Scotland update – ‘A Scottish Approach to Taxation’ and the Budget Process Review Group

General Features

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The CIOT has submitted additional written evidence and given oral evidence to the Finance and Constitution Committee in respect of its inquiry into a Scottish approach to taxation; we have also submitted a response to the consultation on the interim report of the Budget Process Review Group.

‘A Scottish Approach to Taxation’: additional evidence

The CIOT gave oral evidence and submitted written evidence concerning the issues of incorporation and the potential impact on the Scottish Budget if there is a change in the rate of income tax in Scotland.

The Scottish Parliament’s Finance and Constitution Committee has been carrying out an inquiry into ‘A Scottish Approach to Taxation’. The CIOT, LITRG and ATT made a joint submission at the end of September 2016 in response to the initial call for evidence.

The Committee invited CIOT to give oral evidence to the Committee at a meeting in April, and also requested an additional written submission focussing specifically on the issue of incorporation and the potential impact on the Scottish Budget if there is a change in the rate of income tax in Scotland.

In response to this specific request, our new written submission focused on the tax differences between operating a business through a sole trade or a limited company, while noting that incorporation can be motivated by a variety of non-tax factors. We commented for example that various measures, such as the dividend allowance, introduced by the UK government with the aim of tackling tax-motivated

incorporation, were unlikely to achieve their aim. We also considered the tax issues peculiar to Scotland, as a result of the devolution of powers over income tax rates and bands for the non-savings and non-dividend income of Scottish taxpayers. This means that if a self-employed individual who is a Scottish taxpayer incorporates their business, they can switch from paying income tax according to Scottish rates and bands on self-employed profits, to paying income tax according to UK rates and bands on dividends (as well as UK corporation tax on profits).

In terms of income tax, we considered the possible effects if there is a change in the rate of Scottish income tax, including the direct effect on revenues, and longer-term and indirect effects as a result of possible behavioural changes and investment decisions.

In relation to taxpayer behaviour, we noted other factors that taxpayers are likely to consider, including non-tax issues, whether or not a change will be long-term and therefore have an ongoing impact, and the ability of taxpayers to make changes that will affect their tax.

Our response also paid regard to Scotland's funding model, by which the Scottish government receives tax revenues from wholly devolved taxes and income tax paid according to the Scottish rates and thresholds directly, and receives a share of UK taxes, such as corporation tax, indirectly, through the block grant.

The CIOT submission can be found on the CIOT website.

Budget Process Review Group: CIOT response to interim report

The CIOT stress the importance of transparency, and robust budgetary scrutiny, while also referring the Budget Process Review Group to the CIOT's joint work with the Institute for Government and Institute for Fiscal Studies, which resulted in the report 'Better Budgets: making tax policy better'.

The Finance and Constitution Committee of the Scottish Parliament established the Budget Process Review Group for the purpose of carrying out a fundamental review of budgetary scrutiny. The key reason behind the review is to ensure that the budget process accommodates the Scottish Parliament's new financial powers as well as the operation of the Fiscal Framework. As a result of both the Scotland Act 2012 and the Scotland Act 2016, the Scottish Parliament now has powers to both raise and allocate revenue, where previously the Scottish budget was mainly concerned with

expenditure.

The Budget Process Review Group published its Interim Report in March, together with a consultation on their findings to date. The CIOT response focused on the first two themes, which concerned the effectiveness of the existing budget process and the impact of the Fiscal Framework.

In addition to referring to the CIOT's joint work with the Institute for Government and Institute for Fiscal Studies, which resulted in the report 'Better Budgets: making tax policy better', we noted some key aims for a budget process, including transparency, and robust budgetary scrutiny.

Our recommendations included the creation of a new Parliamentary committee with responsibility for scrutiny of taxation legislation and the revenue-raising aspects of the draft budget, and the addition of an annual Finance Bill to provide a practical avenue for effecting annual tax changes, for example in relation to rates and bands.

We also highlighted the need for up-to-date information concerning Scottish taxpayers, better public debate and more informed decisions, and put forward some ideas on how to improve these.

However, we also noted the special constraints on the Scottish budget process, due to the Scottish Parliament's limited tax-raising powers and reliance on the block grant, which means there is a high degree of interdependence between the UK and Scottish budget processes.

The CIOT submission can be found on the CIOT website.