

Financial Scrutiny Unit Briefing

Key issues in relation to the devolution of additional tax powers

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Following on from the referendum on independence, there is a willingness from all five of Scotland's political parties to strengthen the powers of the Scottish Parliament within the UK. Lord Smith of Kelvin is overseeing the process to take forward the devolution commitments on further powers for the Scottish Parliament.

This briefing highlights what tax powers are currently devolved and sets out some of the possible considerations in relation to the devolution of further tax powers. It also looks at the implications of further devolution on public finances, and in particular how it would affect the block grant and the need for greater borrowing powers. Lastly, it provides an overview of the political proposals in relation to further devolution and an analysis of the advantages and challenges associated with devolving further taxes, as well as information about tax devolution in other parts of the OECD.



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WHAT TAX POWERS ARE CURRENTLY DEVOLVED?

Scotland has control over Non-Domestic Rates (NDR) and council tax. NDR, or business rates, are currently the single largest source of revenue under the control of the Scottish Parliament. Business rates are set by the Scottish Government, collected by local authorities on behalf of the Government, paid into the Government's business rates pool and then paid back to local authorities. Council tax is a locally set and collected tax. Since 2008-09, the Scottish Government and local authorities have agreed to freeze council tax across Scotland. The Scotland Act 1998 also gave the Scottish Parliament the power to vary the basic rate of income tax by three pence in the pound (the Scottish Variable Rate).

The Scotland Act 2012 transfers a number of additional tax powers to the Scottish Parliament:

- From April 2015, Stamp Duty Land Tax and Landfill Tax will become fully devolved taxes with the design and collection under the responsibility of the Scottish Government. These are being replaced by Scottish Land and Buildings Transactions Tax and Scottish Landfill Tax. The Act also allows for additional taxes to be devolved in the future by Order.
- From April 2016, the Scottish Rate of Income Tax (SRIT) supersedes the existing Scottish Variable Rate. The UK rates of income tax will be reduced for Scottish taxpayers by 10p at the basic, higher and additional rates and the Scottish Parliament will have the flexibility to set a different rate of income tax each year for Scottish taxpayers by adding a new amount uniformly to all rates. Tax revenues from SRIT will accrue to the Scottish Government, but will still be collected by Her Majesty's Revenue and Customs (HMRC).

Table 1 – Summary of tax powers devolved to Scotland

Tax power	Revenues in 2012-13*	Description
Non-domestic rates	£1,981m	Also known as business rates, NDR are a property based tax charged on properties used as businesses and the public sector. They are based on the rateable value of a non-domestic property.
Council tax	£2,006m	Introduced in 1993, this is a local tax payable by households and used to part fund services provided by local authorities. The rate of tax payable is based on the value of the residential property.
Scottish Landfill Tax	£100m	The Scottish Landfill Tax will replace the current UK Landfill Tax regime in April 2015. It is a tax on the disposal of waste to landfill and the rate is determined by the type of waste.
Land and Buildings Transactions Tax	£283m	Land and Buildings Transactions Tax will replace the current UK stamp duty land tax in April 2015. It is a tax on the purchase or transfer of property or land and the rate is determined by the value of the sale.
Scottish Rate of Income Tax	£4,231m	A Scottish Rate of Income Tax that will apply to the non-savings, non-dividend income of Scottish taxpayers from April 2016. The UK Government will deduct 10p in the pound from the basic, higher and additional rates of income tax. The Scottish Parliament will then have the power to levy a Scottish rate that will apply equally across these three main tax bands.

* Revenues for Scottish or equivalent UK taxes (Scottish Government [2014](#))

CONSIDERATIONS IN RELATION TO THE DEVOLUTION OF ADDITIONAL TAX POWERS

There is a willingness, shared by all five of Scotland's political parties, to strengthen the powers of the Scottish Parliament within the UK. Lord Smith of Kelvin is overseeing the process to take forward the devolution commitments on further powers for the Scottish Parliament (The Smith Commission [2014a](#)).

A PRINCIPLES-BASED APPROACH

The devolution of tax powers to the Scottish Parliament would have consequences for both Scotland and the rest of the UK. It is useful to consider the nature of these consequences when assessing which tax powers are most suitable for devolution. A principles-based approach is one means through which this can be done.

Both the Calman Commission Independent Expert Group (The Calman Commission considered the devolution of further powers to the Scottish Parliament and reported in 2009) and the Holtham Commission (which looked at the case for devolving tax-varying and borrowing powers to Wales and reported in 2010) used the same set of principles to assess the suitability of different powers for devolution¹.

When assessing the suitability of taxes for devolution against a set of principles, no overall tax bundle is likely to wholly achieve all of the desired objectives. It may therefore be necessary to make a judgement on the importance of different principles according to political or constitutional objectives. Considerations in relation to the devolution of additional tax powers may include:

Efficiency considerations

- **The scope for economic distortion** – Devolution of tax-varying powers creates the possibility for both efficiency gains (as taxes can be set in a way more appropriate to local conditions) and also economic distortions (as people change their choices or behaviour to obtain tax advantage, e.g., cross-border shopping to avoid tax). The Holtham Commission aimed to identify taxes that, if devolved, would have either a net gain in efficiency or only a small potential to create economic distortions ([2010](#)).
- **The scope for tax competition** – Devolution of tax-varying powers can lead to tax competition between jurisdictions seeking to attract a mobile tax base. There is a concern that tax competition can lead to a “race to the bottom” where tax revenues become too low to sustain adequate public services. On the other hand, there is also a view that it can lead to a more efficient, productive public sector (OECD [2013](#)). One of the factors which most impacts the scope for tax competition is the mobility of the tax base. In general taxes with the least mobile tax bases are devolved first and to a greater extent as the tax base is unlikely to fluctuate greatly in response to different tax rates.

Practical considerations

- **Administrative complexity** – The creation of a different fiscal regime within different parts of the UK may impose an administrative burden to those operating on both sides of the border. The administrative complexity in relation to the devolution of a particular tax can vary substantially, and can fall on the public sector (in terms of cost of collection),

¹ These were: stability/predictability, simplicity/transparency, autonomy, equity, efficiency and accountability.

citizens or firms. Holtham suggested that “The devolution of a particular tax should not impose substantial additional administrative burdens on citizens or firms, and should not increase the cost of collection unreasonably” ([2010](#)).

