



SCOTLAND'S BUDGET 2017

TAX ISSUES IN THE
POST-DEVOLUTION WORLD:
INFORMING THE DEBATE ON TAXATION

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Foreword

The Institute of Chartered Accountants of Scotland (“ICAS”) is the oldest professional body of accountants. We represent over 21,000 members who advise and lead businesses. Around half our members are based in Scotland, the other half work in the rest of the UK or in almost 100 countries around the world.

ICAS has a public interest remit – a duty to act not only for its members but for the wider public good. Our technical experts work in a positive and constructive manner to advise policy makers on legislation and to raise issues of importance to our members, individual taxpayers and business alike.

Taxation is one such area of importance and ICAS has contributed, and will continue to contribute, to tax policy in Scotland, the UK and beyond.

The Tax Board’s objectives in establishing its policy positions are to:

- act in the public interest
- provide constructive input to the authorities, and
- represent ICAS members, affiliates and students’ interests.

As the Scottish Government discusses the options to use new tax powers, it needs to be mindful that there is more to this than simply revenue raising. The most important source of Scottish tax revenues in 2018/19 is Scottish income tax but, due to the nature of the partly devolved powers and the interaction of income tax with other UK taxes, there are constraints to be considered when setting the rates and bands. These constraints sit around a number of practical and administrative points, which are discussed in this publication. At the same time, Land and Buildings Transaction Tax and the forthcoming Aid Departure Tax, which collect relatively little tax, are prominent in Scottish tax messaging because they are fully within the control of the Scottish Parliament.

There is a need to explain these tax powers, and their practical and administrative limitations, because clarity and public understanding are prerequisites to accountability.

We also suggest that a five-year roadmap to set out the objectives of Scottish tax policy would be helpful: this should set out policy objectives and provide clarity of purpose, tying in with the Scottish Fiscal Framework. For example, to what extent is the tax being levied to raise funds or direct certain behaviours, and to what extent and in what way is tax policy being designed to encourage economic growth.

This publication was drafted as a chapter in the Fraser of Allander’s ‘Scotland’s budget 2017’ report; ICAS is delighted to be able to work in partnership with the Fraser of Allander Institute.

September 2017

Key points

- Around 40% of devolved expenditure is now funded by Scottish taxes – and rising to around 50% when VAT revenues are assigned in 2019 onwards.
- ‘Scottish taxes’ encompass different types of devolved powers and varying responsibilities and, in terms of public accountability, there is a lack of awareness of the Scottish tax powers and great scope for confusion.
- In our view, measures around the budget should seek to inform the public about the tax powers.
- The Finance and Constitution Committee inquiry into a ‘Scottish Approach to Taxation’ offers a fresh consideration of what the collective tax powers offer and how they can be used – both to raise revenue and to set the fiscal messaging. This inquiry should inform the Scottish Budget.
- Scottish income tax cannot be considered in isolation because the powers are only partly devolved. The tax is intricately interwoven with UK taxes, and the Scottish Parliament has only a limited number of pieces of the jigsaw.
- Behavioural responses by taxpayers may limit some options; however, behavioural repercussions may not limit the Scottish Government’s choices if the policies are considered attractive by the electorate. It will also be necessary for the electorate to trust that policy objectives are achievable and will be achieved – that a better economy, desired redistribution, or better public services will result from additional taxation.
- Care needs to be taken in setting a tax competitive policy such as low Scottish rates or reliefs as it may simply lead to further intra-UK competition, ‘a race to the bottom’, and ultimately falling revenues for everyone.
- A key element of tax policy should be, where possible, to enhance and support the economy: at the very least, measures should not add to the complexity of doing business in Scotland and should not put Scottish business at a competitive disadvantage.
- Trends so far with devolved taxes have been to align with UK taxes, evident in both directions with, for example, the new LBTT progressive structure being adopted by the UK SDLT; then the UK 3% surcharge being introduced into LBTT. In the longer term, tax policies which are more distinctive from those in the rest of the UK may be needed to meet spending commitments.
- The Budget Process Review Group has examined the budget processes but the tax processes need further consideration and should be given an equal weighting to the spend side of the budget.
- A five-year roadmap to set out the objectives of Scottish tax policy would be helpful: this should set out policy objectives and provide clarity of purpose, and tie in with the Scottish Fiscal Framework. Transparency of data and the link between Scottish tax receipts and the operation of the Fiscal Framework will be crucial if the public are to maintain faith in the process.

