Devolution of tax powers to the Scottish Parliament: the *Scotland Act 2012*

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At present there are two sources of revenue under the control of the Scottish Parliament: local taxes (council tax and business rates), in respect of its responsibilities for local government, and the power to impose a 'Scottish Variable Rate' (SVR) of income tax: that is, amending the basic rate of tax by up to 3p in the £.

The *Scotland Act 2012* devolved three further powers: the power to set a Scottish rate of income tax (SRIT) from April 2016, and to introduce taxes on land transactions and on waste disposal from landfill, replacing the existing UK-wide taxes Stamp Duty Land Tax and Landfill Tax from April 2015. The Act also provides powers for new taxes to be created in Scotland and for additional taxes to be devolved, subject to certain criteria.

While the receipts from the SRIT are to accrue to the Scottish Government, HM Revenue & Customs will continue to be responsible for assessing and collecting income tax across the UK. In February 2013 the Scottish Government and HMRC agreed a memorandum on their respective responsibilities in establishing and operating the Scottish Rate.[1]

The Scottish Government has introduced legislation to establish a new Land and Buildings Transactions Tax, and a Scottish Landfill Tax, from April 2015. Operational responsibility for collecting these taxes will be given to Registers of Scotland and the Scottish Environment Protection Agency, respectively. The Scottish Government has also introduced legislation to establish Revenue Scotland – the tax authority responsible for the administration of all devolved taxes. To date the process introduced under the Act for the UK and Scottish Governments to create new devolved taxes has not been used.

This note looks at the debates over devolving tax powers in the context of the passage of the *Scotland Bill*, and the introduction of the tax provisions in the 2012 Act. Further details of the financial provisions of the Act, and the introduction of a Scottish rate of income tax, are given in two papers published by the Scottish Parliament Information Service (SPICe).[2]

[1] Scottish Government, *Memorandum of Understanding on the Scottish Rate of Income Tax*, February 2013

[2] *Scotland Act 2012: financial provisions* SB14/11, 4 February 2014 & *The Scottish rate of income tax and additional rate taxpayers* SB14/14, 5 February 2014.

During the Scottish referendum campaign, the main party leaders made a commitment that the Scottish Parliament should have "extensive new powers", should Scotland remain within the Union. Following the vote on 18 September 2014 Lord Smith was appointed to lead a commission to reach cross-party agreement on what these new powers should be. The Commission published its report on 27 November.[3]

On tax powers the parties agreed that the Scottish Parliament should have to power to set the rates and thresholds of income tax on non-savings and non-dividend income. There was also agreement that air passenger duty and aggregates levy should be fully devolved. All other taxes should remain reserved. Receipts from all income tax paid by Scottish taxpayers on non-savings and non-dividend income would be received by the Scottish Government, as well as receipts from both air passenger duty and aggregates levy. In addition the receipts raised in Scotland by the first 10 percentage points of the standard rate of VAT would be assigned to the Scottish Government's budget.

The parties also agreed that "the devolution of further responsibility for taxation and public spending, including elements of the welfare system, should be accompanied by an updated fiscal framework for Scotland, consistent with the overall UK fiscal framework." One aspect of this framework is that the devolution of these tax powers, and (partial) assignment of Scottish VAT revenues, is to be accompanied by appropriate adjustments in the block grant received from the UK Government.[4] On 22 January the Government published draft clauses of how the Commission's Agreement could be implemented. It is anticipated that a Scotland Bill will be introduced by the next government after the 2015 General Election.[5]

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3 Details of the Commission's work is collated on its own site.

4 *The Smith Commission*, 27 November 2014 pp23-7. Further details of the Commission's proposals for further devolution of power, in relation to taxation, funding and borrowing are given in, *Devolution of financial powers to the Scottish Parliament: recent developments*, Library standard note SN7077, 22 January 2015.

5 HM Government, *Scotland in the United Kingdom: an enduring settlement*, Cm 8990, January 2015

1 Introduction

At present the majority of the Scottish Government's public expenditure is funded by a block grant from the UK Treasury.[6] There are two sources of revenue under the control of the Scottish Government: local taxes (council tax and business rates), in respect of its responsibilities for local government, and its power to impose a 'Scottish Variable Rate' (SVR) of income tax. Local authorities in Scotland have set council tax for Scottish residents since its introduction in 1993, while the power to set business rates was transferred to the Scottish Government in the *Scotland Act 1998*.[7]

The *Scotland Act 1998* also devolved the power for the Scottish Parliament to impose an SVR – although to date it has not been used. In a paper on devolution finance Professor Alan Trench argued that there were certain practical difficulties to seeing local taxes as a funding source at the control of the three devolved governments:

> Two sources of revenue are available to the devolved governments at present. All three devolved governments are responsible for local government, including its finance. It would be open to devolved governments to increase the overall resources available to them by reducing the block grants they pay to local authorities and requiring local authorities to increase council tax and business rates instead. There are restrictions on how far this could be used, as the *Statement of Funding Policy* provides that the block grant may be reduced if levels of 'self-financed spending' grow significantly more rapidly than in England over a period, and that threatens public finance targets used to manage the UK economy.[8]
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> Moreover, the Scottish experience of considering replacing council tax with a local income tax of three pence in the pound, blocked by various practical problems raised by HM Treasury, gives further reason to question whether this can be regarded properly as a devolved tax rather than as a delegated source of revenue.

Professor Trench went on to note the limitations to the SVR with regard to the Scottish Government's powers to raise taxes:

> The second source of revenue is the Scottish variable rate: the power, never used, to vary the standard rate of income tax by up to three pence in the pound. This power ceased to be available for administrative reasons in 2007, but figures in the 2010 budget suggested it would have been worth £350 million per penny in 2010/11, in the context of a total devolved Scottish budget of £29.71 billion. Its use would have occasioned a great deal of political pain for little financial gain.[9]

Similarly, in their assessment of devolution finance the Calman Commission, which completed a two year review of Scottish devolution in June 2009, noted that even if the Scottish Parliament had used this power fully, the additional amounts raised would represent only 3% of the Scottish Government's budget.[10] The Commission took the view that the

6 HM Government provides a basic explanation of the current arrangements for funding the devolved administrations on Gov.uk.

7 HL Deb 20 November 2013 c221WA

8 HM Treasury, *Statement of Funding Policy*, 2010 para 6.2.

9 Alan Trench, *Funding Devo More: fiscal options for strengthening the union*, Institute for Public Policy Research, January 2013 p9

10 As the Commission observed, "if used to the full this could change the Scottish Budget by little over £1 billion, compared with total spending of around £30 billion" (*Final Report*, June 2009 p7).

drawbacks to using the SVR in practice highlighted why the SVR had failed to create financial accountability:

> First and most obviously there has never been a political consensus in the Parliament to exercise the power. Additionally, the first ten years of the Parliament's existence have been a time of rapidly growing public spending, and the challenges in managing the growth of that spending wisely may have suggested that further growth from additional taxation was unnecessary.[11]
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> There may however be other reasons. Evidence such as that from the Institute of Chartered Accountants in Scotland (ICAS)[12] that estimates that the cost, especially the start-up cost of using the SVR for the first time, would be quite substantial in comparison with the revenue that might be received, especially for variations of less than the full 3p in the pound. More profoundly, however, there is the nature of the power itself. Because the SVR is a power to alter a rate already set by the UK Government, a decision to do nothing has no effect on the budget of the Parliament.
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> By contrast a local authority which does not take a decision to set a rate of council tax will not be able to levy a tax and would consequently lose the resultant revenue stream. The Independent Expert Group's survey of international practice found the funding of most regional governments worldwide had some transparent connection to tax receipts.[13]

In place of the SVR the Calman Commission proposed a new Scottish rate of income tax, to apply to the basic and higher rates of income tax. The Commission recommended that, as with the SVR, the new rate should not apply to income from savings or dividends although it also proposed that half of the yield from tax on these income sources should be assigned to the Scottish Government's budget, with a corresponding reduction in the block grant.

The Scottish rate of income tax would sit 'on top' of the existing rate structure, initially at the rate of 10%. From implementation, the main UK rates of income tax for Scottish taxpayers would be reduced by 10p, and the new Scottish rate would apply in addition to the amended UK rate. So, Scottish taxpayers would be liable to pay tax to the UK Exchequer at 10%, 30% or 35% - rather than the current rates of 20%, 40% and 45%. They would also pay the Scottish rate – collected by HM Revenue & Customs in the normal way, but allocated to the Scottish Government's budget. As the UK Government noted in the Command Paper accompanying the *Scotland Bill*, "the Scottish rate of income tax represents a significant funding stream – a 1% increase in the income tax rate would currently yield approximately £450m or 1.7% of the present Scottish budget."[14]

The Scottish Parliament could choose to maintain a 10% rate, restoring the overall tax rate to the same level as the rest of the UK, or elect to have a higher or lower rate. For any change in the Scottish rate, the three rates payable by Scottish taxpayers would move in tandem – or 'lockstep'. The Commission took the view that the Scottish Parliament should not take on responsibility to determine the structure of the income tax system, which, in their view "includes the difference between the rates applying to each band. In our view therefore the

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[11] By 2007, the cumulative under spend of the Scottish Parliament amounted to £1.5 billion.

[12] Oral evidence from ICAS, 12 September, 2008.

[13] Commission on Scottish Devolution, *Final Report*, June 2009 paras 3.39-.40. The Independent Expert Group mentioned in this extract was set up by the Commission to advise on improving the Parliament's financial accountability.

[14] Cm 7973 November 2010 p25

same reduction in UK income tax should be applied in relation to each band and the Scottish Parliament should be able to apply one single "Scottish" rate of income tax to each of them":

> Although in some jurisdictions sub-national authorities have scope to alter tax allowances and reliefs, little of the evidence we received suggested doing so. It would create two problems. First the efficiency of the tax system would be seriously reduced, creating problems of compliance and administrative cost for employers and the tax collection authorities.
>
> Secondly, it would not in our view be consistent with the social Union as income tax is, as well as a revenue-raising device, also an instrument of redistribution. A progressive tax system redistributes proportionately more resources away from higher earners and such decisions have effects that are redistributive across different parts of the UK as well as between different individuals. Such decisions, and therefore the structure of the tax system, are properly taken at the UK level.[15]

The Commission also recommended that four taxes should be fully devolved: stamp duty land tax, landfill tax, aggregates levy and air passenger duty – and that the Parliament should have the power to introduce new taxes subject to the agreement of the UK Parliament. All told, the Commission anticipated that as a consequence of these reforms the Scottish Government would collect around 35% of its existing budget directly, compared with about 15% at present:

> Taking into account the local taxes already devolved to the Scottish Parliament, the total of current spending supported by taxes decided in Scotland would be something over a third (35%), as table 3.4 below shows.