- **Compliance with international agreements** – For example, there are a number of EU laws governing taxation policy both between and within Member States (including EU State Aid Laws).

Effectiveness and equity considerations

- **Overlap with devolved policy areas** – Devolving taxes relating to devolved policy areas may better empower the Scottish Government to deliver its policy objectives. The Calman Commission noted the potential benefit of devolving specific taxes, such as excise duties, to the Scottish Government in order to provide a closer alignment between existing devolved policy responsibilities with the fiscal system ([2009](#)).
- **Tax visibility** – The visibility of a tax among the electorate may make it more or less suitable for devolution. For example, Holtham argued that, although the revenues for stamp duty land tax are small, the high visibility of the tax means that it still has an impact on financial accountability ([2014](#)). On the other hand, visibility may inhibit the Scottish Government from implementing reform or setting higher rates than across the rest of the UK.
- **Tax usability** – The visibility of the tax, as well as the way in which it is devolved (e.g., revenue assignment versus tax devolution) are some of the factors that may impact the extent to which the sub-central government will be able to use it as a policy lever. For example, the Calman Commission highlights that “One major disadvantage of tax assignment is that it would import the revenue risk associated with tax receipts to the Scottish Parliament but not provide the Scottish Parliament with the policy authority to change those taxes” ([2009](#)).
- **The desire for reform in relation to each tax** – Devolution is seen by some as a vehicle for reform, and so whether an existing UK tax is considered “good” or “effective” may impact how desirable it is to devolve the tax. For example, the Welsh Government called stamp duty land tax “a poorly designed tax” and called for its devolution to provide an opportunity to make it simpler, fairer and more efficient ([2013](#)). On the other hand, some may argue that where there is appetite for reform, taxes should not be devolved until this process is complete.

Considerations in relation to the overall tax bundle

- **Overall level of accountability** – It can be useful to think about the overall scale of accountability that any tax bundle would deliver. The most recent [Government and Expenditure Revenues Scotland](#) publication shows that 14% of the Scottish Government budget² was covered by devolved taxation (NDR and council tax). Adding in revenues from the taxes that will be devolved under the Scotland Act 2012 takes this figure to around 30%. A number of experts looking at the devolution of taxes believe that sub-central government spending should essentially be covered by own tax revenue (Blöchliger and Petzold [2009](#)). However, there are many different political views in this area.

² Scottish DEL budget

- **Stability** – It may be desirable to have a tax bundle that generates sufficient stability and predictability of revenues so as to allow levels of public spending that are accepted as fair and to ensure that the finances of either the UK Government or the Scottish Government are not destabilised. Where there is a revenue risk, it may be important to ensure that the jurisdiction also has adequate powers to borrow in order to manage any fluctuations in revenue effectively. Consideration also needs to be given to whether or not the arrangements impact macro-economic stability at the UK level.
- **Tax alignment** – Different taxes need to fit sensibly together. For example, personal and corporate taxes need to fit together such that the form in which income is received does not overly influence the amounts of tax paid, otherwise there is an incentive to shift how income is reported for tax purposes (Adam and Johnson [2012](#)).

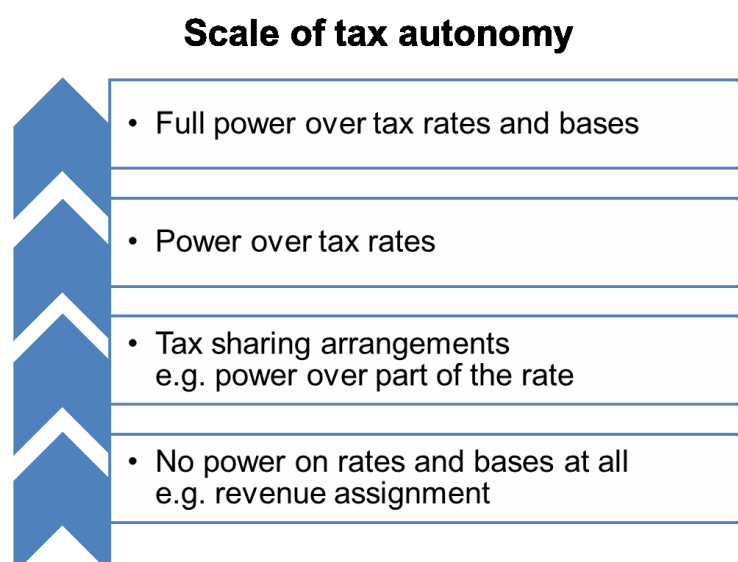
THE SEVEN PRINCIPLES AGREED BY THE SMITH COMMISSION

The Smith Commission has agreed seven principles to guide it towards an agreement on new powers for the Scottish Parliament. They are as follows:

1. A "substantial and cohesive package of powers... meaningful to the people of Scotland".
2. Strengthening the Scottish Parliament within the UK, including its financial accountability.
3. A "durable but responsive democratic constitutional settlement" within the UK, enhancing mutual cooperation and partnership.
4. Not being conditional on other UK political negotiations (e.g. English Votes for English Laws).
5. Not causing detriment to the UK or to any constituent parts.
6. Causing neither the UK nor Scottish Governments to gain or lose financially.
7. Being implementable, compatible with international obligations, including EU law; and with a broad understanding of the potential associated costs (The Smith Commission [2014b](#)).

RANGE OF DEVOLUTION OPTIONS

The devolution of tax powers to sub-central governments can occur to varying degrees, ranging from the full power to introduce taxes and the power to set tax rates and bases to tax sharing arrangements and revenue assignment where the central government allocates a proportion of tax revenues to the sub-central government.



There are advantages and disadvantages associated with different levels of autonomy. For example, tax sharing arrangements can increase fiscal autonomy while keeping the fiscal framework stable and reducing scope for tax competition. However, it would make Scottish public finances less predictable and the Scottish Parliament would have limited powers to use the tax as a policy lever. At the other end of the scale, power over tax rates and bases gives the devolved government more scope to use the tax as a policy lever but increases scope for tax competition.

