**Background**

ICAS – the professional body of accountants – is in an interesting place when it comes to tax devolution.

By tax devolution we mean any form of control of taxes passing from Westminster to Holyrood, whether under the Scotland Act 2012, emerging discussions on full fiscal independence, or anywhere in between. As probably the single largest body of financial and tax experts in Scotland, with members throughout the world, ICAS has the depth of knowledge and experience to inform any debate over tax devolution, highlighting opportunities, pitfalls, administrative issues and behavioural responses. We have a wide range of overseas experiences and insights into the workings of the best, and less successful, practices. The principles are the same whichever part of the UK may seek or obtain tax powers, but when aligned to the political landscape, the Scottish example has particular salience. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. So it is in the enviable position of having both the key competencies and focus to inform, and, arguably, lead the debate on one of the most interesting questions of 2012 – what tax system would Scotland want? The core points of principle and choice were set out in an ICAS discussion paper “Scotland’s Tax Future; What tax system would Scotland want?” earlier this year. This discussion paper seeks to take a different approach – to consider the practicalities that the Government and people of Scotland would have to embrace to make tax devolution a reality.

**Executive summary**

A tax system works on a number of complex and interrelated principles and interactions, practicalities that both the Scottish Government and Scots will have no choice but to get to grips with, should Scotland achieve independence or further tax devolution.

The success of a country’s tax system depends on it being an integrated and coherent part of the country’s wider economic, legal and constitutional package. Any Scottish tax system design needs to take account of these factors as well as any EU membership.

Behavioural economics, or the Scottish cultural dimension, will give essential insights to the design of an effective and efficient tax system for Scotland. Considered research will be needed, to ensure optimum taxpayer compliance and revenue generation.

A strategic and operational vision for any new Scottish tax system is needed. Extensive work would have to be undertaken so it is vital that the chosen tax system principles are translated into an administrative framework as soon as possible. This applies to the powers devolved under the Scotland Act 2012 as it does any future powers or possible independence.

Serious questions need to be addressed, including the nature of information sharing powers and international tax cooperation, including with HMRC.

The scale of the tasks and work needed to fully establish Revenue Scotland and have it take over from HMRC, should Scotland achieve independence, would be massive, complex, and expensive. It is not clear that this is yet understood by taxpayers - who would be expected to pay for it - or politicians; this impact should be explored as the independence debate takes shape.

In any independent Scotland, Scottish taxpayers will need to be identified, particularly in view of the narrow current income tax base; the latest personal income tax statistics suggest that the top 1% of Scots paid income tax of over £2.1bn in 2009/10. When compared to the estimated total corporation tax collection of £2.7bn and total council tax of £1.96bn in the same year, their mobility may give bargaining power, but brings into focus too the question of the relationship Revenue Scotland should have with Scottish taxpayers, large or small.
And at the other end of the income scale, those on ‘negative taxes’ or benefit are party to a system that would need as much, if not more, thought than the tax system. Universal Credits might result in less than half of Scotland’s voters being affected by a change in the Scottish rate of income tax.

All of these points are underpinned by the analysis and insights below.

Introduction

The starting point has to be the Scotland Act 2012, which provides that stamp duty land tax, the tax due on the purchase of a home or business premises, will come under the Scottish Parliament’s control in 2015. Landfill tax, payable on waste put into landfill sites and ultimately borne through council taxes is also being devolved to Scotland at the same time. The Scottish Government is currently consulting on the form of both these taxes. So, regardless of any further tax devolution, there is an existing legislative obligation requiring the Scottish Government to address the practicalities of being in charge of a national tax system. The tax administration and management powers are timetabled to be introduced this autumn and enacted by summer 2014 by the Scottish Parliament, so detailed consideration is timely, if not overdue.

Announcements on the governing principles to be applied have been made by the Finance Secretary, although no parliamentary debates have yet considered or addressed these. The Scottish Government has also announced that it will establish a new body, Revenue Scotland, as the new Scottish tax administration, with further details to be provided later this year.