1.1 Introduction

Scottish taxes have been introduced on a phased basis over the last few years with the objective being one of political philosophy in order to demonstrate accountability for the Scottish Parliament and the devolution settlements. So, what will the Cabinet Secretary for Finance and the Constitution have at his disposal when setting his next budget?

Before the Scotland Act 2012 and the Scotland Act 2016 took effect, 'Scottish' taxes were limited to council tax and business rates, and a power in the 1998 Scotland Act that was never exercised to increase or decrease income tax by a Scottish Variable Rate. Since then, structural fiscal changes have taken place and continue to do so. Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) were introduced in 2015. These were followed by implementation of the Scottish Rate of Income Tax (SRIT) in 2016/17 and the more visible implementation in 2017/18 of Scottish Income Tax (SIT) as a result of Holyrood's new powers over rates and thresholds.

And that is not all. Next year, from April 2018, Air Passenger Duty in Scotland will be replaced by the new devolved tax – Air Departure Tax (ADT); the legislation is in place but the rates still need to be set. From 2019 a proportion of the estimated VAT raised in Scotland is to be assigned to the Scottish budget.

By 2020 an estimated £22bn of annual tax revenue will be raised in Scotland, representing around 50% of the devolved Scottish budget. Whilst this appears as though there is significant control of Scottish revenue raising, the practical realities may be limited – and more so than anticipated at first sight. There are the political considerations over the tensions between needing to raise funds, and to be mindful of taxpayers wishes not to pay more than necessary or more than their neighbours, whether the neighbours live next door or further afield in the rest of the UK.

There are questions such as whether lower tax rates for ADT are attractive, and will they actually boost the economy by the scale that is hoped for, or will they reduce revenue collected? Does the same rationale also apply to LBTT? Do lower rates introduce tax competition and, if so, is this a good thing? A question that may appear more bureaucratic, but is equally important, is the impact and costs on the 'unpaid' collectors of taxes; usually businesses. And a further consideration to add to the mix when setting tax policy and tax rates is the potential for behavioural response if taxpayers react to the policies or rates.

Devolution has introduced new opportunities, but also new complexities, with associated practical and administrative issues that should be evaluated and addressed when setting the 2018/19 Budget. In this budget what businesses will press for is a clear articulation of the Scottish Government's approach to tax and a plan which sets a clear path over, say, a five year term.

This paper focuses on the taxes devolved in the Scotland Acts of 2012 and 2016, which are a number of transactional taxes and the income tax rates and bands.

The Scottish Budget 2018/19 – which taxes are relevant?

Land and Buildings Transaction Tax – maintain or change the rates? (2016/17 £466m)

Scottish Landfill Tax – maintain or change the rates? (2016/17 £149m)

From 1 April 2018 - Air Departure Tax – set the rates (2016/17 UK equivalent APD £264m)

Scottish Income Tax on non-savings, non-dividend income – rates and bands need to be set for 2018/19 (2016/17 £11,313m)

Source – GERS <http://www.gov.scot/Topics/Statistics/Browse/Economy/GERS>

1.2 Scottish taxes: the overall picture

'Scottish taxes', or 'devolved taxes', encompass different types of devolution and varying responsibilities. The terms lack precision. For example, the devolved powers over income tax are fundamentally different from the devolved powers over Land and Buildings Transaction Tax. There is great scope for confusion and it is questionable whether citizens in Scotland understand the taxes, how much the Scottish Parliament can use the powers, or the constraints on these powers. Part of the aim of the next budget should include explaining the taxes to the electorate.

There are three different types of devolved tax powers

Full devolution - Land and Buildings Transaction Tax, Scottish Landfill Tax, Air Departure Tax and, in due course, Aggregates Levy

Partial devolution - Income Tax rates and bands on non-savings, non-dividend income

Assignment – a proportion of 'Scottish' VAT receipts

Fully devolved taxes are the outright political responsibility of the Scottish Parliament and the administrative duties rest with Revenue Scotland. The nature of the taxes, the legislation, and the associated collection and management duties are fully devolved and solely the responsibility of those in Scotland. These taxes have their locus tied to transactions in Scotland, and they are limited in revenue raising terms. Being the only taxes fully within the Scottish Parliament's power, they have a higher profile than the corresponding taxes in a UK context (SDLT and APD being two of the smallest sources of UK revenue compared to other taxes such as income tax, VAT, or corporation tax). Both LBTT and ADT policy, and rates, attract more attention than they might otherwise do, with this being treated as a broader commentary on Scottish taxes, tax policy, and the Scottish Government's approach to the wider economy.

