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More power to the
Scottish Parliament?



Given the agreement across the political spectrum, the Scottish Parliament will in the next few years have greater tax and fiscal powers than it does now. *James Aitken* looks at what is being proposed

We are now in the unique position that all of the main Scottish and UK political parties agree that greater tax and fiscal powers should be devolved to the Scottish Parliament. We also now have two separate proposals for taking things forward. The Scottish government, a minority Scottish National Party (SNP) administration, has its 'National Conversation', and the main opposition parties in the Parliament – Labour, Conservatives and Liberal Democrats – have their 'Commission on Scottish Devolution'.¹

In looking at what is being proposed, I shall review in particular the recommendations that the Commission on Scottish Devolution, better known as the 'Calman Commission', has made. I will also examine a recent European Court of Justice (ECJ) decision, which confirms that tax powers can be devolved to the Parliament if certain conditions are met.

Present taxation powers

So what taxation powers does the Scottish Parliament already have? Its powers are limited by the *Scotland Act 1998* to control over local authority taxes (currently council tax and business rates) and the ability to raise or lower the basic rate of income tax in Scotland by 3p in the pound.

The power to vary income tax has never been used, and the vast bulk of the Parliament's revenue comes in the form of a block grant from Westminster largely determined by the application of the so-called 'Barnett Formula'. This is a population-based formula that gives Scotland a share of any increases in corresponding departmental budgets in England.

The Parliament is responsible for approximately 60% of government spending in Scotland (£32bn), with the balance spent by the UK government (£21bn). However, the Parliament currently has control over taxes, which

raise less than £4bn of the total tax raised from Scotland, equivalent to only 7% of all taxes and 11% of the Parliament's budget.² This lack of financial accountability is one of the main arguments put forward for devolving greater tax and fiscal powers to the Parliament.

So why the sudden interest in devolving further tax powers to the Parliament? In short, it is down to the SNP's success at the 2007 Scottish election.³

Soon after entering government in May 2007, the SNP launched its National Conversation. In response, the opposition parties in the Parliament came together and formed the Calman Commission, named after its chairman. For the Labour and Conservative parties this was a major change of policy – during the 2007 Scottish election they both opposed devolving more powers to the Parliament.

The Commission's remit was to review the provisions of the *Scotland Act 1998*

in the light of experience and to recommend any changes to the present constitutional arrangements that would enable the Scottish Parliament to serve the people of Scotland better, improve the Parliament's financial accountability, and continue to secure Scotland's position within the UK.

Calman did in fact look at all aspects of the devolved settlement. For example, it recommended devolving power over drink-driving limits and airguns to the Scottish Parliament. But for the purposes of this article I shall concentrate on the recommendations made in connection with improving the Parliament's financial accountability.

I gave evidence to the Calman Commission. What was interesting was how far Calman moved from its initial report, which recommended no additional tax and fiscal powers for the Scottish Parliament, and its final report recommendations as outlined in Box 1 (right).

So how much financial accountability do these proposals give? If Calman's recommendations were implemented, taxation revenue from Scotland would be as outlined in Box 2, overleaf.

So what has happened since the Calman Commission published its final report in June 2009?

The UK Labour government published its response to Calman's recommendations in a white paper in November 2009. However, the white paper differs from Calman in a number of ways. Calman suggested that four minor taxes should be devolved. The white paper does not include Air Passenger Duty but instead it is to be 'kept under review'. The borrowing powers proposal also differs in that any borrowing has to be repaid through increasing tax. I cannot imagine such a condition applying to UK government borrowing.

The Labour government stated that a new Scotland Bill based on its white paper would be published after the UK General Election if Labour were returned to power.

The Conservatives have stated that they will not be bound by this white paper and will instead introduce their own white paper if they form the next UK government. Whether a future Conservative government would see this as a priority is a matter of some speculation.

1: Calman's main tax and fiscal recommendations

1. 'The Scottish Variable Rate of income tax should be replaced by a new Scottish rate of income tax, collected by HMRC, which should apply to the basic and higher rates of income tax.'

'To make this possible, the basic and higher rates of income tax levied by the UK government in Scotland should be reduced by 10p in the pound and the block grant from the UK to the Scottish Parliament should be reduced accordingly.'

'Income tax on savings and distributions should not be devolved to the Scottish Parliament, but half of the yield should be assigned to the Scottish Parliament's budget, with a corresponding reduction in block grant.'

'The structure of the income tax system, including the bands, allowances and thresholds should remain entirely the responsibility of the UK Parliament.'

Will this make the Scottish Parliament overly reliant on income tax receipts? The figures outlined in Box 2 show that income tax will make up over 50% of the devolved taxes. This may be a problem in times of recession when income tax receipts fall. The figures in the box also show that the amount of tax income devolved still only makes the Parliament partially fiscally accountable.