As in our last paper, ICAS aims to make observations and ask key questions to stimulate thought and debate. This starts with a consideration of how Scotland’s cultural and social dimension might be the curious, but important, starting point in addressing the practicalities of setting up a new tax system. There is then consideration of how Revenue Scotland would or could take over from HM Revenue & Customs, and how they might work together. The effort required from taxpayers to adjust to Revenue Scotland’s tax system and the key consequences of additional tax powers complete this review.

Finally, it is unlikely that the future tax system of Scotland will take over from football, fishing or fashion as mainstream interests of the Scots. But this is not something as far in the future as the date for any referendum, and is not part of the related political debate. In these coming months, time should be spent reflecting on the practicalities of what we might want now, never mind what we may vote for or against in two years’ time. They who pay the piper will, after all, call the tune, but what would they expect to hear?

Scotland’s Cultural Dimension – the behavioural economics aspect

An interesting point emerged from the ICAS members’ debate on the previous ICAS discussion paper, the view that the success of a country’s tax system depended on the integration, or alignment of the tax system with the country’s political and economic systems and social culture. The Scottish Government has also said that “Scottish Taxes will fit our distinctive social context”, but without further elaboration.

Is the social culture of Scotland the same as that of the UK as a whole? What about when it comes to paying tax? This is worth more than a stereotypical or political response. For example, if Scottish taxpayers were found to be more (or less, for that matter) compliant with meeting their tax obligations voluntarily, then it might be reasonable to assume that less (or for that matter, more) administrative resources and focus might be needed to ensure the tax that should be collected is collected.
Would Scottish taxpayers be willing to be more open in their tax affairs than is required by, or indeed assured by, HMRC’s obligations to protect confidentiality? In some countries, it is usual practice for everyone’s tax returns to be publicly accessible; whilst that might fill Scots (and others) with horror, in those countries it is regarded as a means of achieving social transparency and of supporting tax compliance. Perhaps taxpayers would think twice about tax evasion if their neighbours could see whether their lifestyle was supported by their declared taxable income and gains.

Do Scots taxpayers fill the stereotype of being canny, and if so, what about in their tax affairs? Do they claim more available allowances than, say the English or Welsh, or undertake more tax planning, or tax avoidance (however you define that) when compared to the rest of the UK? Or do they take careful steps to avoid unexpected tax liabilities and penalties, by being more cautious in their planning, more accurate in their returns and more conscientious in managing their tax affairs and obligations?

This cultural dimension, or Scottish behavioural economics, matters. First, any implementation of tax devolution requires data on not just current tax revenues, but at a more detailed level than currently available, on taxpayer profile and behaviours, to know what tax revenues are actually generated in Scotland and on what. This is the data foundation for tax system design, and will inform matters such as the compliance and enforcement regime required and the design of a penalty system, never mind projections of future tax income generated for the Scottish coffers. Taxpayer profiling and an understanding of behavioural insights will also be necessary to understand how any changes in allowances, tax structures, reliefs or tax rates will impact on that total tax paid.

Whilst sociological research and data extraction from HMRC may provide answers to some of these points, is this an area where we would expect our political leaders to consider taking a step forward with a “vision”? After all, as the social cultural debate on the morality of tax avoidance bubbles away at a UK level, setting out a social cultural vision for the tax system of Scotland would make an interesting start. Whether political leaders should be open on a personal level about acting accordingly (akin to the expenses issue) may be the follow up question from others, but is it of fundamental importance, or a salacious distraction for certain elements of the media? And should the debate on the social cultural dimension be open for public consultation? After all, this matters to the financial wellbeing of all Scots, whether net contributors or beneficiaries of the tax system implemented.

Lots of questions, but there is an inescapable truth that these principles and vision would contribute greatly to determining the purpose and objectives of Revenue Scotland and its efficient alignment to those overriding goals.

The Practicalities – “Think, Build, Operate”

A phrase from management consultancy creeps in (there’s a separate debate as to whether that should be a blessing or a worry) but it describes succinctly the process the Scottish Government and Parliament is going to have to go through to establish a tax system and its operation through a tax administration, Revenue Scotland.

Think – the team and task list

The politicians may, or may not, give us and Revenue Scotland, a “vision” at the outset, to set the cultural, financial and behavioural direction as the Scottish Parliament would see fit. Regardless, the process of creating and establishing a devolved tax system has started and requires clarity of thought, and insights, appropriate to the complex task.
The Finance Committee of the Scottish Parliament has received a report from its Budget Adviser on the workload consequences of dealing with the additional tax responsibilities.