Partially devolved tax, which is Scottish income tax rates and bands from April 2017 onwards, involves joint responsibilities. Political responsibility is split between the UK and Scottish Parliaments. The UK Parliament remains responsible for the tax base, ie. what is considered to be income, and how it is measured. It is also responsible for the personal allowance and for reliefs, and the underlying legislation for these is in the UK taxes acts. The Scottish Parliament is responsible for setting the rates and the bands, in other words, the tax is partly devolved or in more colloquial terms Scotland has 'half the lego set'.

Administrative responsibility remains with HMRC but the Scottish Government pays HMRC for costs of collection. However, it needs to be remembered that much of the collection of income tax, through PAYE, is done by employers – and a key reason for the above structure of a partly devolved tax is to minimise collection costs.

The Scottish income tax rates are applied to earned income, pensions and rental income, but not to savings income and dividend income (this was to ease administrative pressures where income tax was withheld at source, although this is no longer applicable). Scottish income tax is a significant part of the Scottish revenues but its interaction with UK income tax legislation, and other UK taxes, makes it more difficult for Scotland to adopt alternative measures from the rest of the UK when setting the rates and bands. This is discussed in 2.3 below.

Assignment of 'Scottish' VAT receipts. VAT at present remains the responsibility of the EU in terms of defining the tax base, and the UK Parliament in setting the tax rates, with administration and collection by HMRC. It was agreed by the Smith Commission, and enacted in the Scotland Act 2016, that a proportion of VAT attributed to Scottish transactions is to be assigned to Scotland, and this will apply from April 2019. However, the methodology of doing so has at the time of writing still to be agreed². The assignment of VAT does not require any direct decisions to be made in the Scottish Budget. There is a lack of transparency as to what level of VAT receipts will be assigned to Scotland and the relative inability of the Scottish Government to have much influence over the level of assigned receipts.

1.3 Scottish income tax

The Scotland Act 2016 replaced the single Scottish Rate of Income Tax (SRIT) with the new Scottish Income Tax (SIT). This allows the Scottish Parliament to set whatever rate or rates of income tax it may wish to levy on the non-savings, non-dividend income of Scottish taxpayers and, if more than one rate, the income bands at which these are to be charged.

SIT was implemented on 6 April 2017. Arguably, it has assumed a higher profile among the electorate because the Government is explicitly forced to set a policy each year. This has been added to by the decision for income tax to differ north and south of the border. The UK higher rate threshold was increased to £45,000 in 2017/18, but the Scottish higher rate threshold was left unchanged at £43,000. Thus, Scots with earnings, property income, and pensions of £45,000 or more in 2017/18 are paying £400 a year more tax than their counterparts south of the border.

The Government's Programme for Scotland 2017/18 notes that the Government will publish a discussion paper on income tax and possible options for using the tax powers ahead of setting the budget for 2018/19. There are a number of practical and administrative matters to consider in the discussion.

UK Legislation implementing Scottish income tax

Key legislation is found in:

- The Scotland Act 1998, as amended by the Scotland Acts 2012 and 2016 – defines who is 'Scottish' for income tax purposes
- The Income Taxes Act 2007 – state the rules for tax bands and separates out non-savings, non-dividend income

A health warning however: for those who wish to refer to the legislation, this is difficult. Measures around Scottish income tax are in both the Income Taxes Act 2007 and the Scotland Act 1998 (as amended by the Scotland Acts 2012 and 2016): it is not accessible, nor is it easy to read, and requires reference to different legislation for completeness. ICAS recommends that a 'tax law re-write' version should be produced so that there is clarity in these taxing provisions.

Setting the income tax rates and bands for the tax year 2018/19

2018/19 will be the second year of 'Scottish income tax' being in place and, with the Scottish higher rate band being different from the rest of the UK in 2017/18, potential tax issues emerge. First, there is greater complexity so the overall tax charge can be more difficult to understand. See example 1.