The level of autonomy can vary according to tax type. Property taxes are usually associated with greater tax autonomy. On the other hand, major taxes such as income tax, corporation tax and VAT are often associated with revenue assignment and tax sharing arrangements (Blöchliger and Rabesona [2009](#)). Note that in some instances EU laws restrict the level of autonomy that can be given in relation to a particular tax, e.g., EU laws only permit member states to have a single rate of VAT.

IMPLICATIONS FOR PUBLIC FINANCES

The Scottish block grant and the Barnett Formula

In the context of the existing fiscal powers, the majority of the funds available to the Scottish Government currently come in the form of a block grant from the UK Government. The Barnett formula is used to make adjustments to the block grant. It applies to changes in spending in England on devolved areas, such as health and education. Where spending in England in these areas increases or decreases, the Scottish and Welsh block grants are increased or reduced by a proportionate amount. The proportion is determined by the relative population and the extent to which spending is devolved.

Block grant adjustment

Upon the devolution of additional tax powers, the block grant will be reduced and replaced with the revenues that the devolved taxes are expected to raise. Both the Scottish Government and the UK Government would need to negotiate the exact 'block grant adjustment' that would apply when new tax powers were brought into effect. In other words, by how much should Scotland's block grant be reduced to reflect the increased ability of the Scottish Government to raise its own revenue?

There are two elements to the block grant adjustment; the initial reduction and the way in which the reduction is calculated, or indexed, in future years. There are a number of considerations to take into account when considering the most suitable form of block grant adjustment. Firstly, some taxes are more volatile making it harder to agree on a representative figure for Scottish revenues. Secondly, the longer-term trend in relation to revenues may be increasing/declining as is the case with landfill tax where the waste being sent to landfill is reducing. In addition, if the tax base is shared between the Scottish Government and the UK Government, as is the case for the Scottish Rate of Income Tax, then there is a risk that a policy change by the UK Government could have a large impact on the revenue raised by the devolved tax. These factors, among others, may make it difficult to reach a decision on the appropriate form of block grant adjustment for each tax.

A stable tax whose receipts are expected to grow should not be subject to the same block grant adjustment as a volatile tax whose receipts are expected to decline. The Holtham Commission ([2010](#)) outlined that, very broadly, the block grant adjustment can take one of four forms:

Own base deduction: the deduction from the block grant is indexed to the assessed growth in the devolved tax base.

Indexed deduction: the initial deduction is indexed to an external variable such as the relevant UK tax base.

Proportionate deduction: the grant is reduced by a given percentage; the initial deduction therefore grows at the same rate as the grant itself.

Fixed real deduction: the grant is reduced by an agreed sum which is then indexed to inflation; i.e. the present value of tax receipts is equated to a real annuity which is deducted from the grant.

The Scottish Government and UK Government have not yet reached an agreement on the block grant adjustment associated with the tax powers devolved through the Scotland Act 2012, and discussions are on-going. If more tax powers are devolved, agreeing the form of block grant adjustment for each tax could become a more complicated process, although this depends on the nature of the tax bundle.

Replacing a portion of the block grant with a stream of tax revenue increases the volatility of public funding in Scotland. This volatility may be lessened or exacerbated by the method of block grant reduction and the type of taxes that are devolved (pro-cyclical taxes³ are associated with increased volatility). The Scottish Government is likely to require some enhancement of devolved borrowing powers in order to manage this volatility.

Borrowing powers

“Revenue borrowing” can be used to manage public spending when actual tax receipts fall short of forecasts. With increased devolution of tax-raising powers, there is an argument for increased revenue borrowing powers to help the Scottish Government manage volatility in revenues and sustain stable levels of public spending in Scotland. “Capital borrowing” is also an important tool for managing the economy. It can be used to fund large-scale capital projects, as part of longer-term investment in the economy or to boost economic activity during an economic downturn. Increased capital borrowing powers can therefore be seen as a means for providing greater economic powers.

At present the Scottish Government has both revenue and capital borrowing powers that were introduced as part of the Scotland Act 2012:

- **Capital borrowing:** the Scottish Government can borrow up to a cumulative total of £2.2 billion for capital investment. Borrowing in any single year is limited to 10% of the Scottish Government's capital budget. In 2015-16, the Scottish Government plans to borrow £304m. Borrowing may be through the National Loans Fund, commercial loan or through the issue of Scottish Government bonds.
- **Revenue borrowing:** the Scottish Government can borrow for revenue purposes up to a maximum of £500m, with a limit in any single year of £200 million.

Proposals for greater borrowing powers

Until the bundle of additional tax powers for the Scottish Parliament is agreed, it is difficult to anticipate the level of revenue borrowing that might be needed by the Scottish Government. However, in its submission to the Smith Commission, the Scottish Government refers to the need for ‘sufficient borrowing powers to ensure budgetary stability and safeguards to maintain Scottish public spending.’

³ With procyclical taxes, revenues increase during times of economic growth and decrease in economic downturns.

In other submissions, the Liberal Democrat and Green Party make specific recommendations on borrowing powers. Alongside increased revenue-raising powers, the Liberal Democrats recommend increasing the revenue borrowing limit to £1 billion and a fiscal pact to define limits on borrowing. The Greens suggest that the Scottish Government should be free to determine the appropriate level of borrowing, without UK Government approval.

Well defined fiscal rules, such as limits on borrowing powers, can help guard against inappropriate budgetary behaviour. However, their effectiveness depends on the wider intergovernmental framework in which they operate. The OECD observes that they are most effective when they are self-imposed, based on medium-long term targets for debt levels and are adjusted to account for the business cycle and pre-empt pro-cyclical policy (OECD [2013](#)).

Other examples of devolved borrowing powers

In Scotland, local authorities have the power to borrow for capital purposes. There are no formal limits on the level of borrowing, although the Scottish Government and HM Treasury monitor borrowing levels to ensure they remain within acceptable limits. The Northern Ireland Executive has similar capital borrowing powers, reflecting the fact that it carries out some of the functions that are undertaken by local authorities in the rest of the UK. The Welsh Assembly Government is able to borrow up to £500m in total from the National Loan Fund to cover temporary shortfalls. The Wales Bill also provides for increased capital borrowing powers.

