Introduction

The Scotland Act 2012 gave the Scottish Parliament the privilege, and burden, of control of two taxes from 2015, as well as over the Scottish rate of income tax in due course. ICAS, acting in accordance with its public interest obligations, is contributing to the development of these initiatives on tax with the Scottish administration and parliament, as it has done for many years at a UK level.

The benefit of that experience in consultations, in observing why certain tax developments succeed and others fail, and of the tax and financial expertise of what might be the single largest body of tax and financial professionals in Scotland is what we bring to this discussion. We will be open and honest in our observations and contributions with the objective of ensuring any tax system design is in line with the chosen policy principles.

This submission aims to summarise our work so far in the area of the devolution, and potential further devolution, of tax powers to the Scottish Parliament, set out at length in two thought leadership papers issued earlier this year; “Scotland’s Tax Future; What Tax System Would Scotland Want?” and “Scotland’s Tax Future; The Practicalities of Tax Devolution”, which are attached as appendices. It also provides observations on the progress achieved to date in the consultations on the devolved taxes and tax management provisions and suggests areas where resources and attention might be focussed in the coming months.

Background comments on tax system design

A tax system works on a number of complex and interrelated principles and interactions, that lead to issues of practicalities that both the Scottish government, and population, 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. European Union membership would impose VAT legislation as well as a number of restrictions on targeted tax advantages (‘state aid rules’) and restrictions on tax charges on transactions with organisations based in other member states. The European Convention for the Protection of Human Rights and Fundamental Freedoms, adopted in the UK by the Human Rights Act 1998, also applies in relation to, for example, tax authority powers and fairness of penalties.

Behavioural economics, or the Scottish cultural dimension, will give essential insights to the design of an effective and efficient tax system for Scotland. Data on the Scottish tax base is limited and considered research will be needed, to ensure optimum taxpayer compliance and the desired revenue generation is achieved.

A strategic and operational vision for any new Scottish tax system is needed. Extensive work is then required to translate the proposed Scottish tax system principles of; the burden proportionate to the ability to pay, certainty, convenience, and efficiency of collection, into an effective and workable administrative framework. This applies to the powers devolved under the Scotland Act 2012 as it does any future powers or possible independence. Wider questions need to be addressed, such as the need for information sharing powers with other jurisdictions, including HMRC for the other parts of the UK, to combat tax avoidance. Internationally, cooperation with other tax jurisdictions will be needed to negotiate, or adopt, the extensive number of double tax treaties applicable at present to the UK, should further powers be devolved.

The scale of the tasks and work needed to fully establish Revenue Scotland and have it take over from HMRC, should Scotland achieve independence, could 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 some politicians; this impact should be explored as the current tax consultations move forward and the independence debate takes shape. Initial consideration by the Finance committee on these points should provide a broad foundation for an approach to tax issues under the Scotland Act 2012.
Key issues for discussion – process

- Avoiding complexity - Tax systems around the world, and in the UK in particular, are complex. Complexity leads to higher administrative costs, increased need for taxpayer support to be compliant, poor understanding of the tax system in the population and opportunities for tax avoidance. This complexity in the UK has emerged over many years, as successive governments have adopted piecemeal changes and political parties have succumbed to the temptation to be seen to be doing something different from their opposition. The opportunity to make a fresh start on the devolved taxes must be welcomed, as issues of complexity could be addressed by radical reform. It might however also be sensible, if a view were taken by parliament on the criteria for future changes, such as triennial rather than annual budgets, to avoid the complexities of ‘tinkering’ emerging at a later stage.

- Passing clear, tested, legislation - Tax systems are only as good as the legislative drafting which gives them effect. Clear terminology and consultation, and testing, of the legislation in draft as well as key principles has to be allowed for as the legislation is introduced. We have seen nothing in the drafting of the Scottish tax legislation so far, to suggest that reviewing tax legislation for Holyrood – for tax specialists and non-specialists alike - will be a substantially simpler task than it is for Westminster. Particularly for brand new legislation introducing new taxes, rather than, say, limited scope amendments to existing legislation, sufficient time must be made available for tax practitioners to consider, test and comment on these in detail, and the short timescales envisaged make this a concern. It is a poor substitute to rely on secondary legislation and guidance as neither can be reliably used as evidence of the intention of parliament, particularly if considering tax avoidance matters.

- Adequate timescale and resources - In relation to the first devolved tax bill to be proposed, the Land and Building Transaction Tax (Scotland) Bill, there are four substantial areas where it has been recognised that further time would be needed for consultation and design. This may be due to insufficient government resources having been allocated; barring the appointment of a new head within the past few weeks, Revenue Scotland is unstaffed, and there are no experienced tax practitioners or administrators in the Scottish government at present. Or it may be due to the considerable and complex task involved, a reflection of the challenge of this task identified by ICAS and its members. Whichever, it may be that lessons need to be learned in relation to process timelines and resourcing experiences so far, if the objective of the Scottish Parliament is to pass intelligent, effective and clear legislation. The ICAS response will be to contribute to this process, but there comes a point when consultation becomes outsourcing to volunteer professionals who will already be stretched by over 1000 pages of UK draft finance bill and explanatory notes, December year ends and the 31 January filing deadlines. In neither approach, nor total resourcing, does this seem optimum.