Example 1: Calculating a Scottish taxpayer's tax bill in 2017/18

For a Scottish taxpayer entitled to a personal allowance, higher rate SIT will be payable on non-savings, non-dividend income in excess of £43,000 (£11,500 of personal allowance; and £31,500 at basic rate of 20%).

SIT only applies to non-savings, non-dividend income so the UK rates and bands must still be used for the purposes of working out the level of the personal savings allowance ('PSA' of £1,000 for basic rate payers; £500 for higher rate payers), the rates of tax on savings and dividends, and the rates of capital gains tax.

This means that when dealing with a Scottish taxpayer's computation, parallel income tax computations may be required, applying the SIT bands first to non-savings, non-dividend income and then reassessing the available bands and rates when dealing with savings and dividend income.

Example

Janet is a Scottish taxpayer. She earns £43,400 in 2017/18 and receives taxable interest of £2,400

	Non-savings, non-dividend income (£)	SIT payable (£)
Earnings	43,400	
Less personal allowance	(11,500)	
	31,900	
Taxed within SIT basic rate band at 20%	31,500	6,300
Taxed within SIT higher rate band at 40%	400	160
Total tax on Scottish earnings		6,460

By contrast, Janet's income tax liability on interest must be calculated by reference to UK rates and thresholds as follows:

	Savings/ dividend income (£)	UK IT payable (£)
Taxable interest	2,400	
UK basic rate band	33,500	
BR band already set against earnings (above)	31,900	
Balance of UK BR band	1,600	
Covered by personal savings allowance	(500)	0
Taxed within the UK basic rate band at 20%	1,100	220
Taxed within the UK higher rate band at 40%	800	320
Total tax on interest		540

Janet's total income tax liability for 2017/18 is therefore £6,460 and £540 = £7,000.

Second, wherever there are differentials there is scope for tax planning. Whether it is worthwhile to the taxpayer concerned is more difficult to predict but, of course, the wider the differentials the more attractive tax planning may become. So, what are taxpayers' possible options to mitigate any increased charges in income tax and to what extent might they be used? To what extent does the Cabinet Secretary need to be mindful of these possible strategies and to what extent might this restrict his options?

Scottish taxpayers fall into the following categories of marginal rate of tax in 2017/18 :

- 36,000 'savers' rate
- 2,150,000 basic rate
- 365,000 higher rate
- 21,000 additional rate

One option is that a taxpayer may move to a new house. Ceasing to be classified as a Scottish taxpayer may be a more feasible alternative for those with greater wealth and higher incomes – and the avoidance behaviour by these individuals will have a disproportionate effect on the amount of Scottish income tax that is raised.

Scottish income and its interaction with UK income tax legislation

For those who are, and remain, Scottish taxpayers, and with a partly devolved tax, consideration needs to be given by the Cabinet Secretary to 'Scottish income' (broadly, earnings from employment, self-employment, pensions and rentals) and its interaction with other income (savings and dividends). The impact of any changes in the rates of income tax in Scotland also needs to be set in context against UK taxes and trends.

There are two areas of tax planning with UK taxes that may be pertinent. One is that a business owner may choose to operate as a sole trader (unincorporated and liable to income tax) or via a company (incorporated and liable to corporation tax). This taxpayer choice can determine some of the tax outcomes so that the main taxes cannot be considered in isolation, nor in this debate can income tax be viewed separately from other policies or matters such as National Insurance Contributions. For example, aspects of the taxation of the self-employed and small companies can lead to tax planning and influence behaviours because of:

- the differential in tax rates, combined with the different timings of payment, between income tax for the unincorporated business and corporation tax for the incorporated business,
- the decision to extract profits from a company by way of salary, pension contributions, or dividends, and
- the different tax consequences arising from receipts of income and receipts of capital.

Any taxpayer who views a tax bill as an unwanted cost will seek to minimise this and so divergent rates across income tax, corporation tax and capital gains tax lend themselves

to tax planning behaviours such as incorporation by an individual who wishes to be paid in dividends rather than a salary.

When some elements are devolved, this opens the way to greater complexity, wider differentials and therefore potential planning if tax costs are increased. For instance, if Scottish income tax becomes significantly more expensive (and it is not clear where this behavioural tipping point might be), taxpayers may seek to convert sources liable to income tax into something else that is liable to, say, corporation tax or capital gains tax. Both corporation tax and capital gains tax are reserved taxes so any increase in receipts will flow to Westminster, with a corresponding decrease in Scottish income tax.