If “Think, Build, Operate” is the process, the appropriate composition of the “think” and “build” teams is recognised as needing significantly more resource than currently deployed. That's not to offer criticism of any of the current civil service team, or politicians, more an observation that this is a new task, as mountainous as our landscape.

Thought might be given to why a tax system works, never mind works efficiently. It requires an essential interaction, and coherence of, a number of components. Whilst it might be expected that for the new Scottish system these would be derived from the process of choosing principles (discussed in the earlier ICAS paper), the core components have to be identified, to create the task list in the design process.

The ICAS view is that there should be a clear alignment of the tax system principles and administration; so the core components list, whatever tax powers are devolved, would include:

- **Clear, well written tax laws** It is helpful to all if there are clear and well written laws, formed intelligently to deal with the commercial or practical circumstances to be addressed. As set out in the earlier ICAS paper, that is the challenge for policy makers and the legislature in the Scottish Parliament; the temptation to resist is the one to "cut and paste" from often flawed UK legislation.

- **Easy taxpayer experience** It should be easy for taxpayers to comply; to understand what is taxed and when, what tax returns are to be filed and avoid the timewasting and uncertainty that comes from complexity. Taxpayer communications should be in ways that taxpayers understand and to which they find it easy to respond.

- **Operational fairness** There should be an experienced and effective compliance and enforcement operation within the tax administration to deliver clarity to taxpayers on tax outcomes, ensure fairness between taxpayers, monitor and challenge tax evasion, and levy proportional penalties for failure.

- **Efficient collection mechanisms** Tax should be gathered quickly and efficiently: the PAYE/NIC system, even if overloaded, of weekly or monthly deductions at source, together with the deduction of tax at source from interest income, and VAT payments, gathers the bulk of UK tax very efficiently. The work is done by business and not civil servants; the balance does need to be addressed to ensure that the burdens on business are also kept to a minimum.

- **Dispute resolutions** As with all legal systems, a process to resolve disputes between taxpayers and the authority will be necessary. A range of options including mediation, arbitration, tribunals and the courts could be used; the costs and timescales of the chosen processes will have implications for both fairness and efficiency.

The list could be longer, and each point needs consideration beyond a bullet point. For example, should Revenue Scotland have a wider role beyond core operations? A look at overseas tax administrations, and HMRC, demonstrates a range of roles undertaken by tax administrations, not least of which is their interaction and cooperation with other government departments. For Revenue Scotland this might encompass, possibly for many years to come, a relationship with HMRC on taxpayer information, with the Department for Work and Pensions on the tax/benefits interaction, and with HM Treasury on yield and analysis, over and above its role to raise taxes for the Scottish Government.

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1 The Scottish Budget Process and the Scotland Act 2012, David Bell, August 2012.
A long term decision is needed, whether or to what extent Revenue Scotland should be designed to deliver only its currently devolved powers, or be future proofed to deal with additional taxes? Is it a gamble to do more now in building foundations for future need, a complex but scalable system, or focus on core efficiencies for the powers now devolved?

Another set of decisions lies below the concept of easy taxpayer experience; will Revenue Scotland’s interaction with taxpayers be online, or through post offices, city centres or call centres? Call centres can be successful in some industries but are they suited to a complex tax system, with considerable opportunity for misunderstanding and extremely limited trail of evidence as to what was discussed? Choosing a model to deliver accessibility, clarity, simplicity or otherwise of processes and procedures will encourage taxpayer compliance, and the generation of tax revenues, at minimal administrative cost.

How might any disagreement with Revenue Scotland be resolved? The volume of tax disputes between taxpayers and the tax administration will depend on the quality and clarity of the tax legislation enacted, the organisational culture established, and clear accountability. Differences of opinion on the interpretation of legislation are inevitable with any law. The choices of dispute resolution processes Revenue Scotland might adopt, such as independent internal reviews, the use of specialist dispute resolution or settlement teams (the latter recently developed and piloted successfully by HMRC) to resolve these will be crucial to the efficiency and convenience to taxpayers. Consistent with other areas of law, the Scottish Court system is likely to play a vital role, but could tax learn from other legal areas, as well as produce a fair allocation of dispute resolution costs or expenses? Time wasting and delays can be frustrations in an adversarial system, and are arguably tools used by tax authorities and taxpayers, particularly in complex avoidance cases, in order to encourage settlement. It’s against the principle of certainty and convenience, but needs to be balanced with a fairness of process.