- Effective taxpayer communication – This is required to support compliance and needs to be undertaken across various channels. The tone set is as important and the message; it should be professional, measured and appropriate. Unduly aggressive communications may be perceived as unfair.

The Land and Buildings Transaction Tax (Scotland) Bill – initial observations

As noted above, the consultation process preparatory to the consideration of the Bill is incomplete in key areas; the Policy Memorandum it refers to further work being carried out, for example at paragraph 90 on non-residential leases, paragraph 104 on residential property holding companies, paragraph 110 on trusts, and paragraph117 on partnerships. Early resolution of proposals on these matters, with draft provisions to support them, would make later stages of Bill consideration more effective.

What would prove useful would be a table of comparison (or even a marked up version by topic) between the pre-existing UK Finance Act 2003 provisions for stamp duty land tax and those in the draft for land and buildings transaction tax, to facilitate review. Some provisions are direct copies, some reordered, and some drafted from scratch. This is being explored with Scottish government officials.
**The Scottish Landfill Tax Consultation – initial observations**

ICAS members have raised few comments at this stage and it is likely that any submission by the deadline will be high level comments rather than at a detailed level. This is due to the volume of other commitments in the timescale as well as the relatively narrow area of interest under discussion.

**The Tax Management Bill Consultation – initial observations**

The extensive intended coverage of this consultation is likely to require considerable thought and scrutiny and its approach is under consideration at ICAS in terms of prioritisation and workload management. One possible approach might be to consider separately the powers necessary to support the two devolved taxes above, from those that may be applicable only to future devolved tax powers; at this stage it is difficult to evaluate whether this will change the workload of scrutiny substantially.

The powers of a tax authority need to be balanced by safeguards, so seen in the ‘round’ with the resources to be applied by Revenue Scotland or delegated bodies, who will give effect to these powers. In particular we note the proposal that, where a tax self assessment is disputed by Revenue Scotland and tax assessed, the taxpayer only has a right of appeal if he or she pays the disputed amount first. This is regarded as having a precedent in the local authority rates system, but probably only in relation to valuation matters. This is a major change in principle, and uncommon in developed country tax systems without extensive exclusions. It can be used to illustrate the point above about the complex and interrelated interactions of principles and practicalities in a tax system and the difficulties of moving principles into robust provisions.

This policy assumes that the law is drafted with absolute clarity, so that there can be no issues of disputed interpretation needing to be resolved by the tribunal or court system, although this is not reflective of any practical experience. It is also inconsistent with legislation using subjective tests that require the taxpayers “purpose” to be ascertained, as is included in the draft land and buildings transaction tax legislation, for example. Other safeguards may be needed, such as independent panel reviews or hardship provisions, to avoid this giving rise to business or personal financial distress; a speedy timescale for appeal cases to be heard would then be needed, and as this is not a feature of the current tribunal process, a change to that process. The resourcing of Revenue Scotland (or the delegated assessing body) would have to be fully appropriate to this extensive power, so that it might be held accountable for the inevitable complaints about business pressures (and possible insolvencies) that might arise as a consequence. The lack of any principle encompassing ‘fairness’ is interesting, particularly under Human Rights law. Alternative routes to achieve the intent should be considered.

**Scottish Rate of Income Tax power – observations**

There are no current consultations on these powers, although working parties continue to consider implementation issues with HMRC. The position was summarised in the HMRC Technical Note of May 2012 “Clarifying the Scope of the Scottish Rate of Income Tax”.

As a power to make Scotland’s parliament more accountable to the taxpayer base, our reports have made two observations that set the context; firstly that whilst are 3.99m voters (for Scottish parliament and local government elections), there are only 2.6m income tax payers. This number is likely to reduce as the tax base narrows due to increasing personal allowance levels, or may vary with other structural changes effected by the UK government. Secondly, any recipients of universal credit (from its expected introduction in around 2013/14), who are also income tax payers will experience no net income effect of any change in the Scottish rate of income tax, due to universal credit being paid on a net of tax basis.

Regardless of whether the power to vary the rate is used to arrive at a different income tax rate for the rest of the UK, which will be an annual decision, significant implementation issues need to be planned for. For HMRC and payroll operators, as well as employees, the identification steps of Scottish taxpayers needs resolved. For, say, pension scheme administrators, potentially extensive system changes will be necessary to capture and process data as to taxpayer residence.
Appendix 1

SCOTLAND’S TAX FUTURE; WHAT TAX SYSTEM WOULD SCOTLAND WANT?

The ICAS viewpoint

August 2012
**Introduction**

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 or 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 the most interesting question of 2012 – what tax system would Scotland want?

