Wales consults on behavioural tax changes and the future of Welsh law

General Features | Personal tax

28 February 2020

The CIOT and LITRG have sent in comments on two recent Welsh consultations, on behavioural responses to income tax variations and the future of Welsh law.

The CIOT and LITRG have submitted joint responses to two recent Welsh consultations; firstly, to the Finance Committee's inquiry into the impact of variations in national and sub-national income tax; and secondly to the Welsh government consultation on 'The future of Welsh law: classification, consolidation, codification'.

The Finance Committee's inquiry into the effect of income tax variations on behaviour

The inquiry raises questions in respect of the possible impact of different income tax rates across the Wales-England border. The terms of reference of the inquiry are:

- to examine the effects of sub-national income tax variations in international tax systems on the behaviour of low, medium and high income earners, particularly migration and tax avoidance;
- to understand how low, medium and high income earners may respond to income tax rate divergence for each tax band between Wales and England;
- to understand the level of divergence in income tax rates that could trigger a behavioural change in low, medium and high income earners in Wales and England; and
- to assess the monetary impact on Welsh rates of income tax (WRIT) revenue with varying levels of tax rate divergence.

We thought that further research is needed, looking at different types of taxpayer and their attitude to paying more or less tax in return for increased or reduced social

funding. It should take into account the effect of geographical differences (such as proximity to work, ease of travel across the Wales-England border, housing costs and the cost of living generally) on individual choice on where to live and work, and to what extent changes in tax rates may influence decisions (as compared to other factors).

Research should look at how much increases in income tax rates would actually increase the tax take (because the increase in revenue from taxpayers who remain in Wales and continue to report high incomes is offset, for example, by more Welsh taxpayers migrating to England to work because of the higher Welsh rates). It is even possible that such behavioural effects could exceed the direct increase from raising the rate; although this is an extreme possibility, it does highlight the importance of such research. For similar reasons, it should not be assumed that reductions in the rate would reduce revenue pro rata.

One of the difficulties identified in our response is that researchers tend (and are maybe constrained) to aggregate behavioural effects to produce a single composite estimate of the sensitivity of reported income to the tax rate, though in real life its different components call for very different responses; for example, increased under-reporting can be addressed by enforcement action. Other types of behavioural response such as tax-driven incorporation of businesses (or potentially in the future, migrating from Wales to escape a social care levy and migrating back later in life to benefit from better social care) can potentially be addressed by design features of the system. It is also possible that individuals will choose to extract more income that is not liable to the WRIT (such as investment income) or realise capital gains to meet their ‘income’ needs.

In addition, reactions to increased tax rates can be emotional as well as practical and this may be influenced by a perception of what the extra money is spent on and whether that commands support.

We pointed to the introduction of the additional rate of income tax of 50% for incomes over £150,000 in the UK in April 2010, subsequently reduced to 45% from April 2013. HMRC’s report concluded that there was a considerable behavioural response to the rate change, including a substantial amount of short term forestalling.

However, determining the longer term underlying behavioural response to the additional rate was more challenging. This issue remains politically and academically controversial but one clear point is that short term effects, including forestalling and more enduring effects, can be very different in both their scale and nature.

The full response is at www.tax.org.uk/ref612.

The future of Welsh law: classification, consolidation, codification

The Welsh government consulted on the following issues:

- **A draft taxonomy for codes of Welsh law organised by subject matter:** We noted that the category of 'Taxation' would potentially encompass not only management and collection legislation, land transaction tax and landfill disposals tax but also the partial devolution of powers to set WRIT, potentially business rates and potentially new taxes such as a vacant land tax or a levy to support social care. There may be fine distinctions as to where boundaries lie between subject categories in the taxonomy. For example, in relation to taxation, would legislative mechanisms for tax appeals fall under 'Taxation' or 'Public administration'? The ability to link between categories by some form of tagging may be appropriate.
- **The consolidation of existing law, including modernising the form and drafting where necessary:** Devolved tax legislation is relatively new, drafted in a modern style and has only been in effect for a short period. Our response saw no obvious case for consolidation of existing devolved tax legislation. We pointed to the UK Tax Law Rewrite Project (TLRP), noting that whether professionals were positive or negative about the TLRP it was felt that the rewrite process had missed the opportunity to simplify. The fundamental issue in terms of accessibility was the inherent complexity of underlying tax concepts rather than language or structure.
- **The codification of Welsh law, that is, the process of adopting and maintaining a structure for Welsh law involving the designation of a principal Act in a particular code:** We recognise the advantages of this approach. However, it is not clear how it might operate in relation to the three current main devolved taxes Acts. Would all three be principal Acts?

We pointed also to the importance of explanatory notes accompanying devolved tax legislation setting out the intention of the measure, as opposed to simply re-stating

the legislation. Our preference is that where the devolved legislation makes reference to or uses a term from a provision of a UK statute, the relevant words are re-stated rather than effected by cross reference.

It would assist the understanding of Welsh law if the legislation does not use a term that already has a commonly understood meaning, but then ascribe to it a different meaning. For example, in UK tax legislation, the personal savings allowance and dividend allowance are not allowances in the commonly understood sense of the term. Rather, they are 0% bands of tax.

Our full response is at www.tax.org.uk/ref613.

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