

DEVOLVED TAXES: A POLICY FRAMEWORK

The Royal Society of Edinburgh (RSE) has a steady record of engagement with the Scottish Government around taxation in Scotland, having produced responses to consultations on issues such as the Scottish Fiscal Commission and proposed changes to taxes in Scotland.

As before, the RSE welcomes the use of Adam Smith's Principles within the Scottish Government's approach to taxation. However, the RSE notes that other than revenue raising, taxation is also used to change behaviour, and this runs on different principles. There is scope to add new principles to Smith's, that explicitly focus on areas such as tackling climate change.

The consultation document rightfully focuses on the two fully devolved and operational taxes, the Land Buildings and Transactions Tax (LBTT) and the Scottish Landfill Tax (SLfT). While a policy framework for these two taxes is welcome the RSE believes that, as a bare minimum, the policy framework must consider the two other fully devolved taxes, Air Departure Tax and Aggregates Levy, as these will be fully devolved and operational in the future.

Furthermore, there could be scope for the framework to be broadened to consider changes in income tax and taxes at the local level, including Non-Domestic Rates and Council Tax. The framework should also be developed to ensure that it can administer other taxes that could be devolved in the future.

The use of a Devolved Tax Collaborative (DTC) is welcome, however, there is need for the consultative process to be widened out. Tax impacts many aspects of the economy, and in different ways. It is therefore important that the Scottish Government have a wider consultation which seeks views from a range of stakeholders before consulting tax professionals through a DTC.

Consultation should be done both collectively and individually and when there are private meetings with either senior civil servants or Ministers, the diary of these meetings should be made public. Meetings with civil servants, unlike with MSPs, are currently not covered by the Lobby Register.

The current legislative cycle is constrained and needs to allow for the complication of changes made by Scottish Government in reaction to UK Government changes. There is a need for a more coherent approach between the policy and legislative cycles, as currently local taxes and devolved taxes are dealt with by different mechanisms. The cycle needs to consider the UK context and be set within a strategy that correlates reviews with UK decisions on taxation and spending through its multi-annual review. As it stands, the proposed changes would do little to ease the constraints of the current process.

The roles of the Scottish Fiscal Commission (SFC) and Revenue Scotland are vitally important. The RSE understands that Revenue Scotland is operating under constraints and so its capacity and funding could be enhanced; this would build and retain the professional knowledge and expertise within the organisation which will benefit the Scottish tax system.

Summary

Introduction

- 1 The RSE welcomes the opportunity to respond to the Scottish Government’s consultation on the Policy Framework for Devolved Taxes. As Scotland’s National Academy, we remain committed to using the expertise and experience of our Fellowship to provide objective advice on public policy issues.
- 2 Despite the devolution of powers over taxes such as LBTT and SLfT being relatively new to the Scottish Parliament the Society has published a considerable amount of work in this area, including the following papers:
 - Competitive and Fair Taxation (2015)¹
 - Scottish Fiscal Commission (2015)²
 - A Scottish Replacement for Air Passenger Duty (2016)³
 - A Scottish Approach to Taxation (2016)⁴
 - Air Departure Tax (2017)⁵
- 3 While many of these responses are on specific areas and proposals, some of our considerations are relevant to this consultation document. For instance, the Society notes that in our response to ‘A Scottish Approach to Taxation’, we recommended that the Scottish Government look at other tax models as illustrations of best practice. The New Zealand model was recommended, and we welcome the inclusion of this model by the Scottish Government in their comparison within the consultation.
- 4 This response was prepared using the expertise of a working group of RSE Fellows from a wide range of institutions and with diverse backgrounds.

Main Body

General Comments:

- 5 As noted above, we welcome that the Scottish Government has included the New Zealand model as a model of best practice. However, while there are positive aspects of this model, the RSE would

recommend caution in copying models exactly, due to the complexity of the multilevelled tax system within which Scotland operates. Given that the New Zealand model informs the public and stakeholders of tax changes at an early stage this could lead to the unintended consequence of forestalling (taking advanced action as a reaction to changes in policy) in Scotland, particularly in relation to LBTT, as changes proposed too far in advance could lead to changes in consumer behaviour.

- 6 While it is important to review examples of good practice and implement them in the Scottish context, there are concerns over whether this will be followed, particularly if there are constraints on resources.
- 7 Some of the tax proposals that the Scottish Government have published appear to have been developed as a response to political pressure rather than policy need. For example, the previously proposed reduction in Air Departure Tax is at odds with the stated Scottish Government policy on climate change. We criticised the Scottish Government proposals in our responses to both consultations on changing Air Passenger Duty. We therefore welcome the recent reversal of the Scottish Government’s commitment to reduce the tax, as a reduction would not have aligned with the wider policy context, particularly in meeting the Government’s climate change objectives.
- 8 It is understandable that this policy document focuses only on the two fully devolved taxes under the direct control of the Scottish Government, while the two taxes which raise significant revenue and are devolved (Council Tax and Non-Domestic Rates NDR – which are devolved to local government), are not included in this policy framework.
- 9 The RSE would note that in comparison to other taxes, such as Council Tax, the revenue raised annually from SLfT (circa £148m) and LBTT (circa £557m)⁶ are relatively small and would not have a significant impact on the Scottish budget even if they are instantly changed.