Table 3.4: Estimated current spending supported by taxes decided in Scotland

Estimated tax receipts 2006 – 07[3.37]	£ million
Income tax basic rate (based on HMT 2009 Budget forecast)	3,500
Income tax higher rate	650
Income tax on savings and distributions[3.38]	500
Aggregates Levy	50
Landfill Tax	75
Stamp Duty Land Tax[3.39]	555
Air Passenger Duty	94
Non-domestic rates	1,884
Council tax	1,812
Total devolved tax revenues	9,120
Relevant budget (SE resource DEL plus NDR & Council Tax)	26,049
% relevant budget from own sources	35%

> It is important to understand that the exact percentage figure is not relevant. It might vary from year to year and will be affected by tax and spending decisions, but we are quite clear that a proportion of this scale would meet the test of creating real devolved financial accountability.[16]

15 *Final Report*, June 2009 paras 3.175, 3.104
16 *op.cit.* pp103-5

In November 2010 the Government published the *Scotland Bill* accompanied by a Command Paper – *Strengthening Scotland's Future* – as its response to the Calman Commission.[17] With regard to devolving tax powers, the Government followed the Commission's recommendations with two important exceptions. First, it opposed assigning income tax revenues from savings and dividends to the Scottish Government:

> The technical changes required to identify Scottish savings and distributions in order to assign the associated tax revenue would be equally onerous, complex and costly given the role of third parties such as banks and building societies in withholding and remitting this tax. Furthermore, we are persuaded that assigning tax revenues would not in itself contribute to financial accountability.[18]

It is worth noting that the amounts raised in Scotland from income tax on savings and dividend income are relatively small.[19]

Second, the Government decided not to devolve two of the four taxes the Commission had proposed for devolution: aggregates levy and air passenger duty (APD).[20] The Command Paper stated that the case of devolving aggregates levy would be kept under review, pending the outcome of legal proceedings to determine if the design of the tax infringed EU rules on state aid.[21] Similarly the case of a devolved APD would be reconsidered, once the Government had completed a general review of the tax. However, following this review, the Government has stated it opposes a Scottish or Welsh APD, as it would distort competition.[22] On the question of new taxes, the Command Paper stated that while this would be provided for by the *Scotland Bill*, the UK Government would only approve a new charge which did not "impose a disproportionate negative impact on UK macroeconomic policy or impede, to any degree, the single UK market."[23]

2 Report of the Scotland Bill Committee

The *Scotland Bill* was subject to the consent of the Scottish Parliament, expressed through a Legislative Consent Motion (LCM). To inform this process the Parliament established a committee to report on the Bill, and its final report was published on 3 March 2011. Overall the Scotland Bill Committee supported the Bill, and, on its tax provisions, argued that the Bill "strikes the right balance at this time" though further changes were likely to be made to this aspect of the devolution settlement in the future:

> Sharing income tax is the obvious and most appropriate start to give the Scottish Parliament its first significant additional tax powers. This will mean the Scottish Parliament has a basket of taxes – income tax, Non-Domestic Rates, Council Tax,

[17] HC Deb 30 November 2010 cc69-71WS. A Library paper gives more background to the Bill (Research paper 11/06, 18 January 2011).

[18] *Strengthening Scotland's Future*, Cm 7973, November 2010, pp29-30.

[19] Total income tax receipts were £10.7 billion in 2008/09, of which receipts from savings and dividends were £646 million, or just 6% of the total: Scottish Government, *Government Expenditure & Revenue Scotland 2008-2009*, June 2010 p37 (Box 4.1).

[20] Cm 7973, November 2010 p32

[21] Recently the Commission found that the credit scheme for aggregate producers in Northern Ireland *met* the conditions for state aid for environmental protection (Case SA18859, 4 August 2014), but a second investigation into certain other levy reliefs is ongoing (Case SA34775, 28 November 2013).

[22] For example, see comments made by the then Exchequer Secretary, David Gauke, during the proceedings of the Finance Bill 2014 (HC Deb 9 April 2014 c377).

[23] Cm 7973, November 2010 p33

> Stamp Duty Land Tax (SDLT) and Landfill Tax – amounting to about one-third of its revenues. Two more taxes are to be considered with powers to add more in the future. Together with its untrammelled spending powers, this will give the Scottish Parliament very wide fiscal powers … There is scope for further development in the future … [and] the Committee is clear …that this Bill will enable future changes to strengthen the position of Scotland within the United Kingdom further.[24]

Some of the submissions the Committee received in its inquiry argued that the Bill should devolve further tax powers – and there was particular interest in the devolution of corporation tax. Since 2010 the UK Government has been exploring options for 'rebalancing' the economy in Northern Ireland, as the private sector has been much weaker than in other parts of the UK, and indicated that this might include devolving the rate of corporation tax.[25] (Indeed, in January 2015 the Government confirmed it would take forward the devolution of corporation tax rate setting powers to Northern Ireland.[26]) More generally many commentators have argued that the strong growth of the Irish economy in the mid 1990s was driven, in part, by the Republic maintaining a very competitive rate on trading profits to attract foreign direct investment.

The Committee took the view that the potential disadvantages to devolving the tax posed too great a risk, despite the appeal in trying to emulating the Irish experience:

> Corporate profits are hard to pin down geographically and companies have a strong incentive to recognise their profits in the place where they will be subject to the lowest tax rate. There will be many devices to enable them to do so, such as registering a legal entity in Scotland or "brass plating", or booking profits in Scotland through manipulation of transfer pricing. These are not fanciful possibilities. They happen whenever companies register in places like the Isle of Man. Similarly, many commentators have noted that a significant proportion the corporation tax paid in the Republic of Ireland relates to economic activity elsewhere in the EU.
>
> A number of problems follow from this. First, it misallocates resources in an economic sense. Tax avoidance may be profitable for companies but is not a productive activity. Nor would it attract jobs and growth to Scotland, Secondly, it increases the risk of a race to the bottom in corporation tax rates (as one can see in other countries such as Switzerland) so that tax revenues are lost.[27] Thirdly, and perhaps most serious, if Scotland were able to cut corporation tax, the risk is that all it would attract are 'paper profits' from companies elsewhere in the UK who had the incentive to recognise in Scotland. The net effect of this would be that overall, less corporation tax was paid in the UK even though Scotland attracted more of it to support devolved spending. This is has been referred to as "cannibalising" the tax base …
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> The Committee understands that it is not possible simply to transfer the Republic of Ireland's experience – good or bad – to Scotland. Ireland set a low rate of corporation tax when its economic base was very weak. It was able to attract mobile investment at the price of losing only a little revenue. Scotland is not in that position and a Scottish Government would have to think very hard about cutting tax rates and income from pre-existing companies in the hope of attracting additional income from new arrivals in the future. The price in terms of lost revenues and reduced services might be high. The

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24 Scotland Bill Committee, *1st Report (Session 3)*, 3 March 2011 paras 26-28

25 In March 2011 the Government published a consultation paper on this issue (HC Deb 24 March 2011 c59WS).

26 HC Deb 7 January 2015 cc296-7. For more details see, *Devolution of corporation tax to Northern Ireland*, Library standard note SN7078, 22 January 2015.

27 Professor Lars Feld, written evidence submitted to the Committee.

> Exchequer Secretary to the Treasury said that the UK Government planned reductions but that each 1% cut in corporation tax rate cost £700-800 million in lost revenues. He did not foresee a date when the lost revenues would be offset by increases in the tax base. Therefore, a 10% cut in corporation tax in Scotland might cost about £600 million per year for an indeterminate period.[28]

The Committee also noted that there were legal hurdles to using corporation tax in this way, as the Scottish Parliament could not be compensated for any shortfall in tax revenues by a rise in funding from Westminster:

> EU State Aids rules constrain the extent to which corporation tax can be varied within a Member State. There are several important European Court of Justice judgements on this but, in summary, the scope exists for a devolved government to set lower rates provided certain conditions are met. Important among these is that the devolved administration must not be protected from the revenue consequences of its decisions.[29]

The implications for the devolved assemblies of European case law – and in particular, the 'Azores' judgement – were discussed in the paper published by the Treasury in 2011 on the case for devolving corporation tax to Northern Ireland, cited above:

> Devolving any tax rate varying power must satisfy the European Court of Justice (ECJ) decision on the "Azores Case", which set out the criteria which would need to be met for regional differences in direct taxation not to involve State Aid, and to be compliant with EU law.[30]
>
> These conditions are:
> - The decision to introduce the regional difference in direct taxation must have been taken by the region which has a political and administrative status separate from that of the central government (*institutional autonomy*)
> - The decision must have been adopted without the central government being able directly to intervene as regards its content (*procedural autonomy*)
> - The full fiscal consequences of a reduction of the national tax rate for undertakings in the region must not be offset by aid or subsidies from other regions or central government (*fiscal autonomy*).

The department thought that Northern Ireland would meet the first two of these tests, but to meet the fiscal autonomy condition, the Northern Ireland Executive "would need to bear the full fiscal consequences of changes in tax revenues resulting from a new Northern Ireland corporation tax rate. This means that Northern Ireland's block grant would be adjusted to reflect the fiscal costs of a reduction in the rate of corporation tax."[31]

Turning back to the Committee's report, the Committee argued that although the Bill should not devolve corporation tax, "if a scheme to vary corporation tax were to be available in some of the devolved countries of the UK as a tool of the UK Government's regional economic policy, it should be available as an option for a Scottish Government to use also."[32]

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28 *1st Report (Session 3)*, 3 March 2011 paras 51-52, 56
29 *1st Report (Session 3)*, 3 March 2011 para 49
30 Commission v Portugal C88/03
31 HM Treasury, *Rebalancing the Northern Ireland economy*, 24 March 2011 p25
32 *1st Report (Session 3)*, 3 March 2011 para 59

The two SNP members of the Committee submitted a minority view to the report, arguing that without the power to set corporation tax, "Scotland is missing out on the opportunity to give itself with a competitive edge over the rest of the UK … we recommend that the Bill be amended to include the devolution of corporation tax so that a competitive rate of corporation tax can be set in Scotland to increase our competitiveness, attract business and create jobs." Further to this the Bill should provide Scotland with "full financial responsibility": the provision made for a Scottish rate of income tax "would make Scotland overly dependent on a single, decreasing and blunt tax"; in particular, "the Bill's failure to grant equal access to the higher income tax bands as it does to the lower band means that even this very limited tax power is further blunted in terms of increasing revenue."[33]

On 10 March 2011 the Parliament passed a motion to support "the general principles" of the Bill, invited the UK Parliament to consider the Committee's proposals, and noted that it would reconsider the Bill with a second motion prior to Royal Assent, in light of any amendments made during its scrutiny.[34]

3 The Committee stage of the *Scotland Bill*

Summary

As with other constitutional Bills, the Committee stage of the *Scotland Bill* took place on the floor of the House – and this proceeded over three days: 7, 14 and 15 March 2011. The House considered the tax provisions of the Bill – **clauses 24-31** – on 14 March. These now form sections 23-31 of the *Scotland Act 2012*. On this occasion no major changes were made to this part of the Bill though a number of minor, technical Government amendments were agreed, without a vote. There were two divisions on amendments tabled by the SNP: to devolve powers to set the aggregates levy to the Scottish Parliament, and to require approval by the Parliament for the regulations which will be laid by the Treasury, setting the first year for the Scottish tax rate to apply. Both were negatived on division. Much of the debate focused on the Scottish rate and the tests for determining whether someone would be liable to pay this rate or not. After the debate the then Exchequer Secretary, David Gauke, gave more detail on the Government's approach to the technical problems to establishing the new rate, and other questions raised in the debate, in a paper which he deposited in the Library.[35]

Devolved tax powers

Section 23 of the Act provides the structure within which the Scottish Parliament may legislate for tax, establishing that the Parliament may set the rate of income tax to be paid by Scottish taxpayers, set taxes on Scottish land transactions and disposals to landfill in Scotland, and introduce new taxes subject to certain restrictions.