This paper is not written with a political perspective, or to address the single, narrow topic of what the rate of a particular tax should be; instead it approaches the issue from a much broader and more challenging perspective. It seeks to share ICAS insights into the many complex issues and decisions involved in tax system design, whether this design is driven by the necessity of raising revenue, the opportunity those new tax-raising powers might bring to deliver more innovative or better funding solutions, or a mixture of both. It seeks to broaden the discussion well beyond the debate on the Scotland Act provisions, which use as a basis the existing UK tax system and some limited tax varying powers. It also contributes the experience of decades of work which ICAS members and staff have undertaken, often without public profile, with the UK Government and its agencies on the shared agenda of a better-balanced outcome for all tax stakeholders. This paper also refers interested readers to recent relevant research work in this specialised field.

The UK tax system has many imperfections; the complexity that comes from over 200 years of accumulated drafting and tinkering; challenges regarding the fairness of the sharing of the tax burden, and difficulties with HMRC computer systems and administration. Although any transition to fiscal devolution would have to start from here, what exactly is the destination? What tax system would Scotland want? What tax system should any Government of Scotland propose to meet the required revenue-raising targets as well as wider key principles, such as fairness, high levels of acceptability and compliance, low costs of collection and ease of administration? How practical and cost-effective would any transition be from the current system? To take matters forward, this paper divides these topical and highly important issues into six key questions that need to be explored.

The aim of this paper is to develop these questions and stimulate debate amongst the wider public. ICAS members have been consulted in the development of this paper and views expressed by members have been incorporated. Whilst the debate cannot abandon the practicalities of any tax system change – which may limit, perhaps severely, any aspirations or wishes for change – nevertheless it is worthwhile focussing on what a tax system can and should achieve, to also inform the approach to those practicalities.
Key observations

A number of observations are worth making at the outset.

Firstly, a number of ICAS members overseas commented that the design of a tax system may contribute to the success of an economy, but that success depends also on the relationship between the tax and political and economic systems of that country, as well as its social culture. For example, a political model designed to support the accountability of government and the engagement of voters, might seek greater identity between voters and income tax payers, so all voters had to pay some income tax, even at a modest level. An interesting debate is what the ideal position might be, but Scotland has, on latest estimates around 2.63 million income taxpayers and around 3.99 million voters (for Scottish Parliament and local government elections).

UK Governments have always liked to be “seen to be doing something”, and have for years applied an annual budget cycle, with inevitable political influences, that has resulted in the tax legislation being in a state of almost continuous change and increasing complexity. Why would or could this stop with more devolved tax powers, which may change the identity of the politicians making the decisions, but not the motivation for the changes?

Addressing the political, economic and cultural interactions of that debate goes well beyond the scope of this paper. The only point to make is that readers should bear in mind that questions on tax can have a wider context and influence that might immediately be apparent.

Secondly, the Scottish Government has at present neither an established mechanism, nor the expertise or resources to respond alone to these questions. The current reservation of tax powers to Westminster means it has to be questioned whether the Scottish Government has the full understanding of the complexities of the operation of a tax system to enable it to opine authoritatively on this topic. It needs to engage the right expertise if progress is to be made to meet public expectations that it is making any credible attempts to move the tax devolution agenda forward in the optimum fashion. It would be helpful in the discussion regarding devolution (whenever and under whatever provisions that takes place) to know when and how these questions might be addressed. Having said that, the announcements of the Fiscal Commission Working Group and of the proposal to establish Revenue Scotland as a tax administration for Scotland are indicators that these points are accepted and understood, and the initial steps appear to be in the right direction. Time will tell if, and how, these announcements and proposals will turn into efficient and effective solutions. After all, raising revenue will be fundamental to the operation of any new constitutional arrangement, and the outcome of the debate could have a very direct and personal impact on every Scottish taxpayer. ICAS is happy to contribute the skills and expertise of its members to discussions to take these forward, and to suggest sources and analyses of interest and relevance.

Thirdly, the complexity of tax systems around the world and their interaction, both structurally and operationally, is more than anyone would set out to design now. This complexity should not be underestimated. The current UK tax provisions are little understood or believed except by those who have spent their careers trying to navigate through the thousands of pages of legislation, guidance, forms and deadlines; a matter not to be taken as an expression of professional or intellectual arrogance, rather one of sad realisation based on sometimes painful practical experiences. Moreover, many UK government tax decisions are determined by European Union provisions, and UK tax law is subject to the terms of over a hundred double tax treaties individually negotiated with overseas countries. In the interests of establishing a sound basis for a debate on a tax system, the legal status of an independent Scotland within the European Union (whether it is bound by European Union or not, and what terms its membership must meet), should be clarified now, as should the terms of continuity of double tax agreements particularly with key international trading partners.
Next, the general public are often dissatisfied and confused by their interactions with HMRC, and might vote for any change as a promise of improvement. But what is this change to be? You do have to start from here.

As anyone who has looked at any isolated change to the tax system recently, such as the brief foray into the zero and 10% corporate tax rates in the past decade would know, the scope for getting any major change wrong is massive and can have serious consequences for tax yield. There is also much opportunity to learn from other regimes, existing expert studies and the talent and expertise pool in Scotland and of Scots.