There are a number of international examples of successful sub-national devolution of borrowing powers, including in the US, Canada, Australia and Switzerland.

A CLOSER LOOK AT TAX POWERS THAT COULD BE DEVOLVED

The five political parties represented at the Scottish Parliament have submitted their [proposals on what further powers should be devolved](#) to The Smith Commission. Although the proposals vary substantially, there are some taxes where the majority of proposals recommend some form of devolution to be considered. These are:

- **Income tax** – The Scottish Green Party and the Scottish National Party (SNP) propose full devolution, including responsibility for rates, bands, reliefs and personal allowances. The Scottish Conservatives and Scottish Liberal Democrats propose devolution of rates and bands, but not the personal allowance. The Scottish Labour Party propose an extension of SRIT to 15p instead of 10p, as well as power to increase the rates of tax in the higher and additional bands.
- **VAT** – The SNP and the Scottish Green Party recommend that revenues should be assigned to Scotland and the Scottish Conservatives recommend that the case for revenue assignment should be examined.
- **Corporation tax** – The SNP recommend that it should be devolved and the Scottish Green Party and Scottish Liberal Democrats recommend that revenues should be assigned to Scotland.
- **Aggregates levy** – The SNP, the Scottish Labour Party and the Scottish Liberal Democrats recommend that it should be devolved and the UK Government state that they will consider devolution as soon as the EU court proceedings in relation to the aggregates levy are completed.
- **Air passenger duty** – The SNP, the Scottish Conservatives and the Scottish Liberal Democrats recommend that it should be devolved.

The following pages look at some of the key taxes that are currently reserved to the UK Government but may be considered for devolution. An overview of each tax is provided, and some of the key advantages and challenges associated with devolution. In addition, political proposals in relation to each tax are outlined as well as information on the extent to which the tax is devolved across other countries in the UK and across the OECD. Information is provided for:

- | | |
|---|---|
| • Aggregates Levy | • Inheritance Tax |
| • Air Passenger Duty (APD) | • Insurance Premium Tax |
| • Betting and Gaming Duties | • Natural Resource Taxation |
| • Capital Gains Tax | • National Insurance Contributions (NICs) |
| • Climate Change Levy | • Tobacco and Alcohol Duties |
| • Corporation Tax | • Value Added Tax (VAT) |
| • Fuel Duties | • Vehicle Excise Duty |
| • Income Tax | |

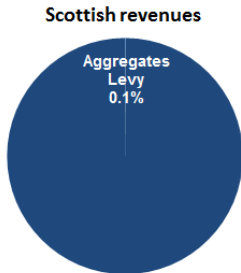
Note that this is not an exhaustive list of taxes currently reserved to the UK Government.

A CLOSER LOOK AT TAX POWERS THAT COULD BE DEVOLVED...

AGGREGATES LEVY

Quick Facts

- Scottish aggregates levy revenues were £45m in 2012-13, representing 0.1% of total revenues*.



- Relative to the UK as a whole, more of Scotland's onshore revenues tend to come from the aggregates levy.
- Aggregates levy revenues are relatively stable.

* Including a geo share of offshore revenues

Political Proposals

UK Government: There is currently a legal challenge to the aggregates levy. As soon as the EU court proceedings in relation to this are completed, the UK Government has committed to consider devolution.

Labour, Liberal Democrats and SNP: Recommend that it should be devolved.

Greens: No specific recommendation.

Wales: The Silk Commission recommended that aggregates levy be devolved to Wales.

Developments Across the UK

Advantages

The tax base (quarries) is immobile, limiting the potential for different rates across the UK to lead to tax avoidance.

It is instrumental in environmental and planning policies which are devolved. For example, it could be used to support Scotland's targets for reducing resource use and increasing recycling.

It would be relatively straightforward to identify Scottish activity subject to the levy.



Challenges

The future of the aggregates levy is subject to the outcome of EU court proceedings. It would not be appropriate to devolve the levy until proceedings are complete.

Some possible negative economic implications where the rate is higher, as some quarries may become less competitive.



Across the OECD

A number of countries apply environmental taxes in relation to the extraction of raw materials including Austria, Denmark, Italy and Sweden. In some countries (such as Denmark) it is a central tax whereas in others (such as Austria) it is administered by the province concerned.

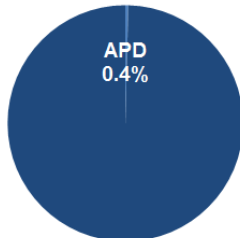
A CLOSER LOOK AT TAX POWERS THAT COULD BE DEVOLVED...

AIR PASSENGER DUTY (APD)

Quick Facts

- Scottish APD revenues were £234m in 2012-13, representing 0.4% of total revenues*.

Scottish revenues



- The percentage of Scotland's onshore revenues coming from APD is equal to that in the UK as a whole.
- APD revenues are relatively volatile, however, because they are also relatively small variations are unlikely to exert significant impact on overall revenues.

* Including a geo share of offshore revenues

Political Proposals

Labour: State that devolution of APD should not be progressed until further consideration is given to "how else this tax might be reformed".

Conservatives, Liberal Democrats and SNP: Recommend APD should be devolved.

Greens: No specific recommendation.

Developments Across the UK

Wales: The Silk Commission recommended the devolution of long haul rates of APD, and consideration of full devolution in the future.

Northern Ireland: The Finance Act 2012 devolved the power to set APD rates on direct long haul flights from Northern Ireland to the Northern Ireland Assembly.

Advantages

APD could be a useful policy lever in areas of existing devolved competence such as tourism, economic development and aspects of environmental policy.

It has already been devolved in Northern Ireland for long-haul flights.



Challenges

Devolution must comply with EU state aid rules, e.g., any cost of reducing the duty must be borne by the devolved authority.

Differing rates between Scotland and England may result in cross-border travel to avoid tax.

Relatively easy to identify actual Scottish revenues, although much of the administrative burden of devolution would fall to airlines.

Impending reform at the UK level.