A second aspect of this area of tax planning that needs to be considered is the 'gig economy' and its drivers, which are the interaction of both employment law and 'employment taxes'. To date, in the UK debate this has covered both income tax and NIC. The key issue is the differential in income tax and NIC costs for employees compared with the self-employed or company owners (where remuneration may be by way of salaries or dividends (the dividends being NIC free)). It should be noted, however, that there are various UK measures designed to block this type of planning.

- New IR 35 regulations are directed at those working on a consultancy basis for the public sector and they negate the attraction of using a one-man company to reduce tax costs. A significant proportion of higher rate tax payers in Scotland work in the public sector.
- For owner-managed businesses, the owners need to consider the post-tax costs after extracting funds from the company - so there is a choice of the salary route which is expensive when NIC is considered, or dividends. Recent changes to the taxation of dividends make this route less attractive than in the past.
- If owners want to convert their income into gains they need to wind up the company, which has a commercial impact, and there is also tax anti-avoidance legislation to be navigated.

These are UK policy issues and outwith the control of the Scottish Government but there is an added dimension if Scottish income tax rates diverge from those in the UK.

It remains to be seen what, if any, impact divergent income tax rates might have. The change to the higher rate threshold for 2017/18 is likely to have had little behavioural impact but there will always be behavioural challenges to the tax base if there are significant differences in tax costs. This is driven by cost management – why pay more than you have to? The Finance & Constitution Committee recently commissioned evidence on this as part of their inquiry 'Scottish Approach to Taxation' and it will be helpful to have the Committee's thoughts on this topic.

National insurance

As well as a lack of clarity about what is 'Scottish tax', across the UK there is a further opaqueness in the presentation of 'tax' to the taxpaying population. For taxpayers, and particularly for those on PAYE, NIC seems to be largely invisible but this has not gone unnoticed by recent UK Governments – NIC has increased considerably over the last couple of decades whilst income tax has reduced. For example, in the 2016 Autumn Statement, the income tax higher rate threshold increase from £43,000 to £45,000 for the rest of the

UK was widely publicised: it offered a saving of up to £400 to each affected taxpayer. At the same time, the NIC threshold for Class 1 employee contributions was also increased to £45,000 but this has the opposite effect and negates over half the income tax saving. This was not publicised.

Some commentators noticed that changing the thresholds in 2017/18 for income tax in Scotland has wider cost implications which, in comparative terms, are held to be unfair. Not only is higher rate tax payable over £43,000 at 40%, but so is Class I NIC at 12% up to income of £45,000, ie. an overall rate at 52%. The NIC and IT thresholds in Scotland are now out of alignment; tax is devolved but NIC is reserved.

Scottish taxpayer employment income – marginal rates of income tax and National Insurance

2017/18	Below NIC primary earnings threshold £8,164	Between NIC and personal allowance threshold £11,500	Between personal allowance and basic rate threshold £43,000	Between Scottish and UK higher rate thresholds £43,000-£44,999	Between HR threshold £45,000 and AR threshold £149,999	Over the additional rate threshold of £150,000
Income Tax	0%	0%	20%	40%	40%	45%
NICs	0%	12%	12%	12%	2%	2%
Total marginal tax rate	0%	12%	32%	52%	42%	47%

It may be that with different jurisdictions having different responsibilities the presentational elements will change, as either Government seeks to distance itself from the costs of a 'tax' it is not responsible for. A different Scottish presentation of what income tax is for, and what NIC is for, would introduce a greater element of hypothecation with NIC going towards state pensions and other reserved benefits, whilst Scottish income tax aligns with Scottish Government spending responsibilities. Clarity is required about income tax being devolved, whilst national insurance remains reserved and, therefore, different Parliaments making the decisions in relation to each.

Are Scottish taxpayers aware of the amounts of SIT they pay?

For employees and pensioners, Scottish income tax is collected through PAYE, and they simply receive the net sum. PAYE is designed to collect tax in as efficient a way as possible so income tax is not as visible as other taxes where an amount has to be paid over based on annual income and tax self-assessment. PAYE 'plucks the goose with as little hissing as possible'. It is not designed to be transparent and, therefore, is unlikely to be viewed as part of a Scottish tax system.