¹ The Royal Society of Edinburgh, July 2015, ‘Independent Commission for Competitive and Fair Taxation in Scotland Call For Evidence’ URL: https://www.rse.org.uk/wp-content/uploads/2016/09/AP15_12.pdf

² The Royal Society of Edinburgh, November 2015, ‘The Scottish Fiscal Commission’, URL: https://www.rse.org.uk/wp-content/uploads/2016/09/AP15_23.pdf

³ The Royal Society of Edinburgh, June 2016, ‘A Scottish Replacement for Air Passenger Duty’, URL: https://www.rse.org.uk/wp-content/uploads/2016/09/AP16_13.pdf

⁴ The Royal Society of Edinburgh, October 2016, ‘A Scottish Approach to Taxation’ URL: https://www.rse.org.uk/wp-content/uploads/2016/10/AP16_21.pdf

⁵ The Royal Society of Edinburgh, December 2017, ‘Air Departure Tax’, URL: https://www.rse.org.uk/wp-content/uploads/2018/08/AP17_24.pdf

⁶ Revenue Scotland, 2019, ‘Annual Report 17/18’ URL: https://www.revenue.scot/sites/default/files/Revenue%20Scotland%20-%20Annual%20Reports%20and%20Accounts%202017-18%20-%20E2%80%93%20Devolved%20Taxes_0.pdf

- 10** The RSE would recommend that, as bare minimum, the framework must work for the all four devolved taxes including the Aggregates Levy and Air Departure Tax. A wider policy framework could be developed which covers all devolved taxes, including Council Tax and Non-Domestic Rates, but this must respect and provide for local decision-making. Development of a broader framework could help to ensure coherence across all taxes and help to reduce any complexities.
- 11** It appears that there may be additional work planned, particularly with the other two taxes that are to be fully devolved. Looking to the medium to long-term, a Finance Bill could be developed to help systematise the budget process regarding all devolved taxes. This would, however, also need to consider constitutional arrangements in the context of the UK budget cycle and UK decisions on Corporation Tax and National Insurance.
- 12** The policy framework may need to give a clear definition of taxes, including what the main aim of the taxes are. For example, SLfT and Air Departure Tax are ‘sin’ taxes aimed at changing consumer behaviour to achieve other policy objectives around climate change. These taxes will have a bigger social impact than others, but it should be recognised that all taxes are likely to have a marginal social impact.
- 13** As indicated in previous responses, the Society welcomes the use of Adam Smith FRSE principles within ‘A Scottish Approach to Taxation’ but would note that one does not need to be distinctly ‘Scottish’ to support these principles. In the consultation paper, the principles are not directly quoted from Smith, who wrote:
- i) The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.
 - ii) The tax which each individual is bound to pay ought to be certain, and not arbitrary.
 - iii) Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it.
 - iv) Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state.⁷
- 14** In judging whether taxes meet Smith’s first maxim, of fairness, individual taxes should not be considered in isolation, but rather consideration should be given to the portfolio of tax (Scottish Government and UK Government-controlled) as a whole.
- 15** The consultation paper is mainly focused on the orderly administration of revenue raising rather than behavioural change. Using taxation for behavioural change runs on a different set of principles and will need different consultees. Therefore, while Smith’s principles are all relevant, there is a case for a wider consultation to consider the addition of new principles, for example, to help tackle climate change.
- 16** There is scope within the policy framework to develop a ‘National Forum’ on tax. This would help to widen the consultation and raise awareness of the impacts of taxes on life in Scotland. It will be important that a local aspect is included within this forum as regions across Scotland vary significantly. Having a local aspect would ensure that there is no reduction in the authority and responsibility of Local Authorities in the raising and collections of taxes and that it could increase. For example, Local Authorities have little control over Non-Domestic Rates, which arguably are one of the most strategic taxes as they collect high revenue, are crucial to the local economy, delivering services and business growth. Revenue from NDR does not go directly to the authorities. In addition, the long-term freeze of Council Tax also took authority, responsibility and flexibility away from authorities. Local components should be maintained or added to these taxes, but they should fall under this policy framework.

⁷ Smith, A, 1776, ‘An Inquiry into the Nature and Causes of the Wealth of Nations, Vol 2’.