Across the OECD

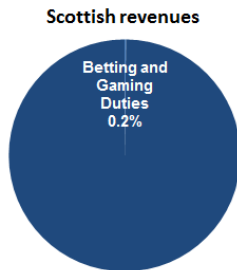
Aviation is taxed in various forms across the OECD, with some countries having introduced emissions charges and others extend VAT to cover flights. Where there is a similar tax to APD (such as Australia, Germany and the US), it is usually levied by central government. For example, federal aviation excise taxes are levied on air passengers in the US, with revenues flowing to the Airport and Airway Trust Fund to finance investments in the airport and airway system.

A CLOSER LOOK AT TAX POWERS THAT COULD BE DEVOLVED...

BETTING AND GAMING DUTIES

Quick Facts

- Revenues from Scottish betting and gaming duties were £120m in 2012-13, representing 0.2% of total revenues*.



- Relative to the UK as a whole, more of Scotland's onshore revenues tend to come from betting and gaming duties.
- Revenues from betting and gaming duties are relatively stable.

* Including a geo share of offshore revenues

Political Proposals

Conservatives and Labour:

Recommend that it should remain reserved.

Liberal Democrats: No specific recommendation.

SNP and Greens: Recommend that it should be devolved.

Developments Across the UK

Wales: The Silk Commission did not recommend that betting and gaming duties be devolved.

Advantages

There is considerable precedent for these taxes to be devolved to sub-central governments across the OECD.

Relatively stable source of revenues. May also be suitable for assignment.



Challenges

Betting and gaming activities have become increasingly mobile due to on-line betting. As a result, differential rates across the UK would be difficult to administer and may result in tax avoidance. Indeed there are questions about how effectively the UK government is taxing activity at present.

Regulation of betting is currently reserved.



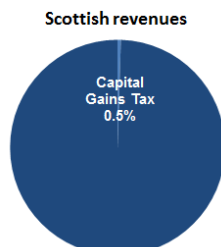
Across the OECD

It is relatively common for these taxes to be devolved to sub-central governments, particularly in federal countries such as Austria, Belgium, Germany and Switzerland. The nature of devolution varies. In countries such as Belgium and Spain the rates for these duties are set sub-centrally. On the other hand, in Germany the rates are set centrally, but the revenues accrue to the Länder.

CAPITAL GAINS TAX

Quick Facts

- Scottish capital gains tax revenues were £292m in 2012-13, representing 0.5% of total revenues*.



- Relative to the UK as a whole, less of Scotland's onshore revenues tend to come from capital gains tax.
- Capital gains tax revenues are the most volatile of all taxes, but as it is a small tax, variations are unlikely to cause significant fluctuations in overall revenues.

* Including a geo share of offshore revenues

Political Proposals

Conservatives and Labour:

Recommend that it should remain reserved.

Liberal Democrats and SNP:

Recommend that it should be devolved.

Greens: No specific recommendation.

Developments Across the UK

Wales: The Silk Commission did not recommend that capital gains tax be devolved.

Advantages

Capital gains tax has a close alignment with income tax. If income tax is fully devolved to Scotland then it may be sensible to devolve capital gains tax in order that they are aligned and opportunities for tax avoidance through converting income into capital gains is reduced.



Challenges

The capital gains tax regime does not currently differentiate between transactions in land and other items that are more mobile, such as shares. The introduction of differential rates across the UK may facilitate tax-avoiding behaviour in relation to more mobile items. However, the tax could be restructured so that tax in relation to immobile items such as land could be devolved.

Administrative costs could be prohibitive if there is a need to amend UK self-assessment forms.



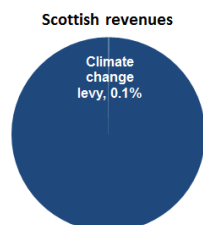
Across the OECD

Capital gains are often taxed as part of income tax (as is the case in countries such as Spain, Italy and France) across OECD countries. As such, whether it is a central or sub-central tax depends on how income tax is treated. However, there are some specific capital gains taxes. For example, in Portugal capital gains in relation to rural real estate are taxed at municipal level.

CLIMATE CHANGE LEVY

Quick Facts

- Scottish climate change levy revenues were £62m in 2012-13, representing 0.1% of total revenues*.



- Relative to the UK as a whole, more of Scotland's onshore revenues tend to come from the climate change levy.
- Climate change levy revenues are relatively stable.

* Including a geo share of offshore revenues

Political Proposals

Labour: Recommend that it should remain reserved.

Conservatives, Liberal Democrats and Greens: No specific recommendation.

SNP: No specific recommendation but in general state that Scotland should have policy responsibility for all taxes unless there is a specific reason for a continued reservation.

Developments Across the UK

Wales: The Silk Commission recommended that it remains reserved and not be devolved to Wales.

Advantages

An estimate of actual Scottish revenues from the climate change levy would be reasonably easy to obtain.



Challenges

The climate change levy is one of a number of energy taxes in the UK. The levy is closely linked to emissions targets and energy policy; significant aspects of energy policy are currently reserved to the UK Government.

Differences in the climate change levy across the UK may give rise to economic distortions whereby activity that produces emissions is moved to lower tax jurisdictions.



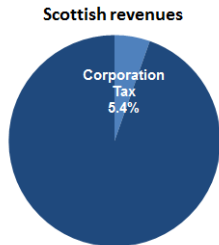
Across the OECD

All OECD countries levy energy taxes to some extent. A few countries levy specific carbon taxes, such as Canada (BC and Quebec), Denmark, Iceland, Ireland, Norway, Sweden and Switzerland. On the whole, carbon taxes tend to be levied at the central Government level, however there are exceptions. For example, in Canada and the US carbon taxes are levied by sub-central Governments.

CORPORATION TAX

Quick Facts

- Scottish onshore corporation tax revenues were £2,872m in 2012-13, representing 5.4% of total revenues*.



- Relative to the UK as a whole, more of Scotland's onshore revenues tend to come from corporation tax.
- Onshore corporation tax revenues are relatively stable although offshore revenues are more volatile.

* Total revenues include a geographical share of offshore revenues

Political Proposals

Conservatives and Labour:

Recommend that it should remain reserved.

Liberal Democrats: Recommend that receipts should be assigned to Scotland.