Speaking for the SNP Stewart Hosie moved a number of amendments and new clauses to allow for four additional taxes to be devolved: corporation tax, fuel duty, aggregates levy and air passenger duty. On the first of these, Mr Hosie argued that its omission "unfairly and unnecessarily removes the numbers of economic or fiscal levers open to the Scottish Government" though he acknowledged that there was "a balance to be struck between

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[33] *1st Report (Session 3)*, 3 March 2011 (Annexe A)

[34] SP OR 10 March 2011 c34358

[35] *Letter dated 21/03/2011 from David Gauke MP to Ann McKechin MP regarding Scotland Bill 2010-11* (Commons Deposited Paper 2011-0503, 21 March 2011).

proper tax competition, which is legitimate and fair and proper to stimulate growth, and unnecessary changes simply to get a quick short-term fix in terms of the arbitrage, which would be unhelpful."[36] Speaking for the Labour Party Ann McKechin strongly criticised the idea of devolving either fuel duty or corporation tax, as did the then Exchequer Secretary, David Gauke, citing the views of the Calman Commission on why neither tax was a suitable candidate for devolution:

> [The Commission] concluded that different fuel duty rates would make artificial opportunities for cross-border shopping, creating economic distortions. More significantly, however, it highlighted the EU energy products directive that sets a principle of one rate of fuel duty per member state. Devolving fuel duty to the Scottish Parliament would require the EU to grant the UK a derogation from this directive, and the Calman commission acknowledged that it would be unlikely to be granted …
>
> [On corporation tax it] concluded that if comparable levels of public services were to be maintained, the scope for substantive reductions in the rate of corporation tax in Scotland was limited, unless the Scottish Government are able to increase revenues from other sources .. under European law there will have to be a reduction in the block grant commensurate with the value of the reduction in the corporation tax rate. Secondly, the commission also believed that the potential administrative impacts of such a move were significant. The creation of compliance costs to businesses operating on either side of the border, as well as the increased collection costs to the Government, would be undesirable in the present economic climate.[37]

The Minister also explained why, in the Government's view, the Bill should not include provision to devolve the aggregates levy or air passenger duty:

> The aggregates levy is currently under legal challenge in the EU courts … should it be found subsequently that the aggregates levy, as currently constituted, is not legal, the loss of that revenue would be immediate and significant for the Scottish Government … once [it] … overcome the legal challenge, we will devolve it to Scotland … The UK Government are exploring changes to their aviation tax system, as stated in last year's June Budget, and will look at devolution of this tax base in that future work. However, it is not appropriate to devolve aviation tax until these changes have been explored, with any major changes subject to consultation, and a decision on the future of UK aviation tax made.[38]

In the event Mr Hosie moved just one amendment to allow for the devolution of the aggregates levy and this was negatived by 292 votes to 8.[39]

Section 24 amends the legislation underpinning the functions of HM Revenue & Customs to take account of this limited devolution of tax powers. There was a short exchange on the clause between Ms McKechin and Mr Gauke, when the Minister simply confirmed that the clause "enables HMRC to share with the Scottish Government information about the collection and management of devolved taxes, while ensuring the confidentiality of that information."[40]

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[36] HC Deb 14 March 2011 c52
[37] HC Deb 14 March 2011 c62, c67, cc68-9
[38] HC Deb 14 March 2011 cc67-8
[39] HC Deb 14 March 2011 c71
[40] HC Deb 14 March 2011 c74

Scottish rate of income tax

Sections 25 & 26 provide for the Scottish rate of income tax – in particular, the coverage of the rate to 'Scottish taxpayers' – and for changes to tax law to take account of the new rate. Section 25 was debated at some length, with contributions focused on the statutory test for determining who would be liable to pay the new rate – and how it would work in practice – as well as the procedure for the Scottish Parliament to agree to any further changes that might be required as HMRC consulted on the detailed implications of the new rules.

Speaking for the Labour Party Ann McKechin raised a series of concerns about the new rate, touching on what help businesses would receive for applying the new statutory test, how the new rate would apply the self-employed and to individuals whose year was split between Scotland and the rest of the UK, whether the statutory test could be exploited to avoid tax, and what impact the Scottish rate might have on a person's social security benefits. Ms McKechin also moved an amendment to require the Treasury to consult on any secondary legislation that might be needed that would have retrospective effect.

Speaking for the SNP Stewart Hosie also raised concerns about consultation, and moved an amendment to require any commencement orders for the tax provisions to be formally approved by the Scottish Parliament. The Exchequer Secretary suggested that the proposals made by both Labour and SNP for changing the Bill were unnecessary, though in turn he moved a number of drafting amendments "to ensure that we have a proper parliamentary process attached to the provision that bring into effect the provisions of the Bill." These were accepted without a vote. Ms McKechin withdrew the amendment she had moved on the grounds that the Committee had had "a reasonable level of reassurance" on the Government's commitment to fully consulting on the implementation of the new rules. Mr Hosie moved his amendment to a vote, and this was defeated by 286 votes to 9.[41]

Much of the Minister's speech was taken up with a detailed explanation of the new statutory test, and replying to concerns raised by the Opposition about its operation. A summary is given below, but, as noted, Mr Gauke also addressed these questions in a letter he sent to Ms McKechin after the debate, which is recommended to those interested in the details.[42] In brief, the new Scottish rate of tax would apply to someone who met two tests in a tax year: that they were resident in the UK for tax purposes – which is an existing test for UK tax liability – *and* that they met one of three conditions – A, B or C:

> Condition A is that the individual has a "close connection" with Scotland …[which] for the majority of people … will be a straightforward question … If they have one place of residence in the UK and it is in Scotland, they will have a close connection with Scotland and will therefore be a Scottish taxpayer, provided that they live there for at least part of the year. This last condition—that the individual lives in the place of residence—is a crucial part of the definition and ensures that it is simple to operate. Someone may stay in a place of residence which is not their home, perhaps while on holiday or as part of their work, but such nights away are disregarded because those are not places where the person lives, but merely places where they stay …
>
> If someone has two or more places of residence in the UK, the question of whether or not they have a close connection with Scotland will depend on whether their main place of residence is located in Scotland for at least as much time as they spend

[41] HC Deb 14 March 2011 cc75-82, cc87-8, c92, c95, c102

[42] Commons Deposited Paper 2011-0503, 21 March 2011

> somewhere else in the UK, again provided that the place of residence is where they live … Condition A has been designed to enable the vast majority of people to decide whether they are a Scottish taxpayer without the need to consider the other two conditions. After all, most people will have no difficulty deciding where their main place of residence is located.

In a small number of cases it would not be possible to determine if someone resident in the UK had a 'close connection' with Scotland or not. This would be because they had two or more places of residence in the UK, but it was not clear which of those was their main place of residence. For someone in this position condition B would apply: a straightforward day count test:

> If they spend more days in Scotland than they do elsewhere in the UK, they will be a Scottish taxpayer. If they spend more days elsewhere in the UK than they do in Scotland, they will not be a Scottish taxpayer. We recognise that it might be onerous in some cases to have to keep a day count record, but the number of people within that category should be relatively few …for the purposes of the day count, an individual has spent a day in Scotland or in any part of the UK when they are present at the end of the day—in other words, at the stroke of midnight. That is consistent with the existing and long-standing rules that determine presence in the UK for the purposes of tax residence.

Finally, under condition C, "if someone represents a Scottish constituency in the Scottish, UK or European Parliaments for any part of the year, they will be a Scottish taxpayer for that tax year, provided of course they are UK resident." Mr Gauke also noted that the Government would table a new clause to the Bill at the Report stage "to apply the new definition of a Scottish taxpayer for the purposes of the Scottish variable rate."[43]

The Minister noted that further work was being done to ensure the new rate would work successfully, and addressed the concerns raised about individuals who split their year between Scotland and the rest of the UK, and about the burden the new test might place on employers:

> It is envisaged that the new Scottish rate of income tax will first be applied from 6 April 2016 ... There are more than five years before the provisions take effect, and during that time we will continue to discuss with businesses, employers, taxpayer representatives, charities and software providers the necessary practical steps to achieve a successful implementation. The measure will need to work successfully throughout the UK tax system, as it will not impact on Scottish taxpayers or on Scottish employers alone …
>
> No split-year treatment applies to those leaving or arriving in Scotland: an individual will be a Scottish taxpayer for a full tax year or not at all. There is no prospect of double taxation when someone lives part of the year in Scotland and the rest of the time in another part of the UK. It would be administratively much more complex were we to try to split the year …
>
> Let me assure the Committee that it will be HMRC's responsibility to identify who is and is not a Scottish taxpayer. Scottish taxpayers will then be given a Scottish tax code by HMRC, and employers will use it in the PAYE system, just as they do with other

[43] HC Deb 14 March 2011 cc 96-8, c95. This provision was moved at the report stage of the Bill on 21 June (New Clause 5 : HC Deb cc 223-4), and approved without amendment. It now forms s27 of the 2012 Act.

> employees. It is also worth mentioning that there will be an awareness campaign in Scotland and in the rest of the UK ahead of the system's introduction.[44]

In his letter to the Member, the Minister went on to address concerns about Ms McKechin had raised about the impact that the new rate might have on self-employed taxpayers and on individuals' benefit entitlement, and whether the rate might be exploited for tax avoidance purposes:

> The definition of a Scottish taxpayer will apply to self-employed individuals in the same way as it applies to anyone else who is tax resident in the UK. Whether or not they are a Scottish taxpayer will not be determined by where they earn their profits or trade, but will instead depend upon the location of their sole or main residence …
>
> Any potential impact that arises on benefits is being considered by the Department for Work and Pensions (DWP). There are many factors that influence an individual's entitlement. The amount of income tax they pay is just one of them. Where an individual lives can already influence the amount ot Council Tax they are liable for, for example. Currently if two people have the same gross salary but different tax liabilities they well be have slightly different levels of entitlement to means-tested benefits where those benefits are calculated on net income. So this is nothing new …
>
> HMRC monitor tax avoidance closely and will discuss these issues with the Scottish Government. On the Scottish rate of income tax HMRC will identify who is and who is not a Scottish taxpayer. Scottish taxpayers will then be given a Scottish tax code by HMRC and employers will use this code in the PAVE system just as they would with their other employees. For those who self-assess, it will use its usual risk based approach, comparing data it holds and that of third party suppliers.[45]

Section 26 was the subject of a short exchange between Ms McKechin and Mr Gauke, when the Minister confirmed that the treatment of tax reliefs associated with pension contributions was "complex" but that the department were consulting on how it would be addressed in the implementing legislation.[46]

Other taxes

Sections 28 & 29 provide for the Scottish Parliament to impose a new tax on land transactions in Scotland, and for the coverage of Stamp Duty Land Tax to be restricted to the rest of the UK when the new tax is introduced. In answer to questions from Ms McKetchin and Mark Lazarowicz the Minister confirmed that the withdrawal of stamp duty land tax would be achieved by Treasury order but that the Government would "consult the Scottish Government in setting the switch-off date and will not disapply SDLT in Scotland until the Scottish Government have the necessary legislation and administrative arrangements in place for the devolved tax." Mr Gauke also clarified the point that "the Scottish Government will be able to delegate the SDLT power in question to local authorities, so the matter could be further localised." **Schedule 4** underpins these provisions, and on this occasion the Government introduced several amendments to the schedule ensure the proper operation of SDLT after its withdrawal from Scotland.[47]

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44 HC Deb 14 March 2011 cc98-9
45 Commons Deposited Paper 2011-0503, paras 6, 11,18
46 HC Deb 14 March 2011 c105
47 HC Deb 14 March 2011 c106, cc107-8

Sections 30 & 31 provide for the Parliament to impose a new tax on waste disposal in landfill across Scotland, and for the equivalent UK-wide tax to be withdrawn from Scotland. In a short exchange with Mark Lazarowicz, the Minister confirmed that any new landfill tax could be devolved further to local authorities, since its design was entirely a matter for the Scottish Government and Parliament. The Member had also raised concerns about tax competition – that is, those deposing of waste exploiting any differential between tax rates in Scotland compared with the rest of the UK: in response Mr Gauke said, "those setting the structure and rates of landfill tax in Scotland will clearly want to take into account the factors that were raised, such is the nature of devolution in such areas."[48]