2. 'Stamp Duty Land Tax, Aggregates Levy, Landfill Tax and Air Passenger Duty should be devolved to the Scottish Parliament, again with a corresponding reduction in the block grant.'

Is a tax truly devolved if the underlying law is not devolved and it is to be collected by HMRC and not by the Scottish Parliament?

Why just these taxes? Calman misses an opportunity to add some logic to the devolved settlement by devolving any tax that is closely associated with an area of devolved responsibility. For example, alcohol and tobacco duty should be devolved, as health is a devolved matter. Or inheritance tax as succession law is devolved, or all the environmental taxes. That would also ensure that the Scottish Parliament had additional economic levers and could develop policy in a more joined-up way.

3. 'The Scottish Parliament should be given a power to legislate, with the agreement of the UK Parliament, to introduce specified new taxes that apply across Scotland.'

Notwithstanding the requirement 'with the agreement of the UK Parliament', it is hoped that this recommendation would overcome the issues that arose when the Scottish government attempted to introduce its local income tax manifesto commitment.

4. 'The block grant, as the means of financing most associated with equity, should continue to make up the remainder of the Scottish Parliament's budget, but it should be justified by need. Until such times as a proper assessment of relative spending need across the UK is carried out, the Barnett formula should continue to be used as the basis for calculating the proportionately reduced block grant.'

I am certain that this issue will come to the fore after the next UK General Election, and irrespective of the result of that election.

5. 'HMRC should advise Scottish ministers in relation to those devolved taxes it is tasked with collecting and their responsibilities in relation to income tax, and should account to them for the operation of these Scottish taxes.'

Given the shambles that was the introduction of Stamp Duty Land Tax in Scotland, the problems surrounding the UK government's planning-gain supplement proposal and the Scottish government's local income tax consultation, any improvement in HMRC dealings in Scotland would be greatly welcomed.

6. 'Scottish ministers should be given additional borrowing powers. The existing power for the Scottish ministers to borrow for short-term purposes should be used to manage cash flow when devolved taxes are used. Consideration should be given to using the power in the Scotland Act to increase the limit on it if need be.'

'Scottish ministers should be given an additional power to borrow to increase capital investment in any one year. There should be an overall limit to such borrowing, similar to the prudential regime for local authorities. The amount allowed should take account of capacity to repay debt based on future tax and other receipts. Borrowing should be from the National Loans Fund or the Public Works Loans Board.'

This proposal was welcomed by all parties and was not seriously argued against once it became known that the Northern Ireland Assembly has borrowing powers.

2: Taxation revenue from Scotland if Calman's recommendations were implemented

	£
Income tax (based on 50% of income tax from Scotland)	5,622
Council tax	1,936
Non-domestic rates	1,724
Stamp Duty Land Tax	454
Air Passenger Duty	164
Landfill Tax	83
Aggregates Levy	52
Total tax revenues devolved	10,035
Total tax revenues from Scotland	52,511
Calman-devolved taxes as percentage of all tax revenues from Scotland	19%
Total devolved spending (2007/08)	32,321
Calman-devolved taxes as percentage of total devolved spending	31%

The Scottish government plans to introduce a Bill that would allow for a referendum on Scottish independence

Shortly after the UK government published its white paper, the Liberal Democrats and the Scottish government joined forces in the Scottish Parliament to demand that the non-tax and fiscal recommendations be implemented immediately.⁴

The National Conversation

In the meantime the Scottish government has pressed ahead with its National Conversation. 'Your Scotland Your Voice' was published on St. Andrew's Day 2009.

This document outlined the advantages and disadvantages of various constitutional options for Scotland's future. This was the next stage in the Scottish government's National Conversation.

These options include:

- full fiscal autonomy in an independent Scotland;
- a position of 'devolution max' – full fiscal autonomy within the UK;
- creating enhanced devolution;
- assigning revenues to the Scottish Parliament;
- continuing with or marginally changing the current framework.

Under independence or full fiscal autonomy within the UK, all taxes would

be raised and collected in Scotland. Scotland would also require its own Revenue & Customs and Treasury.

The Scottish government plans to introduce a Bill in 2010 that would allow for a referendum on Scottish independence. Given that the opposition parties in the Scottish Parliament have indicated that they will vote against this Bill, the chances of its being passed in 2010 are not high.

Implementation issues

The Labour government has indicated that many of the changes on taxation – including giving Scotland scope to set its own income tax level – could not be implemented until 2015. Given the speed with which the *Scotland Act 1998* was implemented, this seems like a simple case of kicking the issue into the long grass.

