About ICAS

The Institute of Chartered Accountants of Scotland (“ICAS”) is the oldest professional body of accountants. We represent over 20,000 members who advise and lead businesses. Around half our members are based in Scotland, the other half work in the rest of the UK and in almost 100 countries around the world. Nearly two thirds of our members work in business, whilst a third work in accountancy practices. ICAS members play leading roles in around 80% of FTSE 100 companies. ICAS is also a public interest body.

ICAS tax principles

ICAS welcomes the opportunity to contribute to discussions on the tax aspects of Scotland’s Economic Future Post 2014. ICAS members have a contribution to make to the debate on Scotland’s future and implications for those in Scotland, the rest of the UK and beyond. ICAS has a duty to act in the public interest, which means that we should contribute information and insights to the debate. For the avoidance of doubt, ICAS does not take any party political perspective and will not be taking a stand for or against in the Scottish Independence Referendum.

ICAS adopts guiding principles for its consultation work in supporting informed decisions and in analysing or explaining the outcomes of different policy options. These principles apply equally to the UK Government and HM Revenue and Customs (“HMRC”), the Scottish Government and Revenue Scotland, and any further jurisdictions acquiring devolved tax powers in future.

Some of the tax principles relevant to the debate on Scotland’s economic future are:

- Support for clear and high quality legislation, based on longer term principles rather than short term tinkering for political ends;
- Support for simplification measures and the work of the Office of Tax Simplification and for more of its recommendations to be taken forward in the form recommended;
- Support for good consultation processes so as to result in the enactment of better legislation; Governments should stick to the processes they introduce to ensure better quality legislation is enacted. The impact of policy intentions should be clearly understood so as to improve the effectiveness and efficiency of policy implementation at a detailed level;
- Support for an international policy solution on tax frameworks, such as by the Organisation for Economic Cooperation and Development (“OECD”), which are necessary to ensure efficient taxation of modern business structures and operations;
- Support for a workable and efficient tax administration, including staff with sufficient knowledge of the tax system for the delivery role;
- ICAS members support tax compliance and compliant taxpayer behaviour, make complex tax systems workable for businesses and reduce the risk of unexpected tax costs for all taxpayers.

Tax and Scotland’s Economic Future

At a time when the outcome of the Scottish Independence Referendum is as uncertain as the outcome of the next UK general election in May 2015, who will control Scotland’s tax system, or different parts of it, and the political influences and policy drivers behind such control are unknowns. The ICAS view is that the design of a tax system may contribute to the success of an economy, but that success depends on the relationship between the tax, political and economic systems of that country, as well as its social culture. It will be challenging to establish a clear steer on the tax system for Scotland’s future given these environmental unknowns. The comments below aim to offer observations on topical issues of debate.

The corporate tax rate debate

The corporation tax rate, for Scotland and the rest of the UK, has been seen as a key plank of economic growth strategy, yet it is massively affected by competitive pressures and restrictions from well beyond UK shores.
The context for considering the corporate tax rate is important. Firstly, corporate tax rates across Europe have been declining steadily for years and the declining rates were the foundation for the OECD’s concerns about the “race to the bottom”. Too close to the bottom was where reduced corporate tax rates meant lower corporate tax revenues which were not affordable without cutting public spending. In recent years in Europe, austerity measures put a halt to this decline, but that may be temporary. More likely than further tax rate cuts is probably the extension of certain tax reliefs; these can be more affordable than a wholesale rate cut, particularly if targeted sectoral reliefs are used rather than across the board measures.

Economic studies of relevance to the consideration of corporate tax rate changes for Scotland have, broadly, one of two bases; theoretical, academic forecasting models, or evidence, analysis and interview based profiling. For example, the study previously quoted by the Yes campaign, from 2011, was academic forecast based, and used a key assumption that Scotland would have a differential corporate tax rate with the UK and its competitors (3% lower). Job creation was expected, but this outcome would only be achievable in practice if the competitive tax rate behaviour changed, and this is questionable when Scotland would have no control over other jurisdictions tax rate decisions.