4 Subsequent scrutiny of the *Scotland Bill*

4.1 Report of the Scottish Affairs Committee

On 23 March 2011 the Scottish Affairs Committee published their own report on the *Scotland Bill*, focusing on the Bill's financial provisions. In general the Committee stated that it was "supportive of the Government's position in relation to the taxation powers to be devolved" and was enthusiastic about the possibility of the Scottish Parliament introducing new taxes: "we find particularly exciting the capacity to develop new taxes, which, when taken together with the advice we received about the attraction of taxes on non-mobile assets, particularly land, opens up an avenue for our colleagues in the Scottish Parliament to undertake interesting work."[49]

The Committee were supportive of the new Scottish rate, as it had "the merit of maintaining the integrity of UK income tax, while also allowing the Scottish Parliament to be accountable and responsible for raising some of its own tax revenues." Devolution of other aspects of income tax was possible but the operation of the new Scottish rate should be properly evaluated before "any consideration or discussion of devolving further powers in relation to income tax." However the Committee were concerned about "the anomalies and difficulties which occur in defining a Scottish taxpayers", stressing that the department "need to undertake detailed design and implementation work [on this test] in order to minimise costly delays and the potential for legal proceedings." The impact of the new rate on businesses was also a concern, and the Committee asked that the Government "clarify the scale of this burden, and the level of responsibility that will fall on employers."[50]

The Committee was disappointed that the Government had decided not to devolve either the aggregates levy or air passenger duty, and argued that provision to this effect should be made "on the face of the Bill" by including "an enabling power" to devolve them "following an affirmative resolution of [the Commons]." The Committee was also disappointed that the Government had not given any examples of the kinds of new charge that would meet the criteria for devolved taxes set out in the Command Paper:

> When pressed, the Secretary of State could not give us examples of the type of tax which could potentially be acceptable, nor tell us whether two taxes mooted (on strongly caffeinated alcoholic drinks or a universal land tax), would meet the criteria and consequently be considered for devolution … We are … concerned by the

48 HC Deb 14 March 2011 cc109-10
49 *Fourth report*, 21 March 2011 HC 775 2010-11 p3
50 HC 775 2010-11 para 49-50, 60, 71

absence of any clear process or mechanism by which the criteria will be applied, and ask the Government to provide a more thorough and detailed explanation of how this process would work, during the passage of the Bill through this House.[51]

On the question of devolving corporation tax the Committee agreed with the views of the Calman Commission and those witnesses who had emphasised the risk that devolution would result in the 'cannibalisation' of the UK tax base, noting that, "this is not necessarily a concern for those who wish to consider the financial position of Scotland in isolation."[52] Professor Jim Gallagher, who had been secretary on the Commission, addressed this point when he appeared before the Committee:

> People often cite the Republic of Ireland for its very low corporation tax rate as being an advantageous thing, and for them it certainly has been pretty advantageous, despite their present circumstances. What they fail to mention is that they have quite a big corporation tax income because many multinationals book their profits in Ireland. The devolution of corporation tax within the UK would be a way of ensuring that we cannibalised our own tax revenue. If it is devolved to Scotland and Scotland takes, for the sake of argument, 10p off the corporation tax, there is a strong incentive for companies not to change their actual economic behaviour but to change their corporate structures so that they book their profits in Edinburgh and pay less tax. The net effect of that is that the UK as a whole gets less tax and we have simply cannibalised our own tax income.[53]

The Committee also noted that those arguing for the devolution of corporation tax had focused exclusively on *cutting* this tax, but had not addressed the wider question of funding this expenditure – given that under EU rules on State Aid, the Scottish Parliament could not be compensated by the UK Exchequer for any consequent shortfall in its funding:

> In the discussion on Corporation Tax there seemed to be an assumption that any variation would be downwards … if the Scottish Parliament had responsibility for varying Corporation Tax, there would be a commensurate reduction in the block grant to match the amount of tax revenue foregone by HM Treasury. At no time has it been made clear to us, by any of those who argued for a Corporation Tax variation and reduction, as to how the inevitable short term drop in revenue would be compensated for.[54]

4.2 Amendments to the *Scotland Bill* at the Report stage

On 5 May the SNP won a Parliamentary majority in the elections for the Scottish Parliament. In its manifesto the Party had proposed that the Scottish Government should be assigned receipts from UK taxes arising in Scotland, *and* that excise duties on alcohol as well as corporation tax should be fully devolved:

> Our plan would see all tax raised in Scotland kept in Scotland. Instead of the Tory government in London deciding how much of our income we get to keep, the Scottish Parliament would make a payment for Scotland's share of ongoing UK services such as pensions, foreign affairs and defence … Responsibility for Corporation Tax would allow Scotland to do even more to create jobs and make our economy more competitive and successful … We also believe Scotland can achieve more with

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51 HC 775 2010-11 para 88, 95
52 HC 775 2010-11 para 106
53 HC 775-II 2010-11 Q23 Ev7-8
54 HC 775 2010-11 para 105

> responsibility for Excise Duty and the Crown Estate Commission. Through Excise Duty we will have the ability to deliver a fair deal for Scotland's whisky producers by ending the current discriminatory tax regime.[55]

In a statement to the Scottish Parliament on 26 May the First Minister Alex Salmond said the new Government would "demand that corporation tax be devolved" and that it needed "control of excise duties, so that we can tackle the problems of alcohol abuse and can benefit the public purse."[56] In a debate a few days later, John Swinney, Cabinet Secretary for Finance, Employment & Sustainable Growth, said the Government would "press for control of corporation tax, to enable us to help to improve the competitiveness of the Scottish economy and to attract companies to Scotland."[57]

On assigning tax revenues, the Calman Commission argued there would be some practical problems to assessing what proportion of a given tax would accrue to Scotland alone:

> Most Scottish tax revenues are not separately identified. Some, in an integrated economy, are quite difficult to define – for example, should all the corporation tax revenue from a company based in Scotland be assigned to Scotland, even if profits are generated by business in England? Major challenges of estimation are involved and the breakdown of tax revenues in GERS (Government Expenditure & Revenue Scotland) shows the difficulties involved. Effort and cost would be involved in developing assignment systems.[58]

In its report on the *Scotland Bill* the Scottish Affairs Committee said that it did not object to the assignment of revenues "in principle", recommending that "further work should be done to evaluate whether the assignment of tax receipts could be achieved without creating a disproportionate financial and administrative burden, and whether the potential advantages of assigning the receipts outweigh the potential disadvantages in this context."[59]

The Committee did not consider the case for devolving excise duties, but it is likely that a separate duty regime in Scotland would face serious problems. Excise duties are levied on five major goods: beer, wine, spirits, tobacco and fuel. They are levied at a flat rate (per pint, per litre, per packet etc.).[60] Although the tax forms part of the final selling price of the good, the duty is not collected by the final retailer; rather it becomes payable when it is distributed for sale, either from the producer/refinery, or from an 'excise warehouse'.[61] If excise duties were devolved, producers and distributors would have to ensure the correct rate of duty was paid, given the final destination of their goods. In addition a differential rate of duty would create incentives for tax avoidance and evasion – from shoppers travelling across the border to buy purchases for themselves, quite legitimately, as well as smugglers reselling goods at a lower price.

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55 *Scottish National Party Manifesto* 2011 p28

56 SP OR 26 May 2011 c67

57 SP OR 1 June 2011 c174

58 Commission on Scottish Devolution, *Final Report*, June 2009 para 3.34. 'GERS' is the Scottish Government's annual estimate of Scottish revenues – the methodology used in set out in appendix A to the most recent report for the 2008/09 year.

59 HC 775 2010-11 para 99

60 Tobacco products are subject to an additional ad valorem tax of 24% of the total retail price (including the flat-rate duty, VAT and the ad valorem duty itself).

61 In essence these premises are a half-way point in the distribution chain between the producer and final consumer. The warehouse may receive excisable goods free of duty, then account for duty when released for consumption.

This has been a feature of the Single European Market since its inception and the difficulties for the UK customs authorities to prevent this type of tax avoidance are well-documented – with the purchase of alcohol and tobacco products on the Continent,[62] and with the purchase of road fuel in Eire by motorists from Northern Ireland.[63] The Calman Commission's 'Independent Expert Group' ruled out the devolution of excise duties for just these reasons in its final report:

> Differing rates of excise duty create incentives for tax avoidance and economically distorting behaviours, perhaps most easily conceptualised at the margin - in this case the borders between Scotland and the rest of the UK. Here consumers could readily obtain goods from whichever jurisdiction offered the lowest excise rates, demonstrating that the tax base – the individuals purchasing alcohol and tobacco – is mobile.
>
> Such practices applying to existing cross border activity are widely recognised. HMRC estimate that tax avoidance in spirits and tobacco products from cross border shopping from outwith the UK corresponds to 4% of the UK market in spirits (that is, alcohol excluding wines, beers and fortified wines) and 8% of the UK market in cigarettes.[64] These figures relate to legitimate activity by consumers responding to differing excise duties across international borders within a free trade area.
>
> Whilst the mobility of consumers facilitates tax avoidance, a further dimension is the growth of internet shopping which further enhances the scope for avoiding, and possibly, evading such duties. The increasing prevalence of enterprises offering internet sales of (most frequently) alcohol across the UK from one operational base demonstrates how differing excise rates across a free market might create a further administrative burden and also an economic inefficiency. Beyond the internet, these effects will also impact upon those retailers and distributors operating across the UK (such as the retail multiples) who will then have to develop systems to both charge and pay differing excise rates, as well as control their stocks accordingly.[65]

The SNP election manifesto had suggested that powers to set duty rates should be devolved *because* the current regime discriminates against Scotch whisky. Certainly it is a long-standing aspect of the duty regime that spirits are charged higher duties than beer or lager. In a review of alcohol taxation published in November 2010 the Government noted that the case for cutting, or raising, the rate of duty on whisky was not clear. On the one hand, there was evidence that spirits consumption is strongly linked with problem drinking, although it also forms a significant proportion of responsible alcohol consumption. Similarly, although the amount of duty paid on whisky is higher – when one looks at the amount paid per unit of alcohol – taxing all drinks on alcohol content alone would mean significant changes to the current rates of duty, with large increases in duty on beer and cider, penalising responsible drinkers with no guarantee this would reduce problem drinking.[66]

On 13 June 2011 the Secretary of State, Michael Moore, announced a number of changes to the financial provisions of the Bill and the wider funding arrangements.[67] The Minister did not

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62 See, for example, Treasury Committee, *Fourth report: Excise duty fraud*, 15 March 2005 HC126 2004-05

63 See, for example, Northern Ireland Committee, *First Report: The Impact in Northern Ireland of Cross-Border Road Fuel Price Differentials: Three Years On*, 21 January 2003 HC 271 2002-03

64 HMRC (2008): "Measuring Indirect Tax Gaps - 2008"

65 Independent Expert Group, *Final Report - the consultation response*, 15 June 2009 paras 5.3-5

66 HM Treasury, *Review of alcohol taxation*, November 2010 (see para 3.9-11, 3.18-22)

67 HC Deb 13 June 2011 cc 55-6WS

announce any greater powers for the Scottish Parliament to set taxes, but stated that the Government would study any further proposals "based on robust evidence on how these … would benefit both Scotland and the rest of the UK."[68] For its part the Scottish Government indicated it would publish detailed proposals on how corporation tax and excise duties should be devolved.[69]