Will there be a desire to continue with the system as at present in the UK, of First and Upper Tier Tax Tribunals to operate as the first specialist tax hearing, before any appeal to the Court of Session. At present the appeal is then to the Supreme Court, although the role of the Supreme Court is one that has been disputed in the past in Scotland. Decisions on tax matters are as important as other areas of the justice system, and processes and provisions need to be written into the core taxes management legislation, due to be consulted on, and legislated for, in the Scottish Parliament in early 2013. This timescale brings into sharp focus the fact that this is not a theoretical or abstract debate, but a real one.

This gets us back to the need for data again, to build efficiencies the disputes and appeals system would need to be fit for purpose and usage. Details again, but information on how many tax appeals, and on what matters, are taken in Scotland would be useful, if not essential, to building something fit for purpose. At present the locus of appeals may be based on taxpayer preference, tax office location, or geographical convenience, not the Scottish border.

**Build – the legislative process and Revenue Scotland**

The “build” part includes substantial issues such as passing the legislation to bring in the necessary tax raising powers and to establish what will probably be the single most powerful non-governmental body the Scottish Parliament will ever establish. So the scoping of powers needed to implement the tax laws it passes, to require taxpayers to comply, to enquire into returns and pursue tax evasion is an early and important priority. And timescale; it’s not a short process, that democratic one of passing legislation, once processes of consultation and debate are factored in. The “build” process needs to start very soon for land and buildings transaction tax and the Scottish landfill tax, but each of those is to operate to quite an extent on existing reporting obligations – those of the land registration and environmental protection reports respectively.
Any wider taxes would need these mechanisms to be built from scratch.

Revenue Scotland has a name, and a chief executive, but not yet much else; it's a bit 'chicken and egg', but it too needs the legislative process to complete before the body proper exists, probably about a year from now. In the meantime, planning for the establishment of an organisation chart, HR policies, recruiting and training the right staff will be quite a task. A mixture of experience from the Scottish Government and HMRC, in numbers, but also some fresh insights and creativity should be useful here. A difficult time for some at HMRC possibly, as work is transferred, and whether employment transfers are possible or desirable, will take time to work through in inter-governmental, never mind trades union, or individual negotiations. And the roles to fill will change as Revenue Scotland takes shape; at an early stage this will involve much policy design work, the writing of practical guidance for staff and taxpayers. Roles will then transform into policy direction, to operations; to check and investigate return submission as well as to provide assistance with taxpayers' queries or support bulk online processing. How to staff and when, and for how many, depends on the tax system design. A classic case of the law of unintended consequences might come into play in the changing career prospects and opportunities for tax staff, in HMRC or elsewhere, over the next few years.

Again, principles play a role. If Revenue Scotland is to be charged with operating efficiently, what is the benchmark measure? Low costs perhaps, but if the burden is placed on business and taxpayers, is that sensible or fair? Processing times for forms and queries perhaps? Elsewhere it has been demonstrated that speedy turnaround times can be achieved but with dubious quality of results or accuracy, so what of quality?

Would it be idealistic, or fair, to set at the outset an expectation of the professionalism and expertise level of the Revenue Scotland staff in contributing towards that efficiency, to be measured against subsequent taxpayer feedback? What is to be the cultural approach to taxpayers and different taxpayer groups, to support compliance and tax collection? Should Scottish taxpayers expect the opportunity of a named tax official to assist with their responsibilities, or is that an expensive luxury that a cost effective administration cannot sustain? Although many tax complexities arise for taxpayers among the wealthy few, is it appropriate or credible to treat them as other taxpayers? The latest personal tax statistics suggest that the top 1% of Scots taxpayers paid income tax of over £2.1bn in 2009/10. When compared to the estimated total corporation tax collection for Scotland for the same year of £2.68bn (excluding the North Sea) and council tax of £1.96bn, focussing more resources on both collecting and celebrating their contribution, might be wise. It might also assist with the debate about whether they are even Scottish taxpayers, under the Scotland Act 2012 definition.