There is often a lack of understanding around PAYE codes and, with responsibility for income tax rates and thresholds in Scotland having diverged from those elsewhere in the UK from April 2017 onwards, it means that clear explanations and guidance, and headline reminders in the Scottish budget announcements, would be helpful to inform taxpayers about Scottish tax raising.

1.4 Scottish devolved taxes: LBTT, SLfT, ADT

Three fully devolved taxes will provide sources of funding for the Scottish Government in 2018/19. These are Land and Buildings Transaction Tax, Scottish Landfill Tax and Air Departure Tax. The first two have been in place since April 2015 whereas the Air Departure Tax is due to come on stream from April 2018. Each has its locus in Scotland, is based on tax law enacted by the Scottish Parliament, and is collected and administered by Revenue Scotland.

In setting the rates of ADT, it would be helpful if a relatively long term view could be taken with a minimum number of changes to the thresholds and rates over time to provide certainty and stability. This will help taxpayers, both individuals and businesses, to plan ahead with confidence.

Importance of messaging as well as the sums raised

Because these taxes are levied on transactions – on land transactions, landfill deposits, or passenger flights – they can be easily avoided by not undertaking the transaction, or not undertaking it in Scotland. As a result, the amounts that can be raised from them will always be limited but due to these taxes being new and fully within Scottish control, they have a prominence that they might not have in a Westminster budget. As a result, they are important in setting the tone and sending messages about the broader tax policy being put forward by the Scottish Government. There needs to be clear articulation of why particular policies and rates are being proposed.

How Scottish are these taxes?

Each devolved tax has been designed using the equivalent UK legislation as a starting point. In the case of LBTT this tax was refashioned on a 'progressive' basis rather than its equivalent SDLT 'slab' basis and this was warmly welcomed. So much so, SDLT has also been amended to become a 'progressive' charge. In November 2015, when the UK Government proposed a 3% supplement to SDLT on second homes, the Scottish Government did likewise with the Additional Dwelling Supplement. This leads to a number of questions, including how much can, or should, each tax be different from its counterpart in the rest of the UK? It may be that taxes on both sides of the border gravitate to a common position but, if so, the reasons for this need to be clearly articulated. On the other hand, if they do differ, this may lead to tax competition or to claims of administrative complexity where LBTT and SDLT rules differ. Again, the reasons for this need clear articulation.

Devolved tax legislation passed by the Scottish Parliament

There are four acts of the Scottish Parliament in relation to devolved taxes. These are:

- The Land and Buildings Transaction Tax Act 2013
- The Landfill Tax (Scotland) Act 2014
- The Revenue Scotland and Tax Powers Act 2014
- Air Departure Tax (Scotland) Act 2017

RSTPA 2014 and the specific tax acts operate together.

There is also a significant number of statutory instruments supporting these acts.

Setting the rates of ADT

The setting of tax rates and policies can be driven by different factors – to raise funds, to encourage or discourage certain behaviours, or to grow the economy. Seeking to influence behavioural responses may limit some options; equally behavioural responses may not be limiting if the policies are considered attractive. This could be by offering an attractive tax rate, such as reduced Air Departure Tax, thereby potentially encouraging more travellers through Scottish airports.

In order to garner support for the ADT rates, the policy objectives need to be clear and clearly articulated. More passengers may use Scottish airports if ADT is reduced relative to the UK's APD, and this may lead to more economic activity, but will this increase the Scottish tax take? Economic growth may lead to more employees (paying Scottish income tax) and /or more businesses (paying UK corporation tax to Westminster), while increasing Scottish VAT receipts (half of which will be assigned to Scotland).

Care is needed when offering a competitive tax regime, particularly if it is an aggressive competition policy, because it may give a broader message to neighbouring jurisdictions of England, Wales and Northern Ireland that may be unattractive. It may also simply lead to further competition, 'a race to the bottom', and ultimately to falling revenues for everyone.

The other feature of competitive tax policies is that where there are differentials – with different jurisdictions taxing different amounts, or charging tax at different rates, from another – this also lends itself to tax avoidance. It may be asked how this fits in with the general tone that was being set by the Scottish Parliament when the Revenue Scotland and Tax Powers Act 2014 was being enacted, with the inclusion of a Scottish General Anti-Avoidance Rule (SGAAR), and much discussion about the evils of tax avoidance.