The Government tabled a number of new clauses and amendments to the Bill to give effect to these changes, and these were approved without amendment when the Bill completed its report stage and third reading in the Commons on 21 June.[70] On this occasion the SNP tabled new clauses and amendments to allow for both corporation tax and alcohol duties to be devolved: Stewart Hosie MP argued that corporation tax was a "key mechanism" for the Scottish Government to promote economic growth, and that having control over alcohol duties would enable it to reduce "excessive consumption of alcohol" and "offer greater protection to the competitive position of Scotch whisky"; an extract from his speech is reproduced below:

> We believe that a centralised and uniform corporation tax structure disadvantages nations such as Scotland to the benefit of London and the south-east of England. To say that is not to be anti-London or anti-south-east; it is just to say that when businesses reach a certain size, they tend, other things being equal, to be attracted to the largest conurbations. In the UK, that of course means London … We believe that the full devolution of corporation tax with an appropriate reduction in the block grant, which covers the Azores issue, would provide the Scottish Government with a new lever to promote growth and jobs …
>
> Devolving responsibility for excise duty to Scotland would help to ensure that the tax system for alcohol consumption was consistent with the alcohol policy of the Scottish Government and equipped to tackle one of the greatest health and social challenges facing Scotland … The devolution of alcohol excise duties would also enable the Scottish Government to implement a revised alcohol duty structure to offer greater protection to the competitive position of Scotch whisky, something we have tried to do on several occasions in a number of past Finance Bills.[71]

In opposing these changes the then Exchequer Secretary, David Gauke, noted the reasons why the Calman Commission had rejected devolving either tax:

> Calman concluded that the potential administrative impact of devolving either tax would be significant. The creation of compliance costs for businesses operating on either side of the border, as well as the increased collection costs for the Government, would be undesirable, especially in the present economic climate. The risks of tax avoidance and arbitrage could also be increased, with additional costs to the Government and the UK Exchequer. These arguments apply to both corporation tax and alcohol duties.[72]

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68 Scotland Office press notice, *UK Government announces Scotland Bill changes*, 13 June 2011

69 Scottish Government press notice, *Scotland Bill*, 13 June 2011. The Secretary of State raised concerns over the limited amount of detail to the Scottish Government's proposals some days earlier (Scotland Office press notice, *Moore hopes for more detail on Scotland Bill requests*, 7 June 2011).

70 HC Deb 21 June 2011 cc222-281

71 HC Deb 21 June 2011 c239, c237, cc242-3

72 *op.cit.* c231

The Minister went on to argue that the behavioural responses to a lower rate of tax in Scotland were likely to be considerable, and in turn, this could have a significant impact on the Scottish Government's finances:

> Calman also noted that if comparable levels of public services were to be maintained, the scope for substantive reductions in the rate of corporation tax in Scotland would be limited, unless the Scottish Government were willing significantly to increase revenues from other sources, such as income tax. The figures involved could be significant.
>
> For instance, if we take the Scottish Government's estimate of the corporation tax base, published in their "Government Expenditure and Revenue Scotland" report, and apply the methodologies developed for the Government's paper on rebalancing the Northern Ireland economy, the cost of reducing Scottish corporation tax to 12.5%—the current rate in the Republic of Ireland—would be just over £2 billion. However, the Scottish economy is very different, not least in the presence of many large multinationals, particularly from the financial sector, whose current activity is unlikely to be adequately covered in the gross value added estimate, but whose profits are additionally likely to be attributable to Scotland with regard to corporation tax.
>
> Provisional HMRC analysis has indicated that losing payments from large Scottish-domiciled groups could add £600 million to the direct costs. Such tax cuts would have to be funded, either by significantly reduced levels of public spending in Scotland or by tax rises in other areas. It is worth noting that these are initial estimates, and are likely significantly to underestimate the scope for profit shifting to Scotland. The model uses similar assumptions to those applied to the costing for Northern Ireland. However, given the geographic proximity of England and Scotland, the integrated infrastructure, the large number of big GB-owned groups with a substantive presence on both sides of the border, and the relatively large and complex nature of the Scottish economy, there are likely to be greater opportunities for groups to shift profits there than may be the case for Northern Ireland.
>
> In addition, corporation tax is a very volatile tax, and would create much more revenue risk for the Scottish budget. For instance, corporate tax receipts fell by 16% from 2008-09 to 2009-10, while income tax receipts fell by 5%. Such a large volatile income stream would place great risk on the Scottish budget. Income tax, which is more predictable and less volatile, is a much more suitable candidate for devolution.[73]

Ann McKechin MP also opposed devolving these taxes, in part because the SNP had said very little in concrete terms about what changes they would make:

> The Scottish Government are advocating a cut in taxes for banks but not for small businesses that do not pay corporation tax. Many employers in the private sector who employ many people do not pay corporation tax, but income tax. Substantially reducing corporation tax would lead to a large cut in public expenditure or increase the burden on income tax payers … The Scottish Government have had many weeks to produce detailed analysis. They have complained that things have been rushed and that we have not had figures from the UK Government on a variety of issues throughout the passage of this Bill, yet they cannot produce the detailed evidence and analysis that would allow people in Scotland to judge whether their calls have validity.[74]

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[73] HC Deb 21 June 2011 c232. More details of the methodology to this £2.6 billion estimate are given in, *Letter dated 13/07/2011 from David Gauke MP to Stewart Hosie MP regarding the costs of reducing corporation tax in Scotland*, Commons Library Deposited paper Dep2011-1292, 20 July 2011. See also, HC Deb 10 June 2013 c29W.

[74] HC Deb 21 June 2011 c255, cc256-7

Ms McKechin also raised concerns about how a devolved duty on alcohol would work:

> The Finance Minister in the Scottish Government, John Swinney, was questioned about the proposals on the BBC "Politics Show" on 22 May. He was asked … how the proposal to devolve excise duty in Scotland would work in practice and what steps would be required to stop the inevitable cross-border traffic if alcohol were suddenly cheaper in Carlisle than in Gretna. It was also pointed out to him that tax is collected not at the point of sale but when it leaves the excise warehouse. Given not only that all Scotch whisky comes from Scotland, but that Scotland accounts for 75% of the UK's gin and vodka production—indeed, Diageo in Fife produces all the Gordon's gin and Smirnoff vodka that one may see in shops throughout the UK—there are serious questions about how the proposal would work, the cost of administration and how tax avoidance and evasion would be tackled.[75]

At the close of the debate the House voted on the new clause to devolve corporation tax, and rejected it by 382 votes to 9.[76]

4.3 Further discussion of devolving taxes

To support its case for the devolution of corporation tax and alcohol duties the Scottish Government published two discussion papers in August and October 2011. In the first of these papers, the Government noted that using a reduction in corporation tax to boost the Scottish economy would pose a funding shortfall for the Scottish Parliament in the short term:

> The Scottish Government is seeking responsibility of corporation tax, with an equivalent reduction from the block grant. Therefore the net effect to the UK Exchequer would be zero … At first glance, cutting corporation tax could be seen to lead to an immediate reduction in revenues collected in Scotland. If such a position was adopted, then decisions regarding budgetary priorities would be needed. However, experience has shown that, particularly over the medium to long-term, a more competitive corporation tax strategy may not necessarily imply lower revenues.
>
> This is because cutting the headline rate of corporation tax has two effects on total revenues. Firstly, setting a lower rate reduces the amount of tax collected on existing profits. Secondly, by stimulating economic activity, the tax base upon which the lower rate is levied can expand, thus acting to increase revenues. This effect can be even more significant once consideration is given to the potential increase in other revenues that may also occur.
>
> A number of countries have attempted to mitigate any short-term impact on tax revenues through a number of avenues. One option has been to pre-announce a future tax cut with the aim of stimulating investment and enterprise in advance of the actual cut in the rate. Another option, and one adopted by the current UK Government, has been to stagger any reduction in the tax rate to balance any short-term fiscal costs with more medium term improvements in the tax base.[77]

The paper acknowledged the risk from companies exploiting a differential rate to avoid tax:

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75 *op.cit.* c259
76 *op.cit.* c277
77 Scottish Government, *Corporation Tax: Options for Reform*, August 2011 p19

> Another key issue is the need to ensure multinational companies do not engage in shifting their profits from one jurisdiction to another to simply avoid paying tax. This is neither fair or desirable. That is why the Scottish Government is committed to establishing a fair and transparent corporate tax system which attracts and retains genuine economic activity in Scotland. In practice, significant institutional and accounting rules already exist both within the UK and internationally to ensure that this does not happen.[78]

The Government invited views on the best way in which to reform a devolved tax to boost growth; on the potential value of cutting the main rate of tax, it made the following comments:

> A lower headline corporation tax rate could … act as a greater incentive for Scots to start up their own business and provide Scottish firms with a competitive edge to help them grow into larger and more successful companies. Furthermore, firms would have greater profits to re-invest within their business which could act to strengthen Scotland's corporate sector. In addition … a lower headline rate of corporation tax could encourage foreign businesses to invest in Scotland.[79]

It also suggested that there was a case for a differential rate as "a unified UK rate of corporate tax is neither desirable nor economically efficient":

> The current system means that a company based in Stornoway pays the same headline corporation tax rate as a company based in London. Given the competitive advantages of London relative to other parts of the UK (such as London's position as one of the largest financial centres in the world, and its transport links with major cities worldwide etc) there is clear evidence that London (and indeed the South East of England) already has an in-built competitive advantage over not only Scotland but also other parts of the UK.[80]

The Scottish Government reiterated its case in a shorter paper published the next month in which it also suggested that pre-announcing a cut in the headline rate equivalent to a cut from 23% to 20% would increase Scottish GDP by 1.4% after 20 years.[81]

In October the Scottish Government set out the case for the *Scotland Bill* to be amended, to allow for the apportionment of alcohol duties as part of the Scottish Parliament's funding allocation – reflecting the fact that alcohol consumption is higher in Scotland than in other parts of the UK. The paper went on to argue that setting a separate duty regime would be something the Government would pursue under independence:

> Under our proposal, there will be an appropriate per-capita adjustment to the Scottish Budget, with all alcohol duty revenues collected in Scotland now allocated to the Scottish Budget. This would more closely align the 'revenue benefit' with the 'public spending cost' from alcohol consumption, thus providing a financial framework that is more efficient and equitable. Furthermore, it would not only enhance the financial responsibility of the Scottish Government, but would have the advantage of providing a new source of a relatively stable tax revenue to counteract the flaws in other aspects of the Scotland Bill tax proposals …

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78 *op.cit.* p19
79 *op.cit.* p33
80 *op.cit.* p34
81 Scottish Government, *Devolving Corporation Tax in the Scotland Bill*, September 2011 p1

> Under independence the Scottish Government would set the most appropriate excise duty regime for Scotland. Therefore, alongside our Minimum Pricing policy, it would provide us with an additional and complementary tool to rebalance Scotland's relationship with alcohol … In principle, the Scottish Government favours a regime that more closely aligns tax rates with alcohol content; that is, duty is levied according to the number of units of alcohol contained within a product. Such a system would provide greater transparency and clarity for consumers, help promote individual responsibility and establish a fairer regime for industry.[82]

Following the elections to the Scottish Parliament in May 2011, a new Committee was established to consider the *Scotland Bill* in its amended form, with a view to complete a report by the end of 2011. On 27 September the Committee took evidence from Mr Gauke, and when asked about the Scottish Government's proposals regarding corporation tax, he said the following:

> There have been a couple of papers on corporation tax but, frankly, they are inadequate as an assessment of the impact of the devolution of corporation tax to Scotland. They do not address some of the fundamental questions … There is nothing on tax-motivated incorporation and there is no assessment of profit shifting. There is no recognition that if Scotland were to have power over corporation tax and it were to be cut, that would involve a reduction in the block grant. We currently have papers for advocacy purposes rather than as an open, straightforward and honest assessment of the pros and cons of devolving corporation tax to Scotland. That is a great pity and it is disappointing that the Scottish Government's focus has been on issues such as corporation tax rather than on the bread-and-butter issues of, for example, implementing devolution of SDLT and landfill tax.[83]

