Devolution of tax responsibilities to the Scottish Parliament: implementation experiences

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Scottish Parliament tax responsibilities

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Tax	Date of Scot Parl responsibility	Forecast revenue 2021/22 (£m)	Degree of devolved control
Council tax	1999	£2,122	Fully devolved; complete autonomy
Non-Domestic rates	1999	£2,139	Fully devolved; complete autonomy
Land and buildings transactions tax	2015	£586	Fully devolved; complete autonomy.
Landfill tax	2015	£88	Fully devolved; complete autonomy.
Income tax (on NSND income)	2017	£12,263	SG sets rates and bands; reliefs/ allowances set by UKG
Air Passenger Duty	tbc	£129	Fully devolved; complete autonomy
VAT: partial assignment	tbc	£5,727	Assigned revenues; no autonomy
Aggregates Levy	tbc	£62	Fully devolved; complete autonomy

Tax devolution: rationale and risks

Tax devolution as a means to improve economic/policy outcomes:

- Enhanced accountability (link between policy decisions and budget outcomes)
- Policy tools (particularly where preferences/needs differ)
- Policy experimentation/ learning

But tax devolution may also have costs and risks:

- Spillover effects (e.g. suboptimal outcome compared to central govt control)
- Institutional burdens (e.g. diseconomies of scale in administration)
- Spatial inequalities (e.g. because of differences in tax capacity)

- *Balance of benefits and costs of devolution likely to depend on economic and political context, design of supporting institutions (e.g. grant mechanisms), and nature of tax powers devolved*

Tax characteristics and devolution

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- Which factors might we want to take into consideration when deciding whether a particular tax is more or less suitable for devolution?
  - Administrative efficiency
  - Tax incidence
  - Visibility
  - Tax base mobility
  - Link to existing devolved policy responsibilities
  - Revenue volatility
  - Inter-regional inequalities in tax base
  - Public preferences

Tax characteristics and devolution (2)

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- Any single tax unlikely to score well on *all* criteria
- In general, land and property transactions taxes often viewed as most appropriate for devolution; followed by residence-based income taxes; corporation tax arguably least appropriate (mobility of base, volatility, estimation issues; incidence not obviously on devolved electorate).
- Design of supporting institutions – e.g. grant mechanisms – and degree of tax autonomy, can often offset some of the risks/costs associated with some taxes
- *The decision over which tax responsibilities to devolve reflects a trade-off between, on the one hand, a desire to assign spending and taxation levers to appropriate levels of government, and on the other hand, the objective that subnational governments should fund themselves through their own sources of revenue as far as possible*

‘Calman’ taxes

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- **Land and Buildings Transactions Tax**
  - Rationale: property is immoveable; taxes on residential and commercial property already devolved
  - Scottish policy has diverged from ‘England/NI’ policy quite markedly in some areas
  - Main issue from devolution perspective relates to timing issues associated with UKG Stamp Duty policy change
- **Landfill tax**
  - Case for seems intuitive: waste management and land use devolved functions, and ‘land’ is immoveable. But SG commited to maintain same tax rates for fear of ‘waste tourism’
- Both taxes ‘fully devolved’ – legacy UK taxes switched off in Scotland and replaced by wholly new taxes, legislated for in Scot Parl. Revenues collected by Revenue Scotland

Income tax: motivation

- Smith Commission didn't provide rationale for their decisions. But retrospectively we can say:
  - Income tax has fairly broad incidence (half of Scottish adults); visible to those who are liable; significant in revenue terms
  - Potential concerns around differential tax capacity (Scottish revenues per head approx. 10% lower than rUK) equalised away through block grant; cyclical volatility also largely equalised away
  - Some evidence that Scots have different preferences for redistribution
  - Administration costs managed by limiting devolved autonomy to rates and bands (not base) – with HMRC collecting the tax paid by 'Scottish' taxpayers

Income tax: practical issues

- Significant policy divergence
- Administrative issues:
  - HMRC costs recharged to SG have turned out somewhat lower than anticipated (£24m set-up costs plus annual costs of £1-3m)
  - Big challenges early on with identifying 'Scottish' taxpayers – currently HMRC correctly identifying 98-99% of Scottish taxpayers
- Issues arising from Scottish policy change:
  - Implications of changes to Scottish rates and bands for reliefs and allowances administered at UK level - Issues generally resolved swiftly by the two governments
  - Interaction between Scottish HRT and UK NICs threshold creating high marginal tax rates for some Scottish taxpayers
- Various other fiscal framework issues (discussed later)

VAT assignment

- Original motivation: largely to be able to say that >50% of SG budget accounted for by devolved and assigned taxation?
- Much scepticism about whether ‘assignment’ will do much to raise ‘accountability’
- But VAT not happened due to practical issues around estimation:
  - Both govts agreed that VAT assignment should not create additional burdens for business
  - As a result, ‘outturn’ Scottish VAT will never exist; instead need a way to estimate Scottish VAT share
  - ‘VAT assignment model’ developed by both govts together is complex and data-heavy; but at same time, resulting revenue estimate is not robust enough for SG to have confidence in
  - Will it happen? 50/50. Sunk costs and face-saving keeping the idea alive for now.

APD & Aggregates Levy: delayed by legal/state aid issues

- **Air Passenger Duty**
  - Motivation: politically motivated by SG policy aspirations at time?
  - Has not been implemented due to what should have been foreseeable issue: EU State Aid issues in relation to APD exemption for flights from highlands and islands
  - Following Brexit, resolution of H&I exemption issue awaits UKG’s developing ‘subsidy control system’.
- **Aggregates Levy**
  - Delayed by protracted legal issue (‘Aggregates UK’ court case against UKG)
  - Now resolved, paving way for devolution to take place

Fiscal framework

- Fiscal framework sets out how new fiscal powers will be operationalised – adjustments to block grant, forecasting roles, budget management tools to address forecast error, dispute resolution, etc.
- Critical component of tax devolution; negotiated by UK and Scottish govts after Smith Commission
- Fiscal framework has many strengths; but does create significant extra complexity in understanding the budgetary outcomes of devolution
- Govts struggled to agree terms of framework – could not agree on technical way to adjust block grant…
- …But aspects around budget management tools received too little attention
- Fiscal framework due to be reviewed in 2021, but UKG and SG cannot agree scope of review

Intergovernmental working/ coordination

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- Some good examples of intergovernmental working. But SG feels that its requests tend to be ignored:
    - Request for more notice of UKG tax policy announcements where these may have devolved implications (note joint letter from all three devolved finance ministers).
    - Issue of ‘no detriment’ in relation to income tax
    - Question of additional fiscal flexibilities during pandemic
    - Scope and timing of fiscal framework review
- Inadequate architecture for effective intergovernmental working.

Conclusions/ lessons

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- Decisions over which tax responsibilities to transfer very challenging – perhaps some easy answers, but not many
- Be honest about risks and costs
- Operational details are critical
- Boring stuff – around block grant, forecasting responsibilities and risks – perhaps just as important as the tax responsibilities themselves