Finally, the design of a new tax system, or any form of tax devolution, is so large a responsibility it cannot and should not be rushed. It will be far from easy to design and to implement. The inevitable efforts and pain need to be because the case is made based on research and evidence, that something better can and will be delivered. A research project is being commissioned by ICAS on the experiences and tax decisions of countries with newly gained independence or newly devolved tax powers, but ICAS alone is not resourced to inform this debate on its own. The question will remain, will it be worth it, and why? Political leaders and others may be interested in the observation in the Mirrlees report “Tax by Design”:

“In addition to administrative practicality and the difficulty of turning economic intentions into robust legislative language, proposals for tax reform are, of course, constrained by politics – not least the unfortunate observation that those who lose from tax reforms tend to be vengeful while those who gain from them tend to be ungrateful.”

If early tax devolution is decided upon, it will only be practical to adopt the current UK tax system with as little change as possible, but with the administrative system costs to be borne. A fresh approach will probably take at least a decade of effort and disruption to achieve; some say longer with exceptionally hard work. But not to take those steps could be to compromise on principles and opportunities, for the reasons set out in this paper. That could lead voters to the stark question: is there then a real point to tax devolution?

**The key questions**

It is proposed that six key questions need to be answered to move the debate forward, and determine what should be on the tax agenda for Scotland. Each of these is addressed in overview below. One caveat however: this is not intended as a complete thesis but rather an overview, based on existing research and publications, and ICAS experience, from which insights and ideas might be drawn. Other questions and approaches will no doubt emerge, and the issues of practicalities can be addressed as a next step, but an agenda for a debate is always useful.

The starting point for a new tax system is a blank sheet of paper. There is only one assumption; that raising taxes is essential to fund public services. It may be helpful to apply the debate to known or given factors, such as the population profile of Scots and business base as at the start of 2012, but only insofar as it may prove the revenue-raising adequacies of the tax system once designed, not to affect the design.

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**Question 1 - What principles should determine the ideal tax system for Scotland?**

Developed economies’ tax systems are a relatively modern phenomenon, most having seen exponential growth in the last 50 years. Tax systems are also man-made, by politicians with a generally limited understanding of the detail of what they do and limited control over the tax administrations they appoint as operators.

It follows then that the people should shape the decisions on the governing principles to be applied, and the establishment of tax policy, by engagement in the debate with elected leaders and policy makers. High-level engagement is perhaps more practical than universal involvement in the detailed drafting of the legislation and the design of the administrative steps that put those principles into practice and make the tax system a reality. But an understanding of the consequences is relevant to the decisions on principles; these consequences need to be considered without allowing them to impede progress on design.

Thinking about tax from the basis of principles, through policy, to practice, is neither new nor particularly controversial for Scots. Adam Smith started this in 1776 in his “Inquiry into the nature and causes of the Wealth of Nations”, with four maxims with regard to taxes; the burden proportionate to the ability to pay (sometimes called a progressive tax approach), certainty, convenience and efficiency of collection. Many of these principles were reflected in an exercise undertaken by The Institute of Chartered Accountants in England and Wales in 1999, when it identified “Ten Tenets for a better tax system”. These comprised principles behind a better tax system; that a tax system should be: statutory (enacted and scrutinised by Parliament), certain, simple, easy to collect and to calculate, properly targeted, constant, subject to proper consultation, regularly reviewed, fair and reasonable, and competitive.

Similar themes were echoed when the current UK Government defined its view of the principles for the UK tax system in 2011 as:

- “Taxes should be efficient and support growth;
- Taxes should be certain and predictable;
- Taxes should be simple to understand and easy to comply with; and
- The tax system should be fair, reward work, support aspiration and ask the most from those who can most afford it.”

These short and simple principles are rather neat. Scotland can come up with its own, or have a different emphasis. ICAS members who commented favour simplicity, fairness and efficiency, but with recognition that progressive tax rates could both improve fairness and increase complexity, through the need for anti-avoidance provisions as taxpayers tried to avoid higher rates. It is when these principles are translated into policies and legislation that it becomes more interesting, as trade-offs, contradictions and piecemeal developments start to add weaves of interaction and complexity. To understand more about these issues, and prepare for the next questions on the list, time would be well spent with a read of the 2011 Institute for Fiscal Studies Mirrlees Review, “Tax by Design” (or even just its introduction).

That paper’s detailed examination of the topic raised further concepts and 21st-century factors influencing policy designs, such as:

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2 Available from the ICAEW website at http://www.icaew.com/~/media/Files/technical/Tax/Tax%20policy/Ten%20Tenets%20for%20a%20better%20tax%20system


4 Available from The Institute of Fiscal Studies website at http://www.ifs.org.uk/mirrleesReview/design

the changing importance of particular business sectors in the economy
the changing demographics in the working population and households
the interaction with benefits systems (negative taxes) in addressing inequality in incomes
globalisation, particularly the role of technology in international business transactions
the influence of the European Union, with its control over VAT and dislike of tax havens.

The debate in recent months has focussed on the competitiveness of a tax system, particularly focussing on the headline corporate tax rate. For the purposes of this exercise, this particular question would ask where competitiveness as a principle would sit in the relative priorities of the tax system design, rather than fix an answer or target rate.