As part of its 'Green Budget' published in February 2012 the Institute for Fiscal Studies looked at the possible implications of the devolution of corporation tax.[84] Notably the authors underlined some of the obstacles to making an assessment of how a regional cut in corporation tax might affect private sector investment in one part of the UK:

> There is a body of academic literature that estimates [the elasticity of investment with respect to the corporate tax burden – that is, the percentage change in investment for a percentage fall in the effective tax rate] … but these tend to be for a specific type of activity (for example, manufacturing activity) in a specific country (often the US). It is difficult to extrapolate these results to other countries (and even more difficult to use them for nations within countries). In particular, there are many factors that affect whether a firm will invest in a country and, if so, how much it will invest, including the skills base, infrastructure and regulatory environment. These factors (which are implicitly captured in elasticities) will differ greatly across countries (and within countries across nations).[85]

The authors went on to note the substantial risks to tax revenues from behavioural changes, as businesses sought to exploit disparities in tax rates by incorporating or profit shifting. When taken together with the administrative costs to devolved taxes, and the uncertain impact on block funding, "implementing devolution would at best be a calculated risk, with unknown long-term consequences for the UK tax system":

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82 Scottish Government, *Devolving Excise Duty in the Scotland Bill*, October 2011 pp8-10

83 Scotland Bill Committee, *Official report (Session 4)*, 27 September 2011 c296

84 Institute for Fiscal Studies, *The IFS Green Budget 2012*, February 2012 pp 207-218. This section of the report appears in in "Chapter 10: Corporate tax setting".

85 *op.cit.* pp 211-12

> The key aim of allowing the devolved administrations to set lower rates of corporation tax is to boost private sector investment, and therefore jobs and growth. We do not know a priori how large an effect a corporate tax rate cut would have on investment in each nation. As a result, it is hard to judge whether the benefits from greater levels of activity would be sufficient to outweigh substantial reductions in (and increased risk to) the devolved administrations' revenues. Importantly, any reductions in revenues would need to be matched with public spending cuts.
>
> Implementing such a policy move would be difficult, and likely require a number of years of transition. A key decision would be how to adjust appropriately the block grant from Westminster. An increase in complexity and compliance costs is guaranteed. There are some compelling reasons to maintain a single rate of corporation tax across the UK: it is administratively much simpler (and cheaper) and reduces the potential for harmful tax competition, which could reduce the revenues of all administrations within the UK.[86]

4.4 Final stages of the *Scotland Bill*

As anticipated the Scotland Bill Committee completed its report in December 2011, in which it argued for a series of changes to the Bill, similar to those proposed by the Scottish Government – including the devolution of several taxes and an extension in the Parliament's power over setting income tax rates for Scottish taxpayers.[87] On the financial provisions in the Bill the Committee took the view that they were "inadequate and will not significantly enhance Scotland's longer term economic performance and delivery of social and environmental objectives." In particular the legislation lacked enough 'economic teeth', and key to this was the "failure to devolve corporation tax":

> The Committee recommends that all powers associated with corporation tax are devolved to Scotland. This would include the ability to set the rate, decide on reliefs, allowances etc. In short, devolve the totality of corporation tax to the Scottish Parliament. This will provide Scotland with the ability to decide itself how to use this lever as a tool for greater economic growth. We do note, however, that the costs of any implementation of a devolved regime must be worked out by the Scottish Government and minimised. The Committee also accepts that volatility is an issue but stresses that the argument of corporation tax as part of a wider basket of taxes minimises this concern. It should also be noted that, in absolute terms, corporation tax is less volatile than income tax.[88]

As happened with the Bill Committee in the previous Session, a small number of Members published a minority report which disagreed with the majority's position on tax powers; on the devolution of corporation tax, for example, they argued that the risks from distorting business behaviour had been ignored in the majority's endorsement of a lower Scottish corporate rate: "cutting the rate of corporation tax and devolving it are not the same thing … there is … no dispute that reducing corporation tax can be used to encourage investment; nor that an independent Scotland would have to take its own tax decisions. The question is whether a system for devolving corporation tax within the UK can be designed without unacceptable

86 *op.cit.* p218

87 Scotland Bill Committee, *Report on the Scotland Bill*, 1st report 2011 (session 4), SP Paper 49, SB/S4/11/R1, 15 December 2011. For more details see, *Scotland Bill : latest developments*, Library standard note SN6185, 26 January 2012.

88 SP Paper 49 vol 1 paras 37, 62-64

distorting effects of the sort that concerned the Calman Commission and the previous Scotland Bill Committee."[89]

The Committee also argued that the Bill should be amended to devolve both air passenger duty and the aggregates levy, and that the receipts from alcohol duties within Scotland should be assigned to the Scottish Government:

> The Committee is disappointed that the UK Government did not include the devolution of air passenger duty and the aggregates levy in the initial Bill as per the recommendations of the Calman Commission. The Committee has received evidence citing frustrations with the way in which the UK Government sets these taxes. We see a strong case for devolving air passenger duty and the aggregates levy to the Scottish Parliament and would see this as an opportunity for the Scottish Government to reform these taxes so that they are more effective environmental taxes and fairer on the industries on which they are levied. We recommend these changes to the UK Government …
>
> The Committee recognises that Scotland has a significant problem relating to alcohol misuse with negative impacts on the devolved areas of health, social welfare and public order. We are concerned that whilst it is the UK Government that benefits from the extra revenues per capita that are raised in Scotland it is the Scottish Government that bears most of the cost of alcohol abuse. The Committee recommends that the revenues from excise duties on alcohol consumed in Scotland are assigned to the Scottish Parliament]. As alcohol misuse and duty revenues are more closely related to consumption, the Committee recommends using consumption as the basis to assign revenues to the Scottish Government. [90]

Without these and other changes, the Committee recommended that the Scottish Parliament should not give legislative consent to the Bill.

The Bill proceeded to the House of Lords, and during its scrutiny negotiations continued between the UK Government and the Scottish Government. On 21 March 2012 the UK Government announced a number of changes to the Bill that the two authorities had agreed, and the Scottish Government submitted a memorandum to the Scottish Parliament, so that it might give its consent to the amended Bill.[91] The Scottish Parliament approved the legislative consent motion on 18 April.[92] Some relatively minor changes were proposed regarding the way in which tax powers would be transferred, and possible future devolution; specifically,

- The Bill would be amended to require the Secretary of State for Scotland and Scottish Ministers to produce annual reports to the UK and Scottish Parliaments on the progress of transferring the tax and borrowing powers to the Scottish Government.

- Although the Scottish Government will pay for their new income tax system of administration, the UK Government would "explore the scope to offset some of the savings from HMRC ceasing its administration of stamp duty land tax and landfill tax."

89 SP Paper 49 vol 2, Annex A

90 SP Paper 49 vol 1 paras 57-61

91 In turn the Scotland Bill Committee reversed its previous recommendation to the Parliament: *Report on the Scotland Bill*, 1st report 2012 (session 4), SP Paper 106, SB/S4/12/R1, 27 March 2012.

92 SP OR 18 April 2012 cc8074-8128

- Aggregates Levy would be devolved "once the legal challenges in the European and UK courts have been fully resolved."

- The Government confirmed that it was "open to considering what further powers might be devolved after a referendum on independence."[93]

Subsequently a series of amendments were made to the Bill at Report and Third Reading in the Lords,[94] and the Bill received Royal Assent on 1 May 2012.[95]

5 Implementation of devolved tax powers

5.1 The Scottish rate of income tax

The Scottish rate has implications for particular aspects of the income tax system, for example Gift Aid and pensions tax relief. Following consultation, in May 2012 HMRC published a technical note on the Government's policy intentions in areas where the rate setting power would interact with other areas of the income tax system.[96] Statutory provision was made for these changes by s296 and schedule 38 of the *Finance Act 2014*.[97]

The *Finance Act 2014* also included provision regarding oversight of HMRC's administration of the Scottish rate. The Command Paper accompanying the *Scotland Bill* had indicated that the Scottish Parliament would "receive a report on the administration of the Scottish income tax receipts, as part of the NAO's annual report on HMRC's overall performance."[98] In the 2013 Budget the Government stated that, to clarify the legal basis for this arrangement, it would introduce legislation to require the NAO to submit an annual report on this issue to the Scottish Parliament.[99] Both these provisions were agreed without debate during the Committee stage of the *Finance Bill 2014*.[100]

In February 2013 the Scottish Government and HMRC agreed a memorandum on their respective responsibilities in establishing and operating the Scottish rate, which included an annual timetable for setting the rate of tax, notifying taxpayers and employers, and collecting receipts.[101]

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93 HC Deb 21 March 2012 cc61-4WS

94 For further details see, see, *Scotland Bill: amendments in the House of Lords*, Library standard note SN6302, 27 April 2012. The new clause requiring annual reports on the transference of tax and borrowing powers was agreed on 28 March (HL Deb cc1508-11), and forms s33 of the 2012 Act.

95 HMRC issued a short brief on the Act at this time: *Devolved taxation in Scotland*, 2 May 2012. More recently it has published, *Scotland Act 2012 guidance*, 19 January 2015

96 Apparently "respondents to this Note were content with the proposed way forward" (Scotland Office, *First Annual Report on the Implementation and Operation of Part 3 (Financial Provisions) of the Scotland Act 2012*, April 2013 para 13).

97 For details see, HMRC, *Clarifying the scope of the Scottish rate of income tax*, May 2012

98 Cm 7973, November 2010 p41

99 *Budget 2013*, HC1033, March 2013 para 2.39. see also, HMRC, *National Audit Office reporting requirements to the Scottish Parliament – tax information & impact note*, December 2013. Section 297 of the *Finance Act 2014* amends the *Scotland Act 1998*, to this effect.

100 Public Bill Committee (*Finance Bill*), *14th Sitting*, 17 June 2014 c537

101 Scottish Government and HMRC, *Memorandum of Understanding on the Scottish Rate of Income Tax*, February 2013 p12 (Appendix B). Non SRIT specific items reflect the general timetable for income tax.

Timing	Activity
By 30 November before tax year	Scottish Government provides information to HMRC about the proposed Scottish rate for the coming tax year
January before tax year	HMRC issues PAYE coding notices to Scottish taxpayers based on Scottish Taxpayer (ST) indicator
Before tax year	SG lodges Scottish rate motion before the Scottish Parliament in time for Scottish rate resolution to be passed by 5 April.
During the tax year	Employers make PAYE returns and payments in respect of Scottish taxpayers
	HMRC updates systems with data from employers
	Scottish block is based on OBR forecast of Scottish income tax; SG draws down funding from block
	HMRC employer compliance
	HMRC updates ST indicator as appropriate
At the end of the tax year	HMRC issues Self Assessment (SA) returns
31 October after tax year	Taxpayer deadline for manual SA returns
31 January after tax year	Taxpayer deadline for online SA returns
February onwards after tax year	HMRC taxpayer compliance
Till 12 months after tax year	Reconciliation of SRIT element in Scottish block by reference to actual income tax liability declared

In March 2012 the Office for Budget Responsibility (OBR) assumed responsibility for publishing regular forecasts of Scottish taxes; in a note on its methodology, the OBR observed:

> In the run up to the devolution of Scottish income tax, HMRC will identify each individual taxpayer as Scottish or not and flag them appropriately on their PAYE and SA administrative systems. Once this has been done, it will be possible to determine the Scottish share of UK income tax with a high level of precision. In the meantime, the main source of information on the Scottish share of income tax is the Survey of Personal Incomes (SPI), an annual HMRC survey based on a sample of 600,000 individuals drawn from their PAYE, SA and Claims systems. The SPI is available only with a long time lag with the 2009-10 SPI released on 29 February 2012.[102]

In March 2014 the OBR published updated forecasts, alongside the Budget report; in this, it gave estimates of the Scottish share of income tax receipts, and its forecast for tax liabilities from the Scottish rate:

> **Scottish share**
> 1.11 The Scottish share of income tax liabilities is currently based on the Survey of Personal Incomes (SPI), an annual HMRC survey based on a large sample of individuals drawn from HMRC's PAYE, SA and claims systems. This is only available with a long lag. In the run up to the devolution of income tax, HMRC will be able to identify each individual taxpayer as Scottish or not and flag them appropriately on their PAYE and SA systems. Once this has been done, it will be possible to determine the Scottish share of UK liabilities with a high level of precision.