Setting the rates of SLfT

When setting the Scottish landfill tax rates there is little scope to diverge from rates in the rest of the UK if consideration needs to be given to the possibility of ‘waste tourism’ which could result in trucks simply crossing the border in whichever direction is favourable. It may also be difficult to align policy objectives of raising revenue and waste reduction.

Setting the rates of LBTT

Setting of the rates of LBTT has been questioned – are the higher rates too expensive? In considering this, the principle of ‘ability to pay’ is generally viewed as a proportionate rise in tax rates as income increases, but this can be less clear cut in transaction-based taxes such as LBTT. Further, the operation of this principle can be undermined by behavioural changes such as fewer purchases of property; the principle itself may undermine other objectives such as stimulating the economy. This needs to be recognised, and balanced, in the matrix of policy objectives when setting the rates.

1.5 Policy changes in current tax law

In the devolved taxes, notably with LBTT, there are some areas that would benefit from being revisited. There are some differences in the law and its interpretation when compared with the corresponding Westminster tax, SDLT. For example, there are questions concerning the LBTT rules for group relief in certain instances – where a transfer of property which gives rise to a taxable transaction takes place between two separate companies that are both in the same commercial group – and group relief from the LBTT charge is denied. This means that there is a tax bill in the commercial group, although there has been no change in overall ownership of a property – its simply been moved amongst group companies. This may be intended by the Scottish Parliament but nevertheless it may also be helpful for policy makers to reconsider whether this is still the desired outcome.

Such examples may not affect many transactions but it can give rise to an impression of Scotland being a less attractive environment for businesses. Commentary so far has invariably led to comparing any tax measure in Scotland with that in the rest of the UK, and usually with a focus on the elements that are ‘more expensive’ and, by implication, less taxpayer friendly. Arguably, this may be seen as negative and particularly so if the broader objectives are to grow the economy relative to other economies. This specific LBTT issue should be addressed in the budget.

Beyond this immediate budget, a process is needed in which to address such matters. There is a need for ‘care and maintenance’ measures in the existing tax law so that if stakeholders such as Revenue Scotland find parts of the legislation do not work as intended, or the legislation does not work as taxpayers may wish from a commercial perspective, there is an opportunity to revisit the law. To date, the budget process has been expenditure focused and so possible amendments to tax law need to be raised on an ad hoc basis.

It may be noted that from a tax perspective an annual budget is needed in the UK because income tax is an annual tax – it must be enacted every year. In Scotland, there is no such requirement, other than for an annual vote on the income tax rates and bands. This limited annual tax procedure is not enough, and to maintain and improve Scottish taxes a regular, formal, tax process is needed.

Furthermore, there is a tendency to use secondary legislation instead of primary legislation and ICAS does not believe that this is an appropriate way to exercise tax powers because it lacks both visibility and active parliamentary consideration.

1.6 Assigned taxes: VAT

The Scotland Act 2016 provides that, where there is agreement between the Treasury and Scottish Ministers for identifying VAT attributable to Scotland, the first 10 percentage points of the standard VAT rate and the first 5 percentage points of the reduced rate shall be paid into the Scottish Consolidated Fund. This is due to be applicable from April 2019 onwards so will not have a direct impact on the forthcoming budget. However, the rationale for this assignment is to provide revenues that are tied to the Scottish economy and this needs to be borne in mind.

The potential to impact the Scottish budget depends upon a 'broad strokes' picture of whether the Scottish economy outperforms or underperforms in comparison to the rest of the UK. Initially the benefit of the VAT assigned to Scotland will be counterbalanced by a corresponding reduction in the block grant. If the Scottish economy subsequently outperforms the rest of the UK, it will see some benefit from assigned VAT in future years. As a stronger economy with higher spending, the share of VAT to be assigned to it will be increased. The opposite applies if it underperforms relative to the rest of the UK.

At this stage of Brexit negotiations there is no clarity of what changes to VAT record keeping, if any, will be required post Brexit. At one end of the spectrum, if a deal is struck for the UK to remain within the EU VAT union, then there will be minimal change. At the other end, there could be a total break such that it would be within the UK Government's powers to totally reshape VAT. And, unless the Scotland Act 2016 powers are changed after Brexit, this source of 'Scottish tax' will continue to be UK based with a proportion of the receipts assigned to Scotland.