Greens: Recommend that a percentage of receipts should be assigned to Scotland.

SNP: Recommend that it should be devolved.

Developments Across the UK

Wales: The Silk Commission did not recommend that corporation tax be devolved in Wales.

Northern Ireland: The UK Government is currently considering the practical aspects of devolving corporation tax to Northern Ireland.

Advantages

The scope to change corporation tax provides the Scottish Government with a potentially powerful economic lever.



Challenges

Devolution would have to be consistent with EU law which precludes tax systems that could be interpreted as state aid. It must therefore comply with the Azores test of institutional, procedural and economic autonomy.

It may be difficult to assign the location of the economic activity across the UK & different rates may give rise to "brass-plating".

It would introduce increased volatility into the Scottish budget and could impose an additional administrative burden on firms.



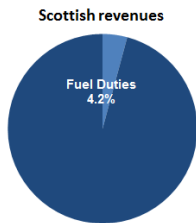
Across the OECD

Corporation tax is one of the least decentralised taxes. In more than half of OECD countries it is totally centralised and in the remaining countries it is largely a shared tax. Only two of these countries (Germany and Switzerland) have decentralised corporation tax by more than 50%. One exception is Spain, where territories in the foral Autonomous Communities (Basque and Navarra) set their own corporation tax rates.

FUEL DUTIES

Quick Facts

- Scottish fuel duties revenues were £2,258m in 2012-13, representing 4.2% of total revenues*.



- Relative to the UK as a whole, more of Scotland's onshore revenues tend to come from fuel duties.
- Fuel duties revenues are relatively stable.

* Including a geo share of offshore revenues

Political Proposals

Conservatives and Labour:

Recommend that it should remain reserved.

Liberal Democrats and Greens:

No specific recommendation.

SNP: Recommend that it should be devolved.

Developments Across the UK

Wales: The Silk Commission did not recommend that fuel duties be devolved.

Advantages



Challenges

Could be a significant source of revenue.

There is a relationship between fuel duty and existing devolved policy areas such as economic development.

Power over the rates, if given clearance from the EU, could help mitigate the impact of fuel prices on the cost of living in rural areas.

Under the EU Energy Products Directive, member states must set a single rate for each fuel. However, there is a precedent for reduction in some circumstances - the UK Government obtained clearance for the rural fuel duty rebate pilot scheme for remote island communities.

Different fuel prices across the UK could be distortionary and may result in tax avoidance around tax borders, undermining the tax base.



Across the OECD

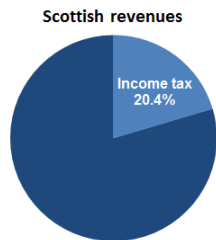
Fuel tax is largely levied by central government. In some countries, such as Canada, it can be levied by the sub-central Government. In other countries, such as Spain, the sub-central government is assigned receipts from fuel duty.

A CLOSER LOOK AT TAX POWERS THAT COULD BE DEVOLVED...

INCOME TAX

Quick Facts

- Scottish income tax revenues were £10,865m in 2012-13, representing 20.4% of total revenues*.



- Relative to the UK as a whole, less of Scotland's onshore revenues come from income tax.
- Although income tax is relatively stable, because of its size small variations can have large implications for overall revenues.

* Including a geo share of offshore revenues

Political Proposals

Conservatives and Liberal Democrats: Propose devolution of responsibility for setting rates and bands (but not personal allowance).

Labour: Propose an extension of the Scottish Rate of Income Tax to 15p instead of 10p, as well as power to increase the rates of tax in the higher and additional bands.

Greens and SNP: Propose full devolution including responsibility for rates, bands, reliefs and personal allowances.

Developments Across the UK

Wales: The current Wales Bill provides for a referendum on the introduction of a Welsh rate of income tax. As recommended by the Silk Commission, the Welsh Government should be able to set separate Welsh rates of income tax for each of the three bands, as the restriction on this was removed at the Lords committee stage.

Advantages

There is a precedent for the Scottish Parliament having the power to be able to vary the rate of income tax in Scotland.

HMRC systems will already be able to administer Scottish income tax separately.

It is the biggest tax in Scotland and so its devolution could deliver a significant level of increased accountability.



Challenges

It is the tax that is the most visible to the electorate, and this may make it more difficult politically to set a higher rate in Scotland.

Full devolution may make it more difficult to integrate income tax and NICs in the future.

Second most volatile tax in terms of absolute variation (although increased borrowing could be used to offset fluctuations).



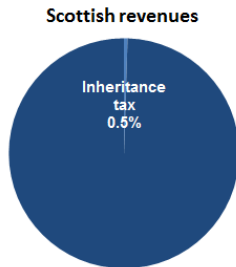
Across the OECD Income tax is the predominant tax that is devolved to sub-central governments across OECD countries. Some form of devolution applies in more than a third of countries, with around half having the power to set progressive income tax rates. The foral Autonomous Communities (Basque and Navarra) in Spain are the only areas where the central government cannot levy income tax in their regions.

A CLOSER LOOK AT TAX POWERS THAT COULD BE DEVOLVED...

INHERITANCE TAX

Quick Facts

- Scottish inheritance tax revenues were £243m in 2012-13, representing 0.5% of total revenues*.



- The percentage of onshore revenues derived from inheritance tax is similar in both Scotland and the UK as a whole.
- Inheritance tax revenues are relatively stable.

* Including a geo share of offshore revenues

Political Proposals

Conservatives and Labour:

Recommend that it should remain reserved.

SNP and Liberal Democrats:

Recommend that it should be devolved.

Greens: No specific recommendation.

Developments Across the UK

Wales: The Silk Commission did not recommend that inheritance tax be devolved.

Advantages

Revenues are relatively stable.



Challenges

There are already substantial efforts by individuals to reduce liabilities and different rates across the UK could incentivise further tax avoidance.



Across the OECD

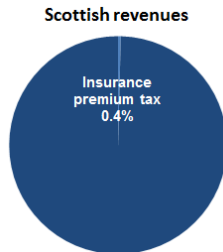
In general inheritance taxes are levied by central governments across the OECD, although there are some exceptions. For example, in Belgium the regions can vary inheritance tax, in Germany the Lander receive revenues from the tax and in Spain the autonomous communities can vary certain parameters of the tax, without increasing the overall tax burden.