[102] OBR, *Forecasting Scottish taxes*, March 2012 p10

1.12 The 2011-12 SPI was published in January 2014 and suggests that the Scottish share was 3.08 per cent in 2011-12. This was higher than the 3.03 per cent assumed for the Scottish share in 2011-12 in our December forecast, but down from 3.15 per cent in 2010-11. Movements in the Scottish share can be due to the effect of different Scottish economic trends or policy measures that have different exchequer effects in Scotland and the UK as a whole. We have not adjusted the Scottish share for different Scottish economic trends but have made adjustments for the asymmetric effect of policy measures.

1.13 Scotland has a lower proportion of higher and additional rate taxpayers than the UK as a whole. In recent years, revenue-raising policies have generally targeted the top end of the income distribution such as the additional rate of income tax for incomes over £150,000, the withdrawal of personal allowances above £100,000, freezes in the basic rate limit and higher rate tax threshold and anti-avoidance measures. In contrast, tax reductions such as raising the personal allowance to £10,500 from 2015-16 would have a larger proportional effect on Scotland. Both of these effects would lower the Scottish share.

1.14 UK liabilities for both PAYE and SA have been affected by forestalling activity related to the additional rate of income tax. The introduction of the 50p rate prompted high-income earners to bring forward income to minimise tax, while the reduction to 45p led to shifting income forward for the same reason. We have allowed for an effect on the Scottish share from this forestalling behaviour. With a smaller proportion of additional rate taxpayers in Scotland, such behaviour will affect the Scottish share.

1.15 Table 1.2 shows our latest estimates of the Scottish share of income tax. The effect of the higher 2011-12 share persists through the forecast.

Table 1.2: Scottish share of income tax

	Fiscal Year; per cent							
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
December 2013	3.03	3.01	2.88	2.88	2.87	2.87	2.87	2.87
March 2014	3.08	3.05	2.92	2.92	2.92	2.92	2.92	2.92

Sources: HMRC, OBR

Forecast of Scottish income tax liabilities from Scottish rate

1.16 Table 1.3 provides a forecast for Scottish income tax liabilities on non-savings, non-dividend income. As noted earlier, these are income tax liabilities specifically for the Scottish rate. Prior to a decision in the Scottish Parliament on the new Scottish income tax rate for the 2016-17 tax year, the forecast assumes that a 10p Scottish rate would be levied.

Table 1.3: Scottish income tax forecast

	£ million							
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Scottish income tax liabilities (pre-measures)	4,331	4,299	4,267	4,437	4,713	5,010	5,326	5,637
Budget 2014 measures	0	0	4	11	-45	-37	-40	-30
Scottish income tax liabilities (post-measures)	4,331	4,299	4,271	4,449	4,668	4,974	5,286	5,607

Sources: HMRC, OBR [103]

[103] OBR, *Economic and fiscal outlook: Scottish tax forecasts*, March 2014 pp55-6

As noted, both Governments are required to publish annual reports on implementing the financial provisions of the *Scotland Act 2012*. The first reports were issued in April 2013. Initial estimates for the cost of implementing the Scottish rate were £40-£45m, with annual running costs of £4.2m thereafter.[104] In October 2013 the Scottish Parliament Finance Committee reviewed this work, noting that HMRC officials expected the set up costs to be significantly less,[105] and most recent estimates are in the range £35-£40m.[106]

The Treasury Committee is in the course of conducting an inquiry into the proposals for further fiscal and economic devolution in Scotland. In November 2014 the Committee took evidence from Edward Troup & Sarah Walker from HMRC (Second Permanent Secretary and Deputy Director, Devolution, respectively). In answer to questions to Steve Baker, Ms Walker gave figures for the projected administrative costs for the Scottish rate:

> **Sarah Walker**: [£1,018,713 was] … the cost in 2013/14 … Because the income tax is not being introduced until 2016, we are still at a very early stage, so we are only doing the planning work. There will be substantial additional expenditure this year and next year. The estimate for the total cost of introducing the Scottish rate of income tax is between £35 million and £40 million.
>
> **Steve Baker:** Over what period?
>
> **Sarah Walker**: Between 2012/13 and probably about 2017/18 I think will be the last of the major spending.[107]

Mr Troup was asked about the application of the statutory test for a Scottish taxpayer, and the numbers who would be affected:

> **Jesse Norman:** You are not concerned about some of the worries that have been raised about the definition of what a taxpayer is within the criteria you have set out?
>
> **Edward Troup**: The criterion, as you know, cascade from the definition of a UK taxpayer and then go to the question of whether you have a place of residence in the UK, and if you do, whether it is in England and Scotland. That will be determinative for the majority of UK residents, because they only have one home. For those who have two homes, then you ask a question about principal residence. Again, in the vast majority of cases, that is likely to be determinatively straightforward. There will be a small number of cases where the question of principal residence is unclear or changes during the year. There are mechanical tests about day counting that can be applied, and I do not think anybody has raised any technical difficulties with that. Obviously, we will have to deal with the administration of that, but we deal with the administration of residents and non-residents all the time because people come and go from the UK …
>
> **Jesse Norman:** How many people move back and forth between Scotland and England every year?
>
> **Edward Troup**: About 40,000 a year is the current estimate.
>
> **Jesse Norman:** How many people have dual residencies that might be caught or that may want to dodge the system by changing their residence?

---

[104] Scotland Office, *First Annual Report* & Scottish Government, *First Annual Report*, April 2013.

[105] Finance Committee, *8th Report, 2013 (Session 4)*, SP Paper 407, 11 October 2013 para 50

[106] Scotland Office, *Second Annual Report*, May 2014 para 17. see also, Scottish Government, *Second Annual Report*, April 2014

[107] Treasury Committee, *Oral evidence: Proposals For Further Fiscal and Economic Devolution to Scotland*, HC 760, 4 November 2014 p27, Qs203-4

> **Edward Troup**: There are two questions. We do not know yet. I do not think we have any estimates of those with dual residence. That will come out of the exercise that we are starting in October 2015 to start identifying Scottish residents. How many people will try to dodge? Nobody will try to dodge it until there is a differential in rate that makes it worth doing. If the Scottish rate moves to 11 pence or 9 pence from the initial 10 pence whether it would have a significant incentive remains to be seen, but I would have thought it was fairly unlikely …
>
> [On the numbers of taxpayers who might have to count their days of residence] there are something like 2 million Scottish taxpayers. I think I would say with some confidence that we would be looking at tens of thousands or a couple of tens of thousands at the most. As I say, I have not done the work and I do not want to be dismissive, because that is a significant number of people, but within the context of the 45 million taxpayers and filers we have, it is a small issue for us to manage.[108]

Ms Walker went on to give details as to how HMRC would contact Scottish taxpayers:

> **Steve Baker:** [One] issue on resources is what is HMRC doing to tell people living in the rest of the UK that they may be Scottish taxpayers, and those that may be Scottish taxpayers that they might have an obligation to count the days?
>
> **Sarah Walker**: What we are planning to do is around about this time next year, so next autumn, we will identify from our own records and from any other databases we can use obviously people who we think are resident in Scotland and we will write to them directly, but we will also be doing general publicity in Scotland so that anybody who does not get a letter from us but is living in Scotland is encouraged to contact us and tell us their status … The vast majority of those will not need to count days and they will not need to worry about that. If you live in England or Wales or Northern Ireland, it will not be an issue. The day counting may apply to people who come from abroad to spend a limited amount of time in the UK and then move between England and Scotland or other parts of the UK. In those cases, they will probably be getting advice anyway on their tax status and we would expect that to be coming through their advisers.[109]

5.2 Taxes on land transactions and landfill

Following the passage of the *Scotland Bill*, in June 2012 Finance Secretary John Swinney set out details of how the Scottish Government would implement its powers, and in particular, what its approach would be in the design of devolved taxes:

> The entire approach the Government takes and intends to take on taxation [is] … firmly founded on principles, Scottish principles, that have stood the test of time. Adam Smith in 1776 in his "Inquiry into the nature and causes of the Wealth of Nations", set out four maxims with regard to taxes; the burden proportionate to the ability to pay, certainty, convenience and efficiency of collection. Smith's maxims allow us to build a system that will meet the needs of a modern, twenty-first century Scotland, grounded on solid foundations. To those four principles this government will add our core purpose of delivering sustainable economic growth for Scotland and meeting the distinctive needs of Scotland.

108 *op.cit.* pp23-4, p26, Qs187-8, Q197
109 *op.cit.* p27, Qs205-6

The Minister went on to announce consultation exercises on the design of new taxes on land transactions and landfill, and in the case of the former, proposed that the structure of the tax would be different from UK stamp duty land tax:

> Our consultation signals our preference for a move from the UK's slab tax approach to a progressive system of taxation where the amount paid is more closely related to the value of the property and therefore to the ability of the individual to pay. At the same time our consultation also indicates a willingness to adjust the threshold at which taxation is levied in order to support those at the lowest end of the market.[110]

The following year the Scottish Government introduced legislation to establish a new Land and Buildings Transactions Tax, and a Scottish Landfill Tax, from April 2015.[111] Operational responsibility for these taxes is to given to Registers of Scotland (which manages the land registration process), and, the Scottish Environment Protection Agency, respectively, though the Government has also introduced legislation to establish Revenue Scotland – the tax authority responsible for the administration of all devolved taxes.[112]

The rates of each new tax were not set by this legislation. On 9 October 2014 the Scottish Government published its draft Budget for 2015/16.[113] In this it proposed that the new tax on land transactions would be charged on a 'slice' basis, as opposed to the way in which UK stamp duty land tax is levied:

> The Scottish Parliament has legislated to ensure that LBTT has a progressive rate structure, which means that the rates shown in the table above are marginal rates, payable on the portion of the total value which falls within each band. This contrasts with the slab structure of SDLT under which the higher tax rate is payable on the whole purchase price when a threshold is crossed.
>
> The progressive rate structure is intended to remove existing distortions in the housing market by smoothing the marginal rate of tax payable when prices cross a threshold between bands. The slab structure leads to 'bunching' of sale prices just below SDLT price thresholds and very few sales just above …
>
> We propose that the following rates and bands of LBTT will apply from 1 April 2015:

Table 2.01 Proposed Land and Buildings Transaction Tax rates from 1 April 2015

Residential transactions		Non-residential transactions		Non-residential leases	
	Rate		Rate		Rate
Up to £135,000	nil	Up to £150,000	nil	Up to £150,000	nil
£135,001 to £250,000	2.0%	£150,001 to £350,000	3.0%	Over £150,000	1.0%
£250,001 to £1,000,000	10.0%	Over £350,000	4.5%		
Over £1,000,000	12.0%				

110 Scottish Government press notice, *Speech by Finance Secretary John Swinney: The Scottish Government's Approach to Taxation*, 7 June 2012

111 Details of the passage of the *Land and Buildings Transactions Tax (Scotland) Act 2013*; and, the *Landfill Tax (Scotland) Act 2014* is given on the Scottish Parliament's site.