- 17** The policy framework should ensure that changes to the tax regime are made gradually to allow planning in advance. The framework should be sufficiently flexible to accommodate minor changes, but significant changes need to be proposed in advance in consultation with stakeholders to ensure the risk of forestalling is minimised.
- 18** The RSE would highlight that within the UK, including Scotland, there is a distinct lack of diversity within taxation especially in comparison to other nations. The UK has a very few taxes which create most of the revenue and a lot of taxes which create a small amount of revenue. The Mirrlees Review⁸ argued that the UK tax system needed reform. Its findings are arguably still relevant today as the system still lacks strategic design. Therefore, there is scope to review the system, making changes to taxes or creating new ones, and the policy framework would be expected to cover any changes.
- 19** Additionally, there is the possibility that further taxes will be devolved to Scotland. After Brexit it is also likely that VAT may be devolved; currently due to European Union (EU) law it is not possible for VAT to be devolved as the rates and base cannot vary within an EU State. Brexit provides an opportunity for VAT to be devolved. Therefore, the policy framework should be developed to ensure that it can administer other taxes which are likely to be devolved in the future.

Question 1: *Do you welcome the use of the Devolved Tax Collaborative (DTC) as an annual tax forum and agree with its stated purposes?*

Question 2: *Do you have any other preferences as to how the Scottish Government should carry out engagement on the fully devolved taxes?*

- 20** The use of the DTC is welcomed by the Society. Seeking the views of professionals within taxation and those with an interest in tax is important, particularly in achieving critical analysis of policy changes and developments.
- 21** However, as stated above, all taxes have some social impact and operate within a wider context. A tax collaborative will consult only a small number of connected individuals / groups and will analyse only a small aspect the tax. Taxes reach out to other areas of policy, and if the government only consults and seeks advice from

small networks they may not get all the relevant information to inform decision making, which could ultimately result in best practice not being followed.

- 22** The framework has to be one in which there can be a discussion on how things can change, for example introducing a Land Value Tax and what its impacts would be. However, the DTC is too focused a mechanism to do so. The DTC appears to be a tax administration group rather than a tax policy group. There is scope either to widen the engagement or create a new mechanism which addresses the policy aspect.
- 23** Therefore, we believe that this process of consultation and engagement should be widened, with externalities and unintended consequences being considered as well as other policies, including policies towards taxes that are not included in this consultation document and / or do not exist yet. So, first there should be a wider consultation reaching out beyond the tax professionals; then, once a policy is proposed, there should be a DTC.

Worked Example – LBTT

LBTT is a tax which can be used to illustrate the importance of considering the wider policy context when developing taxation policy. Across the UK the housing market is widely considered to be dysfunctional. Policies such as LBTT are aimed at tackling this but are by no means the complete answer. While there are technicalities to LBTT, it operates in a wider context that would not be considered through a DTC. The LBTT will require a wider policy consultation and consideration which takes into account other levers (some of which the Scottish Government does not control), such as the volume of social housing, council tax, capital gains tax and financial incentives within the construction industry.

⁸ Mirrlees, J, 2011, 'Tax by Design'

Question 3: *Do you support the Scottish Government's proposed approach to tax consultation, in particular consulting on issues collectively rather than on an individual basis?*

- 24** The RSE supports an approach of consultation taking place on both a collective and individual basis as this is essential to widening input. We do, however, caution against these wider consultations and one-to-one meetings being dominated by professionals.
- 25** While the approach of collective consultation is supported, it is inevitable that one-to-one meetings will happen. Considering this, the RSE would encourage the Scottish Government to include mechanisms within the framework that will guarantee a significant level of transparency, with the diaries of meetings with Chief Civil Servants (who are not subject to the Lobby Register) and Ministers being made public.
- 26** It appears that the consultation document is solely aimed at professionals, which risks excluding key areas of public life by default. This can result in a lack of wider insight decisions such as the proposal to reduce Air Departure Tax which don't take account of broader issues, such as climate change in this instance.
- 27** In terms of the devolved taxes, a deep consultation, collective or on an individual basis, may not be necessary for specific taxes such as Aggregates Levy, but will be for taxes such as LBTT, Non-Domestic Rates and Air Departure Tax. These will require policy discussions, which involves wider public, in addition to technical analysis from tax professionals.

Worked Example – Infrastructure Commission for Scotland

The RSE are aware of the process which the Scottish Infrastructure Commission went through when consulting. This went beyond traditional methods, widening the consultation specifically to get views from younger people. This involved interacting with schools, and higher and further education.

Worked Example – The Participatory Budget Northern Ireland

The Participatory Budget in Northern Ireland is working well and could be used in Scotland for widening discussions around taxation. The process in Northern Ireland is a collaborative effort to raise awareness of and advocate Participatory Budgeting across the region. Those who are interested in developing a project within the process are offered expert training and support.