One caveat however, the European Union’s rules on tax systems, and State aid in particular, cannot be ignored – unless of course Scotland is not part of the EU. The European Parliament is also considering enthusiastic proposals by a number of European countries, towards a Common Consolidated Corporate Tax Base6; effectively an EU set of tax rules for companies based in the EU, overriding domestic provisions, except for decisions on tax rates. Disputes over EU tax issues take a long time to resolve.

The answer to Question 1 sets the aspirations and principles to underlie the rest of the tax system design.

**Question 2 - Should tax play a wider role than raising revenue?**

Wider policy issues can sometimes enhance, and sometimes confuse, tax principles. What other role, if any, should tax play in a future Scotland?

The tobacco industry tax has for a long time now been associated with the costs of treating the health consequences of smoking, regardless of whether that was its original purpose. The recent debate on the costs to health and health systems of alcohol abuse, even with significant alcohol duties already applying has raised this as an issue again, albeit in Scotland as a minimum pricing issue given the lack of tax powers.

A choice may be made to address the obesity issue with a tax on selected foods; that debate has been taken forward recently by Denmark in its introduction of a tax on foodstuffs with a higher fat content, and Hungary with a similar response but a broader categorisation including sugar7. Sugar taxes in fizzy drinks are under serious consideration in parts of the USA. In all of these, tax is seen as a route to influence behaviour against consumption, based on what a government considers unhealthy.

Moving beyond health, Bill Gates’ report to the G20 leaders Cannes Summit in November 20118 also supported carbon tax measures, to address climate impacts and address issues of social responsibility and redistribution of wealth on a global scale. These principles can also be localised; the UK already has a landfill tax aimed at encouraging recycling but is redistribution of wealth a design feature to build in, and how?

This might also be a time to consider whether national insurance contributions should be recognised as a tax, in that they generate revenue for current public spending outflows, rather than as a set aside to fund future retirement provision on a compulsory contributory principle, or both.

After addressing Question 2, the system design principles at least start to take shape.

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7 See observations on the new Institute for Fiscal Studies project to investigate the impact of these types of policies, available at http://www.ifs.org.uk/publications/5712.
The Mirrlees report mentioned above included recent tax yield and demographic statistics for the UK, which can be taken, at best, as a proxy for the shape of those statistics for Scotland for the purposes of starting this debate.

(Let no-one be misled, there are no official statistics for tax paid by those in Scotland, simply because there has never before been a need to measure them and the mechanism has never been set up. This is discussed further under question 6 below).

The first need is to define who would, and would not, be a Scottish taxpayer? Start with individuals, where we can look to recent work in connection with the Scotland Act 2012 provisions to allow limited income tax varying power to the Scottish Government. (Companies currently have a separate tax regime.) Both the UK and Scottish Governments took a straightforward approach to taxation of individuals, fitting those limitations, of regarding “Scottish taxpayers” as a subset of “UK taxpayers”, broadly on the basis of where their main home was. A number of anomalies were found as to the treatment of mobile workers; naturally any existing anomalies in the determination of a “UK taxpayer” would carry through. That taxpayer base has the advantage of relying on known rules (albeit the UK rules are likely to change in 2013) and having an automatic default for an individual Scottish taxpayer to being a UK taxpayer, so setting out the tax boundary with the rest of the UK.

However, if starting with a blank sheet of paper, would the Scotland Act’s approach to income tax be the optimal one? An example of one disadvantage of the approach is given by the current definition of a “Scottish taxpayer” being based on the definition of a UK taxpayer, according to rules of UK tax residence. That Scottish taxpayer “subset” could then be altered by UK decisions, taken at Westminster, on the definitions of UK tax residence, decisions not taken in Scotland and subject to potential ongoing change, albeit that the changes may only affect a relatively small number of taxpayers.

Perhaps those rules aren’t ideal, given that the latest UK consultation process is being extended due to issues with the complexity of the proposals and their impact. Do other international regimes provide the answer?

For companies, is it just Scottish incorporated companies, or any companies with places of business in Scotland, or selling to or from Scotland which should pay tax in Scotland? Whether a company is incorporated in Scotland or England and Wales has had so little impact in recent years it has been a decision of administrative convenience at the time of set-up rather than of import or consequence for the vast majority. The place of business rules might be expected to dominate.

For international businesses - which would then, by definition, also include those who do business inside and outside Scotland but within the UK - this area is fraught with complexities in compliance. Tax jurisdictions across the globe try to make sure they have their fair share of taxing rights; through defining who pays tax, and also what will be taxed in each tax regime – known as the transfer pricing issue.

Each tax jurisdiction demands proof that transfer prices have allocated fair profits and tax to the appropriate exchequer, so the administrative consequences of these rules for businesses operating across the UK could be significant and result in an increased compliance burden.

ICAS expressed its concerns on this matter in representations submitted in 2011\textsuperscript{10}, subsequent comments have been in relation to the balance between any advantage of a lower tax rate against the disadvantage of a greater administrative burden for all.