The second type of economic studies has suggested that economic competitiveness or inward investment attractiveness is not only about the corporate tax rate, rather it is about much more than the tax rate. Inward investment decisions have a number of complex factors; for example the most attractive country in Europe for manufacturing inward investment was recently found to be Germany, whose corporate tax rate is over 30%. It seems that Scotland is successful at attracting inward investment already, so is a potentially expensive tax rate cut really necessary?

It should be borne in mind that no records exist for the corporate tax base of Scotland – the profits of companies that might be attributable to Scotland (as opposed to the rest of the UK) should separate tax regimes be established. Businesses operating across the border have never had to calculate such a split, so any figures used for the tax revenue are wholly estimates. The challenge for any government making decisions on corporation tax changes for Scotland without this evidence base is considerable; the impact of this unknown on tax revenue expectations requires further work.

The administrative burden for companies in introducing the systems to produce such data, together with the tax authority burden in policing the ‘transfer pricing’ system, (the method of splitting taxable profits between jurisdictions) are the areas where ICAS members working in tax have considerable concerns. In addition, the administrative exemption currently enjoyed by many small and medium sized enterprises (“SMEs”) which means they are not required to prepare detailed and costly transfer pricing analyses to support their method of allocating profits, would need to be reconsidered if devolved corporation tax powers are introduced. This is because there are significant numbers of SMEs in each jurisdiction, albeit that around 81% of corporation tax in the UK is paid by 1% of the companies incorporated here. These administrative burdens, and costs, would arise even if any devolved corporation tax rate did not vary significantly from the main UK rate.

It will be interesting to observe whether different solutions are proposed, alternatives that look more like a collaborative or federal system across UK jurisdictions with shared tax rules, for example.

**Tax policy areas for exploration**

Consistent with our recent submission to the UK Treasury, two key areas where attention might usefully be focussed are towards a business tax roadmap, and in focussing tax incentives to those who could provide funding to SMEs.

1. A “Corporate Tax Roadmap" to provide a clear longer term strategy for the tax system was one aspect of the new UK tax making policy approach announced in 2010 which was well-received. ICAS would welcome a broader strategy to be formulated across the business taxes so, for example, there would be a “Business Tax Roadmap" that could aim to examine how to level the rates of taxation across incorporated and unincorporated businesses.
Likewise, it could be helpful to include individuals in business in such a roadmap, with a view to addressing the inconsistencies between employment and self-employment. These differences increasingly appear to drive avoidance behaviours and create further complexity in the tax system.

Such a roadmap could consider the future of the markedly different tax outcomes provided for in different parts of the UK tax code. Corporate tax rates are reducing and the differential between income and corporate tax rates is significant. There is a substantial difference between the corporation tax rate of 20% for 2015 and the highest personal tax rate of 45% - there is no level playing field when deciding which business structure would be appropriate for a new entity. The monies to fund the reduction in the rates of corporation tax have come from changes to the availability of writing down allowances across all business tax payers – so that sole traders and partnerships who have seen no reduction in their rates of tax have still been affected by the reduced tax deductions from writing down allowances.

2. ICAS welcomes the tax reliefs provided to make the UK a more attractive place to start business, such as the Seed Enterprise Investment Scheme (“SEIS”). However, given the current economic situation there is still a need for a step change to encourage investors in SMEs.

Wider targeted tax incentives should be aimed at encouraging those companies and individuals who are sitting on large amounts of cash to invest – a catalyst to unlock the funding blockages at a quicker rate than is presently occurring. For example, to facilitate access by the SME sector to some of the billions of pounds that private individuals currently hold in savings accounts in UK banks (at low interest rates) means a need to incentivise lending by private individuals to SMEs. A suggestion is that the interest individuals receive on loans made for 3 or more years to SMEs should be eligible for tax relief. In addition, extending the eligibility criteria of Enterprise Investment Scheme (“EIS”) to remove restrictions on non-executive directors would help to mitigate the problems of attracting investing non-executive directors to EIS companies.