And where? Finding suitable premises is one thing, but the locational choice might be political; marginal seats rather than employment black spots for the cynical, or close to political masters in Edinburgh, to be practical.

And let's not forget the often troublesome and costly process of the public sector building an IT system that will do what is required. The fewer steps involved - in terms of numbers of returns or payments - and the greater the automation that can be built into the system, the quicker and more cost effective it might be. That's the basis of the sensible sounding plans to build the land and buildings transaction tax system onto the land registry database (itself still in development). Although that tax is still in design phase, it is likely to be aimed at land ownership, and be transaction based. Other tax records are usually based on an individual or business taxpayer, in relation to regular or annual returns, so this one might not be too relevant nor of wider use should further tax powers be devolved.

A tax payment and collection operation needs to be set up to track and allocate tax receipts to taxpayers, to pursue tax overdue, and repay what is overpaid.
As with all online financial systems, the risk of fraud is probably the biggest hurdle in the smooth operation of such a system, and sophisticated solutions may be required.

**Operate - with real taxpayers**

The “operate” part achieves implementation of the tax law as enacted. For any new law, it has to start with an information campaign for taxpayers. The communication needs depend on the tax and the taxpayer base – the number of taxpayers involved. For taxpayers this means being clear about what they have to do and when; accessible guidance, forms and returns written in straightforward language, technically able and timely support from Revenue Scotland to resolve problems, for complex areas, provide tax clearances – written confirmation of the applicability or otherwise of complexities or uncertainties. Clear messages could also be given about the openness and honesty expected of taxpayers, and the consequences of falling short of those expectations. This then means that Revenue Scotland will have to be resourced to build a vast communication methodology - letters, electronic databases and paper leaflets no doubt included, to inform taxpayers of their obligations and deal with queries. It will be interesting to hear from Revenue Scotland the basis on which, if at all, it will permit email correspondence, an approach not currently openly embraced by HMRC for security concerns.

Should it be a campaign style launch, which might be costly, or can social media help manage these? The trade-offs might be that Twitter may be free but doesn’t get to the heart of the matter to make sure the tax obligations are understood by taxpayers, the businesses or advisers operating the tax. As the first tax will be land and buildings transaction tax, which in practice will be operated by property lawyers in IT enabled offices, the connectivity, capability, motivation and professional monitoring of their professional operations should make this a soft landing for the tax administration. That might be as easy as it gets.

For any future tax developments, how expectations are managed will be an interesting indicator; most tend to go for the “there’s bound to be a few teething problems but it’s a great improvement” line, but is there any doubt that laws should be clearly and timeously communicated to those affected, bearing in mind that tax is not always the most interesting subject on the agenda? The conventional expectation is that neither good, nor bad, taxpayer experiences affect voting intentions in the UK, although tax rates can; will that hold with any cultural expectations of devolved tax powers?

**Would, or could, Revenue Scotland take over from HMRC?**

The starting point is to be clear that there is a need to consider separately three different scenarios.

The first scenario is the reality that two taxes (to be land and buildings transaction tax and the new landfill tax) will cease to be levied by HMRC on transactions in Scotland in 2015, and the Scottish Parliament has the right to pass tax legislation to levy any replacement it sees fit. This has nothing to do with the independence referendum, in whatever form that takes place. The replacement provisions are being consulted upon and expected to be passed in the second half of 2013. The second scenario is that control of 10 percentage points of the existing income tax rate will pass from Westminster to Holyrood in 2016 for Scots, but without control of any other income tax matters, such as personal allowances, changing. The tax rate may be increased, decreased or stay the same, all at the discretion of the Scottish Parliament. The third scenario is if control, in whole or part, of other taxes might be transferred from Westminster to Holyrood at some time in the future.
The first scenario, of the two taxes already devolved is, in theory, the most straightforward; as at present they both broadly apply a tax charge at the point of a transaction taking place in Scotland, there’s no transition to deal with; day 1 the UK system with HMRC, day 2, the Scottish system with Revenue Scotland.  Except that’s not quite the way that the existing stamp duty land tax on leases is framed, where there is a virtually incomprehensible periodic recalculation of liability, after the transaction date.  The future of that UK charge is uncertain but, if it remains, the burden of having two tax authorities might remain with the property occupier; it’s difficult to see why Revenue Scotland would want the cost and hassle of the UK legacy system.