It might be timely also to raise again the complexities in the UK system arising from the differences in tax and NIC paid when income is earned by an individual, when compared to income paid to a company owned by that individual. If less tax can be paid by an individual paid through a company, you can argue whether choosing that route is tax avoidance, and what to do about it, or you could eliminate the issue by better alignment of the regimes in a way to remove the tax and NIC differential.

Beyond that, a number of key exemptions are granted in different tax systems, commonly for organisations such as charities (including schools and universities). Focused exemptions are also given to particular types of income; these vary from miners’ free coal, to employees’ Christmas parties (within limits) and asbestos compensation, from electricity micro generation to players in the UEFA Champions League Final 2011. The list of reliefs examined by the Office of Tax Simplification in its March 2011 report\textsuperscript{11} identified 1,042 in the UK tax system although a small number (less than 50) mainly of limited use or expired, have now been removed. In comparison to the existing system, there is no doubt that simplification could be achieved. The Office of Tax Simplification reports about reducing the complexity of tax reliefs and interactions within the system could also be read as a list of “things to avoid putting on the blank sheet of paper”, but also demonstrate the consequences in a tax system of trying to do too much for too many different interests. Which leads to question 4.

**Question 4 - What should be taxed?**

Probably the most fascinating of all questions relating to this matter, as it really includes separate issues of the tax source (the activity, such as earnings or profits, ownership of capital or wealth, consumption), the taxable amount (the calculation of the earnings or profits, less reliefs or exemptions) and the tax rate(s). All of these separately and together are what makes a tax system, not just the tax rate.

This is also where the interaction of the principles becomes evident. For example, if one chosen principle for the tax system is simplicity, then the system design would have simple rules for taxable activity – such as all earnings, profits, gains, pensions – then apply one of the simplest taxable amount calculations – the cash receipt – and tax rates would be a simple fixed and flat percentage.

But if another chosen principle is that a fair tax system should be based on ability to pay, then a simple flat tax rate does not deliver that; progressivity of higher tax rates for higher incomes and greater affordability would be demanded.

Why is the existing UK tax regime so much more difficult? A simplistic answer is because of legislative baggage, because cash receipts can be manipulated - if your employer pays your rent directly to the landlord, whose taxable receipt is it? - and are not currently regarded as giving the recognised measure of the net economic or business performance or health.


\textsuperscript{11} Office of Tax Simplification “Review of tax reliefs Final report” March 2011.
However, the possible use of cash receipts and other simpler approaches for smaller businesses have been the subject of an HMRC consultation\(^{12}\), following a review by the Office of Tax Simplification\(^{13}\) and the Department of Business, Innovation and Skills\(^{14}\); their research and observations will be informative in this debate.

Radical outcomes might be possible and practical. The UK system currently has separate systems for taxing investment income and capital gains, once realised. The rules are lengthy and complex. Other countries have tax systems based not on realised income and capital gains, but a deemed return on invested capital; the Netherlands for example taxes an annual 4% deemed return on relevant wealth; ability to pay is simply assumed and the compliance burden much less. Some of the alternatives to consider based on other jurisdictions’ practices were set out in the Office of Tax Simplification report referred to above\(^{15}\).

Would, or should, inheritances be taxed? Many estates now involve trust arrangements (a trust being a legacy of protection of land and wealth in past generations, perhaps as far back as the Crusades) and a large proportion of the tax code deals specifically with this area. Is it worth looking again at this for the Scottish taxpayer base? Much value is still held in the form of land, on which a transfer tax (stamp duty land tax) is currently payable. What about a simpler, combined approach to taxing these?

This also leads to the question of what activities or groups should be favoured, or otherwise, in the ideal tax system. Do we continue the UK system of favouring entrepreneurs on capital gains and inheritances on the basis that they are employment creators and should be incentivised? Certain types of growth-related activity, such as research and development, often gain support, but again we get back to principles. If economic competitiveness is a key principle, does that mean favouring particular sectors or activities, and which ones, and how? Usually this means adjusting the tax base (the taxed profits) rather than the tax rate, but international tax competitiveness is an ever changing field. Any government needs to make sure that the form of any tax rate or tax base reductions do result in economic growth and so tax yield replacement, rather than a permanent loss of tax revenue without any benefit.

With an ageing population, could Scotland afford to continue the more generous personal allowances for the over 65s, particularly if there is tax relief given on pension contributions – even taking account of the recent Budget announcements? With the challenge of getting school-leavers into work is it worthwhile improving their chances of being employed by giving them and their employer’s tax breaks, or more relief for training costs? Is it time to integrate income tax and national insurance contributions, which might highlight that earned income is more highly taxed than unearned income, and taxed according to different rules? This is not to discuss mainstream party politics but to suggest how wider consideration in our blank-sheet-of-paper world may highlight some different approaches needed for the 21st century.

William Pitt in 1796 presided over taxes on dogs, windows and male servants. Recent calls have been made for taxes on carrier bags, cyclists and tourists. ‘Who pays?’ is always difficult to answer and exercises many minds; popular consensus on this may take time.