In addition, why is it being assumed that Scotland will simply copy the present UK tax system? It is generally acknowledged that the UK has one of the most complicated tax systems in the world. That said, as a starting point I would recommend that if a tax were to be properly devolved, the UK legislation should be copied *en masse*. That would ensure a period of certainty, which is

very important when such a major change is being undertaken. That would also mean that these proposals could be implemented well before 2015.

The Scottish Parliament may also decide to bring together the functions of HM Treasury and HMRC. Other changes could include bringing together bodies such as Edinburgh Companies House, Registers of Scotland and the Edinburgh Stamp Office. This process has already begun. As of last year the Registers of Scotland and the Edinburgh Stamp Office now co-locate. This is very encouraging, as one body is controlled by the UK government and the other by the Scottish government.

What about Europe?

Do the European state aid rules prevent tax competition in a member state? In short, no, if certain conditions are met.

Any doubt as to whether the European State Aid rules prevent taxation powers being devolved to the Scottish Parliament have been removed by the European Court of Justice (ECJ) ruling that annulled the veto the European Commission imposed against the reform of corporation tax in Gibraltar, thus allowing Gibraltar to introduce a tax regime that is different from the rest of the UK.⁵

The Gibraltar case followed cases involving the Azores and the Basque territory. Under the powers devolved to it, the Azores had taken steps to adapt Portugal's tax system to its specific characteristics. By reducing personal income tax by 20% and corporation tax by 30%, the inherent drawbacks of operating in the Azores were, to some extent, countered. The Basque case was similar because it involved lower tax rates than the rest of Spain.

The ECJ also reaffirmed the rules it set in the Azores case, which outline when a different tax rate can be set by a devolved administration. The rules are:

- The devolved administration has its own constitutional, political and administrative status separate from that of the central government.
- The tax reform has been devised without the central government being able to intervene as regards its specific content.
- The financial consequences of any reduction are not offset by subsidies from the central government.

The ECJ also considered whether the degree of autonomy the devolved administration enjoyed is an issue. The European Commission had tried to argue that the devolved administration had to have a degree of autonomy similar to that of the central government – in other words *de facto* independence. The ECJ rejected this argument and ruled that Gibraltar was sufficiently autonomous to justify being its own frame of reference. Despite the UK's residual power to legislate for Gibraltar, the UK was not able to intervene directly over Gibraltar's tax measures.

That means that the Scottish Parliament meets the first of these criteria. There is also little difficulty in meeting the second and third.

Importance to the rest of the UK

The process of devolving further tax and fiscal powers to the Scottish Parliament is being watched very closely in both Northern Ireland and Wales. In the Northern Ireland Assembly there is a cross-party campaign to reduce corporation tax levels to parity with or even lower than the Republic of Ireland. The Welsh Assembly has its independent Commission on Funding and Finance for Wales.⁶

As for England and the UK as a whole, these changes may mean the end of the

UK's unitary tax system, and could possibly mean an era of tax competition within the UK.

Conclusion

Tax and politics are irretrievably linked – and the debate about whether further tax and fiscal powers should be devolved to the Scottish Parliament is primarily a political one.

If Labour wins the next UK General Election, it will introduce a Bill along the lines of its white paper. If the Conservatives win they have said they will introduce their own Bill. Whether that Bill outlines greater or fewer powers than Calman or the Labour government is likely to depend on the Conservatives' Commons majority. If the Liberal Democrats have done well and hold the balance of power in the Commons, then they would be likely to press for greater tax and fiscal powers for the Scottish Parliament. If the SNP has an influence at Westminster, or holds on to power at the next Scottish election in 2011, then it will continue to press for greater tax and fiscal powers, and also a referendum on Scottish independence.

One thing is certain, though. Given the agreement across the political spectrum, the Scottish Parliament will in the next few years have greater tax and fiscal powers than it does presently.

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1. See: www.scotland.gov.uk/Topics/a-national-conversation and www.commissiononscottishdevolution.org.uk/
2. Government Expenditure & Revenue Scotland 2007-08, Scottish Government, 18 June 2009: www.scotland.gov.uk/Publications/2009
3. For the 2007 Scottish Parliament election results: www.scottish.parliament.uk/
4. See the Official Report Scottish Parliament 9 December 2009: www.scottish.parliament.uk/
5. European Court of First Instance judgment in the joined cases T-211/04 and T-215/04 relating to Gibraltar of December 2008 and the European Court of Justice judgment in the case of C88/03 of September 2006 in relation to the Azores judgment in joined cases C-428/06 to C-403/06 of September 2008 relating to the Basque Autonomous Community in Spain.
6. See: www.niassembly.gov.uk and www.walesfundingreview.org



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