Question 4: *What are your views on the proposed policy and legislative cycle?*

- 28** The RSE have no specific comments on the overall cycle but would note that the policy and legislative cycles are two different things. The proposed legislative cycle is constrained and should allow for the complication of changes made by the Scottish Government in reaction to changes made by the UK Government. Additionally, the taxation / policy cycle is disjointed as local taxes are dealt with by different mechanisms than other devolved taxes. There is a need for this to be more coherent.

Question 5: *What are your views on how frequently the cycle should occur – annually or every 2 years?*

- 29** The RSE would suggest that it should be a revenue cycle rather than a policy cycle. Despite these taxes having a small effect on spending decisions it would make sense that this cycle happens annually as there is an annual budget process.

30 This can be on an annual or bi-annual basis but should be set within a strategy which correlates its reviews with UK decisions on taxation and spending in its multi-annual spending review process, which influences the levels of the block grant. This is currently difficult to plan due to the Brexit-influenced disruption to the UK's Spending Review process. HM Treasury's 'Statement of Funding Principles', governing Barnett distributions, is issued after each Spending Review. But the most recent one predates the revenue-sharing agreement between the Scottish and UK governments that arose out of the Smith Commission and the Scotland Act 2016. Scottish Ministers should request HM Treasury to reissue its document without waiting for the next UK Spending review. Any arrangement, whether it be annually or biannually, must provide for the possibility of the cycle being interrupted by an election and possible change of government.

Question 6: *Do you consider the existing documents that are published, and the Scottish Government's approach to drafting them, as sufficient means of clarifying the intention and impacts of a policy?*

31 The RSE would recommend that if everything can be covered within the existing documents then there should be no need to publish further documents; information should be streamlined where and when possible. Additionally, the quality of these documents has improved under devolution and we would recommend that the Scottish Government maintain the same structure of documents.

Question 7: *Do you agree with the Scottish Government's approach to the circumstance set out in this section?*

32 It is clear that there are going to be exceptions within a multi-levelled system of government as there will be problems with coordination. Lack of coordination between both UK and Scottish Government is a concern and will often lead to exceptions and changes. We have explored this lack of coordination and its effect on tax and social policy in a worked example.

33 It is important that the Scottish Government accepts any changes from the UK Government, adapts effectively and does not change any objectives. We would highlight that the framework being consulted on would not be the mechanism to deal with such decisions, rather the Fiscal Framework overall would fulfil this role. Furthermore, the extent to which there is stability is not determined from tax decisions but the spending decisions which affect the block grant.

34 This is where the widening of the context to separate the mechanism and policy is important. There could be scope for research to be carried out and published which would analyse the impact of taxation on social life, and how the tax system operates in Scotland. This will help inform the wider public and could help protect the Scottish Government from political pressure to change tax policy, which often leads to dysfunctional tax policies.

Worked Example – Changes to UK Government and/or Prime Minister

Within the election cycle and parliamentary process, leadership and government may change at any time. Changes at the UK which then lead to changes in taxes and spending will affect the Scottish Budget and policy. Notably reductions in taxes, particularly income tax, at UK level will have an effect in Scotland. This creates a political pressure on the Scottish Government to change policy to keep rates relative to the rest of the UK which ultimately has a wider social impact. If tax reductions are paired with spending reductions in the UK, then there are clear impacts on Scotland, as the block grant is reduced.

Revenue Scotland and Scottish Fiscal Commission

- 35** The RSE would encourage the Scottish Government to increase the capacity within Revenue Scotland. This would build and retain professional knowledge and expertise within the organisation consequently helping to follow best practice.
- 36** The remit of Scottish Fiscal Commission could be expanded with increased financial backing. This would help it produce annual reporting which specifically looks at the overall impact of taxation, specifically the Scottish taxes, but also UK taxes in Scotland.
- 37** The RSE understand that the Scottish Government can develop new taxes, with the permission of Treasury so long as they do not tax money that existing taxes already cover. If the government needs to find new revenue and change behaviour specifically on climate change then there could be scope to explore some additional form of carbon tax and it would be expected that this framework would cover this.

Conclusion

- 38** The policy framework on devolved taxes should be developed, taking into account the wider policy context but should also be equipped to handle all four of the devolved taxes and potentially Council Tax and Non-Domestic Rates.
- 39** It is clear that the Scottish Government is gradually developing its understanding of taxation policy, particularly as there is a delay to the further two taxes still to be fully devolved and operational. As work develops and taxes are introduced the RSE stands ready to advise on any changes.

Additional Information

This Advice Paper has been signed off by the RSE General Secretary. Any enquiries about this Advice Paper should be addressed to Paul Stuart (email: pstuart@theRSE.org.uk)

Responses are published on the RSE website (<https://www.rse.org.uk/>)

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KNOWLEDGE MADE USEFUL