\(^{12}\) HMRC “Simpler income tax for the simplest small businesses” March 2012
\(^{13}\) The Office of Tax Simplification “A simpler income tax for the smallest businesses; a discussion paper” July 2011
\(^{14}\) Department for Business Innovation and Skills and the Financial Reporting Council’s “Simpler Reporting for the Smallest Businesses” Discussion Paper, August 2011
\(^{15}\) The Office of Tax Simplification “A simpler income tax for the smallest businesses; a discussion paper” July 2011
It is also necessary to consider taxpayer behaviour, and the behavioural response to tax legislation and changes. Most people don't like paying tax. Most people will try to avoid paying tax, mostly within the law (tax planning or avoidance) but sometimes outside it, through tax evasion. So whilst you can design any tax system you want, it needs to be workable and collect what you want it to.

This means mechanisms are needed to pursue tax evasion (which is illegal) and address tax avoidance (which is legal); a strong compliance and enforcement regime penalising evasion may be necessary. For tax avoidance, the decision is about what behaviours to tackle; where is the line between acceptable and unacceptable tax planning? Another principled debate is needed here for the tax system to be designed, with contributions no doubt from informed sources such as Graham Aaronson QC’s Study Group report on anti-avoidance legislation16. A few members suggested consideration of the position in some overseas jurisdictions who regard individual’s tax returns as a matter of public record, but that goes back to the point of a tax system’s success being based on its fit with the country’s political and social culture.

Finally, there is the geographic question, particularly for businesses operating overseas as well as in the UK. Does the system aim to tax profits generated in Scotland, or owned by Scottish companies, or use another approach? The UK is at present party to a number of international tax agreements, which, according to the Organisation for Economic and Social Development’s principles, determine the jurisdiction with taxing rights over property or income, and of relevance to companies and individuals. Territoriality has become the emerging theme for the taxation of international business groups globally. Whether some protest groups like it or not, the UK and many other jurisdictions permit, indeed have rules designed to facilitate, an acceptable level of tax planning internationally. Should Scotland sign up to the same principles of territoriality and network of double tax treaties independently? Would this be an absolute necessity in order to gain the tax efficiencies they deliver for businesses located here, such as not having a cash-flow disadvantage from suffering withholding taxes, which is key to competitiveness, and being an acceptable, never mind attractive, business location. Is there a credible argument for taking sectoral favours further and adopting tax haven status for money box companies based here, as is the case for other small jurisdictions such as the Channel Islands? How would the EU view that?

The shape of tax systems changes whichever jurisdiction is reviewed, but each needs to be seen in its entirety, rather than piecemeal. This is probably a matter where learning from overseas systems could be most informative.

**Question 5 - Who should run any new tax system in Scotland?**

Once the tax system is designed, the administrative resource can be aligned accordingly. Even more decisions are then needed; what accountability should there be of that resource to the Scottish Government? Recent examination of HMRC by the House of Commons Public Accounts Committee has revealed gaps in expectations of governance, never mind scrutiny, of the HMRC Board; the outcome of the current Cabinet Office review might be informative. But with Scottish Parliamentary procedures and principles already in place, how would these be built on to achieve the types of performance management and accountability that a tax authority might be expected to deliver?

The UK tax system is run by HMRC, based on massive IT systems developed over many years. A recent announcement from the Scottish Government proposes Revenue Scotland, as a Scottish tax administration, would be established. There would not be outsourcing to HMRC. What would it cost and how long would it take to establish?

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16Available from http://www.hm-treasury.gov.uk/d/gaar_final_report_111111.PDF
With a largely England-based technical division, and following recent reorganisations, HMRC has arguably neither the expertise nor capability to staff a Scottish Tax Administration without major re-engineering. HM Treasury and London based HMRC staff currently drive the majority of policy decisions; the current HMRC staff in Scotland do not have the range of policy and management experience, nor operating structure, to operate a separate tax system at this time.

This question was identified in the Scottish Government paper last year\textsuperscript{17} but perhaps the question would need to be addressed with a specific design in mind.

If an outsourcing approach is considered, why limit consideration to HMRC; why not consider, say, the Australian administration, which on some National Audit Office analysis seems to operate with greater efficiencies\textsuperscript{18}?

Bear in mind also the potential lack of economy of scale in a tax system run for Scotland, at less than 10\% of the size of the UK; a different cost-effectiveness and efficiency model from that for the UK may be desirable to achieve value for money.

\textit{Question 6 - What would be needed to implement any tax devolution in Scotland?}

This is a bit of a chicken and egg dilemma; until the process of designing a tax system is complete, including who should pay tax and on what, it is impossible to know what it will yield and therefore whether it will achieve its economic tax raising purposes. The data that might be needed to prove economic effectiveness, such as statistics for the Scottish taxpayer base of individuals and businesses, is not held by anyone at present; for the simple reason it has never been, nor had to be, collected. A significant data-gathering exercise seems on the horizon if there is to be any tax devolution, as well as extensive economic and behavioural modelling exercises. The Barnett formula impact debate may use or provide some of this data as well.