Should interactions between the systems remain?  David Gauke recently announced the tax raising successes of Connect², a data mining approach through which HMRC can link a wealth of commercial and tax information to form a complete financial picture of a taxpayer’s position, which it can use to ensure the completeness of that taxpayers’ tax returns and payment of all taxes due.  Will HMRC have access to the same tax data from Revenue Scotland, or if not, how can it make its tax collection as smart and efficient as possible?  If not, could Scotland be, as with the Channel Islands, a place for assets to hide from HMRC?  If there’s a transaction that uses aggressive tax avoidance techniques to save tax, including say the future Scottish land and buildings transaction tax, which tax authority and which tax anti-avoidance rules will apply or take precedence?  This raises some serious points of policy and principle to be determined by the Scottish Parliament over the next year in relation to information sharing powers and the nature of international tax cooperation.

There are existing models; the most familiar requires a Finance Act to be passed to give HMRC powers to pass taxpayer information to another government, or perhaps, as with the growing number of Tax Information Exchange treaties which the UK has with overseas, often tax haven, jurisdictions, those powers may already exist at a UK level.  If so, the sharing provisions for Scotland might have to be established by formal intergovernmental agreement.  If the recent proposals in relation to information provision to the US tax authorities by UK companies (via HMRC) is to go by – the FATCA rules - a 33 page agreement, with probably around 50 pages of guidance would be the output.  Maybe Scotland could do better, but the rules of international law are long established; tax devolution in this respect might become more pompous and voluminous than rational or interesting.

The second scenario is where the Scottish rate of income tax provisions come into effect; the power to change the income tax rate belongs to the Scottish Parliament but the tax system administrative burden will remain with HMRC, with no role for Revenue Scotland.  These provisions give rise to a number of implementation issues, attempts to resolve which have benefited already from implementation group working parties, yet despite extensive efforts, leave a number of matters still to be determined.  If anyone believes tax devolution is or should be simple, a read at the official summary of the attempts so far to design an operational system for the Scottish Rate of Income Tax³ might be highly informative.

Individual taxpayers will need to consider the definition of who might be a Scottish taxpayer (see below) but the greatest burden might be for businesses such as pension providers, who will have to make expensive and significant changes to customer systems to cope with the potential for different income tax rates affecting their customer base.  From a commercial readiness perspective, and given the relatively short time frame in which the Scottish Parliament could announce any rate change, business changes need to be made regardless of any rate change being implemented.

³ HMRC “Clarifying the Scope of the Scottish Rate of Income Tax” Technical Note May 2012
The third scenario (transfer of control of other scenarios) has the greatest potential for complexity; the political point for voters may be around whether this is, in practical terms and not as a point of principle, simply too expensive, too much spending on the wrong things in the time of economic challenge, rather than the cost of a longer term change.

A free rein might be given to tax system design, so the greatest issue of practicality might be data transfer from HMRC to Revenue Scotland. The unknown is what the Scottish tax system, and its IT systems, might need as tax records, but the details needed are unlikely to be in the form currently held in the myriad of legacy HMRC systems. HMRC estimates there are just over 2.6m income taxpayers in Scotland, but the Scottish population is over 6m; the balance are likely to be only temporarily not in current contact with HMRC rather than permanently excluded from tax provisions altogether. Tax records may go back a number of years, particularly for the wealthier; capital gains tax and inheritance tax records can last lifetimes. The basic identification and isolation of the data involved, and no doubt massive other amounts of groundwork, need to be done before the IT mining can begin. And no doubt at a one-off cost, with the accompanying debate on who’s going to pay for it. Now these aren’t devolved at present, but if considering building Revenue Scotland to be future proof, will it not be the case that any possibility of further tax devolution needs to consider these too. That’s also before any consideration is given to the possibility of the integration of the operation of income tax and national insurance contributions, so that whole system would need to be planned for too. Finally, not everything is held electronically, so the long term prospects might look to be improving for the freight industry.