A CLOSER LOOK AT TAX POWERS THAT COULD BE DEVOLVED...

INSURANCE PREMIUM TAX

Quick Facts

- Scottish insurance premium tax revenues were £207m in 2012-13, representing 0.4% of total revenues*.



- Relative to the UK as a whole, less of Scotland's onshore revenues come from insurance premium tax.
- Insurance premium tax revenues are relatively stable.

* Including a geo share of offshore revenues

Political Proposals

Labour: Recommend that it should remain reserved.

SNP: No specific recommendation but in general state that Scotland should have policy responsibility for all taxes unless there is a specific reason for a continued reservation.

Conservatives, Liberal Democrats and Greens: No specific recommendation.

Developments Across the UK

Wales: The Silk Commission did not recommend that insurance premium tax be devolved.

Advantages

Revenues are relatively stable.

In some countries insurance premium tax is, at least notionally, linked to the provision of emergency services.



Challenges

Insurance tax is paid by companies and intermediaries so it could be administratively complex to devolve.

There is the potential for differences in tax rates across the UK to increase the risk of tax avoidance.



Across the OECD

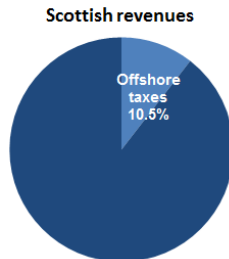
Insurance premium tax is largely levied by central Governments across the OECD, although there are some exceptions. For example, in Germany and Austria the sub-central governments receive revenues from fire insurance tax, although a uniform rate is applied across the country. In Spain, provinces in Basque and Navarra have the right to collect taxes directly from insurers and require insurers to file a specific provincial insurance premium tax return to the province's tax department.

A CLOSER LOOK AT TAX POWERS THAT COULD BE DEVOLVED...

NATURAL RESOURCE TAXATION

Quick Facts

- A geographical share of Scottish offshore tax revenues amounted to £5,581m in 2012-13, representing 10.5% of total revenues.



- Scottish offshore tax revenues are significantly larger as a proportion of total revenues compared to the UK as a whole.
- Offshore tax revenues are highly volatile and variations tend to have a significant impact on overall revenues.

Political Proposals

Labour and Liberal Democrats: Recommend that natural resource taxation remains reserved.

SNP: Recommend that natural resource taxation should be devolved.

Conservatives and Green: No specific recommendation.

Developments Across the UK

Advantages



Challenges

Respond to local ownership claims.

The devolution of taxation, together with regulation and licensing could offer a co-ordinated fiscal and regulatory system as recommended in the Wood Review.

An oil stability and savings fund could be established to manage revenues over the longer term.

Volatility of tax receipts, driven by global commodity prices rather than Scottish Government decisions.

There is inter-relation between the existing tax system and decommissioning relief deeds.

Agreeing the boundary for, and identifying, Scottish offshore activity.

Potential implications for the stability of oil and gas fiscal regime.



Across the OECD

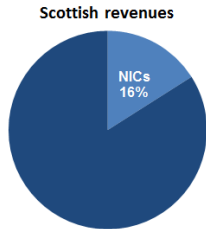
OECD countries with oil and gas natural resources tend to tax these at the central government level. However, there are a number of exceptions. For example, in Canada the provinces own the natural resources within their borders and have the right to tax them as they see fit.

A CLOSER LOOK AT TAX POWERS THAT COULD BE DEVOLVED...

NATIONAL INSURANCE CONTRIBUTIONS (NICS)

Quick Facts

- Scottish NIC revenues were £8,521m in 2012-13, representing 16% of total revenues*.



- Relative to the UK as a whole, less of Scotland's onshore revenues tends to come from NICS.
- NIC revenues are relatively stable, but because of its large size variations tend to have a significant impact on overall revenues.

* Including a geo share of offshore revenues

Political Proposals

Conservatives and Labour:

Recommend that it should remain reserved.

Liberal Democrats: Recommend that powers should remain with the UK or federal level of government.

SNP: Recommend that it should be designed and set in Scotland.

Greens: No specific recommendation.

Developments Across the UK

Northern Ireland: has its own National Insurance Fund.

Wales: The Silk Commission recommended that NICS should not be devolved to Wales.

Advantages



Challenges

Devolution would deliver a significant level of increased accountability.

It is perceived as a less visible tax to the electorate, and this may make it easier politically to set a different rate in Scotland.

Some argue that it would be sensible to aim towards integration of income tax and NICS.

Systems designed to cope with differential rates of income tax should be able to cope equally with different rates of NICS.

The majority of receipts from NICS are paid into the National Insurance Fund which is used to pay for contributory benefits. As money is shifted in to the fund as needed, the link between NICS receipts and expenditure is described as notional. However, some argue that as long as social security is reserved, NICS should also remain reserved.

NICS are partly paid by employers; differing rates across the UK may lead to economically distorting behaviours.



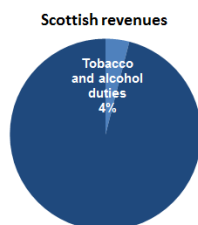
Across the OECD

Social security contributions tend to accrue to central funds linked to the provision of benefits and play a marginal role in tax decentralisation. However, there has been political discussion about decentralisation in countries such as Belgium and Canada. In Canada, this has resulted in asymmetric decentralisation towards Québec. For example, workers in Quebec contribute towards a Québec Pension Plan, although rates are the same as for the rest of Canada. In Switzerland the Cantons levy taxes to provide social assistance, e.g., for unemployment.

TOBACCO AND ALCOHOL DUTIES

Quick Facts

- Scottish tobacco and alcohol duties revenues were £2,108m in 2012-13, representing 4% of total revenues*.



- Relative to the UK as a whole, more of Scotland's onshore revenues tend to come from tobacco and alcohol duties.
- Tobacco and alcohol duties revenues are relatively stable.

* Including a geo share of offshore revenues

Political Proposals

Conservatives, Labour and Liberal Democrats: Recommend that they should remain reserved.