112 Under the *Revenue Scotland and Tax Powers Act 2014.* Further information on Revenue Scotland is on the Scottish Government's site.

113 Scottish Government press notice, *Building a fairer country*, 9 October 2014

> The proposed tax rates and bands for residential transactions will:
>
> - take 5,000 additional house purchases out of tax compared to SDLT by setting a nil rate threshold of £135,000 (£10,000 higher than the current SDLT nil rate threshold) so that no tax will be payable on 45 per cent of transactions;
> - reduce the tax charge relative to SDLT for a further 44,000 house purchases up to £325,000; and
> - ensure that 90 per cent of taxpayers are no worse off than under SDLT.
>
> … The proposed rates and bands for non-residential transactions would ensure that Scotland remains a competitive and attractive location for business, by:
>
> - maintaining a nil rate threshold of £150,000;
> - reducing the tax charge for the majority of transactions below £2,000,000, relative to SDLT; and
> - ensuring that 95 per cent of taxpayers are no worse off than under SDLT.
>
> Our proposed tax rates and bands for non-residential leases ensure parity between the taxing of lease transactions in Scotland and the rest of the United Kingdom.[114]

The Government also proposed that Scottish Landfill Tax would be levied at the same rates as UK Landfill Tax:

> We propose that the following rates of Scottish Landfill Tax will apply from 1 April 2015:
>
> **Table 2.02 – Proposed rates of Scottish Landfill Tax from 1 April 2015**
>
> | | |
> |---|---|
> | Standard rate* | £82.60 |
> | Lower rate* | £2.60 |
>
> *Rate payable per tonne of taxable waste
>
> The Cabinet Secretary for Finance, Employment and Sustainable Growth has previously confirmed that the rates of SLfT would be no lower than the prevailing UK rates. The rate proposals announced today match the planned UK Landfill Tax rates for 2015-16, as provided in the Finance Act 2014. These proposals will address concerns over potential 'waste tourism' were there to be a material differential between the rates of tax charged in Scotland and the rest of the United Kingdom. We also consider that these rates will provide appropriate financial incentives to support delivery of our ambitious waste targets, including our Zero Waste goal that no more than 5 per cent of total waste should go to landfill by 2025.[115]

In both cases the Scottish Government anticipated the impact of both new taxes would be revenue neutral.

However, on 21 January 2015 the Scottish Government announced that it would *change* the rates for LBTT on residential property, following reforms to stamp duty land tax made by the Chancellor, George Osborne, in his Autumn Statement on 3 December 2014.[116] In brief, Mr Osborne announced that from 4 December 2014 SDLT rates would also apply on a 'slice' basis: that is, to the part of a property's selling price that fell within each value band. New rates and thresholds would be introduced, to ensure that in removing these distortions from

[114] Scottish Government, *Scottish Budget: Draft Budget 2015/16*, October 2014 pp14-5. Details of the structure of UK stamp duty land tax are on HMRC's Statistics site. See also, "Better-off Scots feel the pain as 'ability to pay' is set at heart of property tax", *Financial Times*, 10 October 2014

[115] *Scottish Budget: Draft Budget 2015/16*, October 2014 p16

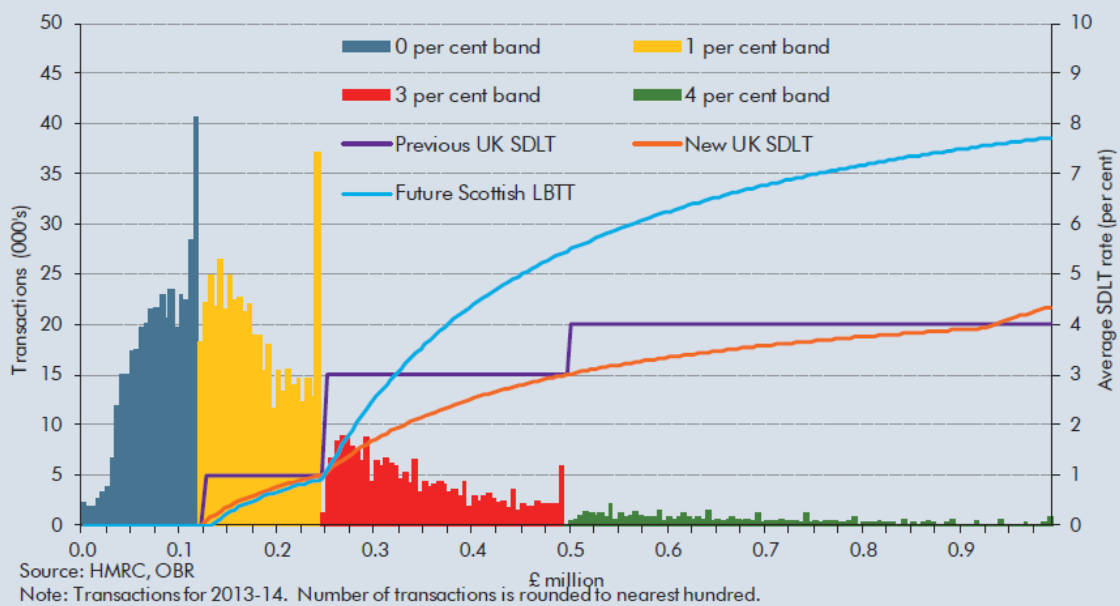
[116] Scottish Government press notice, *Land and Buildings Transaction Tax*, 21 January 2015

the way house sales are taxed, most house buyers will not have to pay more tax.[117] Tax rates and bands under the old UK system, the new UK system, and the original form of LBTT are shown below:[118]

Previous UK SDLT		New UK SDLT		Future Scottish LBTT	
Property value (£'s)	Rate on property value (Per cent)	Value between (£'s)	Marginal rate (Per cent)	Value between (£'s)	Marginal rate (Per cent)
£0-£125k	0	£0-£125k	0	£0-£135k	0
£125k-£250k	1	£125k-£250k	2	£135k-£250k	2
£250k-£500k	3	£250k-925k	5	£250k-£1m	10
£500k-£1m	4	£925k-£1.5m	10	£1m+	12
£1-2m	5	£1.5m+	12		
£2m+	7				

In their report accompanying the Autumn Statement, the OBR illustrated the impact of these reforms, noting that in 2013/14 most residential sales were below £250k:

Chart B: Average SDLT rates under different transaction tax schedules



Source: HMRC, OBR
Note: Transactions for 2013-14. Number of transactions is rounded to nearest hundred.

In turn, presenting the Scottish Government's budget for 2015/16 to the Scottish Parliament, Finance Minister John Swinney announced a revised rate structure for LBTT to apply from 1 April 2015:

> One consequence of the chancellor's announcement in December is that the amount of revenue that I need to raise to meet the commitment to revenue neutrality is lower than was anticipated at the time of the draft budget. As a result, I have chosen to review the rates and bands for residential land and buildings transaction tax … With effect from 1 April 2015, to provide further support for first-time buyers, the threshold for beginning to pay tax will be increased to £145,000, which will take 50 per cent of transactions, or another 5,000 homes, out of tax altogether.

[117] HC Deb 3 December 2014 c316. This reform is discussed in another Library note: *Stamp duty land tax on residential property*, SN7050, 14 January 2015.

[118] Office for Budget Responsibility, *Economic and fiscal outlook (EFO)*, Cm 8966, December 2014 pp124-5

> A marginal rate of 2 per cent will apply to transactions of between £145,000 and £250,000. To restore the benefit of my proposals to those who buy properties up to the value of £330,000, I will introduce an additional marginal rate of 5 per cent for transactions of between £250,000 and £325,000. For those between £325,000 and £750,000, the marginal rate will be 10 per cent. In order to ensure that we are able to provide benefits for those at the bottom of the market while retaining the principle of proportionality, the top marginal rate of 12 per cent will now affect all transactions above £750,000 …
>
> In October, I estimated that the taxes would bring in £558 million. The block grant adjustment has been agreed at £494 million, so the [cost of these rate changes] is the difference between those two numbers.
>
> I will bring orders before the Parliament to set the rates of land and buildings transaction tax that I have outlined, and I can confirm that I will bring forward orders to set the rates of non-residential land and buildings transaction tax and Scottish landfill tax at the rates that I announced back in October.[119]

In a press notice the Chartered Institute of Taxation suggested that this announcement showed that "political and economic competition across the border is now an increasingly visible fact of life":

> Changes to the rates and bands of Land and Buildings Transaction Tax announced today by the Scottish Government show how the UK tax environment is becoming increasingly dynamic and competitive …
>
> Moira Kelly, Chair of the CIOT's Scottish Technical Sub-committee, commented: "Today's announcement shows just how much changes in Holyrood and Westminster are feeding off each other. Political and economic competition across the border is now an increasingly visible fact of life. The Scottish Government got much praise when they announced the end of the 'slab system' … Westminster followed suit in December, sweetening the move with extra money to make 98% of home buyers winners. But that changed the dynamics in Scotland, creating many more potential losers under the changes compared to the rest of the UK, so Holyrood is responding with further changes of its own.
>
> "As further tax devolution takes effect we are likely to see more of this. Westminster will no doubt want to watch carefully to see what reaction changes made by the Scottish Government get, and what effect they have, while Holyrood will inevitably have to take account of any significant changes south of the border which change the relative competitiveness of the two tax systems ... The original proposal included a huge leap from 2% to 10%, and had only three rates. The introduction of an additional band with a 5% rate provides for more progression and differentiation, which is something we suggested to the Finance Committee in October."[120]

As part of its ongoing inquiry on Scottish devolution, mentioned above, on 20 January the Treasury Committee took evidence from the Chancellor and Sir Nicholas Macpherson, Permanent Secretary at the Treasury. On this occasion, David Ruffley asked Mr Osborne, "do you think the devolution of tax rates and bands is going to lead to tax competition?"

> **Mr Osborne:** Ultimately, it is a decision primarily for the Scottish Parliament and the Scottish Government whether they wish to pursue that or not. I think it is quite

[119] SP OR 21 January 2015 cc20-21

[120] CIOT press notice, *Scottish property taxes changes highlight move of dynamic tax environment*, 21 January 2015

> interesting that—if I may make an observation—off the back of the changes to stamp duty that we announced in the autumn statement the Scottish Government said that they would revisit their proposals on stamp duty. You could argue that that is a bit of tax competition in action.[121]

At a later stage in this session there as a discussion of the likely impact of devolving air passenger duty to the Scottish Government. Mike Kane asked the Permanent Secretary, "in terms of having such a different tax regime right next door, would we have to think about regearing APD? A revenue-neutral way forward would be holidays or turning it into a congestion tax":

> **Sir Nicholas Macpherson**: We keep all taxes under review. Personally, I think a bit of tax competition is quite healthy; obviously, it depends precisely on the area. Just as we have seen with the reforms on stamp duty, I think we will see a degree of iteration. If Scotland were to cut APD hugely, they will bear quite a big cost in the short run and will have to make good that cost, either through higher taxes elsewhere or through lower spending. I see this potentially as a bit of a laboratory where can we learn more about the effectiveness of tax and spending.[122]

[121] Treasury Committee, *Oral evidence: Proposals For Further Fiscal and Economic Devolution to Scotland*, HC 760, 20 January 2015 p8, Q248

[122] *op.cit.* p15, Q273