1.7 Scope for new Scottish taxes

There is scope to create new devolved taxes and, for example, suggestions put forward periodically are a tourist tax or a charge on particular goods such as single-use paper cups.

Given the time and work involved in legislating for the existing devolved taxes, where each of these is largely a cut and paste from the UK legislation, the Scottish Government would need considerable resources to design the policy and the supporting legislation to create new taxes. In policy terms, it is also probable that there would be some constraints, such as having the locus of the tax in Scotland. Without this, it would be difficult to establish the basis of the charge to tax and the means and authority to collect it. Consideration would also need to be given to how a proposed new tax would support the wider economic policy objectives and influence any potential behavioural impacts; for example, a tourist tax might reduce the number of tourists.

Any new taxes would take time to develop, would benefit from wide consultation, and are unlikely to feature in the next budget as a means of raising revenue for 2018/19. However, in the longer term, the Scottish Government may wish to consider new devolved taxes as part of a more distinctive use of the powers and to meet spending commitments.

1.8 Conclusion

Accountability by Scottish politicians to their electorate can only come with clarity around tax raising policies and public understanding of tax. With a package of fully devolved, partially devolved, assigned and local taxes, many of which have had different implementation dates, it is questionable whether there is widespread understanding of 'Scottish taxes'. Measures around the forthcoming budget should seek to inform individuals and businesses about the tax powers, with clear explanations of the choices and why particular options are being put forward.

The Scottish Parliament does have the power to make some radical changes but the practical implications of this could be dramatic and unpredictable. There are also challenges in adopting a fundamentally different approach, most of which result from comparison with tax in the rest of the UK. The comparison may be a sense that, collectively, taxes are more expensive, or it may be in relation to individual taxes. Challenges if the tax rates are felt to be too expensive may include:

- The burden of taxation leading to behavioural changes. There are only a relatively small number of additional rate taxpayers in Scotland. If even a few of these chose to move to the rest of the UK or, say, incorporate, then there might be little or no benefit for Scotland from seeking to raise income tax at the upper end of the income spectrum
- UK wide businesses may choose to prioritise their operations outside Scotland if there is a perceived increased tax or administrative cost of transactions in Scotland
- Taxpayers familiar with the current system that has evolved over a long period may react negatively to fundamental reforms. Changes introduce uncertainty and are therefore unlikely to encourage economic investment unless they are introduced gradually over time and widely publicised to encourage public understanding and engagement
- Radical changes to the tax system in Scotland might result in economic growth, but the additional yield might augment revenues from non-devolved taxes such as corporation tax or capital gains tax. The potential to make radical changes may therefore be limited because Scotland has only limited levers in relation to the largest yielding tax – income tax
- Administrative costs are generally underestimated, for example, the costs to businesses of updating systems to deal with changes.

A key element of tax policy should be, where possible, to enhance and support the economy: at the very least, measures should not add to the complexity of doing business in Scotland and should not put Scottish businesses at a competitive disadvantage.

A five-year roadmap to set out the objectives of Scottish tax policy would be helpful: this should set out policy objectives and provide clarity of purpose, tying in with the Scottish Fiscal Framework. For example, to what extent is the tax being levied to raise funds or direct certain behaviours, and to what extent and in what way is tax policy being designed to encourage economic growth.

The ICAS Tax Board

Within the ICAS governance structure, the Tax Board reports to the Policy Leadership Board, which reports directly to the Oversight Board and to the ICAS Council.

The Policy Leadership Board (PLB) has delegated authority from the ICAS Council in relation to the 'policy leadership' activities of ICAS. The Policy Leadership Board is specifically empowered to manage and direct the affairs of all boards, committees and panels within its remit.

The Tax Board has delegated authority from the PLB in relation to taxation - to set ICAS policy positions, to act on behalf of ICAS in relation to all tax matters, and has primary responsibility for managing the relationship with the UK revenue authorities.

Proposals relating to the business affairs of ICAS which are significant to the strategy, contentious or could have a significant financial outcome are reserved to Council.

The Tax Board has oversight of six Committees, each of which has responsibility for a certain area of tax and these are:

- Indirect taxes
- International and large business taxes
- Private clients (capital taxes)
- Scottish taxes
- Owner managed business taxes
- Employment taxes

Members of the Tax Board and the Committees act in a personal capacity and do not represent the views of their firms.

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