Then there remains the need to identify the Scottish taxpayer base. How? There are no complete, tax-system-ready records of who is in Scotland at the moment (if that’s the tax base you decide). HMRC can select details according to postcode but only for those “live” on the system, and there are serious concerns over data accuracy. Reporting of address changes, immigration and emigration render this an ever moving target. The issue for companies was set out above – there is a less immediate linkage of taxable profits to postcodes, given businesses may have many offices or depots – so that exercise too is needed to decide which companies and what proportion of business profits would fall within a Scottish tax net. The compliance burdens and competitiveness impact were outlined in ICAS representations in summer 2011\textsuperscript{19} and addressed at page 6 above.

Any departure of all the Scottish taxpayers (once defined) from the UK tax regime would introduce the scope for potentially interesting negotiations with HMRC on handover matters, such as tax deferrals or exit charges from the UK tax system, as arise for those leaving UK tax residence. This may result in a requirement for the establishment of a separate tax administration for any devolved tax powers or jurisdiction, or some other mechanism to avoid “HMRC Scotland” arguing with “HMRC UK”; a situation commonly agreed to present quite a conflict of interest and accountability.

\textsuperscript{17} Corporation Tax: Discussion Paper Options for Reform, August 2011.

\textsuperscript{18} Report “HM Revenue & Customs Engaging with tax agents” 13 October 2010.

The tax provisions would then have to be passed into legislation, possibly a lengthy process of drafting and review. There are around 80 Acts of Parliament at present relating to UK tax and national insurance contributions with provisions in effect, not to mention a huge quantity of secondary legislation and guidance.

The massive volume of existing legislation is directly related to the number of things the tax system is trying to do; the number of taxes, types of taxpayers, rates, reliefs etc – complexity – plus the drafting style of the legislation. That people just don't like paying tax mean that a plethora of anti-avoidance provisions abound, not always very efficiently or effectively. Whilst in theory a different approach to legislative drafting might be taken with the blank sheet of paper system, it would be a drafting approach not yet developed.

At present it takes a UK Government at least a year, probably nearer two, to shape, draft and enact one Finance Act, so getting to grips with a realistic timescale for any tax devolution is essential, even once the Scottish Parliamentary processes and procedures have been decided. To design and implement an independent tax system in Scotland from scratch may realistically take at least a decade if not two, shorter if a more limited devolution of powers is involved.

Transitional provisions for taxpayers to move from the UK to any new system would also need to be considered, with decisions on changeover dates and records, and no doubt lots of forms to be filled in unless smart thinking is applied. Adopting the conclusions of the Mirrlees\(^{20}\) report might shorten this process, but only perhaps if it received wide support. It may be that as a matter of practical reality the decision is made to adopt the existing UK tax system with the potential for devolved changes over time, but that will defer, rather than avoid, this debate.

Good and clearly established relationships with overseas tax jurisdictions are key to business and economic competitiveness, through the operation of the Double Tax Treaty network as well as cooperation agreements. It is likely these would need to be established and maintained for a devolved tax system as well. Changes to tax systems do not necessarily cause the principles in Double Tax Treaties to fail, but what is the position of any change in the tax authority at the same time? Would any devolved or independent negotiating position be seen as weaker, being from a smaller and newer tax authority? A clear position on how any tax system changes would impact on business competitiveness in this area is an early requirement.

This final question is the one where practicalities and processes loom largest. Given the competitiveness agenda of most countries in economically challenging times, and the need for many for certainty in a world where uncertainty may be seen as risk, is it important that a process and timetable for this debate, or the destinations, are set out sooner rather than later? Or is time better spent in design and on principles? ICAS members welcomed the sentiments behind the UK Coalition Government’s Corporate Tax Roadmap in 2010, and would welcome continuation of those principles of a clear direction of travel. As stated above, this paper is about starting the debate on tax system design options in the light of the devolution debate. Much more will no doubt be written in due course on the practicalities.

But whichever tax future is chosen, there is likely to be agreement that it would be helpful to optimise the benefits of a chosen system and minimise the costs and adverse consequences of change - we come back again to an area where ICAS members contributions to the debate may be hugely valuable.

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 first in a series that aims to do this; we are seeking to ask the questions in key areas that those on all sides of the debate should address over the coming months.

For the avoidance of doubt, ICAS will not be taking any political perspective or taking a stand for or against any referendum proposal.
The ICAS Members Debate

SCOTLAND’S TAX FUTURE; THE PRACTICALITIES OF TAX DEVOLUTION

A discussion document
13 November 2012
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 responsibilities21.

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:

21 The Scottish Budget Process and the Scotland Act 2012, David Bell, August 2012.
• **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.

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 is 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 Connect22, 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 Tax\textsuperscript{23} 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.

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 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.

\textsuperscript{23} HMRC “Clarifying the Scope of the Scottish Rate of Income Tax” Technical Note May 2012
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 these24, 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.

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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.

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.
About ICAS

ICAS is the world’s oldest professional body of accountants, having received its Royal Charter in 1854. 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.