tax Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community; it does this with the active input and support of over 60 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 regulatory system design, and to point out operational practicalities.

General comments

4. ICAS welcomes the opportunity to comment on 'Tax Policy and the Budget – Consultation on Scotland's first Framework for Tax and tax policy in relation to the Scottish Budget 2022-23', which was issued on 31 August 2021.

5. We support the four aims of the Scottish Government to:

   - Be open and transparent
   - Exemplify best practice and embed continuous improvement
   - Improve sequencing, and
   - Take a forward-thinking approach.

6. The third point, to improve sequencing, should be enhanced when the work of the Devolved Taxes Legislation Working Group is recommenced, brought to a conclusion (with its final report), and acted upon.

7. The Framework should help to provide stability in the tax system, which we support.

8. In considering the Framework for Tax for Scottish taxes, there is a distinction to be drawn between 'technical' elements and 'policy'. The latter relates to high level principles and the overall strategic policy which might include, say, a review of council tax or the rates at which income tax is set. Input to such policy making sits with a wider stakeholder group.

9. The 'technical' aspects, however, are more specialist in nature and relate to the health of the tax system. For example, 'technical' elements of the framework may include the tax legislation itself and the ability to refresh and amend it. There should also be regular reviews of the existing taxes to ensure they are operating as effectively as they should – for example, the review of the contentious elements of ADS. This is vital to make sure the existing taxes function as intended, and essential if the system is to have credibility.

Specific questions

Question 1. What are your views on the draft Framework for Tax?

10. The draft Framework for Tax is helpful in setting out the Scottish Government's policy approach to the devolved and local taxes. The document is concise, well written and has useful graphics. In previous submissions we have called for a document such as this; we welcome it.

11. Chapter 1 with its introduction and background information is a useful summary of the taxes and fiscal landscape in Scotland. In broad terms, the Scottish funding constraints are not unique; they also apply to the rest of the UK. What is unique, and which drives greater complexity, is the number of moving components that make up the Scottish Budget and the need to manage these

in the round. It is therefore helpful to have this concise summary of the taxes that the Scottish Government is responsible for, the fiscal framework, and how the various parts fit into the funding of Scotland.

12. It may be that a brief summary of the key agencies involved could also be included; namely, the Scottish Government (policy making), Revenue Scotland (devolved taxes collection), HMRC (Scottish income tax collection), Scottish Fiscal Commission (forecasting), and the FTT Tax Chamber (devolved tax disputes).

13. We note on page 12 of the consultation document that it says, 'The introduction of a formalised Devolved Administrations impact assessment for tax decision-making at a UK level would be a sensible starting point….'. The consideration at a UK level of tax proposals and their potential consequences in the devolved jurisdictions would assist the better operation of all taxes. Even if a UK tax proposal does not have any impact on the devolved settlements, it would still be useful to have considered and documented that this is the case.

14. Any devolved impact assessment at the UK level should include consideration of social security, in order to cover the impact of national insurance changes and any potentially detrimental interaction between employee's NIC rates and limits and devolved income tax rates and bands.

15. Chapter 2 contains the principles of tax policy making in Scotland; it is helpful to have these set out, with an explanation of how they are to be interpreted and applied. The principles may have differing weightings with different taxes; for instance, income tax tends to be the main lever for income redistribution purposes whereas this is less the case with transactional taxes. And as stated on page 13 of the consultation, there may be tension or conflict between the principles in specific cases, so a balance will need to be struck.

16. We question whether 'anti-avoidance' is a tax principle. Nor is it clear who this messaging is directed at – is it taxpayers who might seek to avoid tax, or is it at those who introduce particular tax measures? Part of the issue with tax avoiding behaviour is when legislators introduce taxes that are deemed to be expensive and/or unfair. So, for instance, high income tax rates can drive avoidance behaviours.

17. We are concerned that undue emphasis is being placed on tax avoidance, which could send a counterproductive message – that taxes are avoided by many taxpayers, with the implication that more compliant taxpayers could consider doing likewise. More positive positioning on this would be likely to result in the desired effect of increased compliance.

18. For example, there could be some redrafting after the statement 'Taxes form part of the fabric of society and we should all be proud of the contribution they make.' It could then say: 'Most people want to pay the right amount of tax but where taxpayers do engage in avoidance practices the Government will proactively tackle them.'

19. It may also be helpful to analyse the extent to which there is a tax gap with the devolved taxes; for instance, is there tax avoidance of SLfT or is evasion more of an issue with this tax? Tax gap analysis will assist in deciding whether there is tax avoidance (or evasion) and how it should be best tackled.

20. Anti-avoidance measures need to be workable, which means that the legislative detail needs to be precise, and there needs to be early involvement in any policy design by the tax authority to ensure the associated processes will work. The rhetoric needs to be translated into operational processes to be meaningful.

21. It is useful to see that the Framework sets out the strategic objectives for tax and the Scottish Budget in relation to the wider Scottish Government environment.

22. The consultation makes the point that there is insufficient dialogue between the UK and Scottish governments; addressing this should be a two-way process.

Question 2. What should the Scottish Government's priorities for devolved and local tax be over the course of this Parliament (2021-2026).