If there was full devolution of annually assessed taxes (income tax and capital gains tax for individuals; corporation tax for companies being the main ones) there would have to be a transition from a UK income tax system to a Scottish one. There might be a period of overlap when tax years ended on an earlier 5 April were still open to enquiry, or returns had still to be filed to HMRC, but a new Scottish tax year may have started. Tax system multi-tasking will in itself be a challenge; given the implementation issues in changing any widespread but essential system. The emerging issues around changes to Real Time Implementation of the UK PAYE system, only one aspect of the vast UK tax machinery, gives some insights into the small likelihood of a smooth and timely handover.

Another point to be resolved is around the existence in the UK tax system of deferrals; legitimate holdover and rollover reliefs that delay the payment of tax often while gains or proceeds from prior transactions are invested into “good things”, business start-ups and capital equipment for example. Westminster might not want to give that up, so either needs to find, with Holyrood, a mechanism for tracking such delayed liabilities so that they are paid back to the UK, or levy the tax as an exit tax. Except the latter isn’t possible between European Union states under the Treaty on the Functioning of the Union; once again resolution of Scotland’s position in the European Union would pave the way for informed consideration.

North sea oil tax revenues have been the subject of many a paper already; where the boundary line would be drawn on a map of the North Sea between the Scottish and English portions is not yet resolved, with, it is understood, some conflicting legal precedents in international law. Whether resolved by international law or as part of any devolution negotiation, the revenues gained by the Scottish exchequer may be reduced over time by what are known as decommissioning reliefs. Just work for now on the principle that the oil companies, who have been contributing handsomely to the UK coffers since the 1970s, are expecting future UK tax reliefs – subsidies - as their exploration activities end. Would the Scottish Government retain these reliefs, and what might be their impact in any financial model for tax revenue for a Scotland with devolved corporation tax powers?
As Westminster consults on the proposal to enter binding contracts with affected taxpayers on the future value of these\(^4\), in total estimated at £20bn, what would happen to these in different future scenarios would need to be clarified, negotiated or otherwise resolved.

Leaving aside the decommissioning costs point, it could be postulated that the single largest cost in the further devolution of tax powers might be the extent of work and efforts to separate tax administration, even if the tax liability levied on taxpayers in Scotland never changed. The scale of the tasks and work needed to fully establish Revenue Scotland and have it take over from HMRC is massive, complex and will be expensive.

It could be the advent of a new saying; you can pay the piper and not hear a thing.

**The taxpayer’s roles**

If voters voted for more tax devolution, then it might be reasonable to assume they would cooperate fully in the introduction of new taxes and would willingly engage in making sure any new tax system worked. That’s a bit naive however – the same argument could be put for any tax levied by any Parliament elected to Westminster, and substantial resources have always needed to be ploughed in to education, information campaigns, preventing tax evasion, challenging tax avoidance and ensuring the basics of compliance are met.

Over the next two years, the main impact on Scottish income taxpayers is understanding and monitoring of whether they will or will not be ‘Scottish taxpayers’ – which may not be as straightforward as it might seem for those living in Scotland and working away from Scotland, or those spending a lot of time here and with different homes.

If all taxes were devolved to Scotland, taxpayers as a whole would need to learn a new tax system, alongside the existing UK tax system until any handover or transition was permitted. The simpler any new tax system introduced was, the easier the learning, but that implies significant changes from the existing UK tax system - which is known for being anything but simple. The contradiction however is that many taxpayers are familiar with that existing UK system, so might object to more significant changes. Either way, taxpayers will need to be prepared to dedicate study and learning time, and perhaps costs.

Scottish taxpayers should expect to pay the cost of changeover, although in the absence of any independence settlement, estimate of tax revenue needed to be raised, tax system shape, or taxpayer base, it is impossible at this stage to know what the tax position of any Scot would be. The extent of work needed to achieve changeover will be massive, the taxpayer’s role will also be to pay for it. It is not clear that this has been understood by taxpayers, or politicians, yet exploration of this aspect as the independence debate proceeds could be another step towards voters making an informed choice.