SNP: Recommend that where excise duties are not devolved, revenues should be assigned to the Scottish Government.

Greens: No specific recommendation.

Developments Across the UK

Wales: The Silk Commission did not recommend that tobacco and alcohol duties be devolved to Wales.

Advantages

Have a direct bearing on health and justice, which are devolved policy areas.

They provide a stable flow of revenue.



Challenges

As these are levied at the point of production or importation, devolving the duties could create challenges calculating differential charges, and may also incur significant costs.

There may need to be a change to how tobacco and alcohol are taxed to allow the duties to be devolved, but it must still comply with EU law.

Governments should seek to reduce the tax base.

Different rates of duty across the UK could result in cross-border shopping to avoid duty.



Across the OECD

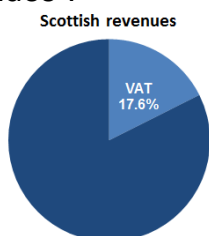
Revenues from these taxes tend to flow to central government, although they do contribute to revenue generation of sub-central governments in countries such as Germany, Austria, Canada and the US. For example, in Germany, rates for excise duty on beer are set centrally, but revenues accrue to the Länder. Similarly, in Austria rates are set by the central government, but revenues are split between the federal government, provincial government and local authorities.

A CLOSER LOOK AT TAX POWERS THAT COULD BE DEVOLVED...

VAT

Quick Facts

- Scottish VAT revenues were £9,347m in 2012-13, representing 17.6% of total revenues*.



- Relative to the UK as a whole, more of Scotland's onshore revenues tend to come from VAT.
- VAT revenues are relatively stable, but because of its large size variations can have a significant impact on overall revenues.

* Including a geo share of offshore revenues

Political Proposals

Labour and Liberal Democrats: Recommend that it should remain reserved.

Conservatives: Recommend that there should be examination of the case for VAT receipts to be assigned to Scotland.

SNP and Greens: Recommend that revenues should be assigned to Scotland.

Developments Across the UK

Wales: The Silk Commission ruled out the devolution of VAT and the assignment of revenues.

Advantages

As it raises substantial revenues, assignment of VAT revenues could give Scotland a source of revenues independent of the decisions of central government.

Revenues are relatively stable.

As there is a link between economic performance and revenues, assignment could potentially incentivise the Scottish Government to promote economic growth.



Challenges

EU law stipulates that VAT must be levied at a single rate across a Member State. Thus, devolution of VAT rate-setting is not possible, but revenues could be assigned to Scotland.

Assigning revenues would mean the Scottish Government takes on risk, but has no control.

There may be practical issues, e.g., in relation to identifying actual Scottish VAT revenues & tax avoidance through cross-border trade.



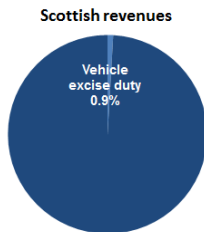
Across the OECD

Consumption taxes, such as VAT, are one of the top three tax categories making up tax revenue at the sub-central level. Due to EU rules, devolution within the EU tends to be limited to the assignment of VAT revenues. However, in Spain, the foral Autonomous Communities have control over the administration of VAT (not the rate) and some special territories across the EU are allowed to apply special rates (such as Azores and Madeira in Portugal and Corsica in France).

VEHICLE EXCISE DUTY

Quick Facts

- Scottish vehicle excise duty revenues were £481m in 2012-13, representing 0.9% of total revenues*.



- Scottish revenues from vehicle excise duty, as a percentage of all onshore revenues, were equal to that in the UK as a whole.
- Vehicle excise duty revenues exhibit very low volatility.

* Including a geo share of offshore revenues

Political Proposals

Labour: Recommend that it should remain reserved.

Conservatives, Liberal Democrats and Greens: No specific recommendation.

SNP: No specific recommendation, but in general state that Scotland should have policy responsibility for all taxes unless there is a specific reason for a continued reservation.

Developments Across the UK

Wales: The Silk Commission did not recommend that vehicle excise duty be devolved to Wales.

Advantages

Overlap with transport and the environment, which are devolved policy areas.

There is considerable precedent for these taxes to be devolved to sub-central governments across the OECD.

Revenues are relatively stable. May also be suitable for revenue assignment.



Challenges

Administratively complex because the legal owner of a vehicle may not be the registered keeper.

Differences in the rate across the UK may create the opportunity for vehicles to be registered in one country when the legal owner resides in another.






It is a tax that is highly visible to the electorate, and this may make it more difficult politically to set a higher rate in Scotland.



Across the OECD

It is relatively common for these taxes to be devolved to sub-central governments, particularly in federal countries such as Austria, Belgium, Germany and Switzerland. The nature of devolution varies. In countries such as Belgium the rates for vehicle tax are set sub-centrally. On the other hand, in Austria and Spain the rates are set centrally, but (all or a percentage of) revenues accrue to sub-central governments.

SUMMARY OF POLITICAL PROPOSALS IN RELATION TO EACH TAX

Tax	Revenues in 2012-13 (£m)	Broad recommendation from each political party:				
						
Income tax	£10,865	Extend SRIT				
VAT	£9,374		Will consider revenue assignment		Revenue assignment	Revenue assignment
NICs	£8,521				-	
North Sea revenues (geoshare)	£5,581		-		-	
Corporation tax (excl. North Sea)	£2,872			Revenue assignment	Revenue assignment	
Fuel duties	£2,258			-	-	
Tobacco and alcohol duties	£2,108				-	Revenue assignment
Vehicle excise duty	£481		-	-	-	
Capital gains tax	£292				-	
Inheritance tax	£243				-	
Air passenger duty	£234				-	
Insurance premium tax	£207		-	-	-	
Betting and gaming duties	£120			-		
Climate change levy	£62		-	-	-	
Aggregates levy	£45		Will consider devolution		-	

Should this tax be devolved?

Yes

Partially/
Potentially

No

No specific
recommendation

See earlier pages
for specific
recommendations

Source: The Smith Commission – Political party proposals ([2014c](#))

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[SB 14-14 The Scottish rate of income tax and additional rate taxpayers](#)

[SB 14-11 Scotland Act 2012: Financial Provisions](#)

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