23. The manifesto commitments and, more recently, the SNP/Green co-operation agreement set out how the tax powers are likely to be used in this Parliament. As a matter of policy, ICAS does not comment on tax rates or the desirability of particular tax measures. Our role is to share insights from ICAS members into the many complex issues and decisions involved in tax and regulatory system design, and to point out operational practicalities. Our comments are made in this context.

24. We welcome the setting out of the proposed plans for rates of taxes to the extent that they provide taxpayers and businesses with certainty and stability.

25. ICAS was a member of the Devolved Taxes Legislation Working Group, which issued an interim report in February 2020. We believe it is important to reconvene this group and progress its work in order to establish better legislative processes for the many aspects of Scottish taxes, whether these are to enable care and maintenance changes or to introduce new measures, such as tax reliefs, or new taxes. Some of the elements in any potential legislative process can be tricky to reconcile with one another, but it would be beneficial to continue and conclude this work. An annual process such as a Scottish Finance Bill process would assist with raising the profile and visibility of taxes, provide a vehicle within which the taxes could be amended when necessary, and assist in keeping the tax law fit for purpose.

26. The fifth principle in the Framework – engagement – has in general worked well to date. For instance, ICAS was pleased to contribute to the consultation on devolved tax policy making in 2019. However, we caution against the approach adopted with tourist tax and the workplace parking levy where there was limited prior consultation; any new tax should only be adopted after a robust and full consultative process.

27. The consultation notes that a Citizens' Assembly will be asked to consider the way forward for council tax reform. There have already been a number of reviews and studies of council tax, the most recent being the Commission on Local Tax Reform in 2015. Although there have been some limited changes since then, we hope that a Citizens' Assembly will assist in facilitating a wider public debate about the difficulties attaching to council tax reform. However, there needs to be clarity in the respective roles; a Citizens' Assembly may contribute to discussions and canvassing views, but it should not be a policymaking forum. It is for Government to put forward policy and for Parliament to scrutinise this.

28. There is also the question of how the Council Tax exemption for under 22s will be implemented in practice, for example, it may be relatively easy if the young person lives on their own but what if they are part of a larger household?

29. We note that this Framework ties tax policy into other aspects of the Scottish Government's work and strategic objectives. With this in mind, a key priority is to support the economy; 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.

30. Taxation needs to both generate funds and support the economy or, at the very least, not create economic disincentives or distort behaviour.

31. Key to the longer-term ability to generate more Scottish income tax is growing the economy and hence the taxpaying base – both through absolute numbers and higher incomes. It would also be desirable to attract more higher rate and additional rate jobs and job holders to Scotland.

32. We agree that VAT assignment, which is currently on hold, may not be satisfactory. However, any alternative proposal such as the full devolution of VAT (see page 25 in the consultation document) to Scotland will require negotiation with the UK Government and also wide-ranging, full consultation. Further work to inform decision making is suggested in the following areas:

    - There should be an examination of how the devolution of VAT could affect the generating of government revenues, and/or support the economy and its growth. For example, if VAT rates were to be cut in Scotland, would this trigger cuts across the UK, which would nullify the competitive advantage and erode revenue? Or, would rate cuts instead boost economic activity for everyone? There would also be questions around compliance across an unpoliced border between the two jurisdictions.

- An analysis of the burdens that could be imposed on businesses is essential. VAT is designed to collect revenue on the ‘value added’ at all stages in a production chain and is most effective across an integrated market. Devolution could lead to different VAT regimes, and hence to increased complexity and increased burdens on business. From the business perspective, it is therefore important to consider how the devolution of VAT powers could affect the efficiency of the British market and how any business burdens could be minimised.

- If the devolution of VAT powers were put in place, it may lead to different VAT regimes, and this may also lead to tax planning. A competitive environment, from a tax perspective, encourages taxpayers to use the regime that will minimise costs. This may appear helpful initially but if all jurisdictions aim to be competitive it may lead to all their tax revenues being reduced. It also sends an ambiguous message in relation to tax avoidance.

33. A full analysis of the potential consequences of VAT devolution would be needed to inform decision making.

34. We look forward to seeing the review of LBTT Additional Dwelling Supplement. We will also look forward to contributing our operational experience to any proposals put forward by the Scottish Land Commission to use taxation to support Scotland’s land reform objectives.

35. Tax powers can be used to nudge behaviours and to help move Scotland towards a more sustainable future and to deliver on Scotland’s climate and environmental ambitions - 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.

36. 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.

37. In order to change behaviour effectively it may be that in some cases the tax needs to be levied on the consumer rather than the producer, as there is no guarantee that producer taxes will always be passed on to consumers in the form of higher prices.

38. It may be helpful to review SLfT and how it ties in with related landfill permit legislation, given that environmental aspirations have changed since the tax was introduced.

39. 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.

40. 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.

Question 3. How should the Scottish Government use its devolved and local tax powers as part of Scottish Budget 2022-23?

41. We consider that the pre-budget meetings the Cabinet Secretary for Finance has held in recent years with interested stakeholders are useful in flushing out current concerns – for both taxpayers and for the Government. It would be helpful to continue to hold such meetings before the budget.

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