**Wider issues and consequences**

Taxpayers efforts were identified above in relation to the identification of Scottish taxpayers, but aligned to that is the need for employers throughout the UK to work with HMRC and their employees to ensure the right Scottish taxpayer PAYE code is allocated.

The power to vary the basic rate of income tax gives separate, and possibly major, issues for, for example, pension businesses across the UK, in ascertaining what rate of tax relief at source is to be claimed by those businesses on pension scheme contributions. Charities operating Gift Aid need to keep a careful eye on developments, hoping the proposed and pragmatic approach (ignoring any tax rate change and the will of the Scottish Parliament) in determining the rate of income tax repayment claims and donor’s income tax withholding, may continue.

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\(^4\) HM Treasury Consultation Document “Decommissioning Relief Deeds” July 2012
The administrative effort burden might therefore fall on businesses in many sectors, and charities, to invest in the necessary learning and adaptation of business systems and reporting mechanisms, as well as providing employee support.

Income tax payers will need to consider the impact of any variation in the Scottish rate of income tax on the benefits they receive. A number of benefits, such as housing benefit are currently paid according to net of tax income, and as the benefits system is not being devolved from Westminster, there’s a potentially troublesome interaction to resolve. The proposed universal credit, to come in from 2014, will combine benefits into one payment, updated according to weekly or monthly income. Universal credit is also to be based on after tax income, so that there would be no net tax cash flow effect from devolved income tax powers for Scottish claimants, unless the universal credits system changed; effectively any increase in the rate of Scottish income tax would be subsidised by Westminster. Any reduction in the Scottish rate of income tax would be matched by reduced benefits. It remains to be seen how large a sticking plaster would be needed to the universal credits legislation to fix this, or what intergovernmental agreement might be reached. But if the Scottish rate of income tax was to be only paid by income tax payers on non-savings income, and did not affect benefit claimants, it might be that far well under half of Scotland’s voters would be affected by a change in the income tax rate; accountability is a weak justification in such circumstances.

If tax were devolved completely to Scotland, the other massive question to ask – which this paper won’t address in detail, is what would happen to ‘negative taxes’ – the benefits or tax credits for those on lower income – on their own. The benefits system would need as much, thought, work, process and development as a tax system; it absorbs around one third of Scottish public expenditure at the moment but little has been heard about plans for it as well, or its potential linkage to the tax system.

Does Scotland want a 5 April income tax year end? It’s not a date that sits naturally in business calendars and requires time apportionment calculations in most tax computations; in which case in any transition from the UK system how would any period of overlap be dealt with? 31 March might tie neatly into the government accounting rules for expenditure. Would it spoil a national holiday to use St Andrew’s day of 30 November, when the thought of a tax bill was the waking thought that (probably) dark, wet and windy morning? Or would we think more fondly of tax collectors if we chose 25 January – after all, that’s what Robert Burns did for a living, for a while at least. Fanciful perhaps, but the point is that a date would have to be chosen, and transitional provisions worked out whatever that was.

And finally, as said at the outset the timescale for the passing of all the core tax legislation around tax administration and management powers in Scotland is for it to be completed by summer 2014. The reality is upon us, is it too much to hope that the main consequence might be engagement of the Scottish voters in this vitally important debate or that our political leaders might provide a vision, direction and answers that address the many issues raised above?
The ICAS viewpoint

A basic tenet for this paper is that ICAS members have a contribution to make to the debate on Scotland’s future, its meaning 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, based on the considerable interest and experience of our members in technical areas such as taxation, but including also pensions, governance and regulatory matters.

This paper is the second in a series that aims to do this; we are seeking to provide information and insights, ask the questions in key areas that those on all sides of the debate should address over the coming months.
The Institute of Chartered Accountants of Scotland is the world’s oldest professional body of accountants having received its Royal Charter in 1854 and since then, ICAS has played a leading role in the accountancy profession. The Institute’s main objective is to uphold the integrity and standing of the profession of chartered accountancy in the interests of society and the membership. We have approximately 19,000 members spread throughout the world and many chartered accountants hold key positions in commerce, industry, the public sector and private practice.